State Tax Review

Discussion Paper

December 2010

State Tax Review Discussion Paper
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Discussion Paper

The former Treasurer, the Hon Michael Aird MLC, announced a review of State taxation in the 2010-11 Budget. The Hon Michael Aird established a review that will examine the existing system and set a vision for a State tax system that will be appropriate for meeting the needs of Tasmania in the light of the long-term demographic, social, environmental, economic and budgetary challenges faced by the State Government and the people of Tasmania.

This Discussion Paper has been prepared to assist potential contributors to the Review by:

- describing some of the contextual issues that are driving change of our state tax system;
- summarising the history and limitations on State taxation created by Commonwealth-State relations and the High Court's interpretation of Australia's Constitution;
- providing guiding principles that will be used by the Tax Review Panel to assess the current State tax system and to consider any proposed changes;
- summarising the current system;
- providing a snapshot of the recommendations of the *Australia's Future Tax System Review* with regards to state taxes; and
- proposing consultation questions to guide those making submissions to the Review.

Submissions in response to this Discussion Paper are strongly encouraged and must be received by **close of business Monday 14 February 2011**.

Submissions can be lodged

Electronically

email: state.tax.review@treasury.tas.gov.au

Electronic submissions are the preferred method. However, submissions may also be made by mail or hand delivered.

Mail

Department of Treasury and Finance
State Tax Review Submissions
PO Box 147
Hobart TAS 7001

Hand delivery

Department of Treasury and Finance
State Tax Review Submissions
21 Murray Street, Hobart

When preparing a submission please note

Submissions in response to this Discussion Paper may be publicly available or referred to, unless you explicitly request otherwise in writing in your submission.

Foreword

The State Tax Review provides an important opportunity for all interested members of the community to provide input into a framework for developing future State taxation policy. The Review will set a vision for a State tax system that will be appropriate for meeting the revenue and (where appropriate) the regulatory needs of the State, while taking into consideration an increasing focus on how and the extent to which State taxation should be seen as part of a national tax system. The trend for business to increasingly be conducted across state borders is highlighting the need for all governments to view their taxation arrangements as part of a bigger picture, rather than the more traditional practice of seeing their policies as separate to, and in isolation, from that of other governments.

The Review will offer an opportunity for everyone in the community to have a say in how best to shape Tasmania's future taxation arrangements, whether this be from businesses or households, community groups or advocacy organisations, government agencies or industry representatives, unions or academics.

The imposition of taxes, while widely criticised and unpopular in its impact, is nonetheless critical to support the core function of government. Because the taxation system has the potential to have so much influence on the everyday life of the community at large, it is one of the most important areas of policy development and implementation for governments to address. Therefore, it is not at all surprising that there will always be vigorous debate about which taxes work best, who should or should not be taxed, how much revenue particular taxes should raise, and whether or not taxes should be used to deliberately guide or change behaviour. However, contributors to this debate are encouraged to avoid the temptation to simply propose changes that reduce taxes by lowering rates or narrowing the tax bases (without the balancing consideration of reducing revenue), or making suggestions that result in passing the incidence of tax onto other parties without consideration of the benefits and costs to Tasmania as a whole.

Taxation is a complex topic and there are broad and most often competing considerations about balancing the interests of different community sectors when considering taxation design. However, the report on *Australia's Future Tax System,* presented to the Australian Government and released in May 2010, provides a comprehensive context for such community consideration and highlights the need for all governments to consider how their arrangements interact with those in other states, and at the Commonwealth level. The Panel will also seek expert advice on tax and economic issues specific to Tasmania.

The Panel will aim to build a broad community understanding of, and acceptance for, changes that should enable a future tax design to meet a number of guiding principles. By necessity these principles will include fairness, minimising the adverse impact on the normal day-to-day behaviour of businesses and households, minimising compliance and administrative costs, and a sustainable state budget.

We also look forward to closer engagement and collaboration with key representative bodies throughout the Review period. We can work together to build an effective reform agenda.

STATE TAX REVIEW PANEL

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1. Terms of Reference

1.1. Objectives

Why review the State's taxes?

It could be argued that the Tasmanian tax system is, in one form or another, under constant review and has undergone considerable change over the past few decades. Over time, the number of State taxes has declined. This has arisen in no small part because of a major shift in the financial relations between the Commonwealth and the states as part of the introduction of the GST. These changes reflected the single greatest coordination of changes to national tax arrangements in the history of the Federation. The only other times there have been events of close coordination between the Australian Government and the states were the "handing over" of income taxing effort from the states to the Australian Government (to help coordinate the funding of Australia's efforts in World War II) and the acceptance by states of the land and payroll tax bases from the Australian Government.

Furthermore, in response to constant community pressure, the scope of the remaining taxes has also tended to contract overtime and this has in large part been why the Commonwealth Grants Commission independently assessed Tasmania as being the third lowest in taxing "effort" of all jurisdictions, including territories, and the second lowest of any state. However, demographic change, increasing international economic competition, cost of living issues and changing social preferences for standards of and accessibility to services all suggest the need for a continuing review of State tax arrangements.

Role of the tax system

The primary difference in the role of the tax system from a national perspective compared to a state perspective is well established. At the national level, taxation serves a number of purposes; raising revenue to provide services, assisting in redistributing income (through income tax and welfare arrangements), and as a regulatory instrument. However, there is a fundamental question whether, at the state level, the role of the tax system should largely be confined to one of raising revenue (to fund a range of public services), or if it should also be used to achieve a range of social, economic and environmental objectives. It is in this light that the core principles outlined for the Review will give useful guidance for debate.

This Review will tend to invite a high degree of scrutiny on the efficiency of our current arrangements because, if the core task of the tax system in Tasmania is to raise revenue, this should be done with the minimum impact possible. This impact can be best described in terms of the complexity of the arrangements as measured by the cost of compliance and administration, changes in behaviour (including the effort that goes into avoiding or minimising tax – effort which would be more productively directed to other means), and on whom the financial burden of paying such taxes falls.

There are, of course, other considerations of which the Review will need to be mindful. One is to avoid to the extent reasonably possible a duplication of effort where the Australian Government either currently has, or is planning to introduce, tax measures for regulatory purposes. This is because a state tax measure could either distort the intended effect of the Australian tax measure, or amplify the distortions such measures impose on community behaviour.

Another objective will be to achieve consistency in the way taxpayers are treated, and the policy outcomes arising from specific measures. For example, if a key objective is to treat the taxation of land used for residential purposes in the same way, then this needs to be given clear expression in taxation law, and policy will need to take heed of this as an overriding consideration.

Yet another consideration will be creating awareness about the limits to which tax measures at the State level can provide useful instruments to pursue other policy objectives, such as industry development, investment attraction, or welfare assistance. Tax measures are usually considered an inefficient way by which to implement these aims, because it is difficult to target them accurately, their success is difficult to measure, and they become obscure overtime in their application (with expenditure measures being far more transparent, targeted and controlled).

Task of the policy maker

It is recognised that the task of the policy maker is sometimes difficult and challenging. Any particular circumstance will provide a set of competing considerations and the best decisions usually arise from clear, targeted policy objectives with the known costs of a particular measure being consciously given lower weighting than the benefits arising from the stated objectives. Designing tax arrangements which are subject to many competing aims will usually, therefore, produce complex and convoluted outcomes.

The principles described in section 8, as well as a clear understanding that the predominant purpose of State taxation is to raise general revenue, should provide useful guidance for the conduct of this Review.

An issue which the Review will address is the extent to which Tasmania can reform its existing tax arrangements in isolation of what will occur at the national level – either by the Australian Government acting independently, or through cooperation with the states. Over recent years there has been considerable debate about the impact of state taxes at the national economic level. There is a building consensus, particularly amongst the business community, that transaction taxes levied by the states are highly inefficient. These concerns cover the inherent distortions in behaviour that are created through taxing transactions, and the fact that state tax bases and their administration are often inconsistent, and can impose additional compliance costs on firms operating across states.

Competition amongst states through tax rates and bases has, for a long time, been regarded as a positive as it has been viewed as imposing limits to which governments can “unnecessarily” raise revenue. This is especially so for businesses that have a greater degree of choice as to where they locate. In some respects this conflicts with more contemporary concerns about the extent to which state tax regimes are harmonised. Harmonisation reduces the costs to business of understanding different tax laws, with their numerous definitions and administrative arrangements. However, significant administrative effort is involved (from the states’ perspective) in achieving and maintaining harmonisation. Ultimately, the focus of much of the debate has shifted to concerns about states competing away their revenue bases and increasing their reliance on transfers from the Australian Government.

A far higher degree of uniformity could be achieved through the “sharing” of national tax bases, which would also result in a greater consideration to their effects on the national economy. However, these are not easy issues to resolve and they will come under increasing scrutiny as part of forthcoming discussions about “national tax reform”.

With this context in mind, it is important to consider how the Australian Government's review of *Australia's Future Tax System* has provided a national set of principles and recommendations that will aid Tasmania in developing its future tax system. While the national tax system and its associated transfer arrangements are broader in scope and more complex in application and incidence compared to state tax systems, the *AFTS* report provides a useful guide to achieving national uniformity and harmonisation in all tax arrangements.

The interactions between regional economies and the national economy are increasing and this cannot be ignored in terms of reforming state tax arrangements. Furthermore, COAG is pursuing a wide range of regulatory reforms under the banner of a "Seamless National Economy" and this gives further impetus for the need to encourage wide ranging reforms that aim to reduce the costs to business from a national perspective. The tax system forms a crucial part of this consideration and as such more work is necessary to identify the most appropriate reforms for Tasmania, while keeping the objectives of harmonisation in mind.

In order for the State Government to provide a range of public services to the community, it requires sustainable own source tax revenue, as well as transfer payments from the Australian Government.

The level of support provided by Commonwealth transfer payments and the taxes from which they are generated in the future is outside the direct control of the Tasmanian Government. Therefore, in the face of long-term economic, social and environmental challenges, State taxes need to provide an adequate complement to this revenue to sustain public service delivery while minimising unnecessary tax-related costs and inequities.

What is the purpose of this Discussion Paper?

This Paper:

- describes the existing taxation arrangements, together with their commonly understood benefits and shortcomings;
- offers some guidance as to what could be considered practical boundaries to the debate, while at the same time providing a core set of principles against which our thinking on issues should be tested;
- raises issues to generate discussion, while avoiding a premature attempt to identify early solutions; and
- suggests some aspirations and objectives, the merits of which will be assessed as a matter of course throughout the Review.

The Paper also refers to and presents an extensive body of accumulated knowledge and experience (from the *AFTS*) to assist in the guidance of future decisions on taxation policy. It would be both naïve and wasteful to ignore this knowledge and experience, although this is not to say by any means that the learning of the past offers all of the answers for the future.

On this basis, the Discussion Paper has been prepared with the purpose to inform and seek the input of interested members of the Tasmanian community. It is hoped that through informing and seeking debate, interest and input is generated from all sectors of the community.

In particular, information is provided on the State's existing taxes. The Paper also provides important information that will inform and guide the Review, such as:

- the contextual issues to be considered (see section 4);
- revenue and expenditure – past and future (see section 6); and
- guiding principles (see section 8).

While the taxation matters addressed in Commonwealth-State relations (see section 5) are outside the scope of this Review, they provide important background information.

Section 9 of the Paper introduces each of the State's existing taxes and includes a high level summary of the findings of the *AFTS* Report. Each section is then followed by a series of consultation questions to be considered in submissions. It is important to bear in mind that these questions do not necessarily reflect proposals for change at this stage.

Expanded summaries on the recommendations, findings and key points of the *AFTS* Report can also be found in Appendix 2.

1.2. Scope

Draft Terms of Reference were released by the former Treasurer, the Hon Michael Aird MLC, in June 2010 following his announcement of the 2010 State Tax Review.

For the purpose of the Review, State taxation means the current primary State taxes, being duties, gambling taxes, land tax, motor tax, payroll tax and vehicle registration fees. The Panel may also consider new State taxes.

The Panel has since finalised the Terms of Reference as shown below.

Terms of Reference

The Panel shall consider, in light of the report *Australia's Future Tax System*, how each State tax impacts the Tasmanian community, the appropriateness of the State tax mix within the context of the national tax system and public services and transfers provided, and other matters relevant to Tasmania contained in the report.

In particular, the Panel will consider, in relation to current and potential taxes:

- the fairness of the tax system – the inequitable outcomes that taxes create, acknowledging that fairness is achieved by the interaction of national and State taxes, as well as government welfare and other spending programs;
- the impact of the tax system on the cost of living in Tasmania;
- the efficiency cost of State taxes – the degree to which the taxes distort household behaviour and economic activity, and therefore constrain wealth generation and the realisation of social outcomes;
- the compliance and administrative costs of State taxes – the costs to both taxpayers and the Government in generating tax revenue, which are often in direct correlation to tax complexity;

- the sustainability of State taxes – the long-term appropriateness of the level of State taxes in light of long-term demographic, social, environmental, economic and budgetary challenges faced by the State Government; and

- the broad principle of revenue neutrality.

The Panel will consult with key representative bodies as well as other groups and individuals.

While the role of national taxes will be explicitly considered in evaluating the equity and appropriateness of State tax design, the Panel will not anticipate specific changes to Australian Government taxes.

While the Panel may generate findings that inform a position on Commonwealth-State tax reforms, the recommendations must be able to be implemented independently of intergovernment policy settings. Therefore, it is to be assumed that current Constitutional constraints will remain in place.

The Panel will take into account the current review of local government rating arrangements.

The Panel shall provide recommendations that are revenue neutral in the short term and provide for a balanced budget over the long term.

2. Tax Review Panel

An across party Tax Review Panel has been formed to oversee the review of the State's taxes. The Panel includes representatives from each of Tasmania's major political parties and an independent member of the Legislative Council.

The members of the Tax Review Panel are:

- The Hon Lara Giddings MP, Treasurer (Chair);
- Mr Peter Gutwein MP, Liberal Party Treasury Spokesperson;
- Mr Tim Morris MP, Tasmanian Greens Treasury Spokesperson; and
- The Hon Ruth Forrest MLC, independent member of the Legislative Council

Support is provided to the Panel by the Department of Treasury and Finance.

3. Timeline

Where to next?

This Paper has been prepared to seek input from the entire Tasmanian community.

Public forums and round table meetings with community groups and industry will take place after submissions have been received.

Submissions received as a result of this Paper will inform the Panel's analysis and review of the State's taxes. This analysis will also be informed by support from the Department of Treasury and Finance and independent technical advice where appropriate.

The Panel's analysis and subsequent findings will be guided by a consideration of the performance of the State's taxes against the key principles discussed in section 8, from both an individual tax and overall tax mix perspective.

The recommendations of the Review will be drafted and released by the Panel for consultation prior to the release of its Final Report. The target date for release of the Final Report is 31 December 2011. However, this deadline may be extended if the results of consultation on the Draft Report warrant.

The Final Report will also be tabled in both Houses of Parliament.

What dates do I need to be aware of?

The Panel will ensure all opportunities for involvement in this Review will be publicly advertised. However, likely upcoming opportunities for input into the Review are shown below.

Discussion Paper	
December 2010	This Discussion Paper is released for 10 weeks of consultation
February 2010	Submissions in response to this Paper must be received by **close of business Monday 14 February 2011**
March 2010	Round Table meetings with industry and community groups Public forums open to the community
Final Report	
September 2011	The Panel's draft recommendations will be available for public comment for four weeks
December 2011	The Panel's recommendations are expected to be published

4. Contextual Issues

This section describes some of the contextual issues that are driving change of our state tax system. It identifies some of the key factors that will need to be taken into account in assessing Tasmania's current tax system and considering what changes may be needed.

These key factors include:

- demographic change, which has implications for government revenue, as well as expenditure;
- economic competition;
- climate change and environmental sustainability; and
- the cost of living, and how State taxes impact on this.

Tasmania's tax system represents a very important source of income to enable the State Government to provide services and infrastructure for the Tasmanian community. In 2010-11, the total State tax revenue is expected to be around $875 million[1], representing almost 20 per cent of the State Government's total income.

State taxes are not evenly spread amongst the community, with some paying significant amounts of tax, depending on their assets and activities, and others paying none at all. On a per capita basis, Tasmanians pay approximately $1 700 in State taxes per annum. However, the majority of Tasmanians pay little or no State tax each year.

The nature of state taxes, and the rates of taxes on different sectors of the community, can have significant impacts on economic activity and the wellbeing and choices of Tasmanians.

Tasmania had in the years leading up to the global financial downturn been experiencing its best economic conditions in decades, with strong employment growth, investment and consumer spending. Tasmania's population has also been growing at above trend rates in recent years.

However, Tasmania continues to face a number of challenges, with low productivity and workforce participation, a higher share of the workforce with low skills, and below average wages, compared to Australia as a whole. The State's tax system needs to ensure that the positive economic momentum can be sustained for as long as possible, while trying to avoid the creation of strong disincentives to invest in the State.

As economic, demographic and environmental conditions change, and as the responsibilities of the State and Australian Governments change, it is prudent to review the State's tax system to ensure that it remains effective, meets the objectives of the Government and balances the interests across the community.

The section below identifies some of the key factors that will need to be addressed in reviewing Tasmania's current tax system and considering what changes may be needed.

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[1] This is based on the Tasmanian Government's *2010-11 Budget*.

4.1. Demographic change

Over the past 40 years, Tasmania's population has been impacted by declining birth rates and increasing life expectancy. These factors, together with the net effect of interstate migration flows, have contributed to an increase in the number of older persons. Over the next 40 years, Tasmania's population is projected to rise by almost 80 000 to over 580 000. It is expected that Tasmania's population will continue to have an increasing percentage of older people, with a declining working age population, and less children.

Demographic change in Tasmania presents a number of challenges due to increasing demand for many government services, especially health care services, and potentially a declining share of revenue from some existing taxes. Payroll tax and some transaction taxes, such as from conveyances on property transfers are expected to fall as an older population is less likely to be “active" in the property market.

Implications on state revenue

Tasmania's working age population – those aged between 15 and 65 years – will decline as a proportion of the total population in coming years. Tasmania's participation rate is already the lowest in Australia, due in part to our older population. If the share of Tasmanians in the workforce declines, this may lead to reduced economic growth and constrain tax revenue from sources that are related to economic activity, such as payroll tax and perhaps some transaction-based taxes.

At the same time, an increasing number of Tasmanian households are likely to be relatively affluent retirees, who have acquired substantial financial assets, due in part to the nation's improving superannuation arrangements.

Government spending

Perhaps the greatest impact of demographic change on the State Government is an increase in the costs associated with an older population. Older persons generally require more health related services and social services such as transport and housing.

Public expenditure on health services generally increases at a faster rate than for other services, as new treatments and technologies are developed and the community expects higher standards of treatment. These trends would continue, even without population ageing. The combined effect of rising health costs and population ageing will result in public health expenditure representing an increasing share of total public spending in the decades ahead. Tasmania will need a tax system, and appropriate Commonwealth-State financial arrangements, to help ensure that health and other services can be provided on a sustainable basis.

4.2. Economic competition

Tasmania's competitors and trading partners

Tasmania is linked to the global economy. Our businesses compete in export markets, both interstate and overseas, and locally against imported goods.

As capital and labour are relatively mobile, Tasmania competes with the other states and territories, and other countries, for business investment, skilled labour and

migrants. Increasingly, New Zealand has emerged as a strong competitor with Tasmania, particularly for manufactured and agricultural goods.

At a national level, the overall trend is to reduce barriers to international trade, including reducing tariffs, and to develop national mutual recognition and occupational licensing arrangements. This provides greater opportunities, but at the same time has the potential to lead to greater economic and fiscal challenges if Tasmania ceases to be competitive.

In addition, Tasmania is becoming more integrated with the mainland states, through Basslink and joining the National Electricity Market, the natural gas transmission pipeline, improved sea and air access and, most recently, advanced telecommunications including the National Broadband Network.

Tasmania's tax system therefore needs to ensure that the State continues to be an attractive location for investment and employment, and as a place to live.

Industry structure change

Tasmania's industry structure has undergone some major changes over the past twenty years, primarily due to the declining importance of the manufacturing industry. Manufacturing accounted for a quarter of Tasmanian gross value added (a measure of the value of goods and services produced in an industry) in 1989-90, but this share was halved by 2009-10. Similarly, the mining sector's share of Tasmanian gross value added (GVA) has fallen from around 6 per cent in the early 1990s to 2.2 per cent in 2009-10.

The shares of most other industries increased, with agriculture, forestry and fishing, health care and social assistance having experienced the most significant increases.

Tasmania's industry structure has often been considered a factor in the State's relative underperformance compared to the national economy. Historically, the State has been over-represented by those industry sectors considered to be slow growing, under-represented by faster growing industry sectors, and heavily reliant on a small number of relatively low value primary industry sectors.

Under Tasmania's tax system, different industries pay different levels of taxes. For example, gaming taxes have a very different incidence (and administrative and compliance costs) compared to taxes on insurance transactions. Land taxes affect the property development sector and the rental property sector. Less obviously, payroll tax has the effect of levying higher taxes on industries with large firms, due to the payroll threshold under which the tax is not paid. The incidence of payroll tax is determined by the effect to which a company can influence the prices it faces in its product market.

Tasmania's productivity (a measure of output for a given level of inputs) tends to be among the lowest in Australia. This leads to lower than average wages, which may make Tasmania an attractive destination for some employers but may act as a deterrent to attracting labour, especially skilled labour. In addition, low average wages impact the revenue to the State Government from payroll tax.

Competitive neutrality

The Tasmanian Government owns several businesses that compete with private sector businesses, such as the electricity businesses and Forestry Tasmania. To promote the efficient use of resources in public sector business activities and ensure that they do not have an unfair advantage against private sector businesses, Tasmania applies certain regulatory requirements to these business activities based on competitive neutrality principles. These requirements aim to remove any net

competitive advantage that businesses may have solely as a result of public ownership. They come in the form of tax equivalents, dividends and debt guarantee fees to the State.

4.3. Climate change and environmental sustainability

Climate change and environmental sustainability are emerging as increasingly important national policy. In many ways, Tasmania is well placed to benefit from the status of a low emission economy with its well developed hydro-electricity generation and world class wind resources.

Reducing greenhouse gas emissions

All governments are identifying cost effective opportunities to reduce greenhouse gas emissions, both in their own activities and through encouraging households and businesses to alter their behaviour and adopt low emission technologies.

An emissions trading scheme, or a carbon tax, is a generally accepted way of promoting economy-wide changes to economic activity towards reduced greenhouse gas emissions. Although the Australian Government has decided to delay implementation of long-term policy response to the greenhouse issue, an emissions trading scheme, or carbon pricing in some form, is expected to be introduced within the next 5-10 years.

An issue for the review to consider is whether the State's tax system can contribute to cost effective measures to reduce greenhouse gas emissions. A constraint is the relatively narrow range of taxes that can be implemented by Tasmania under the Constitution and Australia's Commonwealth-State financial arrangements and the relatively small contribution stand-alone greenhouse measures could have nationally if they are implemented only in Tasmania.

Sustainability of our natural environment

Continued population growth and economic growth increases the demand for Tasmania's natural resources, especially water and land for agricultural and residential development. It is important that the State's tax system does not lead to environmental degradation or inefficient land use.

4.4. Cost of living

Large changes in the cost of living can have a major impact on living standards. The Consumer Price Index is one measure for these changes. The CPI estimates price changes for households as a whole, but does not capture the wide variation in households with different expenditure patterns. For example, low income households tend to spend a greater percentage of their income on food, so when food prices rise relative to other goods and services, these households face greater increases in their living costs.

State taxes have little or no influence on the price of many goods or services purchased by households. However, in some areas, our tax system does have a significant effect. For example, for those renting a component of the rent is likely to be the land tax that accrues to that property. Conveyance duty also has the potential to significantly impact decisions on property purchases which affects the decisions for individuals to move houses to better fit their personal circumstances, such as moving

closer to their employment or downsizing their homes as family moves out (with the benefit of lower maintenance and "running costs").

House prices have experienced strong growth across Australia over the past decade. While the increase in prices led to increased duty from conveyances and land tax for Tasmania, it also added to housing becoming less affordable especially for first home buyers.

According to the most recent survey, Tasmania is the fourth most affordable jurisdiction in which to own a home[2], but is the seventh most affordable jurisdiction for housing rental. Despite this, Tasmanian median house prices remain the lowest of all jurisdictions.

Household transport costs are affected by motor taxes, vehicle registration fees and the tax on insurance premiums.

An issue for this Review is to consider whether the current range of State taxes achieve an appropriate balance between taxes paid by businesses (that are not passed on through higher prices to Tasmanian households) and taxes paid directly by households, or even whether this is a policy consideration for the State to focus on. A further issue is whether the tax burden on households is equitable for different types of households, such as home owners as compared with renters.

[2] This is based on the June quarter 2010 *REIA Housing Affordability Report*.

5. Commonwealth-State Relations

This section provides some of the history and limitations on State taxation created by Commonwealth-State relations and the High Court's interpretation of Australia's Constitution. This includes the Goods and Services Tax, which was introduced by the Australian Government but on which the basis for its transfer in full to the states is governed by an intergovernmental agreement.

This section also presents the concepts of Vertical Fiscal Imbalance (the imbalance between the states and Australian Government revenue raising capacities and their expenditure commitments) and Horizontal Fiscal Equalisation (an Australian Government policy that aims to provide all Australians the opportunity for the potential to access a similar range and standard of service, regardless of the jurisdiction in which they live).

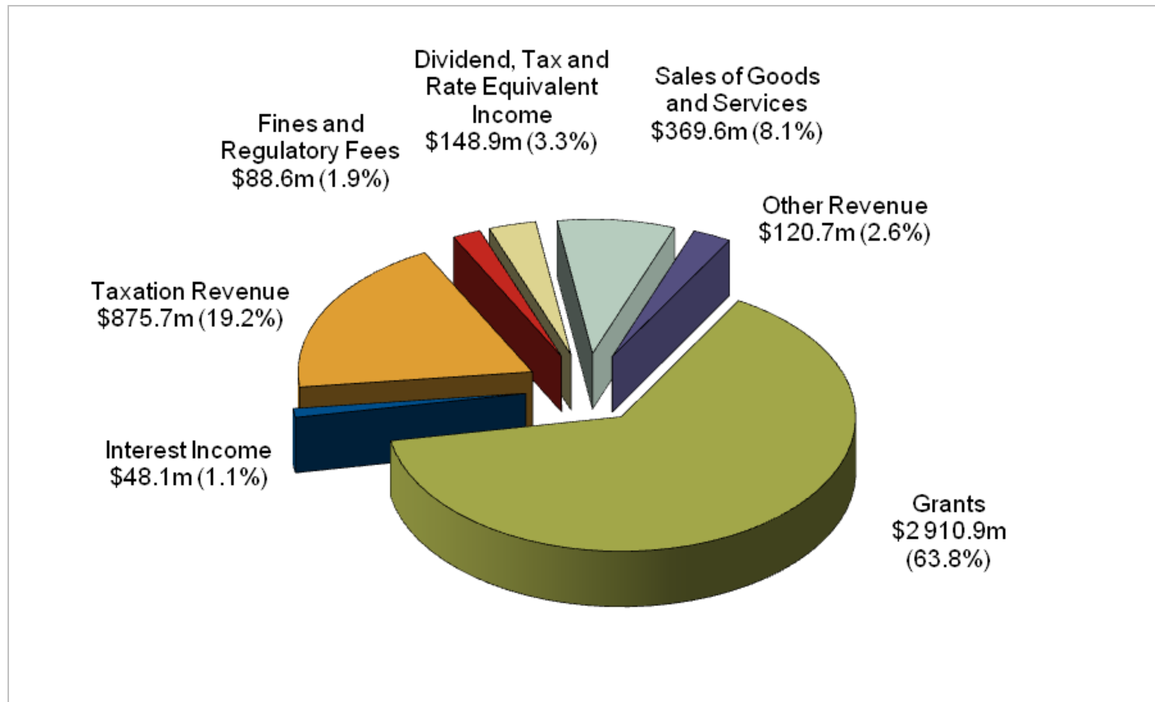
The constitutional limitations, along with those created by Commonwealth-State relations, should be kept in mind in forming proposals for alternative taxation arrangements.

Australia has a three-tiered federal system of governance that allows for a centralised government to have responsibility for the functions and duties common to the nation, while enabling local and state or territory governments to deliver services at a more local level and to meet the needs and preferences of communities as they vary on a regional basis.

Federations are designed around the organising principle of subsidiarity, which is based on the idea that governments closer to the voters have a better knowledge of the policy priorities and service needs of their local communities. This principle also suggests that governments making the expenditure decisions should also be making associated revenue raising decisions. Only in this way do communities best understand the costs of government services.

However, from the beginning of Australia's federation, the Australian Government has enjoyed a concentration of financial power far greater than its expenditure requirements; while the states and territories have had a comparatively lower capacity to raise revenue to fund their comparatively higher expenditure. This situation is known as Vertical Fiscal Imbalance. Tasmania's high budget dependency on grants from the Australian Government is a reflection of this, accounting for 63.8 per cent of total revenue, as shown in Chart 5.1. However, the strong revenue raising powers of the Australian Government allows it to make transfers to the states on the basis of Horizontal Fiscal Equalisation.

Chart 5.1 Sources of Tasmanian Government Revenue 2010-11



Source: Tasmanian Budget Paper 1, *The Budget 2010-11*, p.1.3

The states' taxing powers are governed by a combination of Constitutional limitations, inter-state tax competition, and the historical evolution of federal fiscal relations. In particular, the introduction of the Goods and Services Tax in 2000 resulted in a further shift of revenue raising powers away from the states. However, the GST did improve the efficiency and sustainability of the overall tax system and provided states with a revenue source that would grow overtime with national economic activity.

5.1. Constitutional limitations

Under the Australian Constitution, the Australian Government has the exclusive right to levy excise and customs duties, which include specific taxes on goods such as fuel, alcohol and tobacco. The High Court interpretation of the Constitution was reasonably narrow in the early stages of Federation, in that powers that had not been expressly transferred to the Australian Government were considered by the High Court to be the rights of the states. However, since the 1920s, the High Court's interpretation of the external affairs power and the corporations powers have widened the ambit of the Australian Government exclusive taxing authority. The High Court has interpreted the term "excise duties" widely to include "all taxes on the production, manufacture, sale or distribution of goods": *Ha v New South Wales* [1997]. This has further reduced the flexibility for the states to raise revenue from broader tax bases.

Constitutionally, the states can levy their own income taxes, which they did until 1942 when the Australian Government used its emergency powers to take control of state income tax. However, without the express cooperation of the Australian Government in lowering its rates, it is now impractical for any state to re-impose income tax (although this was mooted by the states as an alternative to receiving the revenues of the GST just prior to its introduction).

5.2. Goods and Services Tax

The most significant recent reform to the tax system was the replacement of a range of state taxes and the Australian Government wholesale sales tax with the GST. In 1999-00, the year before the GST was introduced, Tasmania collected over 25 taxes. In 2010-11, the State Government will collect only 14 taxes.

As part of the *A New Tax System* reforms implemented by the Australian Government in 2000-01, including the introduction of GST, the Australian Government and the states and territories entered into the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*.

Under the terms of the IGA, the Australian Government agreed to provide all of the revenue from the GST to the states. In return, the states agreed to forego a range of Australian Government grants and to abolish a number of state taxes (see section 9.1). The Australian Government also took on some former state responsibilities, resulting in savings to the states, while the states agreed to accept responsibility for a number of other expenditures, including the First Home Owners Scheme and the cost of GST administration.

From 1 July 2005, Tasmania had fully met its obligations under the IGA. It also committed to abolish a range of taxes that were originally listed in the IGA just for review. On 1 July 2008, with the abolition of duty on non-real property (business) conveyances, Tasmania had abolished its final "review" taxes ahead of all other jurisdictions except Victoria. Three jurisdictions are not scheduled to abolish their final "review" taxes until 2012-13. Therefore, the Tasmanian business sector has received accelerated benefits from this national tax reform in comparison to most other jurisdictions.

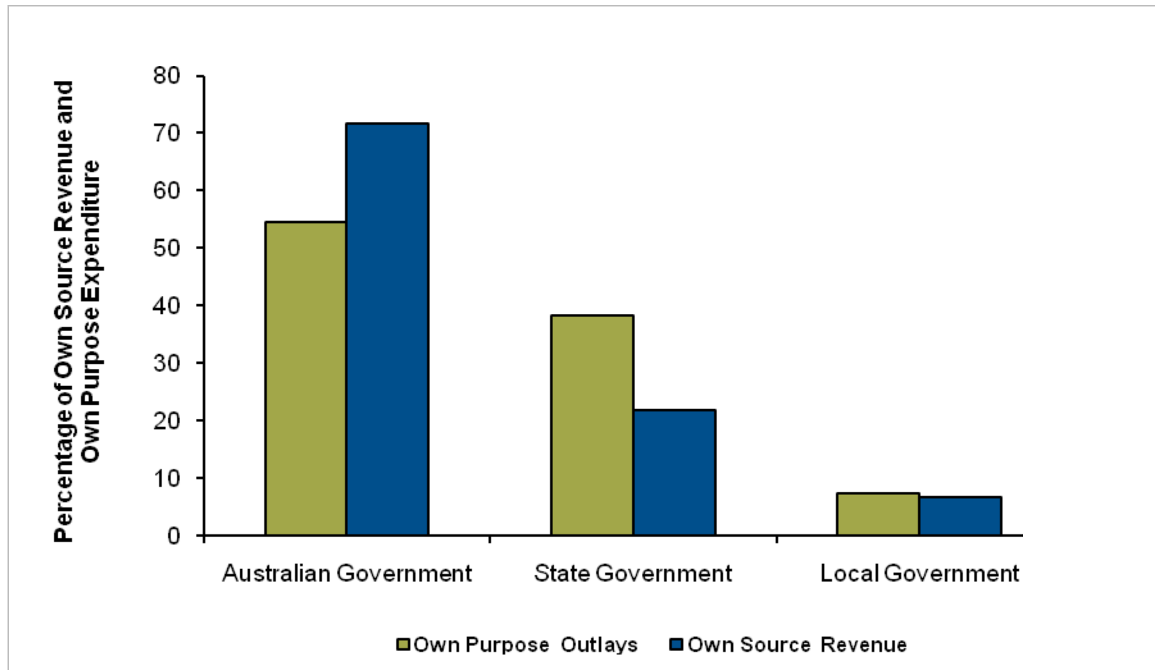
Tasmania has also enjoyed tax relief outside the IGA framework, and this is discussed in section 9.

5.3. Vertical Fiscal Imbalance

Vertical Fiscal Imbalance refers to revenue raising limitations imposed on the states as set out in the Australian Constitution. The package of tax reforms that accompanied the introduction of the GST further entrenched VFI as the states gave away a share of their limited tax bases and agreed not to reintroduce these or similar taxes. This was in return for ongoing transfers of Australian Government revenue in the form of the GST.

In 2009-10, it is estimated that the Australian Government will collect 71.6 per cent of total national General Government revenue, but will only be directly responsible for 54.5 per cent of all General Government expenditure. The extent of VFI is clearly apparent in Tasmania's case, with Australian Government transfers expected to equate to 63.8 per cent of Tasmania's total General Government Sector revenue in 2010-11. Chart 5.2 illustrates the extent of VFI for Tasmania in 2009-10.

Chart 5.2 Vertical Fiscal Imbalance



Source: Tasmanian Budget Paper 1, *The Budget 2010-11*, p9.21.

VFI is also affected by the allocation of spending responsibilities between the Australian Government and state governments. Expenditure responsibilities are much less well defined than revenue raising powers.

In practice, there are relatively few areas where there is a clear separation in responsibilities, with the exception of national defence and international relations.

Both the Australian and state governments have a legitimate interest in the central areas of government activity such as education, health, infrastructure, transport and business regulation. While the Constitution does not reserve these areas for the Australian Government, there is a widely accepted policy role for the Australian Government for national uniformity, which is less likely to be achieved by the states acting in their own interest.

5.4. Horizontal Fiscal Equalisation

Horizontal Fiscal Equalisation reflects a belief that Australians should have access to a similar standard of service, regardless of the jurisdiction in which they live. This is a strong egalitarian principle, which has been widely held by the Australian community and protects Australia's regional diversity and is a strong mainstay of our Federal system.

The Australian Government estimates that in 2010-11, Tasmania will receive approximately $676 million more in GST revenue than it would if the GST revenue were distributed on an equal per capita basis. Without HFE, Tasmania would be significantly disadvantaged, relative to the average fiscal circumstances of all states, because of its higher costs of providing services and lower capacity to raise revenue, both of which are largely unavoidable.

This enables Tasmania to discharge a range of functions that are common to all jurisdictions but without having to impose above average taxes or compromise the standard of services in terms of quality and accessibility.

5.5. Future reform pathways

To overcome limitations on the range of taxes available to the states, governments could cooperate to raise state revenue through tax base sharing or revenue sharing with the Australian Government.

Tax base sharing is where two levels of government levy a tax on the same base. While state land taxes and municipal rates are both levied on land, they use different measures of value. Shared tax bases should be harmonised to make compliance and administration simpler.

Revenue sharing is where a central government or agency collects a tax and redistributes it back to states. The GST, collected by the Australian Government and redistributed to the states (and directly to health and hospitals from 2011-12), can be considered to be an example of revenue sharing (although in this case the share to the Australian Government has been set by agreement at zero).

For major changes to the tax system, the Tasmanian Government will be faced with a choice between stand-alone reform or waiting for cooperative national reform via an intergovernmental agreement. This choice should be made using this Review's principles as set out in section 8.

If stand-alone reforms are expected to improve the welfare of Tasmanians, steps should be taken toward them. The Terms of Reference requires that recommendations of this Review must be able to be implemented independently of intergovernmental policy settings. However, some reforms may only be beneficial if pursued on a national basis in order to achieve low compliance and administration costs, efficiency or sustainability. In such instances, Tasmania should transition towards the ideal model, while advocating national reform at the COAG level.

5.5.1. Consultation question

Question 5.5.1.A

Should the State be looking to be more autonomous in its revenue sources, and seeking to be less reliant on Commonwealth transfers? If so, why?

6. Revenue and Expenditure – 1999-00 to 2010-11

The purpose of this section is to provide an overview of Tasmanian government revenue and expenditure and some of the pressures faced by the Government in these areas when formulating and managing the Budget.

All amounts have been provided in real terms, that is, amounts across the years have been converted into 2009-10 dollars. This enables receipts and expenditure across the years to be compared directly and means that any variations are due to the impacts of government policy and economic factors other than inflation.

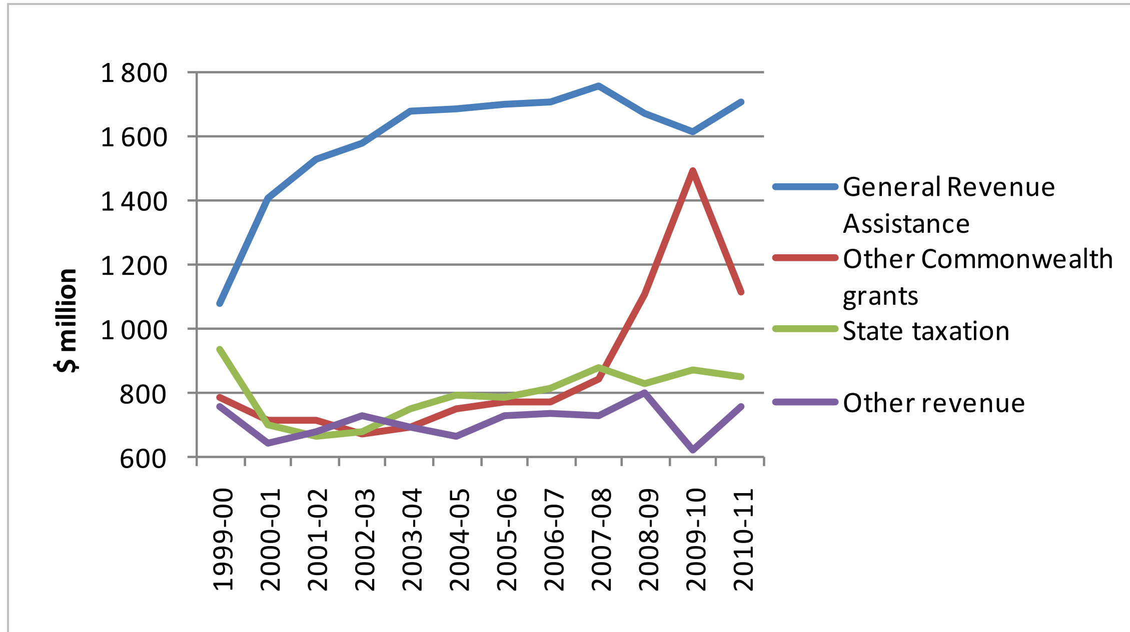
Revenue

As depicted in Chart 5.1 (section 5), State taxation is just one revenue source from which the Government must fund its programs and services. The most significant source of revenue is in the form of grants provided by the Australian Government. General Revenue Assistance (GRA), which is mostly derived from the Goods and Services Tax (GST), is available for the Tasmanian Government to spend at its own discretion. Specific Purpose Payments and National Partnership Payments from the Australian Government are tied to specific programs and must only be spent for the purposes agreed with the Australian Government. Australian Government grants are expected to account for 63.8 per cent of the State's revenue in 2010-11, whilst taxation revenue will account for 19.2 per cent. The remaining 17.0 per cent of income is provided from the sale of goods and services; dividends, tax and rate equivalent income from government businesses; interest; fines and fees.

Actual and forecast receipts (in real terms) for GRA, other Australian Government grants, taxation and other state revenue from 1999-2000 to 2010-11 are shown in Chart 6.1. The sharp rise in GRA in 2000-01 reflects the introduction of the GST in that year. Offsetting this increase is a reduction in State taxation resulting from the cessation of a number of taxes as agreed under the *Intergovernmental Agreement on Federal Financial Relations* (IGA). GST revenue collections are highly sensitive to changes in national consumer spending as is apparent in the significant decline in GRA revenue following the onset of the 2008-09 Global Financial Crisis. GST revenue collection in 2010-11 and in future years is heavily dependent on the rate of recovery of the Australian economy. The significant increase in other Australian Government grants in 2009-10 reflects additional funding provided by the Australian Government as part of its economic stimulus package.

Additional pressure will be placed on the GRA when arrangements under the *National Health and Hospitals Network Agreement* are introduced in 2011-12. Under this Agreement, an amount of GST revenue will be “clawed back” by the Australian Government and dedicated to health and hospital services. Estimates provided in the Australian Government’s *Mid-year Economic and Fiscal Outlook 2010-11* released in November 2010 indicate that around 20 per cent of GRA will be dedicated to health and hospital services from 2011-12 onwards. Fluctuations in GST revenue will affect this calculation, but the percentage of Tasmanian GRA dedicated to health and hospital services is not expected to exceed 30 per cent. Although total funding provided by the Australian Government will not change as a result of the GST dedication to health and hospital services, the decrease in GRA will reduce the ability of the Tasmanian Government to flexibly respond to Budget pressures in the future.

Chart 6.1 Total revenue from 1999-00 to 2010-11 (in 2009-10 dollars)



Source: Tasmanian Budget Paper 1, *The Budget 1999-00* to *The Budget 2010-11*

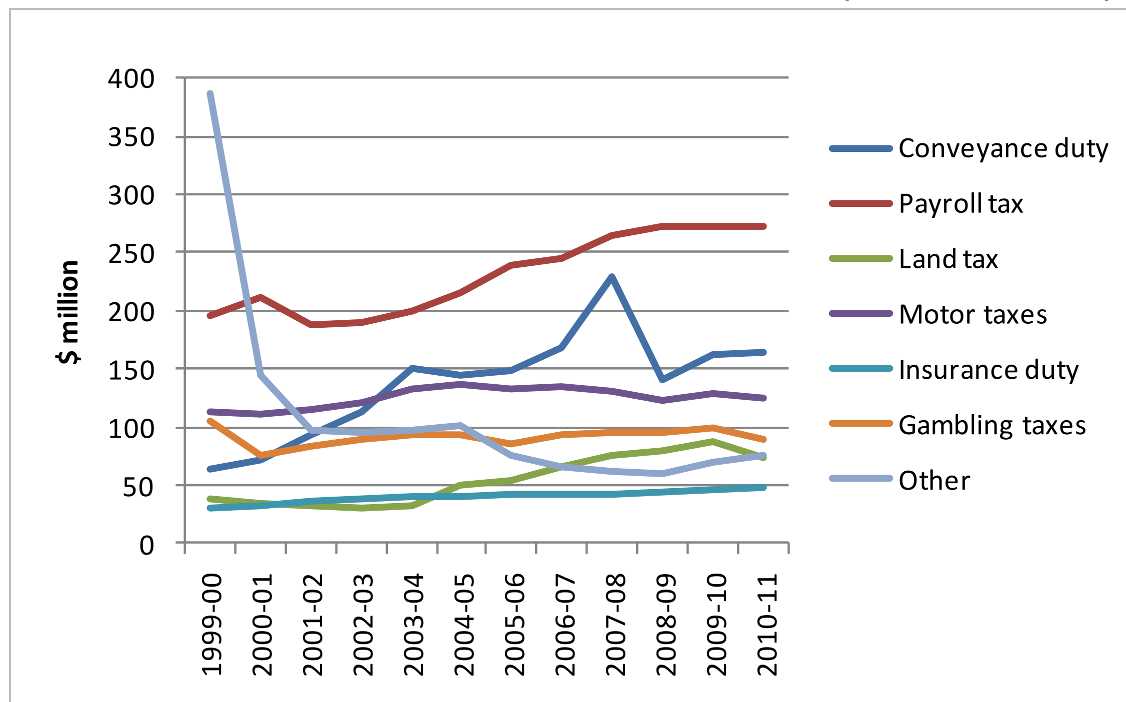
State tax revenue estimates are also sensitive to changes in economic parameters such as employment, wages growth, and inflation, as well as prevailing economic conditions in Tasmania more generally.

State Governments have few counter cyclical policy measures available when confronted with economic downturns and a drop in revenue. Ideally, there should be a stable revenue base for State taxation to help soften the blow caused by any fall in revenue from General Purpose Grants, which are inextricably linked with the economic cycle.

As shown in Chart 6.2, conveyance duty is particularly volatile. Conveyance duty receipts were significantly affected by the GFC. Revenue from conveyance duty relies upon the number of dutiable property transfers as well as the value of the property transferred. Relatively small variations between forecasts and actual property market outcomes have the potential to lead to appreciable variations in conveyance duty revenue. Conveyance duty estimates are also vulnerable to significant upside adjustments arising from large, one-off commercial transactions, which typically involve the transfer of significant business assets or large-scale infrastructure.

Payroll tax receipts are primarily driven by employment outcomes within the Tasmanian economy and wages growth. Estimates of payroll tax revenue are, therefore, subject to variation in the form of wages or employment outcomes that exceed, or fall short of, expectations.

Chart 6.2 Total taxation revenue from 1999-00 to 2010-11 (in 2009-10 dollars)



Source: Tasmanian Budget Paper 1, *The Budget 1999-00* to *The Budget 2010-11*

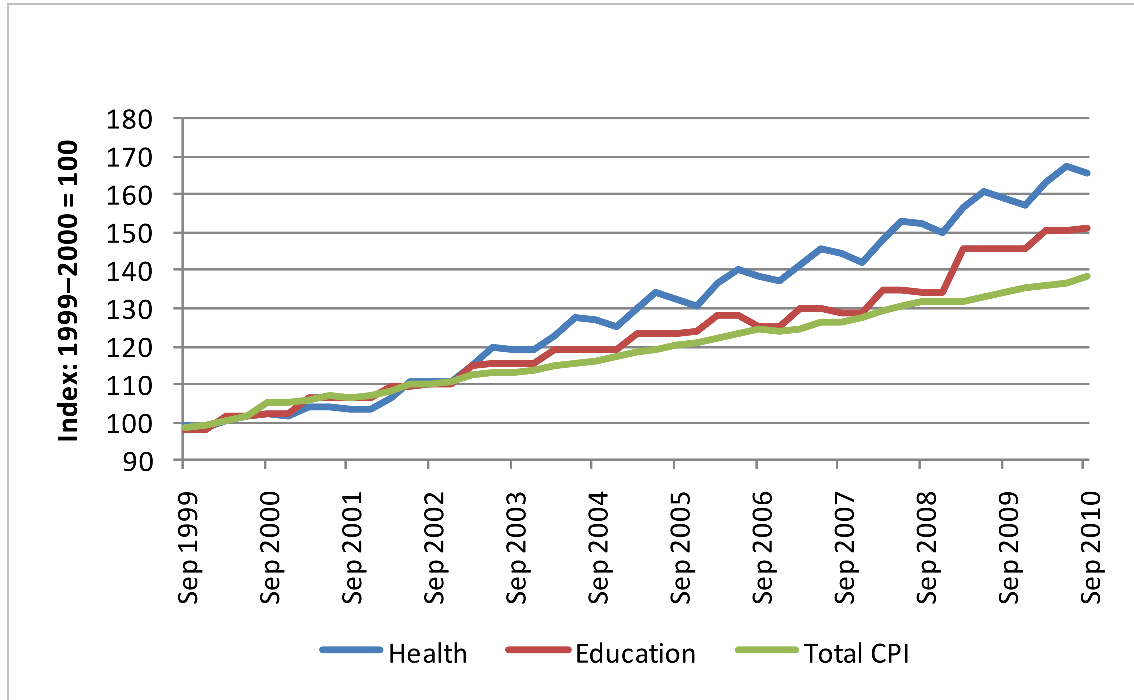
Expenditure

In addition to some uncertainty regarding the level of revenue, the Government also faces a number of pressures on expenditure.

The changing structure of demographics within Tasmania, as discussed in section 4, is expected to place a significant burden on expenditure measures over the next 30 years. The Australian Intergenerational Report, *Australia to 2050: future challenges*, published by the Australian Government in January 2010, attributes a large percentage of expenditure growth over the same period to the health costs of an ageing population. Nationally it has been forecast that health services measures will expand from 4.0 per cent of GDP in 2009-10 to 7.1 per cent of GDP in 2049-50. A similar trend can be seen in aged care (0.8 per cent of GDP in 2009–10 increasing to 1.8 per cent in 2049–50).

In addition to demand pressures, the cost of medical, surgical and pharmaceutical supplies has grown at a significantly higher rate than the Consumer Price Index in recent years (see Chart 6.3). When the growth in demand for health services due to an aging population is combined with the high level of inflation in health service products, Tasmania can expect to face significant ongoing health care cost pressures in the future. Some of this burden will be shared with the Australian Government when it takes responsibility for 60 per cent of the efficient cost of health care under the *National Health and Hospitals Network Agreement*.

Chart 6.3 Growth in Tasmanian CPI and components – 1999 to 2010

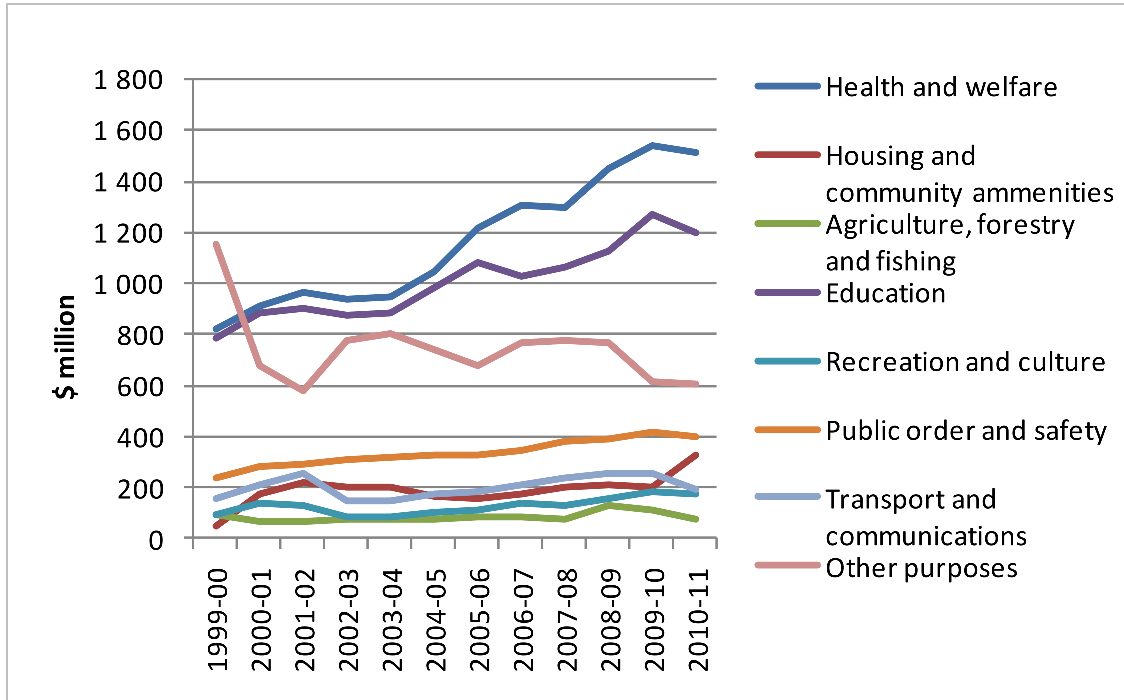


Source: Australian Bureau of Statistics – Consumer Price Index – 6401.0

Education costs into the foreseeable future have been forecast by the Intergenerational report to remain steady over the forecast period (2009-10 to 2049-50), at approximately 2.0 per cent of GDP. However, as shown in Chart 6.3, costs of supplying educational services have also increased above CPI in recent years.

A comparison of expenditure (in real terms) from 1999-00 to 2010-11, by purpose, is provided at Chart 6.4. The chart clearly shows the cost pressures experienced by the Health and Welfare, and Education sectors, in comparison with other sectors.

Chart 6.4 Total expenditure from 1999-00 to 2010-11 (in 2009-10 dollars)



Source: Tasmanian Budget Paper 1, *The Budget 1999-00* to *The Budget 2010-11*

7. Other Government Activities

State taxes cannot be fully assessed against the principles without considering the role of State Government expenditures. For example, expenditure programs play an important role in assisting those in need and improving market efficiency through regulation and funding of public goods and services.

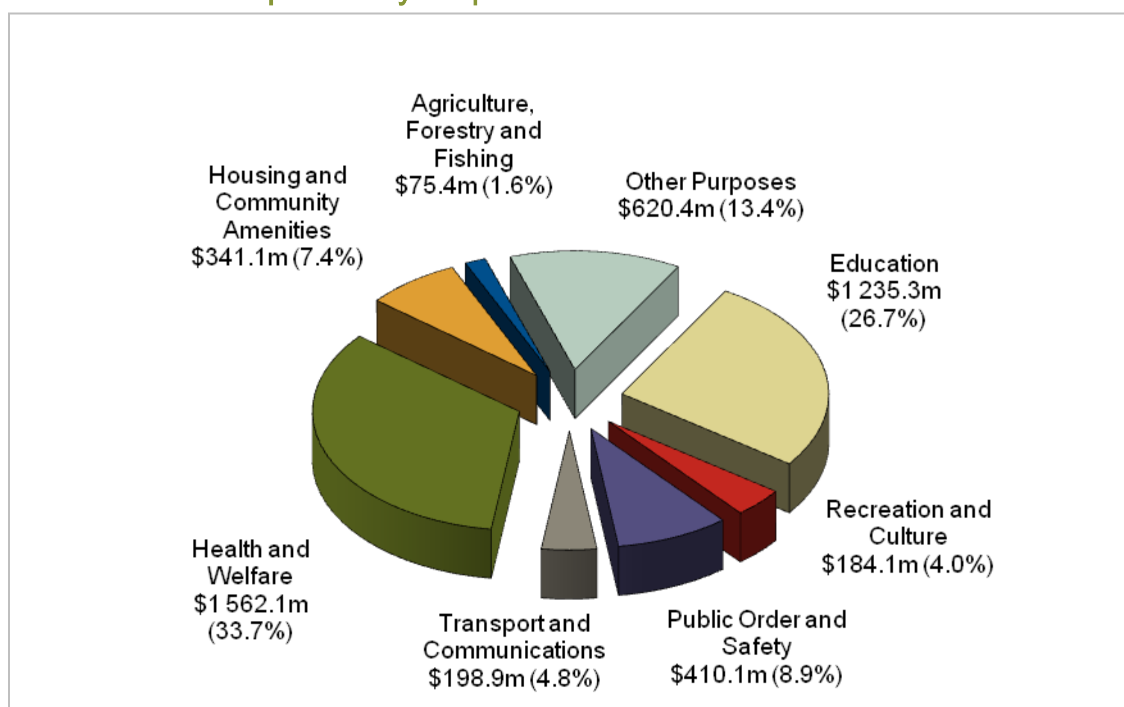
Furthermore, under our federal structure, the Australian Government's transfers and income taxes are powerful tools for redistributing wealth.

State Government services

The benefits of free and subsidised State Government services are not shared equally across the population. As such, any judgments about the role of State taxes in pursuing fairness, or reducing costs of living, is incomplete without considering State Government services.

There is a wide range of services provided by the State Government, as outlined in Chart 7.1 below. Some services benefit the broader community (such as public order and safety), while others provide direct benefits to particular families and individuals (such as public housing).

Chart 7.1 Total Expenses by Purpose 2010-11



Source: Tasmanian Budget Paper 1, *The Budget 2010-11*, p.1.5

Comparing the benefits of Government services to different sectors is difficult. For example, while education and health services can be considered to provide direct personal benefits to students and patients, there are also indirect benefits to the broader community and economy.

A complete assessment of the comparative benefits, or distributive incidence, of State Government expenditure is out of scope of this paper. However, it is generally considered a purpose of government that overall spending provides more benefits to those in greater need.

State Government concessions on goods, services and fees

The State Government provides concessions and rebates on many goods, services and other fees, in addition to concessions on taxes outlined in section 9. Some are available to the broader community while others are targeted to those members of our community with the greatest need – people on low or fixed incomes, those with a disability and their carers, seniors, veterans, widows, sole parents and students.

Tasmanian Government concessions include: local government rates remissions, electricity, heating, buses, taxis, Bass Strait islands air travel, TT Line fares, patient travel, adult education course fees, dental services, community equipment scheme, continuous Positive Airways Pressure Program, enteral feeds and supplements, pharmaceuticals, visual aids, wigs for cancer and alopecia patients, pressure garments for lymphoedema, orthotics/prosthetics, driver's licences, firearms fees, recreational angling licences, recreational game licences, recreational sea fishing licences, water licences, National Parks passes, Overland Track, Port Arthur Historic Site, Royal Tasmanian Botanical Gardens, The Hastings Experience and Mole Creek Caves, access to computers and the Internet, Right to Information requests, and making a Will (source: *Tasmanian Government Concessions Guide 09–10).*

A *Review of State Government Concessions* was undertaken in 2008 by the Department of Treasury and Finance, in consultation with the Department of Premier and Cabinet.

The major recommendations of the Review were to:

- extend the range of concessions to Health Care Card Holders;
- abolish some concessions; and
- enhance the role of Service Tasmania in the promotion and delivery of concessions.

Recommendations focused on employing mechanisms to ensure the system is continually updated and reviewed, and providing clear information to the public on the concessions available and eligibility for these concessions. The review's report is available on the Department of Treasury and Finance website at www.treasury.tas.gov.au.

Australian Government transfers and taxes

Australian Government transfer payments and its income tax structure are central to pursuing fairness and assisting people in need. While Australian Government transfers and taxes are excluded from this Review, they form an important part of the economic and social landscape.

Transfers are cash payments or non-tax concessions provided directly to individuals and families, such as:

- income support pensions (eg Age Pension and Disability Support Pension);
- income support allowances (eg Newstart Allowance and Youth Allowance);
- family payments (eg Family Tax Benefit and childcare assistance);
- supplementary payments (eg Rent Assistance and Utilities Allowance);

- concession cards; and
- housing assistance.

In 2008-09, the cost of transfers to individuals amounted to $111.6 billion. A further $8.2 billion in subsidies was made to providers on behalf of individuals, bringing total transfers to or on behalf of individuals to $119.8 billion or around 43 per cent of total Australian taxation revenue.

The Australian Government levies around 99 taxes, raising $278.7 billion in 2008-09. The majority of Australian Government taxation revenue is sourced from individual and company income tax ($201.4 billion or 72.3 per cent) with the remainder being provided from indirect taxes, such as the GST and excise and customs duties. Assessments of these taxes and transfers are provided in the *Australia's Future Tax System.*

Hence, it is very important when assessing state taxes against the principles outlined in section 8, especially fairness, that we take into consideration Australian Government transfers and taxes.

Findings of the *AFTS* in relation to other government activities

- Governments support people to improve their capabilities through the direct provision of public services such as health and education. The capacity of the tax and transfer system to deliver improvements to people's wellbeing is highly dependent on how governments fund and deliver these services.
- Poverty alleviation is a national goal that should be financed by the national government. The Australian Government should be responsible for funding those transfers that ensure that all Australians have access to a basic standard of living. State and local governments may choose to provide additional funding, reflecting area-specific concerns.

Further summarised information on the findings of the *AFTS* in relation to other government activities can be found in Appendix A2.11 or the report is available at www.taxreview.treasury.gov.au.

8. Principles

This section outlines the principles that will be used by the Tax Review Panel to assess the current tax system and to justify any proposed changes.

The principles should be kept in mind while reading section 9 and when answering the consultation questions posed.

In keeping with the Terms of Reference and other reviews of state and Australian Government tax systems, the Panel will evaluate current taxes and potential changes against the standard taxation principles of:

- equity (fairness);
- efficiency;
- simplicity; and
- sustainability.

Any proposed changes to the taxation system will also take into account any impacts on the cost of living and must be broadly revenue neutral to the State Budget.

These criteria are not always compatible. For example, ensuring equity may require complex legislation and so reduce simplicity and transparency. Harmonising taxes with other states and territories may reduce compliance costs but can be complex and therefore costly to administer. Compromises are therefore inevitable.

The tax system cannot be examined in isolation but must be considered along with expenditure on government programs and transfers[3] from the Australian Government. The challenge for the Panel will be to review the tax system in light of the principles and other considerations and make recommendations that provide the best balanced overall outcomes. Detailed definitions of the tax principles are provided below.

Equity

An equitable tax system taxes individuals in a fair way, taking into account their different means of income and ability to pay. An equitable tax system considers:

- ***vertical equity,*** that is more tax is paid by those with a greater capacity to pay. This may mean that taxes are paid in proportion to wealth, or that those with greater capacity pay a proportionately greater amount;
- ***horizontal equity,*** so that people in similar circumstances bear a similar tax burden; and
- ***who ultimately bears the cost of the tax*** as opposed to just who is legally required to pay it.

[3] Payments from the Australian Government directly to individuals, for example, age and disability pensions.

Efficiency

Efficient taxes have minimal impact on business and individual decision-making and behaviour. An efficient tax system:

- ***does not appreciably influence business decisions***, decisions are ideally made regardless of taxation considerations;
- ***provides little or no incentive for taxpayers to put effort into minimising or avoiding tax***;
- ***does not discourage innovation or entrepreneurial activities***; and
- is ***broad based,*** taxing a wide range of assets and activities, but at a low rate.

However, it is important to note that some taxes aim to change taxpayers' behaviour and are still acceptable. For example, taxes aimed at reducing pollution or achieving a desired social outcome such as reduced alcohol consumption, may be inefficient yet achieve their objective.

Simplicity

A simple tax system:

- is ***readily understood***;
- is ***easy and not costly to comply with and administer*** (relative to the amount of revenue raised);
- is ***transparent,*** so that the accountability of the tax and its enforcement is easily apparent to all;
- has a ***small number of taxes***;
- has a ***small number of thresholds***; and
- has ***minimal concessions***, which are clearly articulated.

Sustainability

A sustainable tax system will grow in line with the needs of changing government expenditure, taking into account changes in economic growth and demographic changes. A sustainable tax system:

- ***will raise sufficient funds*** to meet current and future government spending needs;
- ***provides revenue stability*** - a volatile tax that fluctuates markedly from year to year hinders the government's ability to plan for the future; and
- ***supports a balanced budget*** in the long run - to avoid placing the burden of current government expenditure on future generations.

8.1.1. Consultation question

Question 8.1.1.A

Are these principals appropriate to assess the current tax system and any proposed changes, or can you identify amendments to the principles that should be considered by the Panel? If so, why?

9. State Own-Source Revenue

This section describes in some detail the current Tasmanian State taxation system. It also gives a snapshot of the recommendations of the *Australia's Future Tax System* Report with regards to state taxes, and proposes some consultation questions that those making submissions to the State Tax Review may wish to consider.

9.1. State tax reform

9.1.1. Recent tax reform in Tasmania

Recent tax reform in Tasmania can be separated into three broad categories:

- the abolition of State taxes as agreed to under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations of 1999* and the subsequent *Intergovernment Agreement on Federal Financial Relations of 2008*;
- abolition of State taxes, adjustment of tax rates, creation of new tax concessions and exemptions, and other miscellaneous amendments independent of Commonwealth-State decisions; and
- harmonisation of State tax legislation with other states.

Intergovernmental agreements

Intergovernmental agreements between the Australian and state governments were associated with the introduction of the GST, as discussed in section 5.2. Prior to the introduction of the GST, Tasmania collected over 25 taxes in 1999-00. Recently abolished taxes are noted in Appendix A3.

As part of the 2008 *Intergovernment Agreement on Federal Financial Relations*, the states have agreed not to levy stamp duties on the transfer of emissions trading permits if and when they are introduced.

The states did not agree to review or abolish conveyance duty on the transfer of real property, insurance duty or motor vehicle registration duty.

State-level initiated reform

In addition to abolishing taxes listed for review under the original IGA ahead of all other states except Victoria, Tasmania has also initiated its own program of tax reform.

Additional detail on these specific reforms is contained in the discussion of individual tax categories in this section and Appendix A3.

State tax harmonisation

What is harmonisation?

Harmonisation is the cooperative efforts made by governments to make the application of laws more uniform and consistent across jurisdictions.

The intent is for each jurisdiction to agree on a set of minimum requirements or standards so they can be applied consistently in each jurisdiction. Through creating consistency across jurisdictions, harmonisation reduces the costs of complying with legislation.

In many cases harmonisation means consistent definitions, administration requirements and eligibility requirements. It does not mean that jurisdictions will necessarily harmonise tax rates and thresholds. These remain policy decisions for individual jurisdictions. Although there are many advantages associated with harmonisation, states on-balance prefer to maintain flexibility with regard to rates and thresholds associated with taxes.

Drivers of harmonisation

The main driver of harmonisation is the desire to reduce the regulatory burden on taxpayers.

In 2005, jurisdictions began to examine the opportunities for harmonisation of key elements of payroll tax legislation. This was given additional impetus by the *Rethinking Regulation, Report of the Taskforce on Reducing Regulatory Burdens on Business* released in 2006, which recommended that:

> COAG should develop measures to harmonise the tax base and administrative arrangements of payroll tax regimes across the states and territories. Business raised similar issues about differences in stamp duty administration across the states and territories. (Recommendation 5.45)
>
> While there was some success in harmonising stamp duty in the 1990s, some states and territories did not participate and there are still significant differences. Even where the legislation is the same, there can be differences in interpretation and application. Such differences make it more difficult for business to operate nationally.[4]

This recommendation was progressed under a National Partnership Agreement to Deliver a Seamless National Economy. Output 3, payroll tax harmonisation, has the goal of introducing common state and territory payroll tax administrative provisions and definitions by 1 July 2012.

Advantages of harmonisation

For taxpayers operating across state and territory borders, the main advantage of harmonisation is reduced compliance costs, by eliminating the need to be familiar with the potentially eight different sets of rules to undertake multiple calculations or maintain parallel systems for tax purposes.

Where there is uniform drafting, harmonisation also provides greater certainty as to the legislation and how it applies across jurisdictions.

For state revenue offices, harmonisation offers the opportunity to reduce some costs by sharing work across jurisdictions. For example, different state revenue offices could, in effect, specialise in different areas of administration.

For taxpayers that operate in more than one jurisdiction, harmonisation simplifies the tax system and improves equity by ensuring that taxpayers in similar circumstances are treated the same irrespective of the jurisdiction in which they operate. This should lead to a greater confidence in the tax system and therefore better support for voluntary compliance at the national level.

Disadvantages of harmonisation

From a State Revenue Office perspective, significant administrative effort is involved in achieving and maintaining harmonisation. For example, there is substantial time and effort involved in reaching agreement on legislative and administrative changes due to

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[4] *Rethinking Regulation, Report of the Taskforce on Reducing Regulatory Burdens on Business, 2006, p 123*

the need to consult widely and regularly with other state revenue offices and a broader range of stakeholders.

From a taxpayer perspective, there are also potential disadvantages from harmonisation. While states might harmonise definitions, administrative requirements and eligibility requirements, it is unlikely that jurisdictions will harmonise tax rates and thresholds. Thus, the need to undertake potentially eight different tax calculations is not removed entirely. Contemporary technologies or coordinated web services have the potential to alleviate much of the burden that might otherwise impact on the administration of businesses. In this regard, therefore, some of this disadvantage could be further mitigated.

There is also a tension between harmonisation and the sovereignty of the individual states. If legislative harmonisation is to be maintained, governments need to prioritise harmonisation over other policy objectives. In addition, the task of maintaining harmonisation across jurisdictions can be problematic for practical reasons.

In relation to the administration of tax, there is also tension between harmonisation and the statutory responsibilities of individual Commissioners of State Revenue. Even if legislation is totally uniform across jurisdictions, there are still eight separate sets of legislation and eight Commissioners, each of whom is responsible and accountable for decisions made under their jurisdiction's legislation.

Even if legislation is uniform:

- it may still be subject to genuine differences in interpretation; and
- each Commissioner has a duty to be satisfied that appropriate decisions are being made in his or her jurisdiction. This may make it difficult for Commissioners to simply "accept" decisions made in other jurisdictions.

Current harmonisation arrangements

Duties

In 1994, Tasmania joined with New South Wales, Victoria, South Australia and the Australian Capital Territory in a stamp duties re-write project. This project aimed to maintain unique state specific duties legislation but to utilise common principles, definitions and structures in the legislation of each jurisdiction, to reduce compliance costs for business.

As a result of this, the *Duties Act 2001* commenced in Tasmania on 1 July 2001. This Act utilises common terms and has similarly structured provisions and principles with the other jurisdictions who participated in the project.

While the stamp duties re-write project initially achieved legislative harmonisation, the various Acts are now harmonised in some areas, but divergent in others. This highlights the discipline required across jurisdictions to maintain "true" harmonisation.

Payroll tax

On 29 March 2007, state and territory Treasurers announced a decision to overhaul payroll tax arrangements to achieve greater legislative and administrative harmonisation.

Inter-jurisdictional agreements were subsequently reached to harmonise on eight key areas:

- timing of lodgement;
- motor vehicle allowances;
- accommodation allowances;
- fringe benefits gross-up rate;
- employee share acquisition schemes;
- grouping provisions;
- employment agency provisions; and
- contractor provisions.

Shortly after, Victoria and New South Wales went further and passed harmonised legislation with effect from 1 July 2007.

Tasmania adopted and enacted its own version of the New South Wales/Victorian harmonised legislation from 1 July 2008. The New South Wales, Victorian and Tasmanian Acts still have some state specific provisions that are contained in Schedule 2 of each Act and the individual states have retained their own rates and thresholds.

Queensland also amended its payroll tax legislation to achieve similar harmonisation from 1 July 2008 and the Northern Territory and South Australia harmonised effective from 1 July 2009. Western Australian passed a range of amendments in June 2010 harmonising on the eight key areas, with the exception of the grouping and contractor provisions. The Australian Capital Territory is aiming to have harmonised legislation in place from 1 July 2011.

A key component of payroll tax harmonisation is a clear commitment, at Commissioner level, to maintain legislative harmony and to achieve and maintain administrative harmonisation.

Inter-jurisdictional committees have been created to achieve and maintain this harmonisation.

9.1.2. Consultation question

Question 9.1.2.A

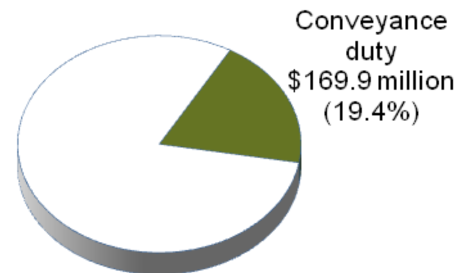
The State currently levies 14 different taxes, with payroll tax, property transfer duty, gambling taxes and land tax constituting approximately 70 per cent of the total raised.

Would you support a reduction in the number of taxes, provided revenue neutrality and adherence to the principles outlined in section 8 is maintained? If so, how should the forgone revenue be raised to meet the expenditure needs of the State?

9.2. Property transfer duty

9.2.1. Property transfer duty in Tasmania

Duty is a "transaction tax" and is assessed on a range of instruments, transactions and arrangements, with the majority of the revenue derived from transfers of real property. Duty on the transfer of motor vehicles will be discussed separately below under motor vehicle taxes and duty on insurance under a separate section again.



2010-11 Budget estimate

Property transfer duty makes up 19.4 per cent of Tasmania's own-source taxation revenue.

"Transaction taxes" are often described as highly inefficient because they distort decision making and behavior by imposing cost on transactions that governments and the community may otherwise view as beneficial. For example, conveyance duty adds appreciably to the costs of buying properties and it can be argued that this dissuades households from relocating, upgrading, or downsizing when these circumstances may otherwise provide wider benefits from doing so.

Similarly, insurance duty effectively increases the costs of obtaining insurance cover and, at the margin, can lead to the community under-insuring.

At the same time, however, these taxes represent an important source of government revenue and so they cannot simply be reduced or abolished, without consideration of the impact on the State's Budget.

Assessment and administration

Duties are imposed under the *Duties Act 2001*. Duty is assessed on the transfer of all real property, including vacant land, capital improved land and fixtures to land. Duty is no longer payable on the transfer of non-real property business assets. This was abolished as part of the IGA reforms. In some cases, the transfer of shares will be subject to duty if those shares give the shareholder a land use entitlement, or are in a company that has land holding as a predominant part of its make-up.

The Commissioner of State Revenue collects duty on property transfers. Special arrangements are in place to allow approved persons, such as banks and law firms, to self-assess duty and to pay tax by monthly return.

Duty is assessed on the purchase price, or if higher, the value of the asset transferred. Property values determined by the Valuer-General are used by the Commissioner to establish the dutiable value of a property.

Generally, duty must be paid within three months of the transfer of dutiable assets, and the transferee (purchaser) is the party liable to pay duty.

Duty is a progressive tax, in that the rate of duty increases as the value of the asset transferred increases.

The rates of duty are set out in the Table 9.1 below:

Table 9.1 Property transfer duty rates

Property value ($)	Rate
0 – 1 300	$20
1 301 – 10 000	$1.50 for every $100, or part, of the dutiable value
10 001 – 30 000	$150 plus $2 for every $100, or part, by which the dutiable value exceeds $10 000
30 001 – 75 000	$550 plus $2.50 for every $100, or part, by which the dutiable value exceeds $30 000
75 001 – 150 000	$1 675 plus $3 for every $100, or part, by which the dutiable value exceeds $75 000
150 001 – 225 000	$3 925 plus $3.50 for every $100, or part, by which the dutiable value exceeds $150 000
Over 225 000	$6 550 plus $4 for every $100, or part, by which the dutiable value exceeds $225 000

Aggregation

Where a series of transactions are between related parties, or are interdependent, the Commissioner has legislative power to treat the transactions as a single transaction for the purposes of duty calculation. Aggregation has been introduced to prevent taxpayers from organising transactions to take advantage of the sliding scale of duty rates.

For example, Mr Smith owns two properties each worth $200 000 and agrees to sell them to Mr Jones for $400 000. Duty on the total $400 000 value of the transaction is $13 550. However, Mr Smith and Mr Jones may agree to split the transaction into two separate transfers of $200 000 value. Duty on $200 000 value is $5 675 and duty on the two transfers would thus be $11 350. Mr Jones would have avoided $2 200 in duty simply by re-structuring the transaction.

The principle of aggregation allows the Commissioner to consider the two transfers to be a single transaction and to assess $13 550 duty on the total purchase price of $400 000.

Exemptions and concessions

The Duties Act provides a range of exemptions, including:

- the transfer of farming land between family members (known as the intergenerational rural transfer or family farm exemption). This exemption was created to facilitate the passing of farm land to a new generation of farmers with a view to retaining agricultural land in farming operations;
- the transfer of property between partners in a marriage, a significant relationship or a caring relationship, or when property is transferred following the breakdown of such a relationship;

- the gift of property that will be used for charitable, educational or religious purposes; and
- the transfer of land to the Crown.

The Duties Act provides a range of concessions, including concessional rates of duty on:

- the purchase of a first home valued at $350 000 or less, where the first home buyer is entitled to a first home owner grant;
- the transfer of dutiable property to or between trustees (including trustees of superannuation funds) in certain circumstances;
- the transfer of dutiable property that is subject to a trust to the beneficiary of the trust in certain circumstances;
- the transfer of the assets of an estate to the beneficiaries of a Will;
- the transfer of property to a shareholder in the course of the winding up of a company; and
- the transfer of dutiable property where the Commissioner is satisfied that there is no change in beneficial ownership.

Tax base

Of the $170 million collected for conveyance duty the majority is received in relation to the transfer of residential properties.

Chart 9.1 shows how around $117 million or almost 70 per cent of total duty received in 2009-10 was in relation to the transfer of residential properties. Of this, $112 million or 67 per cent was for residential property transactions with an aggregated value of less than $1 million.

A summary of transactions and duty by category of property is provided at Table 9.2. Residential transactions account for some 81 per cent of the total.

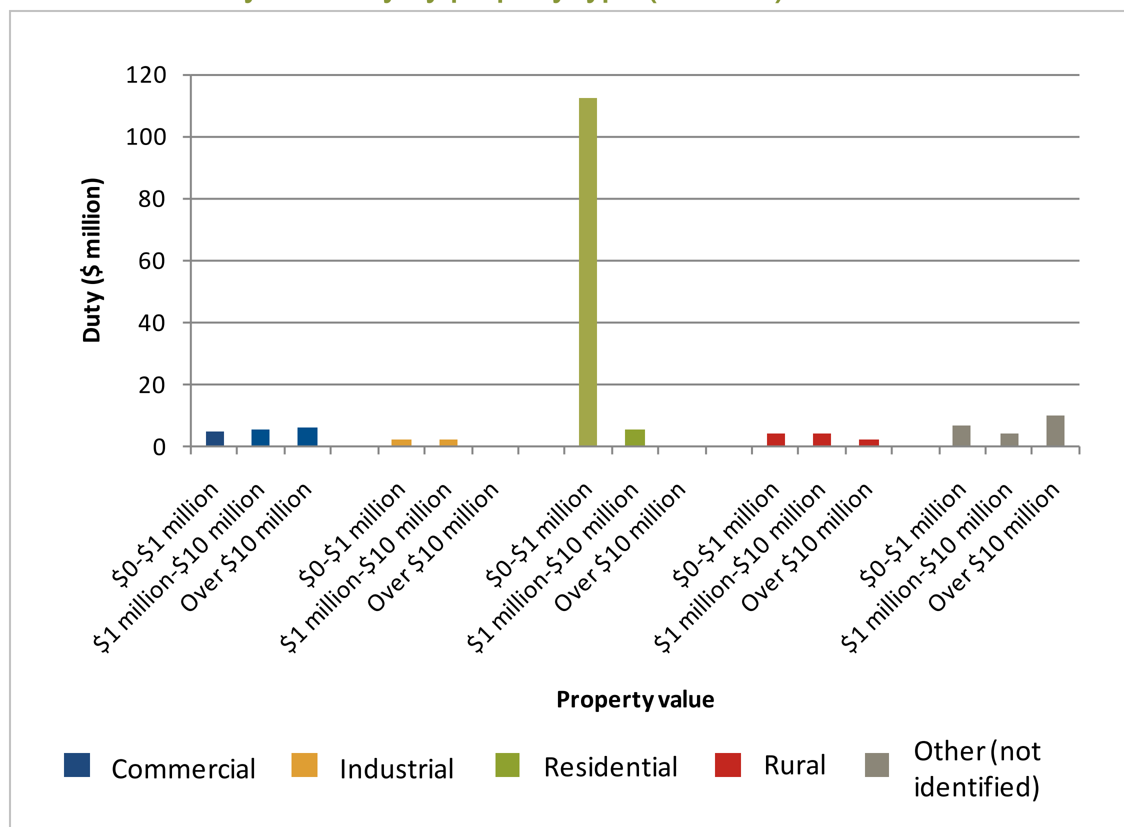
Table 9.2 Conveyance transactions and duty by property type (2009-10) [1]

	Transactions		Duty	
	No's [2]	**%**	**$ million**	**%**
Commercial	650	3.1	16.3	9.7
Industrial	293	1.4	3.9	2.3
Residential	16 792	81.1	117.3	69.9
Rural	889	4.3	10.0	6.0
Other / not identified	2 091	10.1	20.3	12.1
Total	20 715	100.0	167.8	100.0

Notes:

1. The above data is based on returns provided to the State Revenue Office in 2009-10 rather than actual receipts. Consequently, these numbers will vary slightly in comparison with actual receipts due to timing differences.
2. Transaction numbers should be treated with caution as split transfers, documents with multiple counterparts and transactions involving different types of transfer (for example property and licence fees) are counted as separate transactions.

Chart 9.1 Conveyance duty by property type (2009-10)[1]



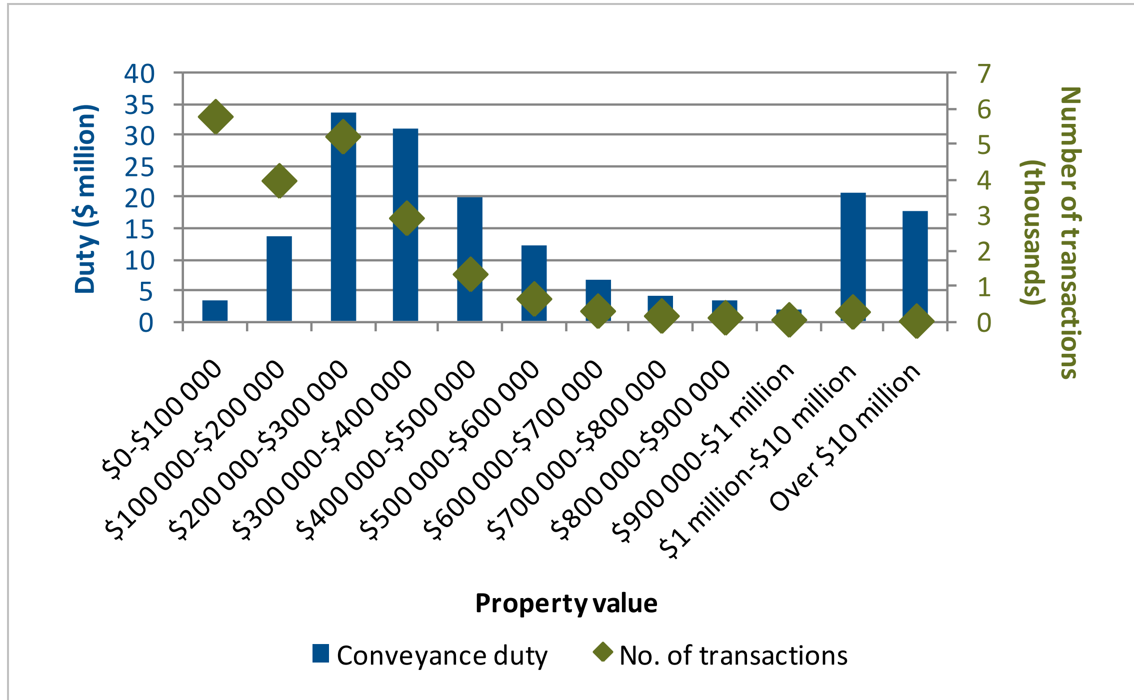
Source: State Revenue Office

Note:

1. The above data is based on returns provided to the State Revenue Office in 2009-10 rather than actual receipts. Consequently, these numbers will vary slightly to actual receipts due to timing differences.

Across all property categories, conveyance duty on the transfer of properties with a value less than $1 million accounted for around $130 million or 77 per cent of total conveyance duty in 2009-10 (see Chart 9.2).

Chart 9.2 Conveyance duty by property value (2009-10)



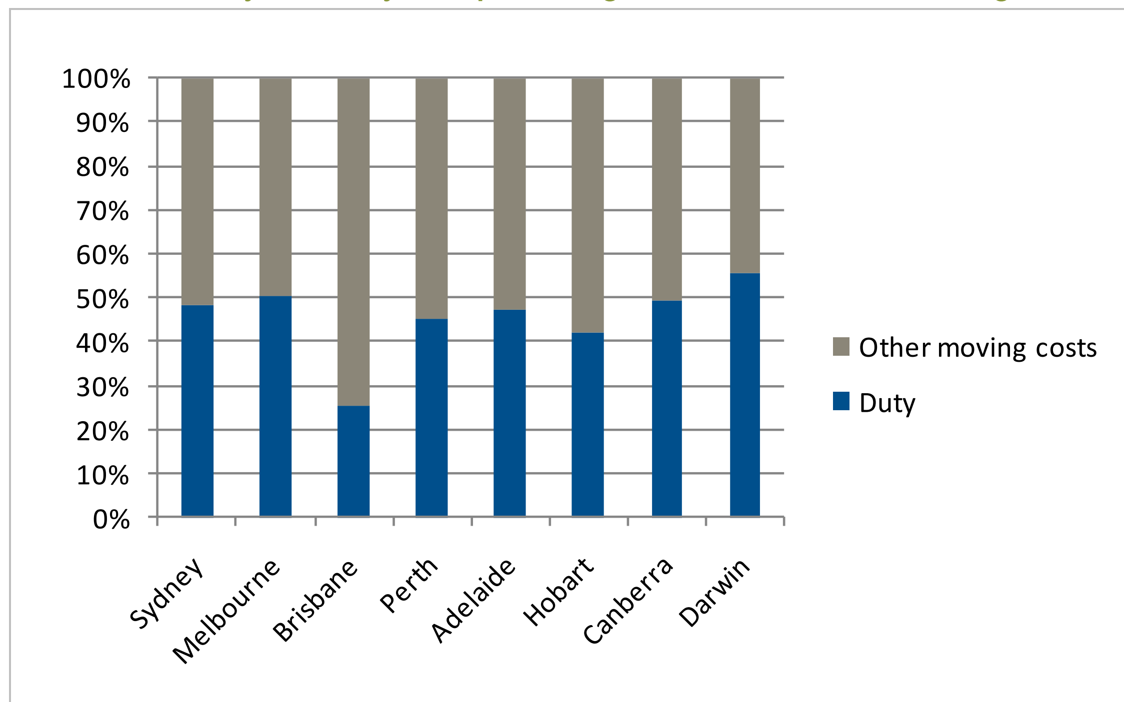
Source: State Revenue Office

The effect of conveyance duty on the decision to buy and sell property is influenced by the size of the tax in comparison to the non-tax costs of moving houses, such as real estate agent fees, removal costs and search costs.

Conveyance duties under some circumstances can double these costs. The cost of conveyance duty as a percentage of total moving costs is provided in Chart 9.3, and although conveyance duty in Hobart is the second lowest when compared to other state capital cities, it is still significant at around 42 per cent of the total cost of moving house. A study by Leigh (2009) found that a 10 per cent increase in the level of stamp duty reduces the numbers of properties exchanged by four to five per cent if the increase is sustained over a three year period, suggesting that the current rates of stamp duty prevent a substantial number of housing sales and purchases.

Source: *AFTS* p.255

Chart 9.3 Conveyance duty as a percentage of the total cost of moving house



Source: Based on Table C2-1, *Australia's Future Tax System Report*, p.255.

Notes:

- Based on median house prices in the respective capital cities in June 2009.
- "Other moving costs" assume real estate agent fees of 3 per cent on the value of the median house price in each of the capital cities, as well as a flat $5 000 cost in all states. Stamp duty payable assumes that the buyer is not entitled to concessions such as first home buyer assistance. These estimates overstate the monetary non-tax costs of moving for those vendors who choose not to engage a selling agent or professional removalists.

Recent tax reform

In 2009, duty on agreements for sale and agreements to transfer dutiable property was abolished. Duty remains payable on the transfer of dutiable property. This amendment simplified the treatment of conditional and off-the-plan sales and ensures that taxpayers are not required to pay duty before completion of a transaction, which could previously occur when an agreement was entered into well before the transfer date.

From 1 July 2008, duty on non-real business conveyances was abolished. Non-real property includes business assets such as:

- goodwill;
- a statutory business license;
- a right to use a statutory business license;
- a business name;
- a right under a franchise agreement;
- a supply right; and
- intellectual property.

The first home buyer duty concession was introduced in 2004-05 for a limited period and extended indefinitely in 2006. At that time, arrangements were introduced to provide a refund to first home buyers of the duty associated with the purchase of land upon which a first home is subsequently built.

Mortgage duty was halved from 1 July 2006 and completely abolished from 1 July 2007.

Debits duty was abolished from 1 July 2005.

From 1 July 2002, a number of other duties levied under the *Duties Act 2001* were abolished, including:

- lease duty;
- non-quoted marketable securities duty;
- public liability insurance premium duty;
- hire of goods duty; and
- a range of miscellaneous duties.

Stamp duty on quoted marketable securities was abolished from 1 July 2001.

In accordance with the original IGA, duty on the transfer of quoted marketable securities and financial institutions duty was abolished from 1 July 2001.

The *Duties Act 2001* replaced the *Stamp Duties Act 1931* from 1 July 2001.

Findings of the *AFTS* in relation to property transfer duty

- Stamp duties on the transfer of commercial and residential land and buildings are a significant, though volatile, source of state tax revenue.
- Existing state stamp duties on property conveyancing are highly inefficient, distorting both residential and business use of property.
- As a tax on transferring land, they discourage land from changing hands to its most valuable use. Stamp duties are also an inequitable way of taxing land and improvements, as the tax falls on those who need to move.

- Reforms to stamp duties and land tax would reduce current impediments to housing supply generated by the tax system.
- While removing stamp duty would lead to more equitable and efficient outcomes, it would create a substantial hole in state revenues. This shortfall should be met though increased reliance on more efficient state taxes.
- There is a case to link the reform of stamp duty to that of land tax to reduce the impact on prices and wealth caused by tax reform.

Further summarised information on the findings of the *AFTS* in relation to property transfer duty can be found in Appendix A2.2 or the report is available at www.taxreview.treasury.gov.au.

9.2.2. Consultation questions

Question 9.2.2.A

Which features of property transfer duty work well, and which do not, having regard to the principles outlined in section 8? Which, if any, of the principles do you think are most important when considering property transfer duty, and why?

Question 9.2.2.B

The *AFTS* recommends replacing property transfer duty with a broad-based tax. Would you support this recommendation? Why, or why not?

Question 9.2.2.C

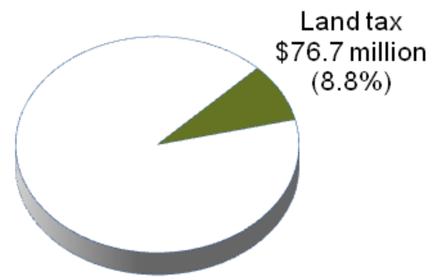
Alternatively, what changes to existing arrangements would you suggest to improve the performance of property taxes against the principles, while maintaining revenue neutrality? Why would this be better than existing property transfer duty?

Question 9.2.2.D

What are the advantages and disadvantages of a transaction-based tax like property transfer duty? How would you rate transaction-based taxes generally against other property taxes such as land tax?

9.3. Land tax

9.3.1. Land tax in Tasmania



2010-11 Budget estimate

Land tax is levied on the ownership of land at 1 July each year. It accounts for 8.8 per cent of Tasmania's own-source taxation revenue.

Land tax is generally argued to be a relatively efficient tax; particularly if the base is broad enough.

The use of land is an essential part of most activities and therefore taxing it is less likely, under appropriate tax arrangements, to distort decisions about engaging in alternative activities. For example, land tax applied under identical arrangements to a residential property development, a factory, or a shopping complex would not in itself influence the purpose to which that land is used.

In addition, a parcel of land cannot be moved from one taxing jurisdiction to another in order to take advantage of differences in tax regimes (or rates).

This results in land tax being preferable, from an efficiency point, to transactions taxes. This raises the question as to whether our land tax base is being used to its full and reasonable potential.

The incidence of land tax is very market dependent and in most cases there is a sharing of the incidence of land tax. For example, where the demand for properties is relatively low, and there are other opportunities or substitutes for lessees, it is very difficult for a landlord to pass land tax onto the lessee. In contrast, where there is high demand for properties, there is a greater opportunity for the landlord to pass the cost of land tax on to the lessee.

Assessment and administration

Land tax is imposed under the *Land Tax Act 2000*. It is currently levied on the basis of four land categories:

- general;
- primary production;
- principal residence; and
- shack land.

However, the rate of tax on primary production, principal residence and shack land has been set at zero, effectively exempting such land from land tax.

General land relates to any land that is not classified as primary production, principal residence or shack land. It includes commercial and industrial land, land used for the rental of residential housing and vacant land.

Land tax is calculated on the assessed land value. The Valuer-General prepares new property valuations for each municipality every six years and annual adjustment factors between valuations. The land is valued on the basis of fair market values taking

into consideration an assessment of land sales data and modifications made for factors such as location, land size and nearby developments and amenities.

Before undertaking valuations, a large number of sales in a locality are analysed to gain in-depth understanding of the real estate market. Allowance is made for the added value of any buildings or other structures on the land. This information and the valuer's expertise are then used to value the properties. Land is valued at its highest practical planning approved use.

In the intervening years between re-valuations, the Valuer-General prepares annual adjustment factors. The valuation adjustment factor for a given district is determined for each land category, representing an estimate of the general movement in land values since the last full re-valuation was undertaken for that district.

The Department of Premier and Cabinet is undertaking a review of the valuation and local government rating model (discussed in section 10). The outcomes of the review will be available for consideration by the Tax Review Panel before the draft State Tax Review Final Report is published.

Land tax notices are issued by the State Revenue Office between October and April each financial year, depending on the amount of tax assessed. Taxpayers with an annual tax liability of greater than $1 000 are able to pay their land tax via three installments. The value of a taxpayer's land holdings is aggregated and the appropriate tax rate applied to that total. Land tax is payable within 30 days of the issue of a notice.

Point in time assessment

Land tax is based on property ownership and classification at 1 July each year. Accounts are issued on this basis. Where a property changes hands during the year, it is common for the vendor and purchaser to agree that the land tax liability will be shared on a pro rata basis. This practice can cause concern for purchasers that intend to utilise the property as their principal place of residence or for other "exempt" land uses. There are more than 56 000 taxable property holdings and it is not feasible to recalculate land tax with regard to an individual property or a taxpayer's total account each time a property changes hands or changes classification. To do so would significantly increase administrative costs.

Table 9.3 below displays land tax rates applying from 1 July 2010.

Table 9.3 Land tax rates for general land

Assessed Land Value	Tax Rate
below $25 000	Nil
$25 000-$349 999	$50 plus 0.55 cents per $1 above $25 000
$350 000 and above	$1 837.50 plus 1.5 cents per $1 above $350 000

Aggregation

The total value of a land holder's taxable land holdings is used to calculate land tax. Where a progressive land tax scale is used (i.e. where the land tax rate increases with property values) aggregation ensures that property owners with large holdings do not

split properties into smaller, lower value, parcels to achieve a lower rate of land tax and it ensures equitable treatment in that a person holding a single property will pay the same tax as a person owning several lower-value properties with the same combined value.

Exemptions and concessions

The primary land tax concessions are those relating to principal places of residence and primary production land. While not technically exempt from tax, the rate of tax applying to these land classifications is zero.

The principal residence classification applies to land on which there is a dwelling or stratum unit that is occupied as the principal residence of the owner. This category also includes retirement village units occupied as principal residences.

The primary production land category applies to land that is used substantially for the business of primary production. It includes land that has been declared a private timber reserve under the *Forest Practices Act 1985*, or a State forest under the *Forestry Act 1920*.

The other current land tax exemptions in Tasmania are as follows:

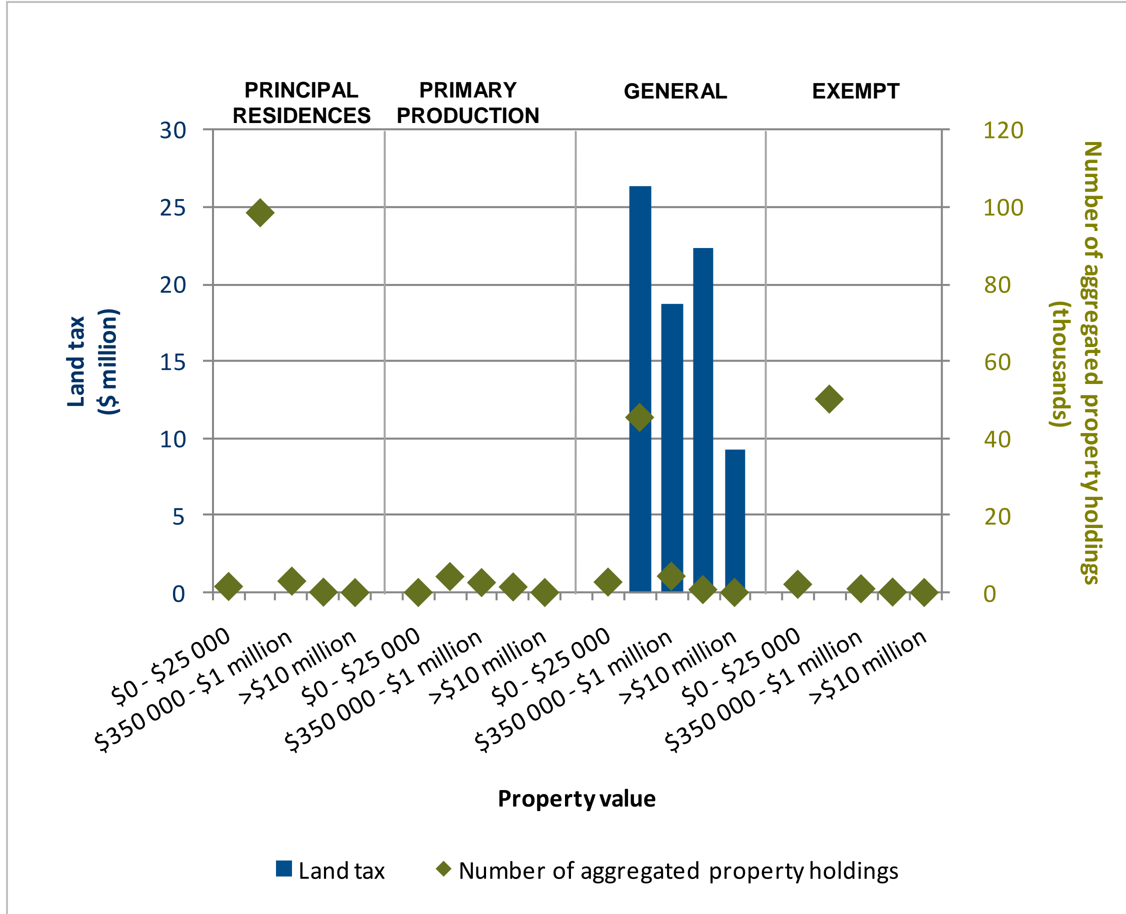
- Qualifying shacks with an assessed land value of $500 000 or less, and businesses operated from home are both exempt from land tax.
- Land tax on dwellings constructed and occupied under the first home owner grant arrangements can be rebated for up to two years of land tax paid, prior to the date of occupation.
- Certain non-profit sporting organisations and bodies that control or promote horse racing, dog racing, athletic sports or motor racing, are eligible for a concessional rate of land tax that is equal to 0.4 per cent of the assessed land value.
- All land owned by an Australian Government Pensioner Concession Card holder and who has a 50 per cent or greater ownership stake in the property is exempt from land tax.
- A rebate is available to home owners who incur a land tax liability in transitional circumstances when they are moving from one residence to another. The rebate is paid to those home owners who have paid the land tax liability and have sold their former residence, provided no income is earned from the property during the transitional period.

Tax base

Chart 9.4 shows the number of aggregated property holdings in Tasmania, and estimated land tax from principal residences, primary production, and general land categories in 2010-11. Also shown are the number of exempt property holdings, including pensioners and State and Australian Government properties. As the tax rates for principal residences and primary production properties have been set at zero, no land tax is collected in relation to these properties.

Of the 218 000 property holdings in Tasmania in total, land tax will be collected for only 50 000 or just under one quarter. Of these, 800 properties will account for over 40 per cent or $31.7 million of a total estimated land tax of $76.7 million in 2010-11.

Chart 9.4 Land tax (2010-11)[1]

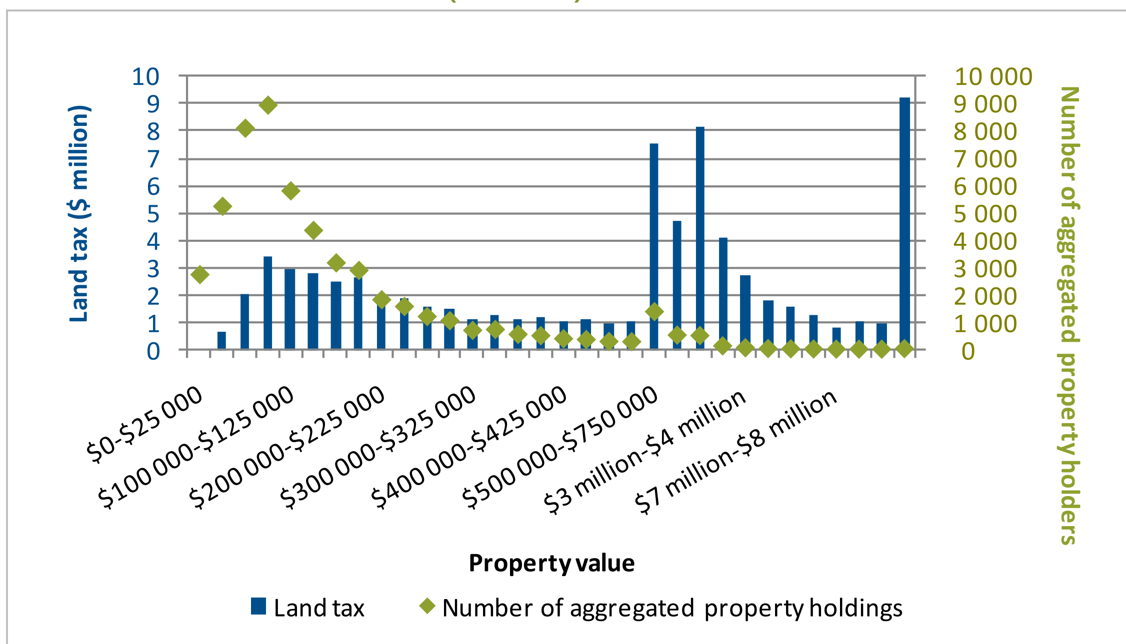


Note:

1. Shacks with a land value of less than $500 000 and home businesses are included in the "Exempt" category.

Chart 9.5 depicts the distribution of land tax for general landholders only.

Chart 9.5 General landholders (2010-11)



A summary of the number and value of aggregated property holdings, and the associated land tax, is provided at Table 9.4.

Table 9.4 Aggregate property numbers, value and associated land tax (2010-11)

	No. of properties (thousands)	Total property value ($ million)	Land tax ($ million)
Principal residence	103	13 537	....
Primary production	8	6 767	....
General [1]	53	10 334	76.7
Exempt [2]	53	8 446	....
Total	218	39 084	76.7

Note:
1. Excludes approximately 4 000 shacks and home businesses, which are now included in the Exempt category.
2. Includes both exempt properties (eg Aged Care homes) and exempt taxpayers (mostly pensioners).

Recent tax changes

A suite of land tax changes announced in December 2009 apply from 2010-11:

- the land tax rate applied to aggregated land values over $350 000 was reduced to 1.5 per cent. For land valued over $350 000 and up to $750 000, this is a reduction of 0.5 per cent; and a reduction of 1.0 per cent for land valued at over $750 000, compared with 2009-10 land tax rates;
- new exemptions were introduced for qualifying shacks with an assessed land value of $500 000 or less, and businesses operated from home; and
- a land tax rebate of up to two years of land tax paid prior to the date of occupation was introduced for people eligible for the first home owner grant who construct and occupy a dwelling as a principal place of residence.

Adjustments to land tax rates and thresholds were also made in 2002-03, when the tax-free threshold was increased from $1 000 to $15 000, and the number of steps in the land tax scale was reduced.

Again in 2005-06 the tax free threshold was further increased from $15 000 to $25 000, and the number of steps in the land tax scale was further reduced.

The *Land Tax Act 2000* replaced the *Land and Income Taxation Act 1910* from 1 January 2001.

Findings of the *AFTS* in relation to land tax

- Existing land taxes are narrow, which make them less efficient and fair than they could be. Broadening the base of land tax would provide a more efficient, reliable and stable source of revenue to state governments.

- Along with natural resources, land tax is the only major tax that can be levied directly on economic rent. Shifting taxes away from mobile bases toward an immobile base increases efficiency and potentially leads to higher long-term economic growth. Further, as land values tend to be correlated with growth in the economy and population, land tax is well-suited to future demographic pressures.
- Broadening the tax base to include land used for owner-occupied housing would add significant revenue raising capacity to the tax base. This would improve the overall efficiency of the tax system, by reducing the reliance on alternative, less efficient taxes.
- The *AFTS* recommends:
  - Broadening the land tax base, and applying marginal rates based on a per-square-metre value.
  - Applying land tax to individual land holdings, rather than on an entity's aggregated land holdings.
  - Integrating land tax and local government rates, by using a joint billing arrangement and using the same valuation method.

Further summarised information on the findings of the *AFTS* in relation to land tax can be found in Appendix A2.3 or the report is available at www.taxreview.treasury.gov.au.

9.3.2. Consultation questions

Question 9.3.2.A

Which features of land tax work well, and which do not, having regard to the principles outlined in section 8? Which, if any, of the principles do you think are most important when considering land tax, and why?

Question 9.3.2.B

The *AFTS* recommends broadening the land tax base to include all land (including principal place of residence land). Would you support such a recommendation? Why, or why not?

If this change to land tax were made, how should transitional arrangements be managed?

Question 9.3.2.C

The *AFTS* recommends applying progressive rates based on a per-square-metre value, do you support this recommendation? Why, or why not?

If this change to land tax were made, how should transitional arrangements be managed?

Question 9.3.2.D

Should land tax be applied to individual land holdings, rather than to aggregated land holdings? What are the positive and negative implications of a proposal to abolish aggregation?

Question 9.3.2.E

Alternatively, what changes to the current land tax arrangements would you suggest to improve their performance against the principles, while maintaining revenue neutrality? Why would this be better than existing arrangements or the options above?

Question 9.3.2.F

As most local government rates are based to some extent on land value, would you favour integration of land tax and local government rates as proposed by the *AFTS*? Why, or why not?

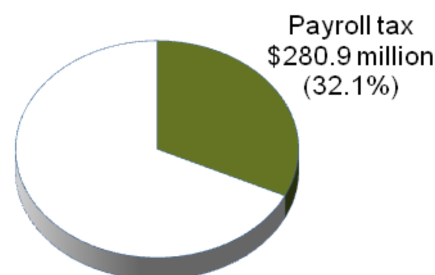
How could this be achieved administratively, and what implications would arise from councils and the State directly sharing a tax base?

9.4. Payroll tax

9.4.1. Payroll tax in Tasmania

Payroll tax is levied on employee wages and salaries, commissions, bonuses, fringe benefits and allowances, directors' remuneration, and employer superannuation and central fund contributions.

The tax also applies to certain contract payments and to employment agencies.



2010-11 Budget estimate

Payroll tax is a widespread but little understood tax mechanism. It is widely criticised as a "tax on jobs" but it is far from clear there is a substantial merit to this claim.

It is true that businesses that are price takers in their markets (and this is particularly so for firms exporting into international markets) would find it difficult to pass the tax on in the form of higher prices. In these instances businesses usually have to absorb some of this impact through higher costs and downward pressure on wages and salaries.

There is a body of technical work that suggests that under certain conditions the incidence of payroll tax is similar to that of a value added tax (or GST). There are a mix of price, cost and income effects for a business depending on their circumstances and industry in which it operates.

Payroll tax is generally regarded as falling somewhere between a land tax and transactions tax in terms of efficiency. As for the case of land tax, efficiency considerations suggest a broader-based payroll tax will introduce fewer distortions in business decisions although there would be costs associated with complying with this tax.

The main control over the tax base is the tax-free threshold.

Payroll tax also presents a worthy candidate for harmonised tax arrangements because it typically is assessed on large businesses, which tend to have a greater propensity for operations in multiple jurisdictions.

This tax is also paid by government departments and agencies, but receipts from these organisations are excluded from the actual and estimated payroll tax receipts reported for Budget purposes.

Private sector payroll tax accounts for 32.1 per cent of Tasmania's own-source taxation revenue.

Assessment and administration

Payroll tax is administered by the State Revenue Office. It is primarily self-assessed by payroll tax registrants, who submit monthly returns online or by paper within seven days of the end of the month in which wages are paid. Annual reconciliations must be submitted by 21July each year and adjustments made where necessary.

Payroll tax is levied at a rate of 6.1 per cent of an employer's total taxable wages above a $1.01 million tax free threshold. The definition of wages is set so as to include all remuneration to employees, including employer superannuation contributions.

Tax free threshold

Businesses with taxable wages not exceeding $1.01 million per annum do not pay any payroll tax. Businesses with payrolls that exceed this threshold pay tax only on wages in excess of $1.01 million.

For example, in 2009-10 JMC Cleaning employed 18 staff and had total taxable wages of $900 000. JMC did not exceed the tax free threshold and was not required to pay any tax in 2008-09.

The following year JMC employs an additional four staff and pays taxable wages of $1 210 000. JMC has exceeded the tax free threshold by $200 000. Payroll tax is calculated at a rate of 6.1 per cent of the amount by which taxable wages exceed the $1.01 million threshold. JMC is liable to pay $12 200 in payroll tax for the year, which is equivalent to 1 per cent of its total taxable wages.

Exemptions and concessions

A number of exemptions are available to employer types in all of the harmonised jurisdictions, including non-profit organisations, schools and educational services, and health care service providers, which include public hospitals and hospitals run by not-for-profit organisations.

In addition, wages paid by employers to volunteer firefighters, emergency service volunteers and defence personnel are exempt.

Tasmanian specific exemptions include wages paid to:

- schools and colleges;
- administrative staff; and
- students under a non-profit group apprenticeship or traineeship scheme.

Wages paid to an employee in respect of maternity or adoption leave are exempt for up to 14 weeks leave. Payments under the Australian Government's Paid Parental Leave Scheme (which commences on 1 January 2011) will not be subject to payroll tax.

Although not technically an exemption or concession, two payroll tax rebate schemes are currently in place:

- the Employee Incentive Scheme (Payroll Tax Rebate), introduced in the 2009-10 Budget. This provides payroll tax relief to all employers liable for payroll tax for any new positions created during the period of 11 June 2009 to 30 June 2010, and maintained continuously until 30 June 2011. Rebates for any payroll tax paid by eligible employers during this period will be paid with regard to wages paid up until 30 June 2011; and
- the Tasmanian Trainee and Apprentice Incentive Scheme (TTAIS) provides industry development and training incentives through the payroll tax system. TTAIS enables employers to claim a rebate on the payroll tax paid in relation to wages for eligible trainees and apprentices.

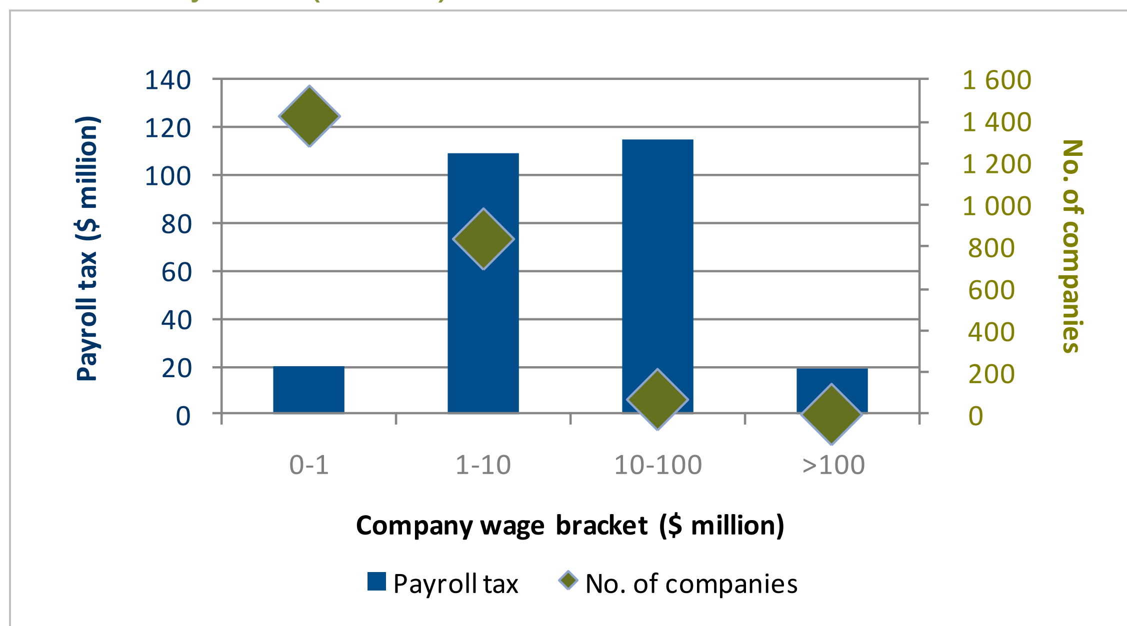
Tax base

In Tasmania, 35 138 Business Activity Statements were provided to the Australian Tax Office in 2008-09 with a location in the State identified as their main business address. Only 2 336 (or 6.6 per cent) of these were liable for payroll tax.

Tasmania's tax-free threshold is the highest of all states, with only the territories having higher exemptions. However, the marginal rate is also one of the highest.

Chart 9.6 shows the amount of payroll tax collected in 2008-09 for companies grouped by the size of their payroll in Tasmania. Of the 2 336 companies that paid payroll tax, just 73 or 3.1 per cent, with Tasmanian payrolls between $10 million and $100 million, accounted for $115 million or 43.7 per cent of the total payroll tax paid. The combined payroll of the 2 336 companies that paid payroll tax in 2008-09 was around $4.9 billion. This represents around 43 per cent of total wages paid in Tasmania in 2008-09 or 21 per cent of the 2008-09 Tasmanian Gross State Product (source: ABS).

Chart 9.6 Payroll tax (2008-09)

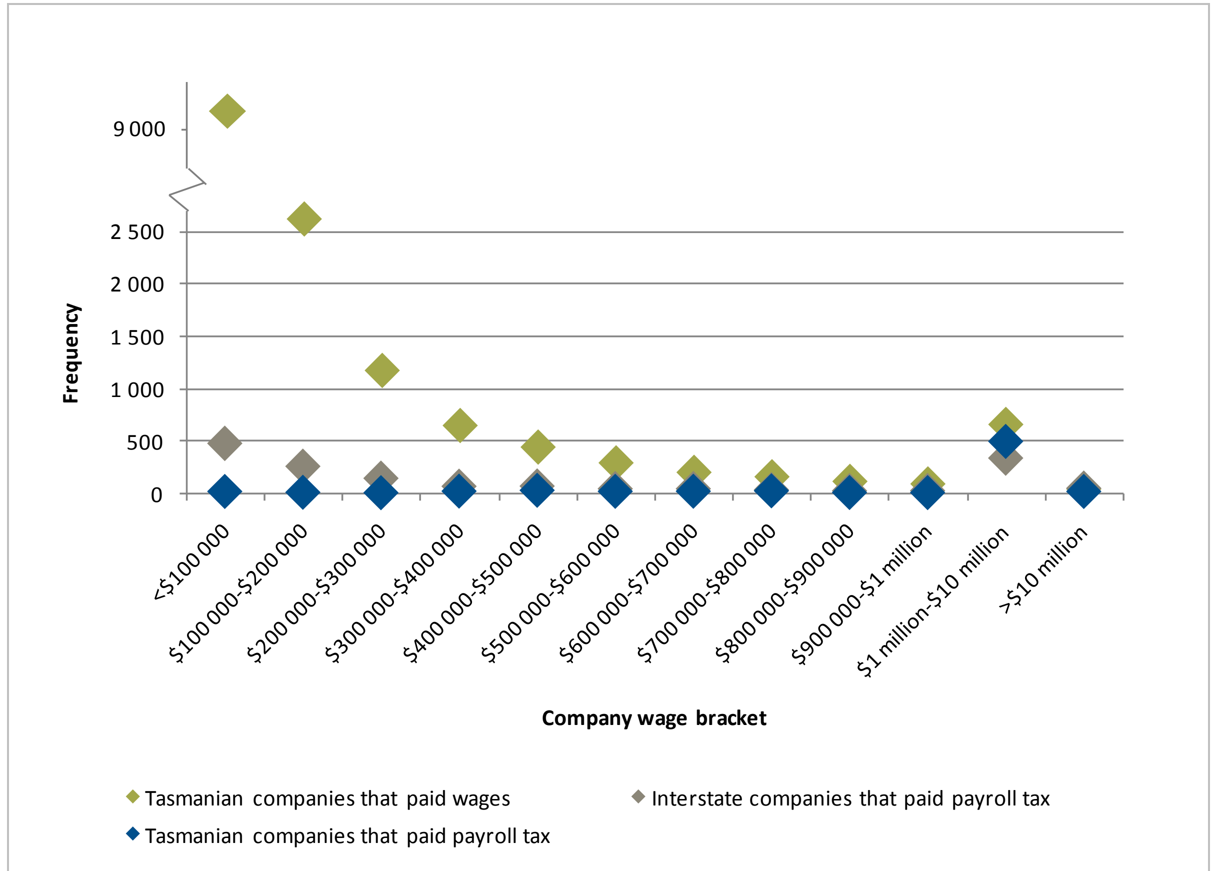


Source: State Revenue Office

Note:

1. Payroll tax is assessed on the aggregated wages of a company group, rather than on an individual company basis. Consequently, a particular company or subsidiary may be liable for payroll tax even though its wages are below the $1.01 million threshold.

Chart 9.7 Breakdown of companies that did / did not pay payroll tax in 2008-09



Sources: Business Activity Statements 2008-09 statistics from the Australian Taxation Office
Payroll tax returns to the Tasmanian State Revenue Office in 2008-09

Notes:

1. The number of Tasmanian companies that paid wages is based on the number of entities that provided Business Activity Statements to the Australian Taxation Office in 2008-09 and that identified a location in Tasmania as their main business address. A further 19 559 entities that identified Tasmania as their main business address, but declared nil wages, have not been included.
2. Company numbers exclude superannuation and government entities.
3. Payroll tax amounts exclude payments from government entities.

Recent tax reform

From 1 July 2008, Tasmania's payroll tax legislation was harmonised with New South Wales and Victoria. South Australia, the Northern Territory and Queensland have since enacted harmonised legislation, while Western Australia has harmonised with the exception of grouping and contractor provisions. The Australian Capital Territory is aiming to have harmonised legislation in place from 1 July 2011. This harmonisation provides significant benefits through reduced compliance costs to approximately 70 per cent of Tasmanian payroll tax registrants that operate in other states.

The new *Payroll Tax Act 2008* also provided direct benefits to all Tasmanian payroll tax registrants through increased allowances and new and expanded exemptions. Each harmonised state retains its own schedule containing tax rates, tax-free thresholds and state specific provisions such as additional exemptions and concessions.

Since 2001-02, the rate of payroll tax in Tasmania has been reduced in several steps from 6.53 per cent to 6.1 per cent and the tax-free threshold increased from $606 000 to $1.01 million.

Findings of the *AFTS* in relation to payroll tax

- The existing payroll tax systems administered by the states are narrow-based labour income taxes that reduce overall labour force productivity.
- A cash flow tax could be introduced over time to replace taxes such as payroll tax.
- A single rate tax applied to an entity's net cash flow position (cash flow tax), would be a simple consumption based tax that does not distinguish between different taxpayers, goods and services.
- However, the introduction of such a tax would represent a significant change and consultation and analysis on this alternative tax regime is required.

Further summarised information on the findings of the *AFTS* in relation to payroll tax can be found in Appendix A2.4 or the report is available at www.taxreview.treasury.gov.au.

9.4.2. Consultation questions

Question 9.4.2.A

Which features of payroll tax work well, and which do not, having regard to the principles outlined in section 8? Which, if any, of the principles do you think are most important when considering payroll tax?

Question 9.4.2.B

The *AFTS* recommends the introduction of a broad-based cash flow tax and the removal of some State taxes, including payroll tax. Do you support this recommendation? Why, or why not?

How do you envisage a cash flow tax could be applied?

Question 9.4.2.C

Because of the relatively high tax-free threshold, only a small proportion of businesses that operate in Tasmania pay payroll tax. Would you support lowering the tax-free threshold to broaden the tax base if this was accompanied by a lowering of the payroll tax rate? Why, or why not?

Question 9.4.2.D

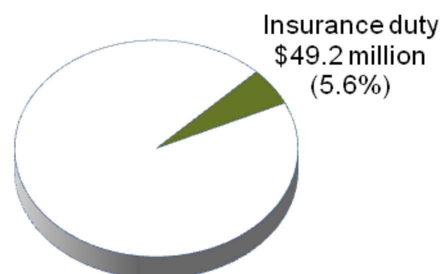
Alternatively, what changes to the current payroll tax arrangements would you suggest to improve performance against the principles, while maintaining revenue neutrality? Why would this be better than existing arrangements or the options above?

9.5. Insurance duty

9.5.1. Insurance duty in Tasmania

Insurance duty taxes various forms of insurance. Duty is based on the premium paid and falls into the class of "transaction tax".

Insurance duty accounts for 5.6 per cent of Tasmania's own-source taxation revenue.



2010-11 Budget estimate

Assessment and administration

Insurance duty is imposed under the *Duties Act 2001*. It is based on the premium paid for contracts of general insurance that are applicable to property in Tasmania or a risk that may occur within Tasmania.

Insurance duty is also imposed on a contract for life insurance where the person or persons insured have their principal place of residence in Tasmania at the time the policy of insurance is issued. Mortgage insurance, term or temporary insurance and annuities are considered a form of life insurance.

The incidence of insurance duty falls on the purchaser of insurance, with the insurer required to collect and remit duty to the State Revenue Office.

An insurer must be a registered entity for the purposes of the Act, and must submit a return to the State Revenue Office for the previous month, on or before the 21st of each month.

The duty charged on the different types of insurance is displayed in the Table 9.5 below:

Table 9.5 Insurance duty rates

Insurance	Rate
General	8%
Life	If the sum insured does not exceed $2 000, 10 cents per $200, or part, of the sum insured If the sum insured exceeds $2 000, $1 plus 20 cents per $200, or part, of the sum insured that exceeds $2 000
Term or temporary insurance	5% of the first year premium
Mortgage insurance	2%
Annuity	$20

Exemptions and concessions

Policies of insurance issued to a number of organisations are exempt from insurance duty.

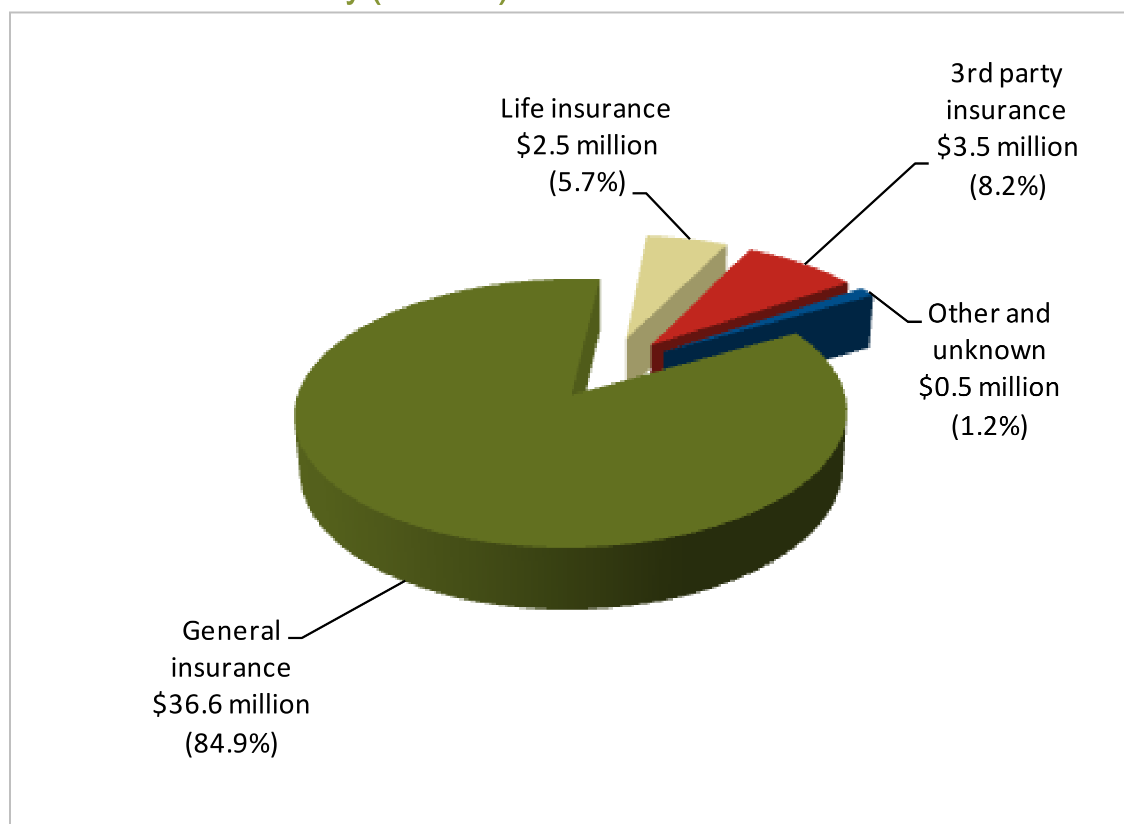
These organisations include the Crown, the University of Tasmania, the Commission for the Conservation of Antarctic Marine Living Resources, and insurance taken out with regards to a medical establishment.

Exemptions also exist for a number of types of insurance, including most significantly: medical benefits insurance; workers compensation insurance; reinsurance; and public liability insurance.

Tax base

The majority of insurance duty is paid with respect to general insurance. In 2008-09, this contributed $36.6 million or 84.9 per cent of total insurance duty received in that year (see Chart 9.8).

Chart 9.8 Insurance duty (2008-09)



Sources: State Revenue Office; Department of Infrastructure, Energy and Resources.

There are many factors that may deter people and businesses from entering the insurance market or from purchasing an adequate level of insurance (*Australia's Future Tax System* 2009), including home type and tenure, and financial position (Tooth & Barker 2007). There is also some evidence of a correlation between non- or under- insurance and higher insurance taxes (Tooth & Barker 2007).

Recent tax reform

Public liability insurance (including the separately itemised public liability component of an insurance package) was exempted from duty from 1 July 2002.

Findings of the *AFTS* in relation to insurance duty

- Taxes with narrow bases, such as insurance duty, are inefficient and should not be levied unless needed to correct a market failure.
- Insurance duty increases the cost of premiums and can lead to under-insurance or non-insurance, particularly by low-income earners.
- All specific taxes on insurance products (i.e. other than the GST), including the fire services levy, should be abolished.
- Revenue from insurance taxes should be replaced with revenue from a more efficient and equitable tax.

Further summarised information on the findings of the *AFTS* in relation to insurance taxes can be found in Appendix A2.5 or in the *AFTS* report (section E8-1) at www.taxreview.treasury.gov.au.

9.5.2. Consultation question

Question 9.5.2.A

The *AFTS* recommends that insurance duty be abolished and the revenue foregone be replaced by alternative taxes? Do you support this recommendation? Why, or why not?

Question 9.5.2.B

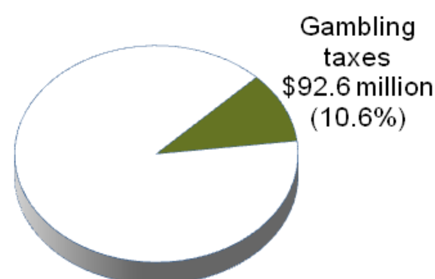
What alternative to insurance duty would you suggest to improve performance against the principles outlined in section 8, while maintaining revenue neutrality? Why would this be better?

9.6. Gambling taxes

9.6.1. Gambling taxes in Tasmania

Gambling taxes in Tasmania cover activities associated with lotteries, casinos (including table gaming, electronic gaming machines and keno), keno and electronic gaming machines in hotels and clubs, and betting exchanges.

From 2009-10 a fixed annual wagering levy for the conduct of totalizator wagering was also applied to a totalizator operator (the current licence is held by TOTE Tasmania Pty Ltd).



2010-11 Budget estimate

Gambling taxes are provided for under the *Gaming Control Act 1993*. These taxes are administered by the Department of Treasury and Finance, except for lottery tax, which is administered by the Victorian Government.

Gambling activities in all forms are only possible under specific and highly regulated licence regimes and thus through policy decisions, governments create limited and special opportunities for businesses to engage in certain gambling activities.

Gambling taxes can be viewed as taxes on higher than normal returns generated by licensed operators as a result of the monopoly positions created by Government regulation of gambling activity.

The administration of these arrangements is usually costly to government and gambling taxes can also be viewed as a means of compensating for these costs.

The businesses involved also gain an opportunity to profit from activities that are usually unlawful without a licence. Some of this profit is directly attributable to the creation of the licenses and therefore taxing gambling activity is a way of government getting a return for the value it creates through providing a licence.

Industry and business reputational value premiums can also arise from how well governments regulate the activities. This suggests that higher taxes can be assessed in the better managed regimes, although inter-jurisdictional tax competition needs to be taken into account.

Betting exchanges

Betting exchanges effectively match counter-party bets between gamblers for approved gaming and wagering activities. The operator does not hold any direct risk on the outcome and takes a commission from the winning bets. The exchange of bets can be conducted via any electronic means, such as over the internet or telephone. There is currently only one betting exchange operator in Australia, Betfair Pty Ltd.

A licensed betting exchange operator is required to pay a licence fee equivalent to 300 000 fee units (equivalent to $408 000 in 2010-11) per annum, although the current arrangements provide for the first three years' licence fee of a five year licence to be paid up front.

A betting exchange operator is also required to pay tax of 5 per cent of commissions on net winnings earned on brokered wagering on events held in Australia and overseas. Considering that turnover on a betting exchange can be substantial as punters back and lay a variety of wages to hedge their bets, it would be inappropriate to tax turnover as there is little relationship between turnover and betting exchange commission. Taxing commission rather than turnover is consistent with other gaming operators.

For all wagering made by Tasmanians via a betting exchange on events held in Australia, four per cent of the tax collected is directed to the Community Support Levy.

Casino taxes and licence fees

The Gaming Control Act provides for the payment of licence fees by Tasmania's two casinos and a tax on the gross profit from casino operations, including gaming in hotels and clubs. The tax rate for keno is 5.88 per cent and 0.88 per cent for table gaming. For gaming machines the sliding scale is:

- 20.88 per cent for the first $35.0 million of gross profit per annum; and
- 25.88 per cent for gross profit in excess of $35.0 million per annum.

From 1 July 2013, a single flat tax rate of 25.88 per cent will apply to all gross profit on gaming machines.

The licence fee payable by the casino operator for each casino is indexed by movements in the Consumer Price Index. In 2010-11, it is expected that the fees for the two casinos will total $3.5 million.

The Act also provides for the payment of a Community Support Levy of four per cent of gross profit from gaming machines in clubs and hotels. The Levy is disbursed as follows:

- 25 per cent for the benefit of sport and recreation clubs;
- 25 per cent for the benefit of charitable organisations; and
- 50 per cent for the provision of:
  - research into gambling;
  - services for the prevention of compulsive gambling;
  - the treatment or rehabilitation of compulsive gamblers;
  - community education concerning gambling; and
  - other health services.

It is estimated that the Levy will raise $5.0 million in 2010-11.

Lottery tax

Since 1960, agreements have been in place between the governments of Tasmania and Victoria regarding the sale of lottery tickets in Tasmania and the sharing of duty attributable to Tasmanian lottery subscriptions.

Victoria remits to Tasmania 100 per cent of the tax paid on all Tattersall's products sold in Tasmania, together with a proportionate share of unclaimed prizes. All of Tattersall's lottery tax is collected by the Victorian Government, which in turn remits the required payment to Tasmania each month.

A similar agreement with the Queensland Government was entered into during 2008-09 for lottery tickets sold in Tasmania by Golden Casket, a Queensland based wholly owned subsidiary of Tatts Group Ltd.

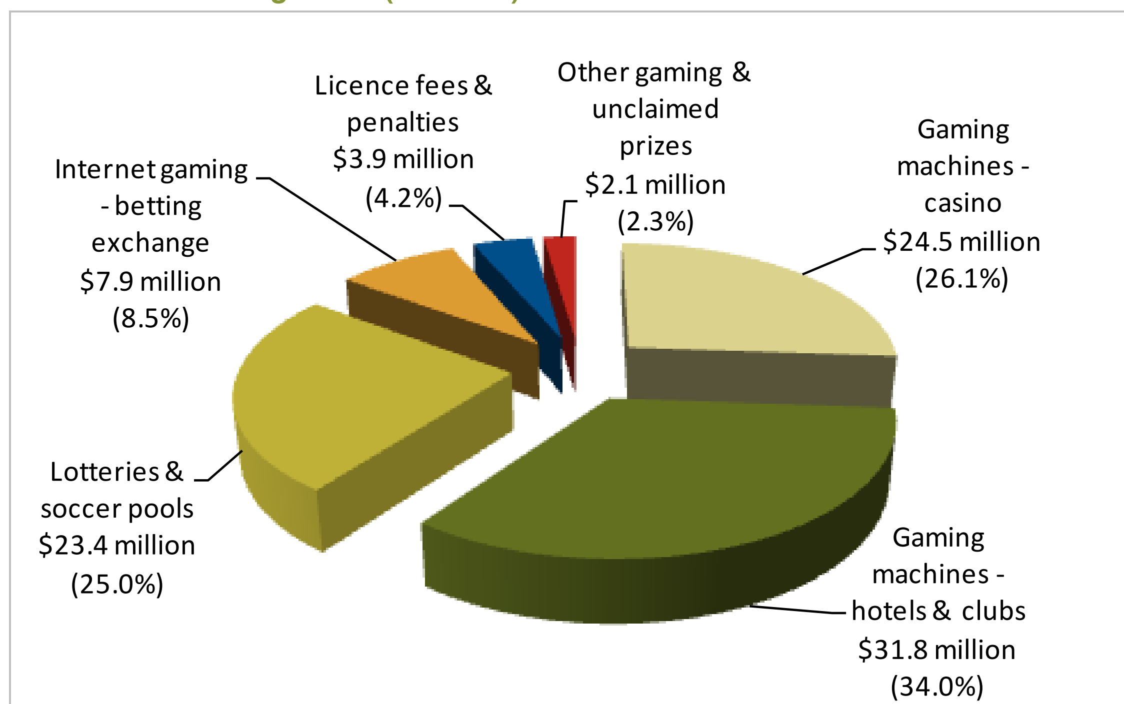
Totalizator wagering levy

Amendments made to the Gaming Control Act in 2009 provided for the establishment of a Tasmanian Gaming Licence with a totalizator endorsement. The licence is held by TOTE Tasmania. The Act provides for the holder of the licence to pay a fixed annual wagering levy of 4.7 million fee units. Fee units are adjusted annually in line with movements in the Consumer Price Index. The value of a fee unit in 2010-11 is $1.36, and therefore the current value of the licence is $6.4 million.

Tax base

The majority of gaming taxation comes from gaming machines located in casinos, hotels, clubs and the TT-Line. In 2008-09, taxation from gaming machines amounted to $56.3 million or 60.1 per cent of total gaming revenue of $93.6 million. See Chart 9.9 for a breakdown of gambling tax revenue in 2008-09.

Chart 9.9 Gambling taxes (2008-09)



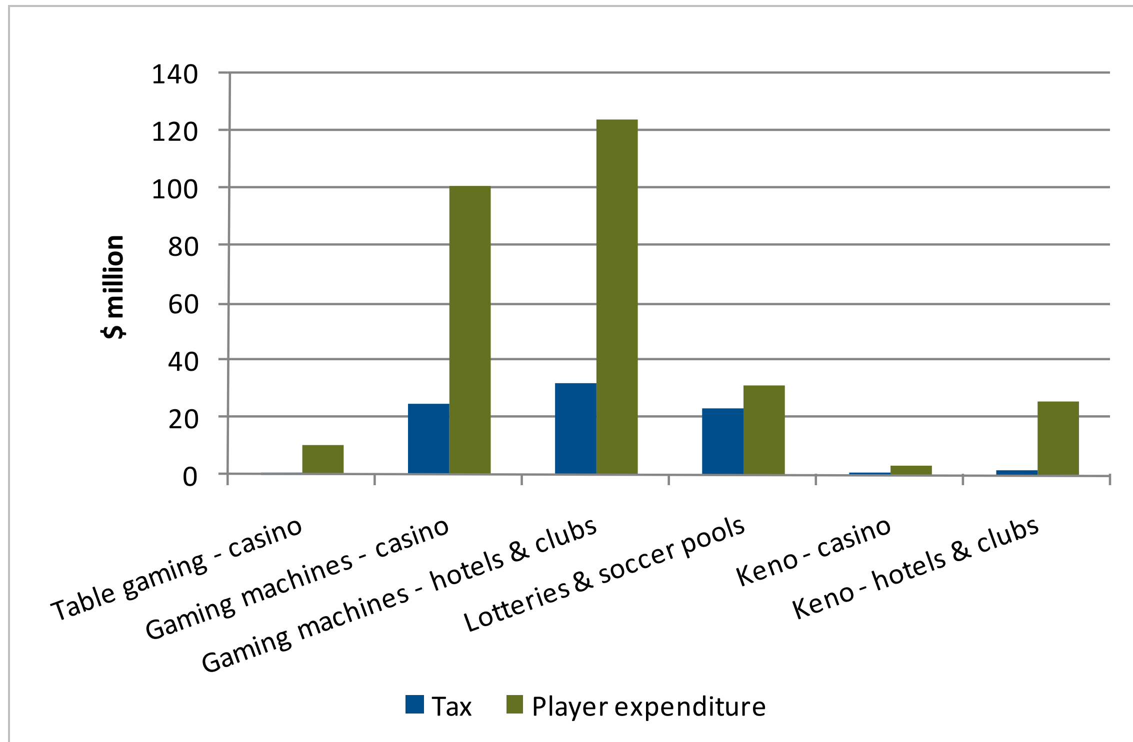
Source: Tasmania Budget Paper 1, *The Budget 2008-09*, p.5.10

Notes:

1. The totalizator wagering levy was not introduced until 2009-10 and so is not included in the above chart, which is based on 2008-09 revenue.

Player expenditure is the amount of money lost by players. It is equivalent to the total amount staked less winnings. In 2008-09, gaming machines accounted for $224.8 million or 76.3 per cent of total player expenditure of $294.6 million (see Chart 9.10).

Chart 9.10 Gambling tax and player expenditure for major gambling categories (2008-09)



Source: *Tasmanian Gaming Commission Annual Report 2008-09*

Notes:

1. Player expenditure information for minor gaming and internet gaming not available.
2. Player expenditure = player loss (i.e. gross turnover less winnings).
3. Gaming machines – hotels and clubs includes TT-Line.

The rates of taxation revenue vary depending on the type of gaming activity. The taxation rates applied to different gaming activities are detailed in Table 9.6 below.

Table 9.6 Gaming tax rates

Gaming activity	Tax rate
Gaming machines [1,2]	
TT-Line	17.91% of annual gross profit
Hotels, clubs and casinos	20.88% of annual gross profit up to $35 million
	25.88% of annual gross profit above $35 million
Keno – hotels, clubs and casinos	5.88% of annual gross profit
Table gaming - casino	0.88% of annual gross profit
Other gaming – TT Line	7.91% of annual gross profit
Internet gaming – betting exchange (Betfair)	5.00% of commission
Lotteries	100.00 % of tax paid to Victoria and Queensland Governments for Tasmanian subscriptions

Source: Tasmanian Gaming Commission Annual Report 2008-09

Notes:
1. Gaming machine tax is calculated on the combined gross profit of hotels, clubs and casinos.
2. Hotels and clubs are also required to pay a Community Service Levy equivalent to 4 per cent of annual gross profit

Recent tax changes

The *Gaming Control Amendment Act 2010* amended the taxes applying to betting exchanges by:

- abolishing the product levy payable on commissions earned from brokered race wagering events;
- reducing the tax rate of 10 per cent of commissions on overseas events and 15 per cent on Australian events, to 5 per cent; and
- reducing the annual licence fee by 50 000 fee units.

These amendments secured a commitment from Betfair to maintain its Tasmanian operations for a further two five year licence periods commencing from February 2011.

From 2009-10, returns to Government from TOTE Tasmania were replaced by a fixed annual totalizator wagering levy of 4.7 million fee units (equivalent to $6.3 million in 2009-10). Turnover tax on Tasmanian Gaming licences with race wagering and sports betting endorsements was abolished to facilitate the attraction of corporate bookmakers to Tasmania.

From 1 July 2004 a range of minor gaming taxes were abolished, including tax on lucky envelopes, bingo, raffles and Calcutta sweepstakes.

The collection of racing tax revenue from TOTE Tasmania Pty Ltd ceased from 1 August 2000.

Gambling tax rates were reduced in 2000 to offset the introduction of the GST.

Findings of the *AFTS* in relation to gambling taxes

- Gambling taxes should aim to recapture the economic rent the gambling industry possesses due to government legislation.
- Economic rent is the greater than normal level of profit available due to there being only the single provider of the good.
- Taxing economic rent does not change the price or supply of the good a business will provide to consumers, merely reduce the businesses profits, and as such is a good tax base.
- Gambling taxes, unlike most taxes, have not been shown to deter people's behaviour through higher prices, as the price of gambling is not easily observable. Therefore gambling taxes should not be used to achieve social outcomes.
- Gambling taxes are a regressive tax base, as people on lower incomes spend proportionately more on gambling than those with higher incomes.
- Governments that wish to reduce problem gambling should do so via restrictions or other legislative requirements as market based tax incentives have minimal effect on the reduction of this social cost.

Further summarised information on the findings of the *AFTS* in relation to payroll tax can be found in Appendix A2.6 or the report is available at www.taxreview.treasury.gov.au.

9.6.2. Consultation questions

Question 9.6.2.A

Gambling taxes are unlike most other State taxes because they are not paid directly by the community, but by licensed operators. Which features of Tasmania's gambling taxes work well, and which do not, having regard to the principles outlined in section 8? Which, if any, of the principles do you think are most important when considering gambling taxes?

Question 9.6.2.B

The *AFTS* recommends that gambling taxes should be reviewed to ensure that they are focused on recouping the economic rent generated by the monopolistic conditions allowed through government restrictions. Do you support this recommendation? Why do you support, or not support, this recommendation?

Question 9.6.2.C

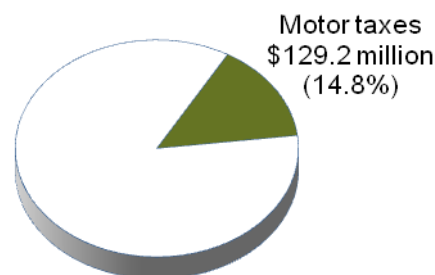
Alternatively, what changes to gambling tax arrangements would you suggest to improve performance against the principles, while maintaining revenue neutrality? Why would this be better than Tasmania's current gambling taxes?

9.7. Motor taxes

9.7.1. Motor taxes and vehicle registration in Tasmania

A range of taxes are imposed on the ownership of motor vehicles. These include:

- motor tax;
- motor vehicle registration duty, which is duty on the transfer of a motor vehicle; and
- a range of light vehicle registration fees (including registration fees, plate fees and transfer fees).



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There are also Motor Accident Insurance Board premiums, a motor vehicle fire levy, and an annual road safety levy per vehicle of $20. However, these fees are outside of the scope of this review.

A tax may be defined as money paid to the Government other than for transaction-specific goods and services. On this basis, each of the above are taxes, with the exception of plate fees and MAIB premiums.

By charging different fees depending on the type of vehicle, some of the above motor vehicle taxes attempt to allow for the impact of vehicle ownership and use on infrastructure and environmental costs. The most effective of these is motor tax, which varies depending on the number of cylinders of the insured vehicle – more cylinders equates to more tax – and the mass of the vehicle – the tax on trucks is higher than the tax on light vehicles.

However, none of these taxes are linked directly to the amount of vehicle usage. The number of kilometres driven arguably has a greater impact on infrastructure and environmental cost.

The purchaser of a four cylinder passenger vehicle worth $25 000 would typically pay $541.55 (or $429.60 as a pensioner) in fees per annum to register the vehicle. This includes $94 in motor tax. A further $450 in motor vehicle registration duty would be due on the transfer of the vehicle ownership.

Motor tax

Motor tax is imposed under the *Vehicle and Traffic Act 1999* on the owners of motor vehicles and trailers.

Assessment and administration

Motor tax is paid at the time of initial registration and annual renewal. Depending on the type of vehicle, the tax is determined by the number of cylinders and/or weight, seating capacity, or the number of axles and mass of each vehicle. The legislation specifies six classes of vehicles, each with its own scale of rates.

Motor tax rates are indexed annually and this tax is collected by the Department of Infrastructure, Energy and Resources.

The National Transport Commission determines the rates applying to heavy vehicles.

Exemptions and concessions

The Crown, the State Fire Commission and an institution that is, or is entitled to be, endorsed by the Australian Tax Office as a charitable or benevolent institution, are exempt from motor tax.

Vehicles used for specific purposes are also exempt from motor tax. These purposes include: agricultural machines, machines used exclusively for firefighting operations, ambulances, self-propelled wheelchairs, and vintage vehicles used as approved by the Registrar of Motor Vehicles in respect of a club. Various construction and road maintenance vehicles are also exempt from motor tax.

Vehicles that are exempt from motor tax are also exempt from motor vehicle registration duty.

Partial motor tax rebates are available in certain cases to eligible pensioners owning commercial goods vehicles, provided they are not engaged in any trade or business; commercial vehicles used predominantly for farming or horticultural purposes; special interest vehicles; interchangeable semi-trailers; and certain 3-axle buses.

Recent tax reform

Motor tax on light vehicles was reduced by 21 per cent from 1 October 2007.

Motor vehicle registration duty

Motor vehicle registration duty is imposed under the *Duties Act 2001* and is paid at the time of initial registration and on the application to transfer ownership of a motor vehicle.

Assessment and administration

Motor vehicle registration duty is based on the dutiable value of the vehicle, being the greater of the amount paid or the market value of the vehicle, and on the type of vehicle. It is classed as a “transaction tax”.

Different rates apply to passenger vehicles, vehicles subject to manufacturer’s fleet discount, heavy vehicles with mass greater than 4.5 tonnes, such as trucks, buses and heavy trailers, and all other vehicles.

The Department of Infrastructure, Energy and Resources collects motor vehicle registration duty on behalf of the Commissioner of State Revenue.

The rates of duty are outlined in Table 9.7 below.

Table 9.7 Motor vehicle registration duty

Vehicle	Value	Rate
Passenger vehicles	Under $600	$20
	$600-$34 999	$3 per $100 or part thereof
	$35 000-$39 999	$1 050 + $11 for every $100 or part that exceeds $35 000
	Over $39 999	$4 per $100 or part thereof
Vehicles subject to manufacturer's fleet discount	All	$3.50 per $100 or part thereof
Heavy vehicles (mass >4.5 tonnes)	Under $2 000	$20
	Over $2 000	$1 per $100 or part thereof
All other vehicles	Under $600	$20
	Over $600	$3 per $100 or part thereof

Exemptions and concessions

There are a number of exemptions from motor vehicle registration duty, including:

- transfers of vehicles to a motor dealer who holds an exemption certificate, providing the vehicle is to be trading stock or used as a demonstrator vehicle (soon to include licensed motor vehicle dealers);
- transfers of vehicles to motor vehicle wreckers, provided the vehicle is to be wrecked and never re-registered; and
- transfers of vehicles to parties after a marriage that is dissolved or annulled, or personal relationships that have terminated under certain circumstances.

Transfers of vehicles exempt from motor tax are also exempt from duty. Exemptions from motor tax include:

- the Crown, the State Fire Commission and an institution that is, or is entitled to be, endorsed by the Australian Tax Office as a charitable or benevolent institution; and
- vehicles used for specific purposes are also exempt from motor tax. These purposes include: agricultural machines, machines used exclusively for fire fighting operations, ambulances, self-propelled wheelchairs, and vintage vehicles used as approved by the Registrar of Motor Vehicles in respect of a club. Various construction and road maintenance vehicles are also exempt from motor tax.

Recent tax reform

Duty on the transfer of heavy vehicles was reduced by two-thirds from 1 October 2007.

Vehicle registration fees

Description

Vehicle registration fees, payable in accordance with the *Vehicle and Traffic Act 1999*, are collected on the registration and transfer of vehicle ownership.

Assessment

Vehicle registration fees are payable annually by the registered owner of any motor vehicle. The annual registration fee for all vehicles in 2010-11 is $62.55, except for caravans, trailers and horse floats, which are subject to a $27.20 registration fee.

Also included in this class of taxes are:

- an administration fee, which is incurred when a vehicle owner chooses to pay their registration periodically rather than annually;
- a $24.45 fee for the transfer of registration; and
- a one-off $18.35 fee for the issue of registration plates ($15.60 for motorcycles).

Exemptions and concessions

Pensioners are eligible for a concessional rate on their registration fee.

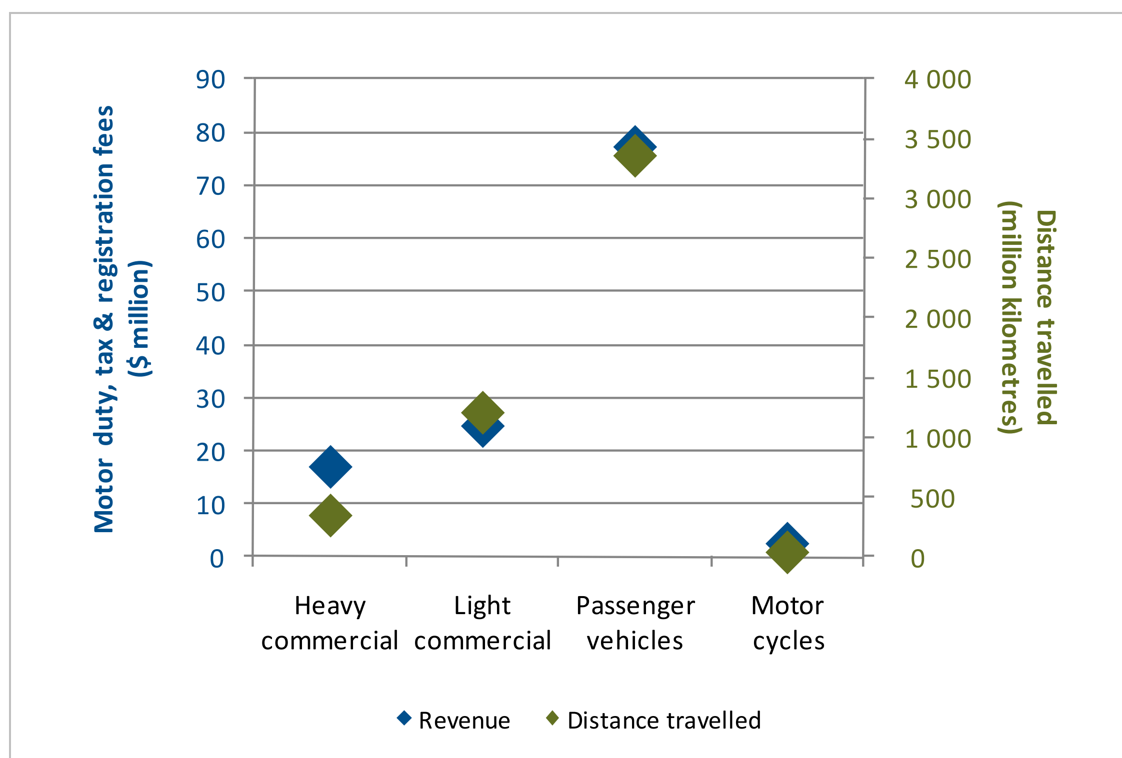
Administration

Vehicle registration fees are collected by the Department of Infrastructure, Energy and Resources and are generally paid at Service Tasmania outlets or online.

Tax base

Chart 9.11 compares revenue collected from motor tax, duty, and registration fees in comparison with the total distance travelled by different motor vehicle classifications. Revenue and distance are proportionately very similar, except for heavy commercial vehicles, which pay slightly more per kilometre than the other categories. This slight imbalance is consistent with the user-pays recommendations of the *AFTS* given that the heavier vehicles cause more damage to roads per kilometre than other vehicle categories.

Chart 9.11 Comparison of annual revenue from motor taxes and kilometers travelled



Sources: 2009-10 motor tax, duty and registration receipts from the Department of Infrastructure, Energy and Resources (DIER).

Annual kilometres travelled in Tasmania from Table 4, Australian Bureau of Statistics (ABS) Publication No. 9208.0 *Survey of Motor Vehicle Use, Australia – 12 months ended 31 October 2007*.

Notes:

1. The data in the above chart is indicative only as DIER and the ABS use different motor vehicle classifications.
2. Non-classified receipts are not included in the above. These amounted to around $11 million in 2009-10.

Findings of the *AFTS* in relation to road transport taxes

The *AFTS* has a number of findings that relate to road transport taxes that are particular to issues faced by major cities and arrangements to be discussed between jurisdictions to implement. The findings that relate to state-based arrangements are summarised below:

- Motor vehicle taxes currently collected by the states include compulsory third party insurance that does not consider individual driving behaviours or risk, and should be improved to consider these factors.
- In some instances there is competition between road and rail freight on certain routes across the country. The cost of rail is often priced above its short-run marginal costs, i.e. rail also needs to cover capital costs. As a result, the distribution of freight across rail and road infrastructure may not be efficient, as road freight has lower costs as it is based on short-run marginal costs.
- Revenue for road transport taxes should move over time to broad-based taxes and user charges.

- Stamp duty charged by the states on the transfer of motor vehicles is an inefficient means of collecting revenue.

- The current collection of state based road transport taxes may include a general revenue raising component, i.e. revenue that is collected for expenses other than those related to the provision of road infrastructure. This component of road transport taxes should be clearly identified and phased out over time.

- The number of taxi licences available is currently limited by the states issuing the licences. These limits increase the costs for taxi users and such limits should be phased out.

- To support the development of road infrastructure that will meet future needs, major projects should be informed by transparent cost-benefit analysis.

Further summarised information on the findings of the *AFTS* in relation to road transport taxes can be found in Appendix A2.7 or the report is available at www.taxreview.treasury.gov.au.

9.7.2. Consultation questions

Question 9.7.2.A

Which features of Tasmania's motor taxes work well, and which do not, having regard to the principles outlined in section 8? Which, if any, of the principles do you think are most important when considering motor taxes?

Question 9.7.2.B

Do you believe that motor taxes should be seen as a "user charge" and based on the use of the State's roads and the environmental impact, rather than simply on the ownership of a motor vehicle? Why, or why not?

If you agree with a "user charge" system, how would you propose such a system should operate, and what other opportunities are there to apply this principle?

Question 9.7.2.C

The *AFTS* recommends that the compulsory Motor Accidents Insurance Board (MAIB) premium included in your annual motor registration fees should be based on the owner's risk profile or accident history, which is similar to the approach taken by insurance companies, rather than on the type of vehicle registered? Do you support this recommendation? Why, or why not? If you support this recommendation, how should the MAIB premium be implemented?

Question 9.7.2.D

Alternatively, what changes to the current motor tax arrangements would you suggest to improve performance against the principles, while broadly maintaining revenue neutrality? Why would this be better than current motor taxes or the options above?

9.8. Climate change

9.8.1. Tasmania's climate change policies

In July 2008 the State Government released the *Tasmanian Framework for Action on Climate Change*. This report identifies the objectives, principles and priority areas for action and is the Government's framework to guide its responses to climate change.

Objectives

Tasmania will not be immune from many of the challenges as a consequence of climate change. To help Tasmania deal with these challenges, the Framework seeks to achieve four key objectives:

- reducing our greenhouse gas emissions to at least 60 per cent below 1990 levels by 2050;
- adapting to the changes in our climate that are occurring now and will continue to occur;
- capturing the new social, economic and environmental opportunities that climate change will present; and
- demonstrating national and international leadership as a model low-carbon economy, and contribute to global climate change solutions.

Climate Change (State Action) Act 2008

Following the release of the Framework, the *Climate Change (State Action) Act 2008* was enacted. This Act:

- includes the State's interim target of reducing greenhouse gas emission to at least 60 per cent below 1990 levels;
- enables the creation of greenhouse gas, emissions and general regulations; and
- established the Tasmanian Climate Action Council, which reports annually and biennially to the Houses of Parliament through the Minister for Climate Change, providing independent advice on climate change.

The State Government's full report on the *Tasmanian Framework for Action on Climate Change* and further information on Government's completed, current and future action in relation to climate change can be found at www.climatechange.tas.gov.au or www.earnyourstars.com.au.

Findings of the *AFTS* in relation to taxes to improve the environment

- Market activities can lead to environmental damage that is generally not reflected in the market price of the resulting goods or services.
- Tax concessions to promote environmental outcomes lack transparency and are often poorly targeted. Accordingly, these should be reviewed and consideration should be given to replacing them with more effective mechanisms.
- The introduction of a Carbon Pollution Reduction Scheme provides an opportunity to impose costs on the polluters rather than on all of the community, in a

cost-effective way, to reduce Australia's carbon emissions through a single transparent policy instrument.

- Following the introduction of such a scheme, the merits of existing taxation measures that are intended to promote environmental objectives should be monitored and replaced with more transparent spending programs as a more effective and efficient way of achieving targeted outcomes.

Further summarised information on the findings of the *AFTS* in relation to taxes to improve the environment can be found in Appendix A2.8 or the report is available at www.taxreview.treasury.gov.au.

9.8.2. Consultation questions

Question 9.8.2.A

The *AFTS* recommends the use of targeted spending programs over the use of concessions to achieve environmental outcomes. Do you support this recommendation? Why do you support, or not support, this recommendation?

Question 9.8.2.B

What taxing arrangements that meet the principles outlined in section 8 could be introduced to achieve environmental outcomes, while maintaining revenue neutrality? Do you think that State taxation arrangements are a sensible means by which to achieve environmental outcomes? Why, or why not?

9.9. Tax expenditure – exemptions, concessions and rebates

Tax expenditure includes exemptions, concessions and rebates. Exemptions and concessions represent tax revenue foregone, and are discussed under the appropriate tax heading earlier in this section. A number of rebate schemes are also provided and are discussed below. These schemes are designed to provide assistance to specific industries, or promote particular activities, such as the creation of employment or training of apprentices or trainees.

Not all concessional elements of the tax system are classified as tax expenditure. This is because some concession arrangements are considered to be an integral part of meeting basic taxation principles. For example, the progressive tax rate applied to conveyance transactions results in proportionately more tax being collected in relation to higher value transactions. However, the concessional benefits given by these structural elements are often obscure and are rarely considered after their initial introduction. Over time, the benchmarks often become somewhat arbitrary in application, even if they were not designed as such from the outset.

First Home Owners Scheme

As part of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, the states and territories fund and administer a First Home Owners Scheme grant. The Scheme was designed to offset the impact of the introduction of the GST on newly constructed and existing houses. The FHOS commenced on 1 July 2000. First home purchasers who meet the eligibility criteria are entitled to a $7 000 grant. Over time the rationale for this scheme as a means of compensating entrants to the property market after the introduction of the GST could be argued to have diminished. The FHOS has provided more than $239 million in support to first home buyers since it was introduced, and is expected to cost $19.3 million in 2010-11.

Payments in relation to first home owners under the *Duties Act 2001*

A First Home Buyer Duty Concession of up to a maximum of $4 000 is applied to the purchase of established dwellings up to a dutiable value of $350 000. As a concession, rather than a rebate, the cost of the First Home Buyer Duty Concession is not forecast. However, the concession cost $8.6 million in 2009-10.

Duty refunds are provided in relation to the purchase of land on which a first home is built. To qualify for a duty refund, full duty on the land purchase must first be paid. The maximum concession available for the purchase of vacant land is $2 400, providing the dutiable value of the vacant land does not exceed $175 000. This rebate has an expected cost to government of $250 000 per annum.

The concession and duty refund have provided more that $58 million in relief to first home buyers since they were introduced.

First home builder land tax rebate

People eligible for the First Home Owner Grant who construct and occupy a dwelling as a principal place of residence are eligible for a rebate for up to two years of land tax paid prior to the date of occupation. This rebate is expected to cost $600 000 per annum.

Employment Incentive Payroll Tax Rebate Scheme

Payroll tax relief has been made available to all employers liable for payroll tax through a rebate for the payroll tax payable for any new positions created between 11 June 2009 and 30 June 2010 and maintained until 30 June 2011. The rebate will be payable on payroll tax incurred from 1 July 2009 to 30 June 2011. This rebate is expected to cost $2.4 million in 2010-11.

Tasmanian Trainees and Apprentice Incentive Scheme

The Tasmanian Trainee and Apprentice Incentive Scheme provides industry development and training incentives through the payroll tax system. It is designed to encourage employers to employ Tasmanian apprentices and trainees, increasing the skilled workforce in Tasmania. This scheme is expected to cost $4 million in 2010-11.

Findings of the *AFTS* in relation to exemptions, concessions and rebates

- In contrast to government spending programs, which are scrutinised annually as part of the Budget process, tax expenditures are often only considered when they are first introduced. This lack of transparency and accountability can mean that concessions do not fully reflect current community values and make it difficult to determine whether they are achieving their original policy objectives. A more symmetrical treatment of tax expenditures and spending programs as part of the Budget process would ensure that government policy objectives are pursued at least cost.
- Much of the support provided to the not-for-profit sector is provided in the form of tax concessions. However, these are complex, inconsistent and opaque.
- Tax concessions for not-for-profit organisations should be simple and transparent, reflect community needs and values, and encourage activities that provide broad public benefits.
- A national charities commission should be created to streamline not-for-profit tax concessions, and modernize and codify the definition of a charity.

Further summarised information on the findings of the *AFTS* in relation to tax expenditures and tax concessions provided to not-for-profit organisations can be found in Appendix A2.9 or in the *AFTS* report (sections B3 and G5-2) at www.taxreview.treasury.gov.au.

9.9.1. Consultation questions

Question 9.9.1.A

Are all charities being treated equitably as far as tax concessions are concerned? If not, how should this be addressed?

Question 9.9.1.B

What do you understand to be the basis on which charities are granted a tax-free status, and is it clearly understood and appreciated by the community?

Should the consideration of community benefit always be more important than simplicity and the risk of creating opportunities for tax avoidance?

Question 9.9.1.C

In the absence of a National Charities Commission, do you believe there is an alternative method for streamlining not-for-profit sector tax concessions, and modernising and codifying the definition of a charity? If so, how would you envisage the design and implementation of this?

Question 9.9.1.D

Should commercial ventures by not-for-profit organisations be eligible for tax concessions? Why, or why not?

Question 9.9.1.E

Should tax concessions for not-for-profit organisations be replaced with direct government funding? Under what circumstances would this be a better funding option and why?

Question 9.9.1.F

What is the best method for incorporating the provision of tax expenditures and "benchmark" tax concessions into the budget and reporting processes?

Question 9.9.1.G

Do any state tax concessions provide not-for-profit organisations with an unfair competitive advantage?

9.10. Tax Administration

9.10.1. Tax administration in Tasmania

Development of taxation policy and implementation of that policy through legislation is the responsibility of the Treasurer, who receives advice from the Department of Treasury and Finance.

Administration of most State taxation legislation is the responsibility of the Commissioner of State Revenue who is appointed under the *Taxation Administration Act 1997*. The Commissioner, supported by the State Revenue Office, which is a branch of the Department of Treasury and Finance, is responsible for the administration of duties, payroll tax and land tax, which account for over 70 per cent of total State taxation revenue.

The State Revenue Office also develops administrative arrangements to implement tax law, educates and advises taxpayers about their rights and obligations, and pursues compliance with the law.

The State taxation laws are administered under the "umbrella" provisions of the Taxation Administration Act which gives the Commissioner of State Revenue the power to:

- appoint taxation officers;
- delegate tasks / functions;
- make assessments;
- process refunds;
- impose interest and penalty tax for late payment and under payment of taxes;
- pay interest where tax has been overpaid;
- conduct investigations (including rights of access and compulsive powers to obtain information); and
- collect tax.

The Taxation Administration Act also provides mechanisms for taxpayers to object to tax assessments or decisions made by the Commissioner. Where a taxpayer is dissatisfied with an objection determination, under the Taxation Administration Act they can seek a review or appeal the determination through either the Magistrates Court Administrative Appeals Division or the Supreme Court of Tasmania.

Collection of State taxes

State taxes are collected by a variety of means, including "demand" and "return" based taxes.

Demand based taxes include land tax, where the Commissioner issues an assessment (or demand) to a taxpayer requiring them to pay land tax.

Return based taxes involve the lodgement of a return or documentation, on which tax is assessed and paid. Examples of return based taxes include payroll tax, where taxpayers lodge periodic returns with the State Revenue Office; and motor vehicle

duty, which is generally collected as part of the administrative process of transferring the registration of a motor vehicle.

Payroll taxes, insurance duty and some property transfer duty are self-assessed. This means that taxpayers calculate their own tax liability and pay on the basis of that calculation. To monitor that these payments match tax assessments and obligations, the State Revenue Office carries out a range of compliance activities.

As part of the State Revenue Office's compliance monitoring, data from external sources are compared to self assessments. In particular, the SRO obtains regular information from:

- Australian Tax Office
- Australian Securities and Investment Commission;
- Workplace Standards Tasmania;
- Land Titles Office;
- Rental Bond Board;
- other State Revenue Offices;
- Australian Business Register;
- AUSTRAC;
- Electoral Commissions;
- Aurora Energy; and
- local government.

In practise, many business taxpayers engage professionals to deal with their tax affairs. The State Revenue Office regularly consults with a number of taxpayer representative bodies and peak bodies to maintain an awareness of stakeholder groups and how they interact with the tax system.

Administrative challenges

Complexity

Many aspects of State taxation legislation are very complex. Examples are:

- land tax grouping provisions relating to companies;
- payroll tax grouping and contractor provisions; and
- property transfer duty provisions relating to land rich acquisitions and sub-sales.

These complexities create a range of issues, including:

- difficulties, in ensuring staff in the State Revenue Office are adequately trained to be able to apply the provisions.
- difficulties in ensuring taxpayers and/or their representatives understand the provisions, particularly when the provisions may only apply in limited

circumstances. Failure to understand the complexities means that taxpayers can often incur unintended tax liabilities. This in turn generates perceptions that the taxation system, and the taxation administrator, is unfair. This can undermine overall confidence in the tax system.

- increases in compliance and administrative costs. Complex legislation often means additional administrative processes, for example evidence requirements, to ensure compliance with the provisions. These requirements do not necessarily match natural business practices, which can impose additional compliance costs on taxpayers. Detection of non-compliance may also be difficult.

Lack of awareness of State taxation obligations

Many taxpayers interact with the State taxation system infrequently and may be unaware when they do. For example, taxpayers may not be aware that certain transactions incur duty or when they become liable for payroll tax or land tax because they are no longer eligible for certain exemptions or concessions.

In the case of duties, taxpayers only interact with the tax system when they undertake a taxable transaction, most commonly, purchasing a property or a motor vehicle. In these instances, the imposition of the tax is not necessarily very transparent as it is one of a number of costs that are incurred as part of the transaction, along with solicitor and real estate agent fees.

Despite recent publicity about land tax increases, the exemption of the principal place of residence means that most land owners do not pay land tax. This means that many are unfamiliar with the land tax requirements and, if they acquire an investment rental property, are not aware of the need to pay land tax on that property.

Likewise, even though payroll tax does receive attention in the media from time to time, many businesses do not seem to be aware of the need to register for payroll tax when they reach the taxable wages threshold. Each year, approximately 30 per cent of new payroll tax registrations are identified through compliance activity. Also, for businesses that employ across a number of jurisdictions, the threshold at which payroll tax becomes liable can vary across those jurisdictions creating more uncertainty.

This is compounded by the fact that many tax advisers seem to be unaware of State taxation requirements. For example, there is relatively little, if any, coverage of State taxation requirements in undergraduate courses undertaken by accountants and lawyers.

It appears that taxation and financial advisers focus on Australian Government taxation matters and the interaction between these taxes and State taxation can often be overlooked. Examples include the interactions between duties and capital gains tax, and land tax and income tax deductions.

This means that transactions which are structured to provide Australian Government taxation benefits may have unintended, and often potentially expensive, State taxation consequences. Again, this can create perceptions that the State taxation system is unfair, potentially undermining overall confidence in, and voluntary compliance with, that system.

In recent years, the State Revenue Office has significantly increased its efforts to improve awareness of State taxation obligations. While there has been some improvement, progress has been slow.

Some taxpayers, or their representatives, do not understand that it is their responsibility to make sure that they are aware of their State taxation obligations. The State Revenue Office has a responsibility to make sure information is available to:

- assist taxpayers and their representatives to determine the legal requirements; and
- provide specific advice in the case of complex transactions or where there is a high degree of uncertainty about the application of the law.

However, it is important to note that individuals should take responsibility for making sure they are aware of their State taxation obligations.

Communicating with the target audience

The lack of awareness of State taxation obligations is compounded by the difficulty in reaching large segments of the taxpaying community. For example, land tax is paid by a diverse range of taxpayers, ranging from the general public to large corporations. Additionally, land is held by both Tasmanian and non-Tasmanian based taxpayers. The size and diversity of this group makes it difficult to educate all taxpayers on the sections of legislation that apply to their specific circumstances.

Some aspects of State taxation law are very complex. However, this complexity may only apply to relatively few taxpayers in relatively narrow sets of circumstances. Specifically identifying and targeting the taxpayers that need this information, and the situations and times in which they need it, is difficult.

However, new methods of communicating with taxpayers are being pursued, such as using data that the State Revenue Office can collect from third parties to attempt to identify State taxation liabilities before they are incurred. For example, access to Rental Bond Board information enables the identification of those properties that are being rented, which means landowners can be advised of their obligation to pay land tax.

Compliance is not easy

People are expected to understand their taxation obligations and, in many cases, to self-assess. This is often not easy. For the reasons outlined above, people are often unaware of their State taxation obligations.

In addition, State taxation administrative requirements do not necessarily integrate well with natural business process. For example, in the case of conveyancing, financial institutions self-assess property transfers using Tasmanian Revenue Online. However their business need is to secure a mortgage over the property. This, combined with the fact that, in Tasmania, purchasers generally engage legal representation after they have entered into a contract for sale, means that duty implications for the client may only be fully considered just prior to settlement.

Further, non-compliance with State taxation laws is usually identified some time after the event. This imposes administrative costs on taxpayers and their representatives, for example the need to provide access to records which may not be readily available, as well as financial ones, such as penalty tax and interest. While it is not practical, or appropriate, to undertake one hundred percent up front compliance checks, with modern technology and data matching techniques, it should be increasingly possible to use techniques generally used to identify non-compliance to identify and notify taxpayers of potential tax liabilities before they are incurred.

Finally, the State Revenue Office's systems are structured around processing State taxation transactions. They are therefore focussed on tax lines, rather than taxpayers, and are not integrated. While a taxpayer may have land tax, payroll tax, and duty liabilities, these are all handled by separate tax systems, with no linkages between them. From a taxpayer's point of view, this means that a taxpayer may need to provide basic information (for example, identity and address details) on multiple occasions. This situation also means that the State Revenue Offices does not have an understanding of a taxpayer's liable and non-liable relationships with other entities, and may not be able to see a full history of compliance behaviour when considering a case relating to a particular revenue stream. This may influence a decision made in regard to that taxpayer.

Competing objectives

One of the State Revenue Office's main objectives is to be a trusted authority on all matters relating to State taxation, grants and rebates. To be a trusted authority, they must be seen to be fair, efficient and effective in the administration of the tax system, not only from the perspective of the individual taxpayer, but by all the Tasmanian community.

Applying fairness to an individual taxpayer requires the State Revenue Office to take into account an individual's circumstances.

To be fair to the Tasmanian community requires the State Revenue Office to impose some rigour on individual taxpayers to justify a particular tax treatment, and to provide supporting evidence.

While it might be reasonable for the State Revenue Office to assist the individual taxpayer to a certain extent in justifying a particular tax treatment, this may not be an efficient process from the perspective of the Tasmanian community.

The State Revenue Office has a responsibility to ensure that taxpayers pay the right amount of tax in accordance with Tasmania's tax laws and receive the right amount of any concession for which they may be eligible. However, there are significant costs in doing this and it is not possible or efficient, for every tax return to be checked for its compliance as the resource burden is too high. This places a compliance burden on individual taxpayers to make sure they understand their obligations and comply.

In administering the taxation system, the State Revenue Office must continually balance the interests of the individual taxpayer against the interests of the Tasmanian community, as well as the balance of the competing objectives of fairness, efficiency and effectiveness.

One interpretation of fairness might be that the State Revenue Office should pursue every instance of non-compliance and ensure that exactly the right amount of tax is paid in every circumstance. However, there are likely to be considerable costs involved and it is unlikely to be either efficient or effective from either the individual taxpayer's point of view or the Tasmanian community.

While these decisions might be straight forward from a pure cost-benefit point of view, if they were purely "commercial" decisions, the fact is that such decisions go to the heart of the integrity of the tax system and the community's confidence in the tax system. That is, this pragmatic approach needs to be balanced against the need for the community to be confident that there is broad compliance with the tax system and that the payment of tax is not an elective activity.

This requires taxation administrators to exercise careful judgements and to think broadly about the consequences of decisions.

Findings of the *AFTS* in relation to the administration of state taxes

- If the states require additional fiscal autonomy, they could raise revenue from sharing a tax base with the Australian Government, such as the personal income tax base.
- Greater administrative efficiency could be achieved through central administration of a shared tax base, as is already the case with the GST, which is administered by the Australian Taxation Office on behalf of the states.
- The abolition of a number of state taxes with the replacement revenue largely coming from centrally administered taxes would mean that the states could devote fewer resources to tax administration.

Further summarised information on the findings of the *AFTS* in relation to the administration of state taxes can be found in Appendix A2.10 or the report is available at www.taxreview.treasury.gov.au.

9.10.2. Consultation questions

Question 9.10.2.A

How can State tax administration be changed to improve the "client experience"? Are there any taxes where the "client experience" is particularly good or bad?

Question 9.10.2.B

Do you believe that the Tasmanian tax system is too complex, and is this a particular concern to business? How could the Tasmanian tax system be simplified?

Question 9.10.2.C

How can State tax administration be changed to reduce taxpayers' administrative costs? Administrative changes to which taxes would be most beneficial to taxpayers?

Question 9.10.2.D

There are arguments for and against nationally harmonising parts of the state tax system. For example, maintaining harmonised tax arrangements has a high administrative burden (from the states' perspective), but taxpayer compliance costs are lower. Maintaining harmonisation also means that state governments may be unable to adjust taxation policy to suit local issues.

Do you think the benefits of harmonising some state taxes outweigh the loss of local flexibility? What are the main benefits of harmonising State taxes, and for which taxes are these benefits greatest?

What are the potential risks or negative consequences of harmonising State taxes?

9.11. Other own-sourced revenue

A number of other revenue sources are also considered to be taxes, and are reported as such in the Tasmanian State Budget. However, these fees are outside of the scope of the State Tax Review.

9.11.1. Guarantee fees

Guarantee fees are payable by government-owned businesses, on financial accommodation and are primarily loans obtained from the Tasmanian Public Finance Corporation to offset the borrowing cost advantage of public ownership. Without the payment of guarantee fees, Government businesses would receive an unfair advantage over their private sector counterparts as they would be able to access borrowings at lower costs given the State Government support that they receive.

9.11.2. Fire Service Levy

The major source of revenue for meeting operational costs and capital needs of the State Fire Commission is provided via a number of levies applied in accordance with the *Fire Service Act 1979*. The levies are a fire service contribution on property (levied on assessed annual values) that is collected by councils; a motor vehicle fire levy on all vehicle registration (excluding motor cycles); and a fire levy on prescribed classes of insurance.

State Fire Commission Revenue is reported as a tax for the purposes of the General Government Sector reporting. However, all revenue is passed directly to the State Fire Commission.

10. Local Government Valuation and Rating Review

The Department of Premier and Cabinet is undertaking a review of the valuation and local government rating model. This section has been included because land valuations, the frequency of valuations and valuation methodology have a significant effect on the land tax system and, to a lesser extent, conveyance duty. The outcomes of the review will be available for consideration by the Tax Review Panel before the draft State Tax Review Final Report is published.

A review has been established in response to a number of issues effecting both State Government and local councils. Recent increases in property valuations have resulted in significant fluctuations resulting in higher land tax bills and variations in rating values.

In response, the State Government has committed additional funds to enable more frequent property valuations in an effort to eliminate major valuation spikes. Separate funds have been made available to complete a valuation and rating review.

A steering committee has been appointed to undertake the review. The steering committee includes representatives of the Departments of Premier and Cabinet, Treasury and Finance and Primary Industries, Parks, Water and Environment - including the Office of the Valuer-General, the Local Government Association of Tasmania and Local Government Managers Australia.

The steering committee has facilitated the appointment of Access Economics to provide expert technical advice.

The review's terms of reference include:

- assessment of the effectiveness of current valuation practices and local government rating;
- evaluation of alternative models for valuation and rating, including their applicability within the Tasmanian context; and
- recommendation of preferred valuation and rating models for Tasmania, including any legislative amendments required to give effect to the preferred models.

The review will also consider the impact of any preferred valuation models on other government users of valuation information and provide advice on transitional issues for any recommended valuation and rating models.

Scope of the review

Access Economics' approach to the Valuation and Local Government Rating Review is to combine desktop research and analysis, which includes a review of rating and valuation practices employed in other states and territories, consultation with major stakeholders, and detailed economic modelling to analyse the implications of any proposed changes.

The review has two components:

Part A – Valuation Review component

- An assessment of the effectiveness of current valuation practises.

- Assessments of the alternative valuation bases employed in other jurisdictions and their applicability to Tasmania.

- Assessment of the cost and resource implications of implementing these valuation bases, including observations on the regularity with which valuations could be undertaken and the capacity of the market to provide the service level envisaged. This will include issues of capacity and whether valuations will be undertaken by the Office of the Valuer General staff in-house or by contractors.

- Potential impact on other government users of valuation information if an alternative is implemented.

Part B – Rating Review component

- An assessment of the effectiveness of current rating options available in Part 9 of the *Local Government Act 1993*, including their cost effectiveness and equity.

- Evaluation of alternative rating models having regard to their applicability within the Tasmanian context.

- Assessment of the impacts of changing the current rating system (moving away from Assessed Annual Value) on councils and ratepayers.

- Identifying options that could allow for achieving equity among ratepayers that may include, (but are not limited to):

  - maximum rates by class of property;

  - caps and collars – limiting the percentage rate increase/decrease of any particular property owner or category; and

  - differential rating.

Consultation and timelines

Consultation will occur on two separate occasions during the review.

- The release of a discussion paper to council officials, to assist with discussion and input at a council workshop held in August 2010. The purpose of the workshop was to procure a direct input from the councils, mainly on technical considerations.

- Release, for public consultation, an Expert Report completed by Access Economics on 30 October 2010, seeking public submissions by 17 December 2010.

Following broad public consultation including key industry groups, the steering committee will develop a number of recommendations for consideration by the State Government in early 2011.

Any major changes arising from the review are not likely to be implemented until the 2012-13 rating year.

Table 10.1 Key deliverables

Action	Timeframe
Theoretical and analytical evaluation	Early August 2010
Preparation of discussion paper	Early August 2010
Discussion workshop – council involvement	Late August 2010
Draft Interim Report	September 2010
Delivery of Expert Report (Access Economics)	October 2010
Public consultation	October to December 2010
Ministerial consideration of steering committee recommendations	January – February 2011 (indicative)

Interaction with the State Tax Review

The key dates of the State Taxation Review include:

- Discussion paper – released in December 2010 for 10 weeks consultation;
- Round table and public forums to be conducted in March 2011;
- Draft Report – released at the end of September 2011 for four weeks consultation; and
- Final Report – released by the end of the December 2011.

Considering that the draft final report of the State Taxation Review will not be released until September 2011, there will be a considerable amount of time to consider the recommendations of the Valuation and Local Government Review – Final Report, prior to making recommendations in the State Taxation Review Final Report due to be released in December 2011.

A1. Comparison with Other Jurisdictions

A1.1. Interstate comparisons

This Appendix compares the tax paid in each state for the major Tasmanian taxes: conveyance duty, payroll tax, land tax, motor vehicle registration duty and insurance duty. In each case, tax rates for each state are sourced from the *Interstate Comparison of Taxes 2009-10*, produced by New South Wales Treasury with the assistance of other agencies in New South Wales and the other states and territories.

For a more comprehensive view of the difference in taxing arrangements in place in other states, including taxes applied to gambling and motor vehicles, the full Interstate Comparison of Taxes is available at www.treasury.nsw.gov.au/Treasury_Research_Papers.

In publishing the Interstate Comparison of Taxes, New South Wales Treasury notes that:

- the Interstate Comparison of Taxes is not intended as an exhaustive analysis. For a complete description of the operation of each tax, the relevant Acts of Parliament and/or regulations should be consulted;
- some information is based on proposed or announced changes, which at the time of publication may not have been legislated; and
- all care has been taken in the preparation of this document, however, NSW Treasury takes no responsibility for any errors in the information provided.

Charts displaying the tax payable at different value points have been included. Each of these charts is based on calculators available on each State's Revenue Office or Treasury websites.

The taxes and rates that apply in Tasmania are often compared to those that apply in other states, and it is tempting to compare the rates of one or another tax against those that apply in our mainland counterpart's community. However, it is important to bear in mind that each state applies taxation policy that suits the revenue raising (and public expenditure) priorities of that state, as well as the tax base available.

Rather than attempting to ensure that one or other tax rate is comparable with that applying elsewhere, it is more important to ensure that Tasmania has a tax system that is able to sustain public service delivery in the face of long-term economic, social, demographic and environmental challenges, whilst minimising unnecessary tax-related costs and inequities.

Appendix A1.2 discusses the taxation severity ratio, which is an assessment by the Commonwealth Grants Commission of the "effort" made by each state to raise taxation as a ratio of its "capacity" to raise taxes. By this assessment, it is possible to measure the overall taxation environment in Tasmania, compared to that operating elsewhere.

Conveyance duty

Conveyance duty is levied on the transfer of property. The duty is usually paid by the purchaser and based on the sale price or, if higher, the value of the property.

Displayed in the table below are the current rates of conveyance duty and tax liability on the transfer of property for a variety of values.

Where some states have differing rates for general and (principal) residence property, general rates have been used.

Chart A1.1 Conveyance duty payable by property value

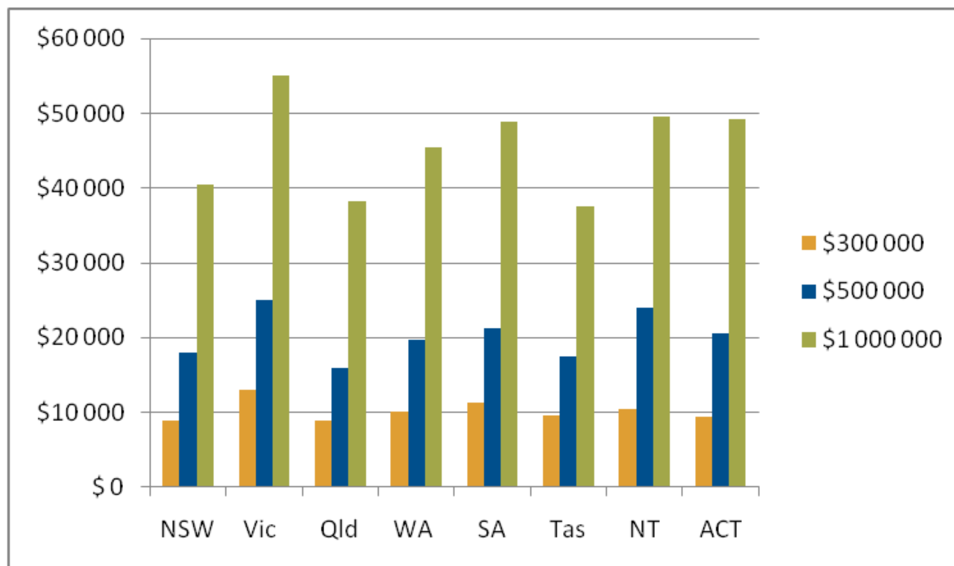


Table A1.1 Conveyance duty rates

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Marginal rates are applied per $100 or part of the excess above the lower limit of the range unless explicitly specified.	General duty rates **$0-$14,000:** 1.25% (min $2) **$14,001-$30,000:** $175+1.50% **$30,001-$80,000:** $415+1.75% **$80,001-$300,000:** $1,290+3.50% **$300,001-$1,000,000:** $8,990+4.50% **Over $1,000,000:** $40,490 + 5.50% For Residential Property **$0-$14,000:** 1.25% (min $2) **$14,001-$30,000:** $175+1.50% **$30,001-$80,000:** $415+1.75% **$80,001-$300,000:** $1,290+3.50% **$300,001-$1,000,000:** $8,990+4.50% **$1,000,000-$3,000,000:** $40,490 + 5.50% **Over $3,000,000:** $150,490 + 7.00%	General duty rates **$0-$25,000:** 1.40% **$25,001-$130,000:** $350 + 2.40% **$130,001-$960,000:** $2,870 + 6.00% **Over $960,000:** 5.50% of total value. Duty rates for principal place of residence purchases **$0-$25,000:** 1.40% **$25,001-$130,000:** $350 + 2.40% **$130,001-$440,000:** $2,870 + 5.00% **$440,001-$550,000:** $18,370 + 6.00% **$550,001-$960,000:** $28,070 + 6.00% **Over $960,000:** 5.50% of total value.	General duty rates **$0-$5,000:** Nil **$5,001-$75,000:** 1.50% **$75,001-$540,000:** $1,050+3.50% **$540,001-$980,000:** $17,325+4.50% **Over $980,000:** $37,125+5.25% For Homes (not first) (Effective 1 July 2008) Concessional rate of 1% for values up to $350,000 plus scheduled transfer duty on the excess.	General duty rates **$0-$80,000:** 1.90% **$80,001-$100,000:** $1,520+2.85% **$100,001-$250,000:** $2,090+3.80% **$250,001-$500,000:** $7,790+4.75% **Over $500,000:** $19,665+5.15% Duty rates for principal place of residence purchases **$0 – $120,000:** 1.90% **$120,000 – $150,000:** $2,280 + 2.85% **$150,000 – $360,000:** $3,135 + 3.80% **$360,000 – $725,000** $11,115 + 4.75% **Over $725,000** $28,453 + 5.15%	**$0-$12,000:** 1.00% **$12,001-$30,000:** $120+2.00% **$30,001-$50,000:** $480+3.00% **$50,001-$100,000:** $1,080+3.50% **$100,001-$200,000:** $2,830+4.00% **$200,001-$250,000:** $6,830+4.25% **$250,001-$300,000:** $8,955+4.75% **$300,001-$500,000:** $11,330+5.00% **Over $500,000:** $21,330+5.50%	**$0-$1,300:** $20 **$1,301-$10,000:** 1.50% **$10,001-$30,000:** $150+2.00% **$30,001-$75,000:** $550+2.50% **$75,001-$150,000:** $1,675+3.00% **$150,001-$225,000:** $3,925+3.50 **Over $225,000:** $6,550+4.00%	**$0-$525,000:** Duty calculated by the formula: $D=(0.06571441V^2)+15V$ Where D = duty payable in $ V = 1/1000 dutiable value **Over $525,000:** 4.95% of total value.	**$0-$100,000:** $20 or $2.00 per $100 whichever is greater. **$100,001-$200,000:** $2,000+$3.50 per $100 or part thereof. **$200,001-$300,000:** $5,500+$4.00 per $100 or part thereof. **$300,001-$500,000:** $9,500+$5.50 per $100 or part thereof. **$500,001-$1,000,000:** $20,500+$5.75 per $100 or part thereof. **Over $1,000,000:** $49,250+$6.75 per $100 or part thereof.

Land tax

Land tax is levied on the unimproved value of selected categories of land held at a particular date.

The table below shows the current rates of land tax and the tax liability on property for a variety of values.

Where states have differing rates for general and residential property, general rates have been used. Land tax in the Australian Capital Territory also incorporates local government rates.

Chart A1.2 Land tax payable by land value

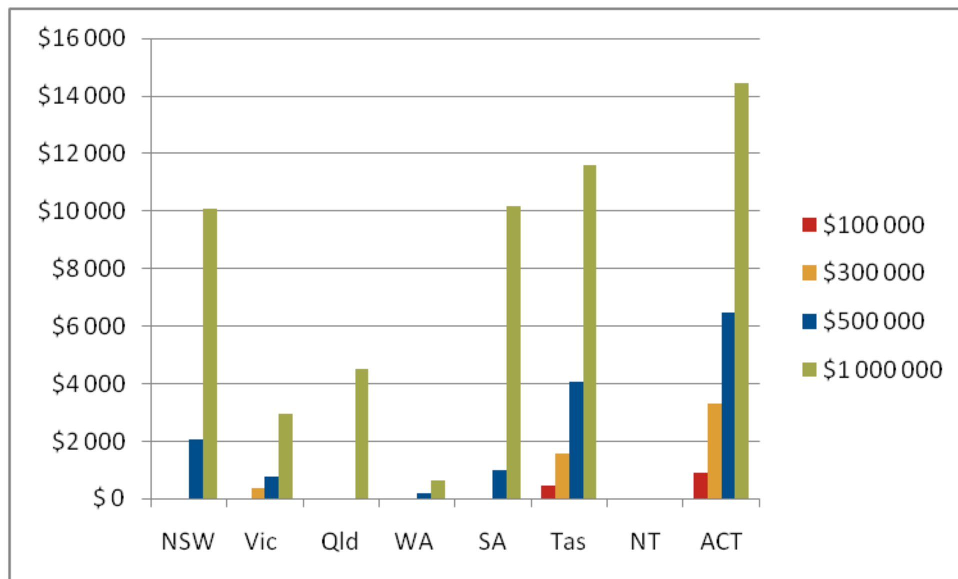


Table A1.2 Land tax rates

TAX	NSW	VIC	QLD	WA	SA	TAS[1]	NT	ACT
Tax Scale: Marginal rates apply to excess above the lower limit of the range unless explicitly specified.	**For 2010 land tax year:** **$0-$376,000:** Nil **$376,001 to $2,299,000:** $100 + 1.6 % **Over $2,299,000: $30,868 + 2.0%** The threshold is a three year average and is indexed annually according to movements in State-wide property prices. The threshold cannot fall. The minimum land tax payment is $100. Non-concessional companies and special trusts are taxed at the flat rate of 1.6% to $2,299,000, plus 2% for value over $2 299 99.	**For 2009 land tax year:** General: **Less than $250,000:** Nil **$250,000-$599,999:** $275 + 0.2% **$600,000-$999,999:** $975 + 0.5% **$1,000,000-$1,799,999:** $2,975 + 0.8% **$1,800,000-$2,999,999:** $9,375 + 1.3% **$3,000,000 and over:** $24,975 + 2.25% **Special trusts:** **Less than $25,000:** Nil **$25,000-$249,999:** $82 + 0.375% **$250,000-$599,999:** $926 + 0.575% **$600,000-$999,999:** $2,938 + 0.875% **$1,000,000-$1,799,999:** $6,438 + 1.175% **$1,800,000-$2,999,999:** $15,838 + 0.7614% (a) **$3,000,000 and over:** $24,975 + 2.25%	**For 2009-10 land tax year** For resident individuals: **Less than $600,000**: nil **$600,000 - $999,999**: $500 + 1.0% **$1,000,000 - $2,999,999:** $4,500 + 1.65% **$3,000,000 – $4,999,999:** $37,500 + 1.25% **$5,000,000 and over:** $62,500 + 1.75% **For Companies, trustees and absentee:** **Less than $350,000:** nil **$350,000 to $2,249,999:** $1,450 + 1.7% **$2,250,000 - $4,999,999:** $1,450 + 1.5% **$5,000,000 and over:** $75,000 + 2%	**For 2009-10 land tax year:** **$0-$300,000:** Nil **$300,001-$1,000,000:** 0.09% **$1,00,001-$2,200,000:** $630+0.47%. **$2,200,001-$5,500,000:** $6,270+1.22% **$5,500,001-$11,000,000:** $46,530+1.46%. **Over $11,000,000:** $126,830+2.16%. The Metropolitan Region Improvement Tax (MRIT) is levied on the unimproved value of land situated in the metropolitan region at the rate of 0.14c per $1 for land valued at over $300,000. A 50% cap on land value increases applies for land tax and MRIT purposes.	**For 2009-10 land tax year:** **$0-$110,000:** Nil **Exceeding $110,000-$350,000:** 0.30% **Exceeding $350,000-$550,000:** $720 + 0.70% **Exceeding $550,000-$750,000:** $2,120 + 1.65% **Exceeding $750,000-$1,000,000:** $5,420 + 2.40% **Over $1,000,000:** $11,420 + 3.70%	**Effective 1 July 2005**: **$0-$24,999:** Nil **$25,000-$349,999:** $50.00+0.55% **$350,000-$749,999:** $1837.50+2% **$750,000 or more:** $9,837.50+2.50% 1. Current Tasmanian land tax rate can be found in the land tax chapter of section 9.	Not imposed	**For 2009-10** *Residential Properties Marginal Rates* **Up to $75,000:** 0.60% **$75,001-$150,000:** 0.89% **$150,001-$275,000:** 1.15% **Over $275,000:** 1.40% Based on Average Unimproved Value, which includes the 2007, 2008 and 2009 Unimproved Land Values. **Commercial Properties Marginal Rates** **Up to $150,000:** 0.89% **$150,001-$275,000:** 1.25% **Over $275,000:** 1.59% **Based on Average Unimproved Value, which includes the** 2007, 2008 and 2009 **Unimproved Land Values.**

Payroll tax

Payroll tax is levied on employers and is based on wages paid or payable, which in most states includes non-cash fringe benefits, to employees. In most states, the base also includes employer superannuation contributions.

Displayed in the tables below using the current rates of payroll tax and national average weekly earnings, is the payroll tax liability of medium and large employers for a variety of employee levels.

Chart A1.3 Payroll tax per annum by number of employees – medium employers

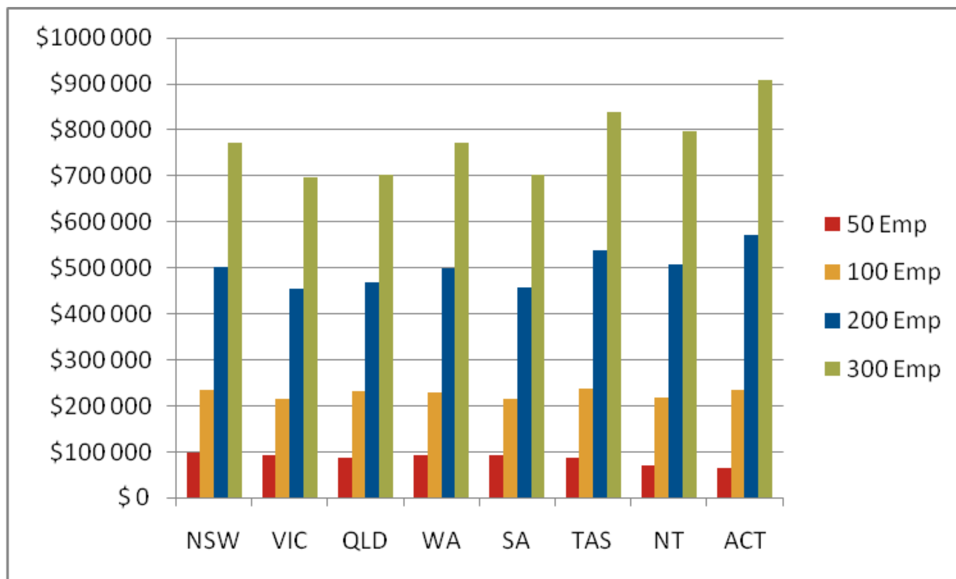


Chart A1.4 Payroll tax per annum by number of employees – large employers

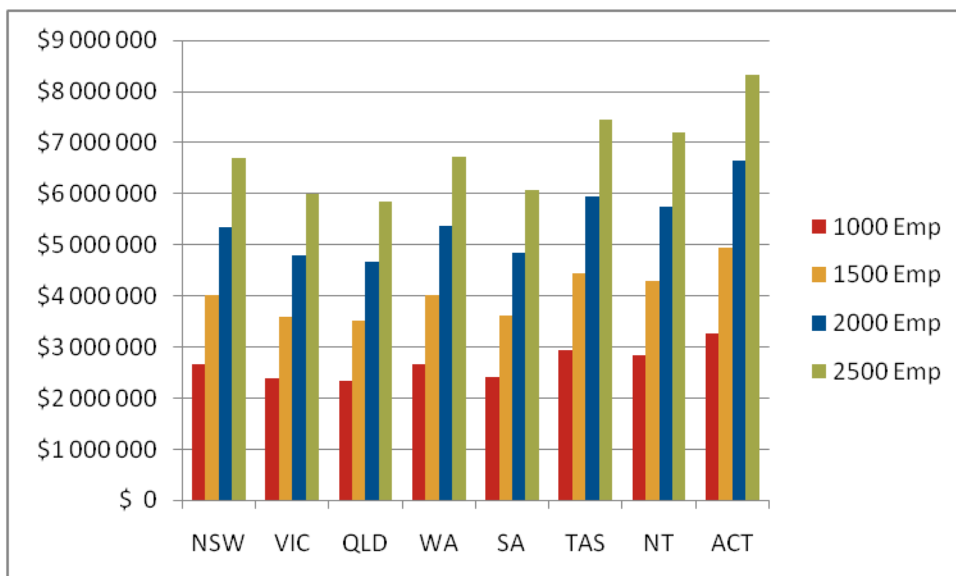


Table A1.3 Payroll tax rates

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Basic Flat Rate:	5.75% (5.65% from 1 Jan 2010 and 5.5% from 1 Jan 2011)	4.95%	4.75%	5.50%	4.95%	6.10%	5.9%	6.85%
Tax Scale and Small Business Concession:	First $638,000 exempt. (From 1 July 2009) Threshold is indexed annually to the Sydney CPI from 1 July each year.	First $550,000 exempt.	First $1,000,000 exempt. For payrolls $1,000,000 up to $5,000,000, deduction of $1,000,000 reducing by $1 for every $4 payroll exceeds $1,000,000. No deduction for payrolls of $5,000,000 or more.	First $750,000 exempt.	First $600,000 exempt	First $1,010,000 exempt.	First $1,250,000 exempt.	First $1,500,000 exempt.

Motor vehicle registration duty

Motor vehicle registration duty is payable when first registering a motor vehicle or when changing the name of the registered owner. The duty is based on the value of the vehicle. This is distinct from motor vehicle registration fees and motor tax.

Displayed in the table below using the current rates of duty, the tax liability on the first registration or application to transfer a passenger vehicle for a variety of values is shown.

Chart A1.5 Motor vehicle registration duty by value

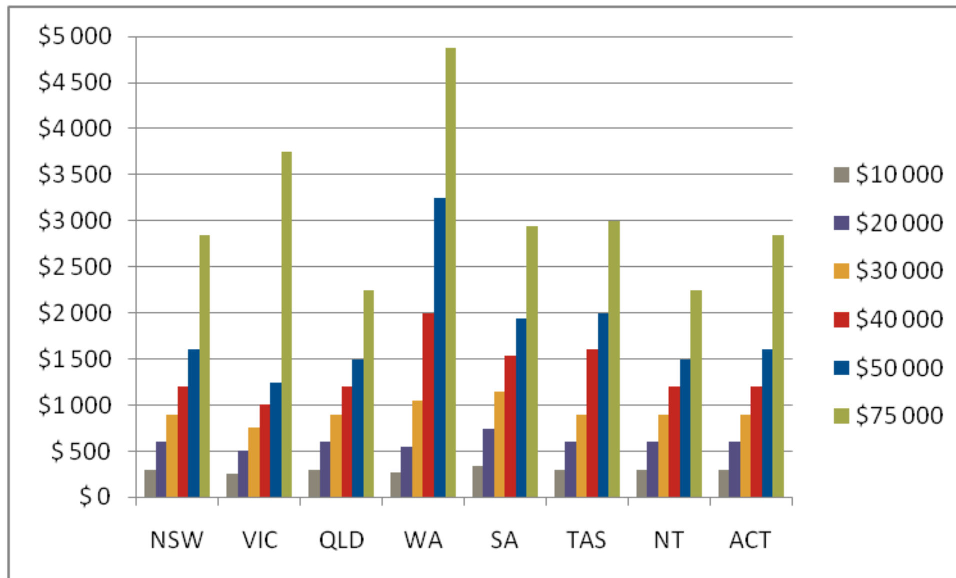


Table A1.4 Motor vehicle registration duty rates

The amounts shown in this table are based on the dutiable value of the vehicle, which is the amount paid or, if higher, the market value.

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
$3.00 per $100, or part, except for Passenger Vehicles* **$1,350+$5.00 per $100, or part, of the dutiable value of the motor vehicle in excess of $45,000.** * a vehicle: a) with a dutiable value of not less than $45,000, and b) that is constructed primarily for the carriage of not more than 9 occupants, including a sedan, station wagon, coupe, convertible, four wheel drive vehicle with seats and windows, two wheel drive panel van with seats and windows, three wheel car, forward control vehicle passenger vehicle, small bus (seating not more than 9 persons, including the driver), motor home, and snow vehicle, but **not** including: a motor cycle (with or without a side car), large bus (seating more than 9 persons, including a driver), hearse or invalid conveyance. Duty on purchases and transfers of caravans and camper trailers are exempt from 1 July 2009.	Passenger Vehicles **$0-$57,009:** $5.00 per $200 or part. **Over $57,010:** $10.00 per $200 or part. Other Vehicles (Including Non Passenger) $5.00 per $200 or part. Previously Registered Vehicles $8.00 per $200 or part.	1 to 4 cylinders or 2 rotors and a steam vehicle: $3 for each $100 and each part of $100 5 or 6 cylinders or 3 rotors: $3.50 for each $100 and each part of $100 7 or more cylinders: $4 for each $100 and each part of $100 Hybrid/Electric: $2 for each $100 and each part of $100 Special vehicles (as defined) Flat rate of $25	New and Used Heavy Vehicles 3.0% Max duty $12,000 Other Vehicles **$0-$25,000:** 2.75% **$25,001-$50,000:** 2.75%-6.50% **Over $50,000:** 6.50% flat. *There is a sliding rate scale between $25,000 and $50,000.	**$0-$1,000:** $1 per $100 (min $5) or part $100. **$1,001-$2,000:** $10+$2 per $100 or part $100 above $1,000. **$2,001-$3,000:** $30+$3 per $100 or part $100 above $2,000. **Over $3,000:** $60+$4 per $100 or part $100 above $3,000. Except for commercial vehicles where the rate is: **0-$1,000:** $1 per $100 (min $5) or part $100. **$1,001-$2,000:** $10+$2 per $100 or part $100 above $1,000. **Over $2,000:** $30+ $3 per $100 or part $100 above $2,000.	Passenger vehicles **Under $600:** $20.00 **$600-$34,999:** $3.00 per $100 or part in excess of $600. **$35,000-$40,000:** $1,050+$11 per $100 or part in excess of $35,000. **Over $40,000:** $4.00 for each $100 or part of $100 of the value of the vehicle. Vehicles subject to manufacturers fleet discount Minimum $20.00 or $3.50 per $100 or part of $100.00 of the value of the vehicle – whichever is the greater. $3.50 per $100 Heavy Vehicles (mass >4.5 tonnes) **Trucks, utilities, buses and heavy trailers** **Under $2,000:** $20.00 **Over $2 000:** $1 per $100 or part of the value of the vehicle. All Other Vehicles **Under $600:** $20.00 **Over $600:** $3.00 per $100 or part.	**$3.00 per $100 or part.**	**Vehicles Under $45,000:** **A-rated** vehicle nil, **B-rated** vehicle $2 for each $100, or part of $100, of the dutiable value of the motor vehicle, **C-rated** vehicle and **non-rated** vehicle $3 for each $100, or part of $100, of the dutiable value of the motor vehicle, **D-rated** vehicle $4 for each $100, or part of $100, of the dutiable value of the motor vehicle **Passenger vehicles* $45,000 or over:** **A-rated** vehicle nil, **B-rated** vehicle $900, plus $4 for each $100, or part of $100, of the dutiable value of the motor vehicle that is more than $45,000, **C-rated** vehicle and **non-rated** vehicle $1,350, plus $5 for each $100, or part of $100, of the dutiable value of the motor vehicle that is more than $45,000, **D-rated** vehicle $1,800, plus $6 for each $100, or part of $100, of the dutiable value of the motor vehicle that is more than $45,000 * a passenger vehicle is: a) with a dutiable value of not less than $45,000, and b) that is constructed primarily for the carriage of not more than 9 occupants, including a sedan, station wagon, coupe, convertible, four wheel drive vehicle with seats and windows, two wheel drive panel van with seats and windows, three wheel car, forward control vehicle passenger vehicle, small bus (seating not more than 9 persons, including the driver), motor home, and snow vehicle, but **not** including: a motor cycle (with or without a side car), large bus (seating more than 9 persons, including a driver), hearse or invalid conveyance.

Insurance duty

Insurance duty is levied on a variety of insurance policies such as private motor vehicle, occupational indemnity, and home and home contents. The duty is generally based on the annual premium.

Duty on life insurance is levied on either the sum insured or the annual premium.

Table A1.5 Insurance duty rates

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Life: ***(Based on sum insured, except in SA.)***	***$0-$2,000:*** *$1.00* ***Over $2,000:*** *$1.00+20c per $200 or part thereof in excess of $2,000.*	***$201-$2,000:*** *12c per $200 or part.* ***Over $2,000:*** *$1.20+24c per $200 or part above $2,000.*	***$0-$2,000:*** *0.05%* ***Over $2,000:*** *0.05% of the first $2,000 + 0.1% of balance.*	*No duty on life insurance policies.*	*$1.50 per $100 or part thereof of net premiums of previous year paid as annual licence (Min $100).*	***Up to $2,000:*** *10c per $200 or part.* ***Over $2,000:*** *$1.00+20c per $200 or part in excess of $2,000.*	*10c per $100 or part thereof the sum insured.*	***Life insurance*** *(other than a temporary or term insurance policy, or disability income insurance)* ***$0-$2,000:*** *$1.00* ***Over $2,000:*** *$1.00+20c per $200 or part thereof in excess of $2,000.*
Term/Temporary:	**Term or Temporary:** 5% of first year premium. **Life insurance riders:** 5% of first year premium on the life insurance rider. Insurance under which an amount is payable in the event of the disablement of the insured by accident or sickness. 5% of the premium paid.	**Term insurance:** 5% of first year premium.	**Term or Temporary insurance:** 5% of first year premium			**Term or Temporary policy:** 5% of first year premium.	**Term or Temporary:** 5% of first year premium.	**Term or Temporary insurance policy:** **5% of the first year** premium. **Life insurance rider:** 5% of the first year premium. Insurance in the event of the disablement of the insured by accident or sickness: 10% of the premium paid. Annuities exempt.

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
General Insurance:	9% of the premium. Concessional 5% of premium payable on aviation, consumer credit, disability, directors liability, motor vehicle, professional indemnity. Concessional 2.5% of premium paid on crop and livestock.	10% of previous month's premiums.	7.5% of the premium for contracts of general insurance not mentioned below. 5% of premium for motor vehicle (other than compulsory 3rd party), professional indemnity insurance, personal injury related to a person's travel on an aircraft, home mortgage that is a first mortgage, and life insurance riders. 5% of net premium for workers compensation. 10c flat on compulsory 3rd party motor vehicle.	10% of gross premiums. 10% of premiums on compulsory 3rd party insurance for motor vehicles.	$11 per $100 or part thereof of premiums. (Including compuls*ory 3rd party premiums*).	8% of premiums. $6 flat on 3rd party motor vehicle insurance.	10% of premiums (including indemnity insurance).	10% of gross premium.

A1.2. Taxation severity

How is taxation severity measured?

Taxation competitiveness plays a key role in encouraging growth in the business environment.

An independent measure of taxation competitiveness across jurisdictions, the taxation severity ratio, is provided by the Commonwealth Grants Commission (CGC) in its annual reports and updates on state relativities.

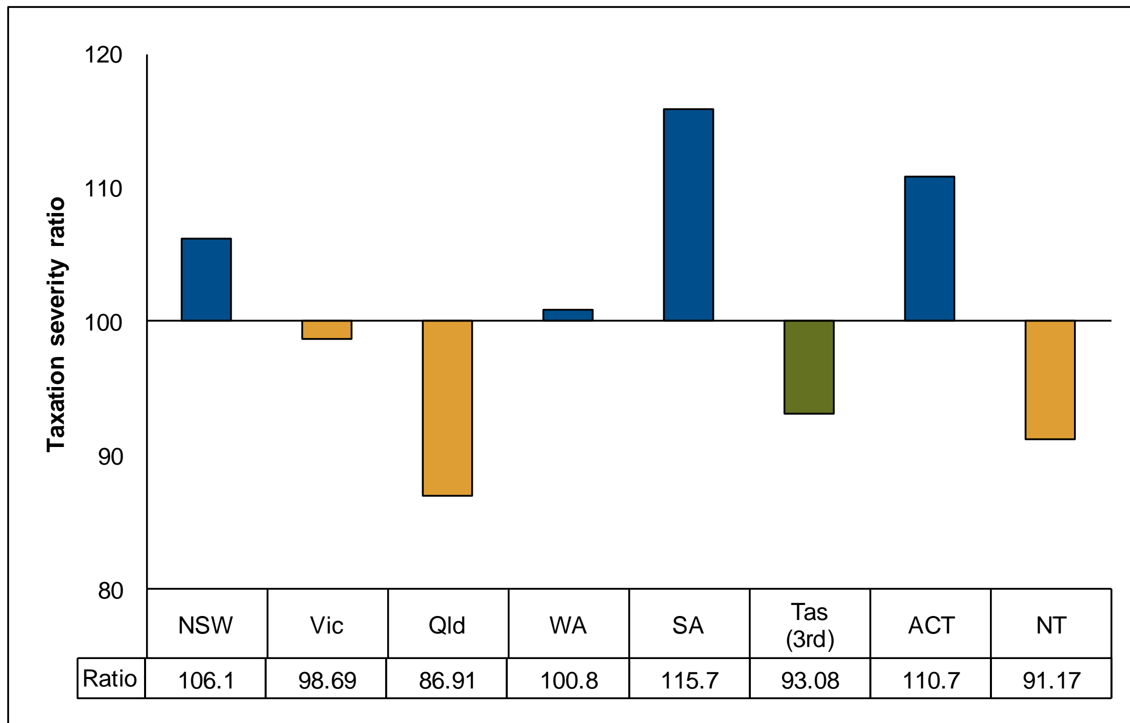
The taxation severity ratio is not a straightforward comparison of tax rates or the amount of tax collected in different states. Rather, it is an assessment by the CGC of the “effort” made by each state to raise taxation as a ratio of its “capacity” to raise taxes. A ratio greater than 100 indicates that the state or territory raised more revenue than average relative to the underlying capcity of its tax base to yield revenue. A ratio less than 100 indicates below average effort.

In its most recent publication, the *Report on GST Revenue Sharing Relativities – 2010 Review*, the CGC changed its methodology and no longer provides a comparison of total taxation severity. Instead, it assesses state own-source revenue severity, which includes mining revenue, returns from government businesses and miscellaneous user charges in addition to taxation revenue.

In addition, the CGC no longer identifies gambling taxes separately but includes them in “other revenue”. Consequently, it is no longer possible to compare overall taxation severity across states and territories. However, comparisons can still be made across individual taxes, and a combination of these provides an overall comparison comprising around 87 per cent of total taxation revenue.

Total taxation (excluding gambling taxes)

Chart A1.6 Inter-jurisdictional comparison of taxation severity (excluding gambling taxes) for 2008-09



	NSW	Vic	Qld	WA	SA	Tas (3rd)	ACT	NT
Ratio	106.1	98.69	86.91	100.8	115.7	93.08	110.7	91.17

Source: *Report on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

A comparison of the taxation severity of all taxes (excluding gambling taxes) shows that Tasmania is:

- third lowest of all jurisdictions, including territories; and
- second lowest of any state (see Chart A1.6);

based on the taxation arrangements in place in each jurisdiction in 2008-09, the latest year for which this assessment is available.

Tasmania has been assessed as being amongst the lowest three jurisdictions since 2000-01.

In line with the objectives of the Government's Interim Fiscal Strategy, Tasmania's taxation severity is also below the average of all states and territories. Tasmania is one of only two jurisdictions that have been assessed as having taxation severity below the national average in every year from 2000-01.

Tasmania's taxation performance is a significant turnaround from the mid-1990s, when the State was assessed as being the second least competitive state.

A sustained program of tax relief and tax abolition is the principal driver of Tasmania retaining its relatively low taxation severity. Beginning with the 2001-02 Budget, a series of complementary tax relief measures have combined to deliver approximately $242.5 million per annum in reduced state taxes (in real terms) from 1 July 2010 onwards.

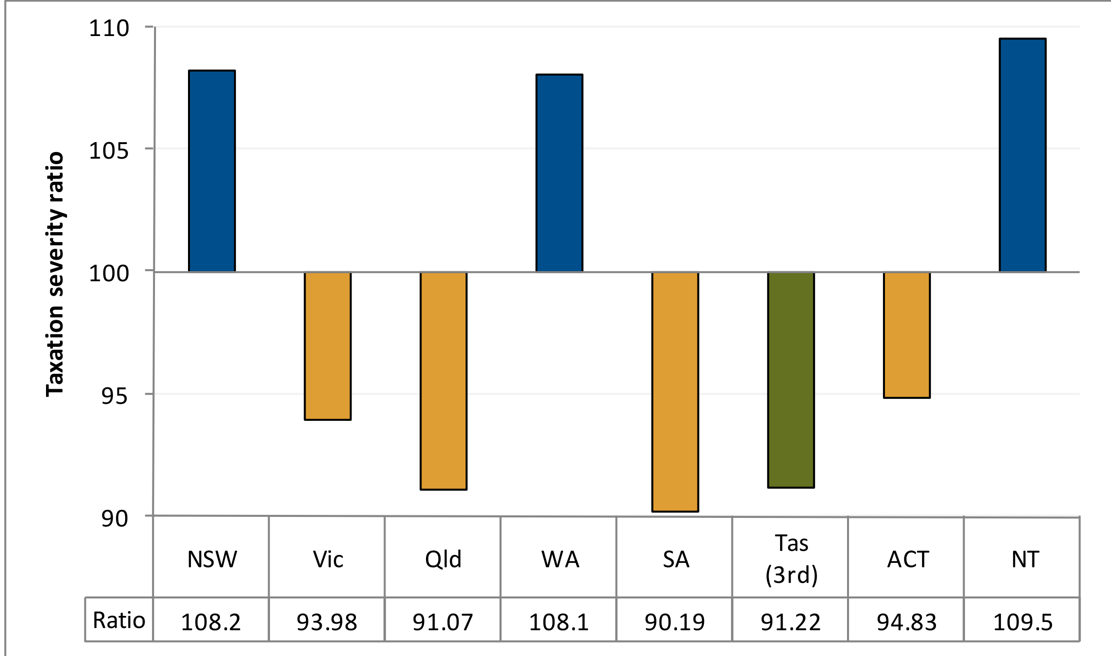
These include the abolition of taxes and duties agreed under the IGA as discussed in section 5.2, and taxes abolished by the State, noted in Appendix A3.

Assessed and actual taxation amounts are provided in Table A1.6 on page A1.19 of this appendix.

In 2008-09, Tasmania collected $1 298 in tax per capita, the lowest of any state or territory. However, Tasmania was also assessed by the CGC as having the least capacity to raise taxes at $1 394 per capita. It is the ratio of these two amounts which provides the taxation severity number of 93.08.

Payroll tax

Chart A1.7 Inter-jurisdictional comparison of payroll tax severity 2008-09



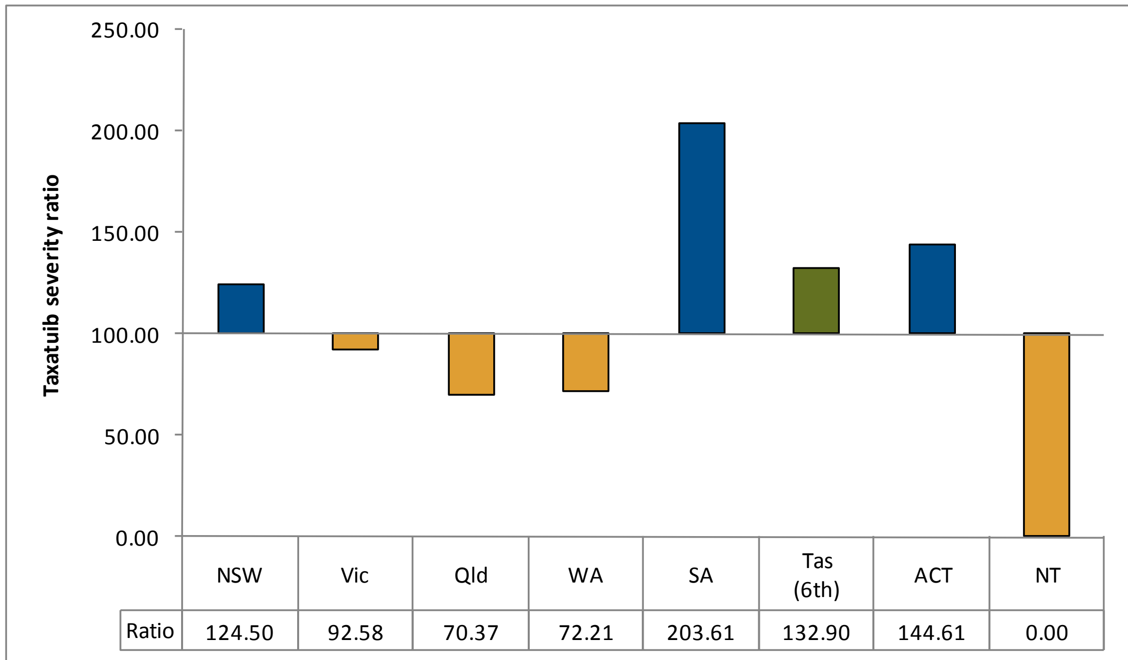
	NSW	Vic	Qld	WA	SA	Tas (3rd)	ACT	NT
Ratio	108.2	93.98	91.07	108.1	90.19	91.22	94.83	109.5

Source: *Report on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

Tasmania has the third lowest payroll tax severity of all states and territories and, with a ratio of 91.22, is below the average of all states and territories.

Land tax

Chart A1.8 Inter-jurisdictional comparison of land tax severity 2008-09



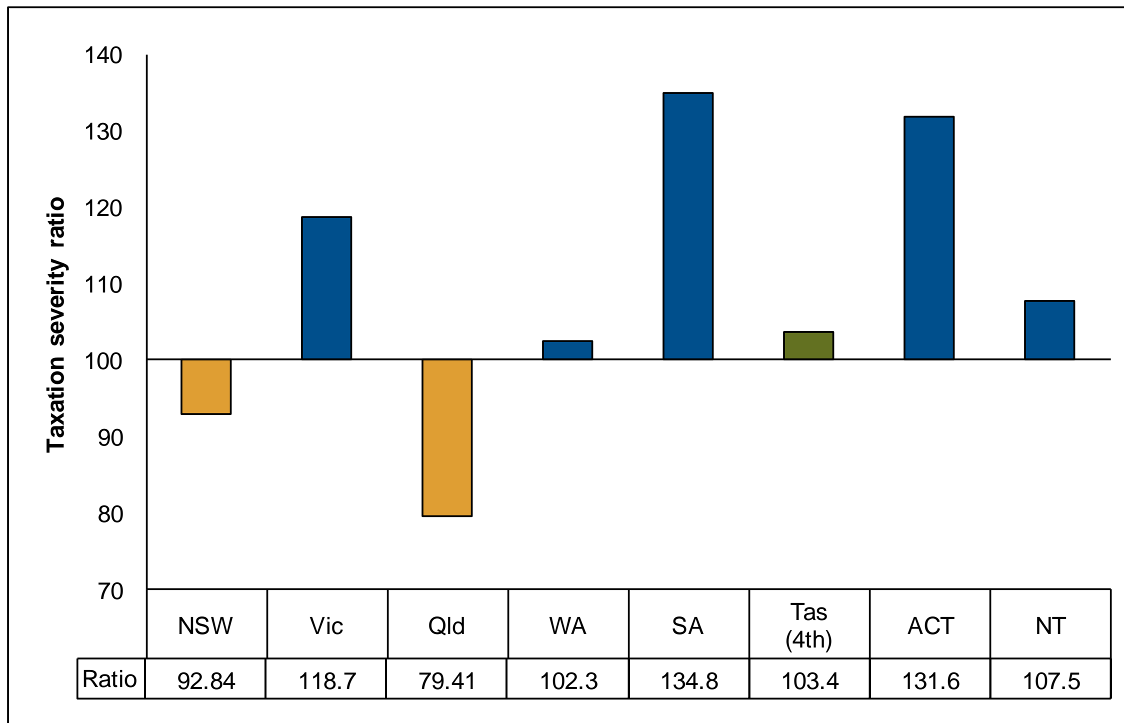
Source: *Report on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

As at 30 June 2009, Tasmania had a land tax severity ratio of 132.90, above the national average and 6th in comparison with other states and territories. Nevertheless, apart from the Northern Territory (which does not impose land tax), Tasmania had the lowest per capita land tax impost of $159.91.

Tasmania's land tax reforms introduced in 2010-11 are likely to have reduced Tasmania's land tax severity ratio in comparison with other states, but this will not be publicly reported until the CGC report in 2012, which will be based on taxation levels in 2010-11.

Conveyance duty

Chart A1.9 Inter-jurisdictional comparison of conveyance duty severity 2008-09



	NSW	Vic	Qld	WA	SA	Tas (4th)	ACT	NT
Ratio	92.84	118.7	79.41	102.3	134.8	103.4	131.6	107.5

Source: Report *on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

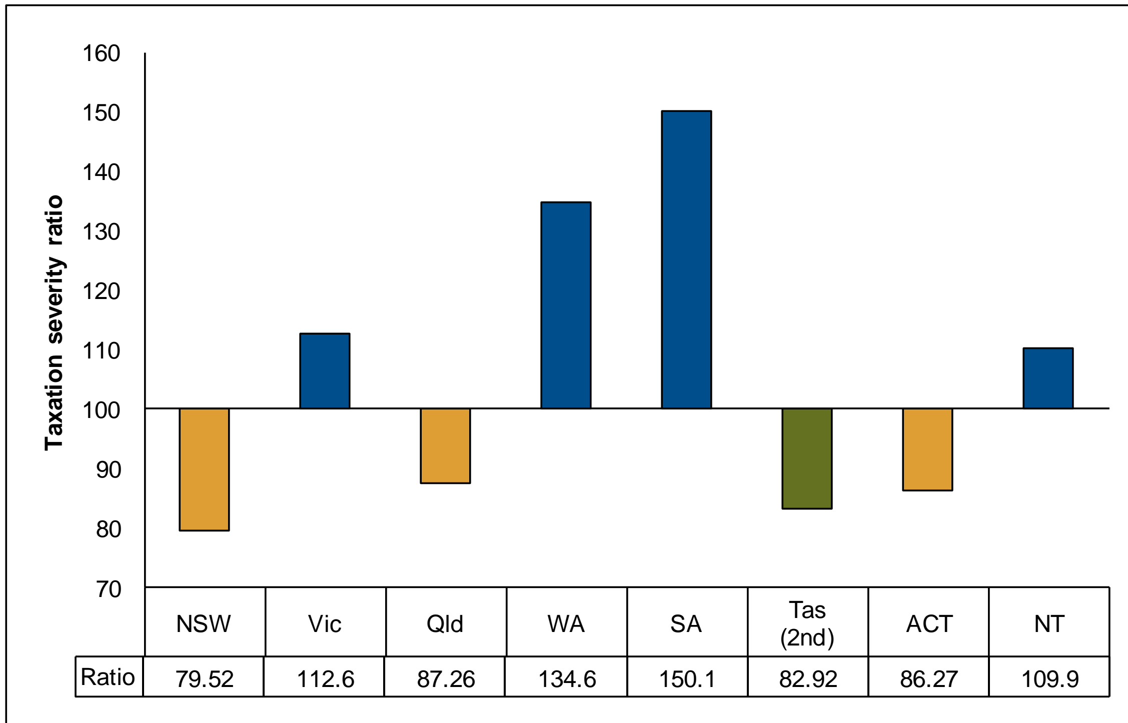
Tasmania is ranked fourth and, with a tax severity ratio of 103.48, is close to the national average when comparing conveyance duty across states and territories.

In Tasmania, conveyance duty on non-real business assets was abolished from 1 July 2008.

Although it is the intention of all other states and territories to abolish duty on non-real business assets, a number of jurisdictions, including New South Wales, Queensland, Western Australia, South Australia and the Northern Territory will delay doing so until at least 1 July 2012. When this happens the average taxation effort and Tasmania's severity ratio is likely to increase slightly.

Insurance tax

Chart A1.10 Inter-jurisdictional comparison of insurance tax severity 2008-09



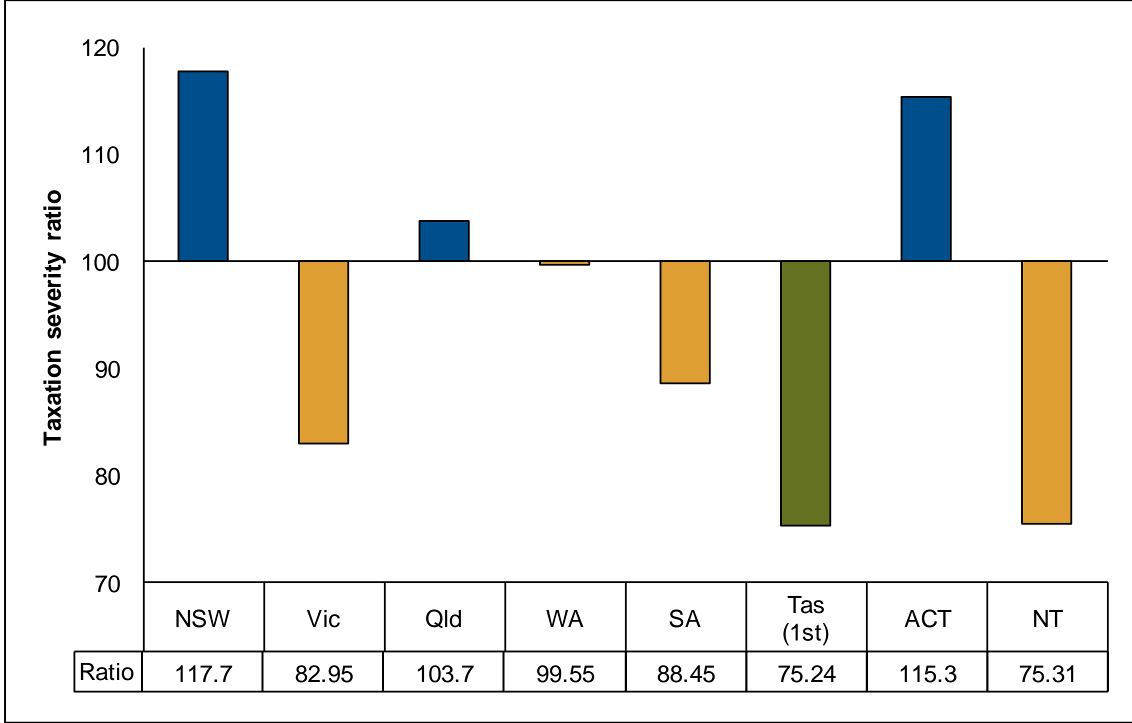
	NSW	Vic	Qld	WA	SA	Tas (2nd)	ACT	NT
Ratio	79.52	112.6	87.26	134.6	150.1	82.92	86.27	109.9

Source: *Report on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

As at 30 June 2009, Tasmania had an insurance tax severity ratio of 82.92, the second lowest of all states and territories and well below the national average.

Motor taxes

Chart A1.11 Inter-jurisdictional comparison of motor taxes severity 2008-09



	NSW	Vic	Qld	WA	SA	Tas (1st)	ACT	NT
Ratio	117.7	82.95	103.7	99.55	88.45	75.24	115.3	75.31

Source: *Report on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

Tasmania has the lowest motor tax severity of any state or territory and with a ratio of 75.24 is well below the national average.

Table A1.6 Comparison of the assessed and actual taxation revenue raised per capita in each state and territory in 2008-09

	NSW		VIC		QLD		WA		SA		Tasmania		ACT		NT	
	Assessed /	Actual	Assessed /	Actual	Assessed /	Actual	Assessed /	Actual	Assessed /	Actual	Assessed /	Actual	Assessed /	Actual	Assessed /	Actual
	$	$	$	$	$	$	$	$	$	$	$	$	$	$	$	$
Payroll tax	834	902	789	742	695	633	940	1 016	629	567	568	518	812	770	633	693
Land tax	257	320	271	251	274	193	405	292	155	316	120	160	172	248	184	0
Stamp duty on conveyances	417	387	419	497	523	415	447	457	313	422	286	296	428	563	454	488
Insurance tax	150	120	132	149	129	113	134	180	135	203	104	86	125	108	111	122
Motor taxes	263	310	308	256	328	340	387	386	299	265	317	238	262	302	276	208
Total	1 921	2 039	1 919	1 894	1 949	1 694	2 313	2 332	1 531	1 772	1 394	1 298	1 798	1 991	1 658	1 511

Source: *Report on GST Revenue Sharing Relativities – 2010 Review*, Commonwealth Grants Commission.

A1.3. Commonly Raised Issues

This Appendix summarises the issues that are most commonly raised by taxpayers, either in their correspondence to elected Parliamentary representatives, the media or to the State Revenue Office.

Duties

Aggregation	The *Duties Act 2001* provides that dutiable transactions relating to separate items of dutiable property are to be aggregated and treated as a single dutiable transaction where they arise from what is substantially one arrangement relating to all items of dutiable property. Because of the progressive nature of Tasmania's conveyance duty rates, aggregation often results in a greater tax liability.
Rates of duty (comparison to other states)	Affected taxpayers criticise Tasmania's rates of conveyance duty.
Use of Government valuation in cases where consideration inadequate	Duty is calculated on the value of dutiable property. In some cases, particularly those involving transfers between related parties, the consideration paid for the transfer may not reflect the true market value of the property. Accordingly, the Duties Act provides that duty is to be calculated on the consideration, or Government valuation, whichever is higher. However, provided it can be shown that a property has been widely advertised and sold for the best price achievable on the open market, the Commissioner of State Revenue will generally accept a consideration that is lower than the Government valuation.
Transfers between related entities	It is common practice that, regardless of ownership structure, related companies, and companies and their shareholders are treated as separate legal entities. Duty is chargeable on a transfer between associated entities (be they related companies or companies and their shareholders). Unlike some other states, Tasmania's Duties Act does not provide an exemption on transfers resulting from corporate restructures.
When business assets are dutiable	Duty on the sale of non-real business assets was abolished from 1 July 2008, but the transfer of land-related business assets remains dutiable. While taxpayers are aware that real property remains dutiable, they are not always aware that the transfer or assignment of a lease transfers an interest in land, and is thus dutiable.

Transfers to charitable organisations	Transfers by way of gift to charitable organisations are exempt from duty. However, where any consideration is paid, including the assumption of any liability such as a mortgage, the transaction is not exempt and duty is payable on the full value of the property. Organisations that have not sought legal advice, or have received inadequate advice, may accrue an unexpected duty liability.
Intergenerational rural transfer (family farm) exemption eligibility criteria	The eligibility criteria for the family farm exemption are complex and restrictive. With family relationships growing more complex, and with greater use of family trusts and company structures to hold farming assets, the complex nature of the eligibility criteria has been criticised.
Rectifying error on title	The *Duties Act 2001* does not contain a provision to exempt from duty a transfer designed to correct an error on title.

Insurance Duty

Duty on GST inclusive premium	Duties are based on the total consideration, including any GST that the purchaser is required to pay to the vendor. The practice of calculating duty on the GST inclusive purchase price or premium attracts criticism. This issue is often compounded by the mistaken belief that all duties were agreed to be abolished when the GST was introduced.

Motor Vehicle Transfer Duty

Duty on total GST inclusive price	Duties are based on the total consideration, including any accessories and GST that the purchaser is required to pay to the vendor. The vendor is subject to GST, and the vendor commonly increases the purchase price to cover their GST liability. The practice of calculating duty on the GST inclusive purchase price or premium attracts criticism. This issue is often compounded by the misapprehension that all duties were to be abolished when the GST was introduced.
Duty on caravans and trailers	Tasmania is the only jurisdiction to levy duty on caravans and trailers. This incentivises Tasmanian's to purchase such vehicles interstate (despite provisions that would eventually require them to register the vehicle in Tasmania and pay duty in Tasmania).
Transfer between related entities	Duty is chargeable on the transfer of motor vehicles between associated entities (be they related companies, companies and their shareholders or trusts and their beneficiaries).

Land Tax

Aggregation	The total value of a land holder's taxable land holdings is used to calculate land tax. Aggregation ensures that property owners with large holdings do not divide properties into smaller, lower value, parcels to achieve a lower

incidence of land tax. Aggregation ensures that a person holding a single property will pay the same tax as a person owning several lower-value properties with the same combined value.

Apportionment on property sale

Land tax is based on property ownership and classification at 1 July each year. Accounts are issued on this basis. Where a property changes hands during the year, it is common for the vendor and purchaser to agree that the land tax liability will be shared on a pro rata basis. This practice may cause concern for purchasers that intend to utilise the property as their principal place of residence or other "exempt" land.

Land tax apportionment is a matter for negotiation between the vendor and purchaser, and is not mandatory. The State Revenue Office assists the practice by issuing estimates of land tax liability on settlement date.

Valuation:

- adjustment factors
- time between valuations
- ability to object against valuations

The Valuer-General currently re-values each municipality every six years (nine municipalities are re-valued every two years). Adjustment factors, representing estimated changes in land values for property types and locations, are calculated during intervening years.

This cycle can cause a number of issues:

- Adjustment factors attempt to represent changes in values between valuations, and smooth out large changes in valuations every six years. Recent experience has seen large increases in valuations, which have large impacts on land tax.
- The infrequency of valuations means that there is little opportunity for land owners to object to valuations applied to their properties. In the intervening years, property owners cannot object to the adjustment factors applied to their property, only to the adjustment factor calculated for the entire location.
- A property owner has 60 days to object to a new valuation issued by the Valuer-General. However, property owners that are not conscious that an increased valuation may result in a greater land tax liability, may be surprised when their land tax notice is issued by the State Revenue Office. By the time that the land tax notice is issued, the property owner is commonly out of time to object to the new valuation.
- The progressive nature of the land tax rates means that an increase in a property's value may result in a greater increase in land tax.

Payroll Tax	
Reaching tax-free threshold considered disincentive to employ additional staff	Some employers whose taxable wages are close to the $1.01 million tax free threshold, or who have recently exceeded the threshold, see it as a disincentive to employ additional staff. However, these employers do not always realise that payroll tax is only payable on taxable wages that exceed the tax-free threshold (rather than their entire wages bill). The effective rate of tax for employers that exceed the tax-free threshold by a small amount is much less than 6.1 per cent.
Rates of payroll tax	It is common for taxpayers to criticise Tasmania's payroll tax rate. Tasmania has the second highest payroll tax rate of all states and territories. However, it also has the third highest tax-free threshold. As a result of the high tax-free threshold, the effective rate of payroll tax in Tasmania is comparatively low.
Differing treatment of for-profit and not-for-profit businesses.	Religious institutions, public benevolent institutions and non-profit organisations (that have as their sole or dominant purpose a charitable, benevolent, philanthropic or patriotic purpose) are exempt from payroll tax. To be exempt, wages paid must be for work performed in connection with the religious, charitable, benevolent, philanthropic or patriotic purposes or the organisation. In some industry sectors, such organisations compete with for-profit businesses and the competitive advantage given by this payroll tax exemption is a common issue raised by for-profit businesses.

A2. Excerpts from *Australia's Future Tax System*

A2.1. State tax reform

Recommendation 119

- Reforms to state taxes should be coordinated through intergovernmental agreements between the Australian government and the states to provide the states with revenue stability and to facilitate good policy outcomes.

Source: *AFTS* p.684

Key points

- Although the states currently have access to significant taxes, there are problems with either the quality of these taxes or the way they are levied. Increasing the rates of tax on existing state taxes would not be a sustainable way of funding services in the future.
- The states would be better placed to meet cost pressures in the future if they received the revenue from a broad-based cash flow tax. This could fund the abolition of a number of state taxes. The states could also raise some revenue from tax base sharing of the personal income tax, with the Australian government keeping a share of the consumption tax revenue.
- Reforms to state taxes should be implemented over time through an intergovernmental agreement to allow for revenue stability as taxes are reformed and to facilitate good policy outcomes across the federation.

Source: *AFTS* p. 669

Findings

- If the states required additional fiscal autonomy, they could raise revenue from sharing the personal income tax base. This could be done by the states levying a flat rate surcharge on income tax payable to the Australian government or a flat rate of tax on income above the tax-free threshold. The Australian government would need to reduce its rates of personal income tax and the states would receive lower revenue from grants or an existing revenue sharing arrangement. Any tax base sharing arrangement would need to be designed so that it was consistent with national objectives for redistribution and workforce participation and avoiding additional complexity.

Source: *AFTS* pp. 669-687

Principles

- The assignment of tax responsibility in a federation should take into account the revenue needs of each level of government. Each level of government should have access to tax revenue it can use to finance significant marginal expenditure decisions.
- To the extent that there is a choice about the assignment of taxes in the federation, the Australian Government should have control of taxes with more mobile tax bases and taxes used for redistribution and macroeconomic stabilisation. The states should have control of taxes on more immobile bases.

- Tax base sharing or centrally administered State taxes can provide the states with the capacity to raise revenue sustainably and with some autonomy.

Source: *AFTS* pp. 669-687

Directions for reform

Table A2.1 Reform directions for state taxes (including resource royalties)

State tax	Reform direction	Reference to *AFTS*
Payroll tax	Payroll tax should be replaced by a tax that better captures the value-add of labour. This could be a broad-based wages tax or, preferably, a cash flow tax.	Section D3
Conveyance duty	The removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad bases (including consumption and land).	Section C2
Land tax	Land tax should be levied using an increasing marginal rate scale applying to the per-square-metre value of the land. The tax should be calculated per land holding, not on an entity's total holding. There should be no specific exemption for principal place of residence or primary production.	Section C2
Insurance taxes	All specific taxes on insurance products, including the fire services levy, should be abolished.	Section E8
Motor vehicle taxes	State taxes on motor vehicle use and ownership, including motor vehicle registration transfer (stamp) duty and taxi licence fees, should be replaced with efficient user charges where possible.	Section E3
Gambling taxes	Explore options for reducing conflicts in policy-making between regulation and revenue-raising.	Section E7
Resource royalties	Most existing output-based royalty and resource rent tax arrangements imposed on non-renewable resources should be replaced by a single rent-based tax. The Australian government and State governments should negotiate an appropriate allocation of the revenues and risks from the resource rent tax.	Section C1

Source: *AFTS*, Table G2-1 p. 680

The long-term reform directions for State taxes would mean that the states rely less on transaction taxes and more on the efficient and immobile land tax base. The abolition of a number of taxes would contribute to a more coherent tax system across the federation.

Providing the states with better revenue sources

The states would need access to alternative sources of revenue to fund the abolition of a number of existing taxes. While the broadening of the land tax base is expected to

yield additional revenue, it is envisaged that this reform would principally replace the revenue from conveyance duty.

Providing the states with more efficient and sustainable revenue sources is to some degree contingent on the reforms to consumption taxes, including payroll tax, outlined in Section D. Over time, revenue from a broad-based cash flow tax could provide a sustainable revenue base for the states to meet future cost pressures.

Different variations of consumption tax reform will have different implications for the role of the states. For example, the states currently levy their own payroll taxes, setting both the base and rate and could continue to set their own rates on a broad-based wages tax. In contrast, as a cash flow tax would be applied to business cash flows across Australia, to avoid significant complexity, and possible constitutional issues, the rate of the cash flow tax would need to be uniform across Australia.

Tax base sharing options

While the reforms to State taxes outlined above would provide the states with better revenue sources, the states would lose some discretion over how they raised their revenue (particularly if payroll tax was absorbed into a new cash flow tax). This calls into question whether the states would have sufficient revenue-raising autonomy — that is, whether they would have the capacity to raise revenue to finance significant marginal expenditure. How the states raise or receive revenue may also impact on how large cost pressures are over time. In Germany, for example, a reliance on intergovernmental grants in some German states have been linked to weakened fiscal discipline[5]. If the states are not responsible for raising any of the revenue to fund increased spending, then there may be less incentive for them to provide services in more cost-effective ways.

While the states would have control over a reformed land tax, there may be some practical limitations on how this tax could be used to fund changes in expenditure. Although a reformed land tax base would be an appropriate revenue source for the states, the relative variability in land values may mean that changes in land tax rates may not always be a responsive mechanism for the states to use to fund expenditure decisions. Further, the revenue from the land tax may not be enough to allow states to have control over a significant amount of revenue (relative to their expenditure responsibilities).

If the states require further revenue-raising autonomy, then this could come through a tax base sharing arrangement. The Australian government currently raises significant amounts of revenue from two broad tax bases: the company tax base and the personal income tax base. It is possible that the states could share one of these bases, by applying a State-based surcharge.

While company tax has a broad base, as capital is highly mobile, it is expected that in the future the proportion of company tax revenue to total tax revenue will be lower than it is now (see Section B1 Company and other investment taxes). Further, as capital is mobile, states are likely to face pressure to reduce rates and they may be forced in to a “race to the bottom” as they compete to maintain investment in their State. It is likely that these pressures are magnified (compared to international competition) in the case of states as the other characteristics that may attract investment (such as skilled labour and strong governance structures) are similar in each State. This would make the rate of the surcharge in each State a relatively more important factor in businesses'

[5] Stehn and Fedelino, 2009 *Fiscal incentive effects of the German equalization system*

decisions about where to locate within Australia. At the same time, a State surcharge on company tax could not satisfactorily be integrated with the dividend imputation system.

The personal income tax base, which largely comprises the labour income of individuals, is less mobile between the states (as people move less freely than capital investment). Even where the personal income tax base includes some return to capital (for example, income from savings), the base is relatively immobile as the surcharge rate of tax would be based on where the person lives, not where the investment is undertaken.

Tax base sharing of income tax operated in Australia before the Second World War, although there was little coordination between the two levels of government. In 1976, the Australian government introduced the possibility of the states levying a personal income tax surcharge to replace financial assistance grants. No State took up the option. A key reason for this was that the Australian government did not reduce its own tax rates to make room for the states[6].

For a tax base sharing arrangement to work, therefore, it would be necessary for the Australian government to reduce its tax rates to allow room for the states. The revenue from tax base sharing that the states raised (and the Australian government gave up) should be offset by a reduction in grants from the Australian government or by the Australian government keeping a share of revenue from an existing revenue sharing arrangement. The revenue that the Australian Government kept should be commensurate with the amount of revenue it gave up from the personal income tax base.

Administrative arrangements

Key design elements of a tax base sharing arrangement are how much scope the states would have to change or influence the tax base and rate thresholds that applied in their State. As the personal income tax would continue to be centrally administered, the tax base should be uniform for all jurisdictions, and the Australian Government would maintain policy control over changes in the tax base. One option could be that changes in the tax base would have to be agreed by the states — similar to the way the GST currently operates. However, this could compromise the flexibility that the Australian Government needs to ensure that the tax base can remain coherent with changes in the economy and business practices. Further, as the Australian Government would still raise the majority of revenue from personal income tax, it should maintain policy control of the tax base, and the states can be assured that the Australian Government has the incentives that the tax base is managed appropriately.

In terms of setting the rate thresholds, as the Australian Government is the appropriate level for determining distributional policies, one approach is for the Australian Government to retain policy control of tax thresholds and the structure of the rate scale. While the structure of the personal income tax would be nationally uniform, the states could levy a flat rate surcharge on total income tax payable to the Australian Government (with the surcharge payable based on the individual's place of residence). For example, if an individual's liability for Australian Government personal income tax was $20,000, a state surcharge of 10 per cent would add $2,000 to the taxpayer's liability (which would be returned to the relevant state government).

[6] Carling, 2007 *A state income tax for Australia?*

Alternatively, the states could levy a tax rate (or rates) on the uniform tax base, potentially providing the states with more scope to change the structure of rates and thresholds. However, this could lead to a proliferation of marginal tax rate structures across the different states. Accordingly to ameliorate interaction with distributional policies and to limit complexity, it would be sensible under this approach to have some restrictions on the choices states had over rates and thresholds. A suitable approach may be the states being restricted to levying a flat rate of tax on income above the tax-free threshold.

If a personal income tax base sharing arrangement was desired, consideration would need to be given to how alternative approaches would impact on the complexity of the personal income tax structure and the administrative arrangements for returning revenue to the states. The personal income tax is also a key mechanism for the Australian Government to influence workforce participation. The rate that states could levy in addition to the Australian Government's personal income tax rates would need to be determined with careful consideration of participation objectives, particularly the relationship between the personal income tax and the transfer systems.

Source: *AFTS* pp. 669-687

A2.2. Property transfer duty

Recommendation 51

- Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system. Recognising the revenue needs of the states, the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad consumption or land bases. Increasing land tax at the same time as reducing stamp duty has the additional benefit of some offsetting impacts on asset prices.

(Source: AFTSR p. 263)

Key Points

- Stamp duties on the transfer of commercial and residential land and buildings are a significant, though volatile, source of state tax revenue. Stamp duties are poor taxes. As a tax on transferring land, they discourage land from changing hands to its most valuable use. Stamp duties are also an inequitable way of taxing land and improvements, as the tax falls on those who need to move.

- Stamp duties on conveyances are inconsistent with the needs of a modern tax system.

  Source: AFTS p. 247

- Reforms to stamp duties and land tax would reduce current impediments to housing supply generated by the tax system.

  Source: AFTS p. 409

Findings

- Existing state stamp duties on property conveyancing are highly inefficient, distorting both residential and business use of property.

- Stamp duty encourages people to stay in houses when they would prefer to move, contributing to longer commuting times, larger average home sizes and lower labour mobility.

- Stamp duty is also inequitable as people who move more regularly— such as those needing to change homes for work — pay more tax than those who do not. Stamp duties also directly reduce access to housing for people who are credit-constrained.

  Source: AFTS p. 257

Directions for Reform

- Ideally, there is no place for stamp duty in a modern Australian tax system. Stamp duties generate large efficiency costs, as they discourage turnover in property and tax improvements as well as land. The tax also imposes a higher burden on people who need to move, which is not equitable. The only positive feature of stamp duty — its relative simplicity — has long since ceased to justify its continued use in the face of the costs it imposes on Australian society (see Recommendation 51).

- While removing stamp duty would lead to more equitable and efficient outcomes, it would create a substantial hole in state revenues. This shortfall should be met though increased reliance on more efficient state taxes.

- The Australian government should consider facilitating a transition away from stamp duties, reflecting the national benefit of reforms to state taxes and the quality of the Australian government tax bases. Another option is to reduce stamp duties incrementally, including capping the maximum rate, possibly as part of an intergovernmental agreement.

- There is a case to link the reform of stamp duty to that of land tax to reduce the impact on prices and wealth caused by tax reform. Some of the reduction in stamp duty would lead to higher property prices, whereas increases in land tax would lead to lower land prices. The overall impact on property prices and investment is uncertain and depends on a range of policies affecting land use, but there is likely to be two effects of note. First, (depending in part on future policies affecting land use) property prices might increase because a more efficient tax system increases economic growth, some of which is captured in land rent — what was a "deadweight" loss from stamp duty is captured in higher economic returns to the land owner. Second, land is a complement to property investment, so moving to a zero tax rate on capital investment (as stamp duty rates reduce) would increase the demand for land. International empirical evidence on the impact on building activity from switching an improved property tax for land is inconclusive (Oates & Schwab 1997) or mildly positive (Plassman & Tideman 2000).

Source: AFTS p. 263-264

Box C2–3: The real-world effects of stamp duty

Making housing transactions more expensive means that people tend to move less (Van Ommeren & Van Leuvensteijn 2005; Van Ommeren 2008). This can have a range of efficiency and equity effects, including:

- People may commute more, creating greater road congestion (Larsen et al. 2008).
- People who want larger houses may choose to renovate, rather than move; or they may buy a larger house than they need in anticipation of eventually needing the space. This could lead to a housing stock that is larger than necessary, which may have environmental consequences.
- Making housing transactions more expensive may lead to higher unemployment, as people are less likely to move to get a job, and to lower productivity, as there is greater impediment to shifting to a better-paying job (Van Ommeren 2008).
- Some groups may have less access to the housing market since they need to save to pay the stamp duty.
- Stamp duties may discourage older Australians from moving to a smaller home and reduce the amount of equity withdrawn from a home if they do downsize (Wood et al. forthcoming).

A2.3. Land tax

Recommendation 52

- Given the efficiency benefits of a broad land tax, it should be levied on as broad a base as possible. In order to tax more valuable land at higher rates, consideration should be given to levying land tax using an increasing marginal rate schedule, with the lowest rate being zero, with thresholds determined by the per-square-metre value.

Recommendation 53

- In the long run, the land tax base should be broadened to eventually include all land. If this occurs, low-value land, such as most agricultural land, would not face a land tax liability where its value per-square-metre is below the lowest rate threshold.

Recommendation 54

- There are a number of incremental reforms that could potentially improve the operation of land tax, including:

– ensuring that land tax applies per land holding, not on an entity's total holding, in order to promote investment in land development;

– eliminating stamp duties on commercial and industrial properties in return for a broad land tax on those properties; and

– investigating various transitional arrangements necessary to achieve a broader land tax.

Source: *AFTS* p. 263

Recommendation 121:

- Over time, State land tax and local government rates should be more integrated. This could involve:

– moving to a joint billing arrangement so that taxpayers receive a single assessment, but are able to identify the separate State and local component; and

– using the same valuation method to calculate the base for local government rates and land tax (with this method being consistent across the State).

Source: *AFTS* p. 695

Key points

- Land has the potential to be an efficient tax base for the states capable of delivering significant and sustainable revenues. Land is an efficient tax base because it is immobile; unlike labour or capital, it cannot move to escape tax. This means that economic growth would be higher if governments raised more revenue from land and less revenue from other tax bases. However, this efficiency is harmed if there are significant exemptions from land tax that encourage people to change how they use land.

- Existing land taxes are narrow, which make them less efficient and fair than they could be. Levying higher taxes on larger holdings discourages investment in land by institutional investors in rental housing. Since owner-occupied housing is exempt, land tax on residential investment properties is probably passed through to renters as higher rents.

- Land tax needs to be reformed. Broadening the base of land tax would provide a reliable and stable source of revenue to State governments. Land tax rates should be based on the value of a given property, so that the tax does not discriminate between different owners or uses of land.

  Source: *AFTS* p. 247

- Over time, State land tax and local government rates should be more integrated. This could involve moving to a joint billing arrangement so that taxpayers receive a single assessment but are able to identify the separate State and local components. This could also mean that land tax and local government rates use the same valuation method to calculate the base (with this method being consistent across the State).

  Source: *AFTS* p. 689

Findings

- Several features of current land taxes, in particular their narrow base, make them less efficient and fair than they could be.

- By levying the tax at increasing rates on an entity's total holding, land tax discourages large-scale investment in land, particularly for rental housing.

- Because owner-occupied housing is exempt, the burden of land tax on residential investment properties is probably borne by renters through higher rents.

  Source: *AFTS* p. 262

Directions for reform

- The future Australian tax system should increasingly rely on land values as a tax base.

- Along with natural resources, land tax is the only major tax that can be levied directly on economic rent. Shifting taxes away from mobile bases toward an immobile base, increases efficiency and potentially leads to higher long-term economic growth. Further, as land values tend to be correlated with growth in the economy and population, land tax is well-suited to future demographic pressures.

- Current land taxes should be reformed to make them more efficient and equitable.

Reform the assessment mechanism

- Land tax should no longer be based on aggregate land holdings. As well as discouraging large-scale investment in the rental property market, this approach does not appropriately target the economic rent from land.

Broaden the base

- Land used for owner-occupied housing should not be exempt from the tax base. The current exemption is inequitable, as it is likely that it contributes to renters bearing some or all of the tax. Excluding owner-occupied land also reduces efficiency of the tax, by distorting land use.

- Broadening the tax base to include land used for owner-occupied housing would add significant revenue raising capacity to the tax base. This would improve the overall efficiency of the tax system, by reducing the reliance on alternative, less efficient taxes

Land used for primary production

- Uniform application of the marginal rate scale on a per-square-metre basis with a low minimum threshold is likely to result in no tax paid by most land likely to be used for primary production. However, as it is based on value, this would significantly reduce the administration and compliance burden of land tax compared to the current use-based exemption.

Land used for commercial and industrial use

- A large share of land tax is currently raised from land subject to commercial and industrial use. However, large thresholds may mean that the full incidence of land tax is not borne in lower property values and fall instead on those who use land for business. Taxes on business inputs are a particularly high-cost source of tax revenue. In combination with stamp duty, levying increasing rates on a base with large thresholds means that the taxes borne by businesses are likely to be variable and, in some case, high. This affects efficient land use, as well as increasing the complexity and uncertainty for business.

- A potential reform priority could be to remove the thresholds for land used for commercial and industrial purposes in return for rationalising the rate scale and for abolishing stamp duty on those properties.

Valuation methodology

- A redesigned land tax system could be simply administered by aligning local government rates with the land tax. Ideally, landowners should receive just one bill per year covering both and have a single point of contact for enquires, debt management and compliance. More significant simplification could be achieved if all local government rates had the same base as State land tax. This would reduce administration and compliance costs for individuals and businesses that pay rates across different councils in the same State and lower the cost of valuation, which is a significant part of the cost of collecting land tax and rates.

- To instil confidence in a system where greater revenue is raised from taxes on land values, greater investment in valuation and information collection methodologies would be warranted. This should include moving to a standard land or site value basis, using transparent and nationally consistent valuation methodologies and the updating of valuations on a consistently frequent basis to maintain alignment with movements in values.

Ensuring a smooth transition

- This Review is not the first to consider a shift in the tax mix from inefficient transaction taxes towards a broader land tax base (for example IPART 2008, Productivity Commission 2004, Harvey 2001). While this would deliver substantial long-term benefits to the Australian community, the transition is

clearly challenging. Transitional arrangements are important to build community acceptance and to minimise potential disruption (see Recommendation 54).

- Successful transitional arrangements are likely to have a number of key design features.
  - First, any special transitional arrangements to a broader land tax regime should be limited to existing owners. Land tax is borne by existing owners of land when the tax is introduced. Future owners who are required to remit land tax are effectively "compensated" by paying a lower price for the land. Future owners who remit tax payments only bear land tax on any unexpected capital growth in their land. Since this is associated with an unexpected windfall, there is no case for compensating future owners.
  - Second, the clearest need for a transition mechanism is for owner-occupied land. Existing owner-occupied landholders are likely to have bought their homes with the expectation that they would continue to be exempt from land tax. Additionally, a shift to land tax might generate perceptions of unfairness for people who purchased their property recently and paid stamp duty. Compared to longstanding holders of land, recent buyers would not have benefited from the land tax exemption and would face higher effective tax rates on their property over the time of ownership. Therefore, for new land taxpayers, transitional mechanisms may have to take into account the time at which properties were purchased. These concerns are ameliorated somewhat by the fact that reducing or abolishing stamp duty is likely to improve the property values of all owners.
  - Third, transitional mechanisms need to be designed to minimise harmful unintended consequences. If transitional arrangements exempted existing landholders from a tax until they sell, they would create lock-in effects that discourage sales. These should be minimised, recognising that lock-in caused by stamp duty is an important reason for removal of that tax. Further, during the time between announcement and introduction of a significant reform to taxation, there is the potential for significant market disruption. For example, if it were announced that land tax would replace stamp duty from a specific date in the future, people might defer the purchase of property pending the abolition of stamp duty.
  - Fourth, transitional arrangements that reduce tax burdens to facilitate reform also reduce revenue collections. These lower revenues mean that higher rates of tax must be applied to other tax bases or spending reduced. Some of the revenue cost could potentially be met by reductions in spending that may be less effective at improving housing affordability than tax reform. The overall revenue cost should be balanced, particularly where transitional arrangements over long time periods are concerned.

Source: *AFTS* pp. 262-268

Integration of council rates and land tax

- Unless there are genuine policy reasons for doing otherwise and these reasons provide greater benefits than the associated costs, land-based taxes should make use of the same valuation method as this is likely to reduce administration costs. Therefore, as State governments make more use of the land tax base over the long term (see Section C2 Land tax and conveyance stamp duty), there should be one valuation method across the State used to calculate the base for both rates and land tax (see Recommendation 121). That

is, land valuation would be the same for both taxes. However, local governments could continue to charge a fixed charge to ratepayers and there should not be a low land value threshold for local government rates, as even those who own land with a low per square metre value receive benefits from local government services.

- If land tax and council rates can be better integrated with landowners receiving one bill per year covering both, it may be possible to have a single point of contact for enquires, debt management and compliance of both taxes.
- Such a reform could see taxpayers receive one tax assessment notice for both taxes, with each tax rate and tax liability clearly identified. In some states this change would substantially alter some rate assessments — a long transitional arrangement may be appropriate in these cases.

Source: *AFTS* p. 695

Box C2–4: Different approaches to levying ongoing land value taxes

Methods of valuing land for tax purposes vary from State to State. There are subtle differences in base definitions of value in each State, but the following broad categories are indicative.

Measures of the value of land itself

Unimproved value, unimproved capital value, land value and site value are currently the bases on which land-only taxes are determined. Each of these bases is the value of the land without "improvements" (for example, buildings as well as, in some bases, draining, levelling or filling). Site and unimproved capital value are similar, as both include the value of merged improvements (such as draining) in their values, though do not include building values. All of these valuations are influenced by the effects of nearby infrastructure (such as access roads, schools and parks).

Measures of land and buildings

Capital value and capital improved value include the total market value of the land, including any buildings or other improvements.

Annual value, annual assessed value and gross rental value estimate the sum of all rental payments that are paid to the landlord in a year or would be if the property was rented. These measures give a similar tax result to capital improved value. However, they do not allow for the deduction of the costs a landlord would incur in maintaining the land.

Net annual value is also the rental value of the property but allows the deduction of landlord's costs, including land taxes and maintenance costs.

Source: *AFTS* p. 258

Box C2–5: Potential transition mechanisms for land used for owner-occupied housing

A simple option for facilitating the introduction of land tax on owner-occupied housing would be to levy the tax only on land that had been acquired after a given date, while continuing the exemption for all land held before that time. However, this complete grandfathering approach retains the lock-in effect of stamp duty for existing owners —

they would begin to pay land tax only if they move — and would also come at a significant revenue cost.

A more flexible way of managing the transition would be to give purchasers of owner-occupied housing a choice between paying stamp duty or paying land tax, while grandfathering existing landholders. Once a property became liable for land tax it would remain liable. Purchasers who intended to move again soon would probably choose to pay land tax while purchasers who intended to live in the house for many years would probably choose to pay stamp duty. This option would have advantages and disadvantages. It would give purchasers more options. Since home buyers could avoid paying stamp duty up-front, access to housing would be immediately improved. Existing concessions and exemptions from stamp duty could be retained. Where people opt to pay stamp duty, this would reduce the revenue shortfall from the transition to land tax. On the downside, the transition could be very protracted unless some end date were specified.

An alternative approach may involve providing a credit to be used against any future land tax liability. A credit could be based on previous stamp duty paid or on the land tax expected to be paid over a set period of ownership. A full credit could be provided to people who buy between the announcement and introduction of the tax, to prevent people deferring purchases to avoid the tax. The credit would offset their annual land tax liability until it was exhausted. A partial credit — possibly on a sliding scale based on years held — could be provided to people who had paid stamp duty in a specified period before the announcement. A sliding scale would reflect revenue considerations and the fact that the effective tax rate from stamp duty declines with length of holding period. Alternatively, a flat credit irrespective of the length of time owned or amount of previously paid stamp duty could be provided to all existing holders of land for owner-occupied housing. This approach would be simpler to administer and allow longer deferral of land tax liabilities for holders of lower value land. Compared to permanent grandfathering of existing landholders, the use of a credit scheme would bring owner-occupied housing into the tax base sooner and lead to smaller revenue shortfalls.

Finally, a phase-in arrangement could be adopted. For example, the level of stamp duty could annually step down by one-tenth of its current level and the level of land tax could step up by one-tenth of its ultimate level. Under this arrangement, for example, a house sold in the third year would pay 70 per cent of the full stamp duty on the transaction and 30 per cent of the assessed land tax each year for a specified period. This would result in some stamp duty collections occurring in the phase-in period, reducing the fiscal cost compared to complete grandfathering. Limiting the period over which discounted land tax applies, perhaps to 10 years, reflects the fact that the discount will have lock-in effects eventually. After this period, the percentage paid in land tax could gradually phase up to the full rate. Similarly, people who never transact could remain fully exempt for a period, say 15 years, with the tax then gradually phased in, in line with the time periods applied to others. This would provide a measured phase-in over a predictable period and would avoid sudden jumps in liability.

Source: *AFTS* p. 269

A2.4. Payroll tax

Recommendation 55

- Over time, a broad-based cash flow tax — applied on a destination basis — could be used to finance the abolition of other taxes, including payroll tax and inefficient State consumption taxes, such as insurance taxes. Such a tax would also provide a sustainable revenue base to finance future spending needs.

Source: *AFTS* p. 276

Recommendation 57

- State payroll taxes should eventually be replaced with revenue from more efficient broad-based taxes that capture the value-add of labour.

Source: *AFTS* p. 301

Key Points

Payroll tax

- Existing payroll taxes are more complex and less efficient than they could be because of tax-free thresholds and other exemptions.
- A broad-based consumption tax, such as a cash flow tax, would tax returns from labour and would provide additional revenue, providing scope to remove current payroll taxes.

Source: *AFTS* p. 293

A cash flow tax

- A simple cash flow tax (CFT) designed to tax private consumption as broadly as possible could be an important element of Australia's tax system into the 21st century.
- A CFT could tax the difference between an entity's cash outflows (purchases) and cash inflows (sales). Cash outflows related to labour remuneration would not be deductible. To ensure that the tax fell on consumption in Australia, exports would not be taxed, but imports would be. While financial flows (such as interest payments) would not be included in a simple CFT, they should be taxed through an equivalent tax on the domestic consumption of financial services.
- A broad-based CFT at a single rate could replace many other taxes on consumption, while significantly reducing tax compliance costs, particularly for small business. The CFT could also provide a sustainable source of revenue to fund government services, while significantly reducing tax-induced biases to consumption choices.

Source: *AFTS* p. 279

Findings

- Exemptions in the payroll tax base introduce biases into the allocation of labour across the economy and lead to complexity in administration and compliance, particularly when the exemptions differ (even slightly) between states.

- Some states have broadened their payroll tax base by limiting growth in the payroll tax threshold, while other states have narrowed their base by rapidly increasing the threshold.

Source: *AFTS* p. 297

Principles

- In the long run, the burden of a stable labour income tax, such as payroll tax, is likely to fall on workers rather than on capital.
- In the short run, however, an unexpected increase (decrease) in the payroll tax burden might be borne partly by the owners of capital through lower (higher) returns.
- The burden of a relatively narrow-based labour income tax, such as the current State payroll taxes, is likely to be shared between workers in the taxed and non-taxed sectors. This also means that some workers are not working in their most productive jobs, with the result that overall labour force productivity is reduced.

Source: *AFTS* p. 300–301

Directions for reform

- Recent reforms of indirect taxes in Australia have seen the GST replace a number of inefficient indirect taxes, such as the wholesale sales tax, financial institutions duty, debits tax and a range of stamp duties. Australia also has a pre-paid consumption tax levied on a narrow base (payroll tax) as well as a number of narrow-based taxes on particular products (such as insurance duties). Many of the indirect taxes levied by the states apply both to businesses and consumers (such as stamp duty on motor vehicles and insurance).
- It would be possible to replace the current narrow state taxes base with a low, single-rate, broad tax on the difference between inflows and outflows of cash (excluding wages; that is, the value-add of labour would be taxed) of businesses. In large part this could simply be added to existing tax reporting obligations of businesses. By exempting business export sales, this tax would apply to the consumption base. By using existing tax reporting mechanisms, a new cash flow tax could more readily be based on the automated systems increasingly used by businesses.
- A cash flow tax (see Section D1 A cash flow tax) that applies a single rate of tax to the net cash flow position of an entity would perhaps be the simplest possible utilisation of the consumption base, as it does not distinguish between different goods and services, or between different types of taxpayers. Such a cash flow tax could have very low administration and compliance costs if it utilised existing GST systems, such as the business activity statement. One concern is that the cash flow tax does not have the integrity due to the self-enforcement incentives of the invoice-credit method GST (see Section D2 The Goods and Services Tax).
- The introduction of a tax on cash flows would be a significant change to Australia's tax system requiring additional analysis and community consultation.

Source: *AFTS* p. 276–277

A2.5. Insurance duty

Recommendation 79

- All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption.

Source: *AFTS* p. 474

Key Points

- Insurance allows people to manage their risk and provides them with the flexibility to exploit economic opportunities. Australia has high taxes on insurance, both in comparison to the taxes imposed on other products and industries, as well as compared to other countries. Imposing specific taxes on insurance adds to the cost of insurance premiums and can lead to under-insurance or non-insurance. Specific insurance taxes should be abolished.
- Taxes with narrow bases that raise small amounts of revenue are usually inefficient unless they effectively correct for a failure in a particular market or unless they function as charges for particular goods and services.

Source: *AFTS* p. 469

Findings

- Australia has high taxes on insurance, both in comparison to other countries and to the way that other products and industries are taxed. Specific taxes on insurance add to the cost of insurance premiums and can lead to under-insurance or non-insurance.
- Low-income earners are more likely than high-income earners to abandon insurance in response to higher premiums. The result is that they bear more risk themselves, although they are less well-placed to do so than people with higher incomes.

Source: *AFTS* p. 474

Directions for Reform

- There is little justification for levying specific taxes on insurance products. Rather than correcting a market failure, insurance taxes can add to existing problems in the insurance market. The revenue from insurance taxes should be replaced by revenue from a more efficient and equitable tax.
- If governments wish to provide incentives for people to consider the fire risks when deciding where to live, other mechanisms — such as a risk adjusted charge on property — may be more appropriate. However, it is not necessary that these charges should be set to exactly match the costs of providing fire services. In fact, it may be undesirable particularly where the cost of providing fire services varies significantly from year to year.

Source: *AFTS* pp. 474-475

A2.6. Gambling taxes

Recommendation 76

- Gambling taxes should be reviewed to ensure that they are focused on recouping economic rent generated by government restrictions on the supply of gambling services or are being used efficiently to impose such restrictions.

Recommendation 77

- Governments should eliminate gambling tax concessions for particular types of gambling business, such as clubs. If governments wish to subsidise particular types of businesses, they should do so through direct expenditures.

Recommendation 78

- Governments should consider the allocation of responsibilities for the regulation and taxation of gambling, with a view to minimising conflicts in policy-making between revenue-raising and addressing problem gambling

Source: *AFTS* p. 463

Key Points

- Government restrictions on the supply of gambling services, implemented through licensing arrangements, mean that some gambling businesses earn economic rent. Economic rent is an efficient tax base and should be appropriated by the government, either through licence fees or taxation.
- For the large majority of gamblers, gambling is simply consumption spending, comparable to spending on any other leisure activity. A small minority of gamblers experience self-control problems that lead to excessive losses. Problem gamblers impose costs on themselves and others.
- It is not clear how problem gamblers react to higher taxes. In some forms of gambling, the price of gambling is not easily observable. Even if problem gamblers do observe changes in price, it is not clear that they respond by reducing the amount they lose. Gambling taxes that more than recoup economic rent earned by gambling businesses do, however, impose costs on responsible gamblers, who must pay higher prices for their entertainment.
- Gambling taxes constitute an important revenue source for State governments. This means that they may have to make difficult choices in balancing revenue-raising with regulating gambling in a way that limits problem gambling. For this reason, the Australian government and State governments should together explore options for the regulation and taxation of gambling that would minimise conflicts in policy-making between revenue raising and addressing problem gambling.
- The current tax burden on the gambling industry as a whole may be appropriate, but the way it is distributed across the industry may not be. The current rates of tax on different forms of gambling differ markedly from form to form though the reasons for these variations are not clear.
- Gambling taxes should be focused on recouping economic rent generated by government restrictions on the supply of gambling services. If State

governments retain gambling taxes, they should increase the focus on capturing rent.

- Some gambling taxes and fees are used to provide common services to the industry — for example, some revenue from horse racing is used to support the racing industry

Source: *AFTS* p. 457

Findings

- Gambling taxes constitute an important revenue source for State governments. Online gambling, however, may break down market power in some sectors of the gambling industry and reduce the states' capacity to tax economic rent. Competition between states may also limit their capacity to raise revenue from gambling.
- The current tax burden on the gambling industry as a whole may be appropriate, but the way it is distributed may not be. The current rates of tax on different forms of gambling differ markedly from form to form for reasons that are not entirely clear. The burden of gambling taxes may sometimes fall on economic rent, but sometimes on gamblers and gambling businesses. There are also biases in the way different race wagering is taxed, which damages competition.
- It is not clear how problem gamblers react to higher taxes. In most forms of gambling, the price of gambling is not easily observable. Even if problem gamblers do observe changes in price, it is not clear that they respond by reducing the amount they lose. Higher gambling taxes do, however, harm responsible gamblers, who must pay higher prices for their entertainment.

Source: *AFTS* p. 460

Directions for Reform

Recouping economic rent created by government restrictions

Gambling businesses are able to earn economic rent only because State governments restrict the supply of gambling services. Capturing economic rent is the most compelling reason for imposing special taxes on gambling services (See Recommendation 76).

One option for capturing economic rent that State governments could consider is a simple rent tax calculated on the basis that, for most gambling businesses, the amount invested in the business is closely related to the amount provided to gamblers as prizes. Any return to the business above a normal rate of return on the amount of prizes would be regarded as economic rent and taxed at a relatively high rate.

A tax based on the amount of prizes would, however, be a very rough approximation to a rent tax. A normal profit for a business arises when its sales just meet the full costs of its inputs; that is, wages plus a normal return on the capital invested in the business (taking into account how risky the business is). A business earns economic rent when its sales exceed the full costs of its inputs. In a gambling business, player loss is the gross revenue of the business, equivalent to gross sales for other businesses.

The allowance for capital could be calculated for each tax paying business individually (at the cost of additional complexity) or could be set at an average value for each form of gambling, on the assumption that cost structures are similar across any particular

industry segment. It would also be necessary to consider what, if any, allowance for licence fees should be included in the measure of capital invested.

The effectiveness of gambling-specific taxes in capturing economic rent is affected by the way they are structured. Governments need to consider trade-offs between the accuracy of the tax in targeting economic rent and the compliance costs that it could impose on gambling businesses. Most gambling businesses already calculate the amount bet and the amount paid in prizes for GST purposes, but an allowance for capital would require capital investment to be allocated between gambling and other activities. Some non-profit organisations are not currently required to lodge a Business Activity Statement for GST purposes, so some additional compliance costs might arise in that quarter. It would also be necessary to consider how a gambling rent tax would interact with income tax and the GST, including the priority of debts incurred under the different taxes.

In theory, all economic rent accruing to the gambling business could be taken in tax without reducing the supply of gambling services, but in practice uncertainties in estimating the magnitude of the available rent suggest that a lower tax rate should be adopted.

A simpler step to reduce the efficiency costs of gambling taxation would be to abolish gambling taxes on gambling businesses that operate in competitive markets.

Raising revenue

Gambling taxes are well-established and constitute an important source of revenue for State governments. While existing gambling taxes have deficiencies, many other State taxes perform even more poorly when assessed against the criteria of efficiency, equity, simplicity, sustainability and policy consistency. State governments may therefore be reluctant to give up this own-source revenue stream.

Rent-based gambling taxes have little effect on equity

Spending on gambling is not proportionally spread across the income distribution — low income people spend a higher proportion of their income — 1.4 per cent — on gambling than high income people — 0.3 per cent[7]. Accordingly, gambling taxes appear to be regressive overall, falling as a proportion of income as incomes rise (Smith 1998). However, some gambling taxes represent a transfer of economic rent from the gambling business to the government. In these cases, a marginal change in gambling taxes would not change the supply of gambling services or the prices that gamblers pay to gamble. Reducing taxes would simply increase the profits of the gambling business.

Spending on particular forms of gambling is less evenly distributed than spending on gambling as a whole. For example, participation in casino gaming and sports wagering is strongly biased towards young single men. Lotteries and gaming machines are disproportionately patronised by low income people. Thus where the burden of the tax is borne by gamblers, taxes on lotteries and gaming machines are the most regressive; taxes on wagering are also regressive, though there is significant variability among income groups; and casino taxes are neither regressive nor progressive[8].

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[7] Australian Bureau of Statistics, 2006 *Household expenditure survey*

[8] Productivity Commission, 1999 *Australia's gambling industries*

Taxes on specific goods and services should not generally be used for redistributive purposes. Even without appealing to this general principle, gambling expenditure is too evenly spread across the income distribution to make reductions in gambling taxes an effective tool for redistributing income.

Tax concessions are a poor way of subsidising clubs

The rationales for imposing specific gambling taxes apply to clubs just as much as they do to other gambling businesses. If governments wish to subsidise clubs for reasons of social policy they should do so through direct expenditures, not through gambling tax expenditures (see Recommendation 77). Direct funding would be much more transparent than the current practice of providing tax concessions for gambling in clubs, and it would relieve clubs of the incentives set up by the current link between concessional gambling tax rates and the delivery of community services.

State and federal governments should together develop policy for regulating and taxing gambling

Given that economic rent in the gambling industry can be created by local restrictions, gambling taxes would appear to be a matter for State governments. However, if they have few other viable revenue sources, reliance on gambling taxes may set up incentives for State governments to manage the supply of gambling services so as to maximise the available revenue. Given that problem gamblers account for around one third of all player losses[9], taxes on gambling by problem gamblers account for around 3 per cent of total State tax revenue. Incentives to reduce the social costs of problem gambling may be diluted by unwillingness to forfeit the tax revenue derived from problem gamblers.

For this reason, the State and Australian governments should together explore options for the regulation and taxation of gambling that would minimise conflicts in policy-making between revenue-raising and addressing problem gambling (see Recommendation 78). Such policy discussions cannot be undertaken outside a broader consideration of federal financial arrangements.

Source: *AFTS* p. 464 - 467

[9] Productivity Commission, 1999 *Australia's gambling industries*

A2.7. Road transport taxes

Recommendation 63

- States should improve compulsory third party insurance to better reflect individual risks.

Source: *AFTS* p 377

Recommendation 64

- On routes where road freight is in direct competition with rail that is required to recover its capital costs, heavy vehicles should face an additional charge on a comparable basis, where this improves the efficient allocation of freight between transport modes.

Source: *AFTS* p 377

Recommendation 65

- Revenue from fuel tax imposed for general government purposes should be replaced over time with revenue from more efficient broad-based taxes. If a decision were made to recover costs of roads from road users through fuel tax, it should be linked to the cost of efficiently financing the road network, less costs that can be charged directly to road users or collected through a network access charge. Fuel tax should apply to all fuels used in road transport on the basis of energy content, and be indexed to the CPI. Heavy vehicles should be exempt from fuel tax and the network access component of registration fees if full replacement charges are introduced.

Source: *AFTS* p 392

Recommendation 66

- The revenue-raising component of State taxes on motor vehicle ownership and use should be made explicit, and over time only be used to recover those costs related to road provision. The administrative costs of providing government services should be recovered through user charges where applicable. Quantity limits on taxi licences should be phased out.

Source: *AFTS* p 392

Recommendation 67

- Governments should continue to reform road infrastructure provision, applying economic assessment to investments comparable to that for other forms of infrastructure.

Source: *AFTS* p 401

Key points

- Current road tax arrangements will not meet Australia's future transport challenges. Poorly functioning road networks harm the amenity, sustainability, liveability and productivity of society. Moving from indiscriminate taxes to efficient prices would allow Australia to leverage the value of its existing transport infrastructure. Less congested roads, shorter travel times and investment in road infrastructure that addresses user demand would provide a

foundation for further productivity growth, improved living standards and more sustainable cities.

- In major cities, location-specific congestion charges would vary according to the time of day. City roads would be less congested during peak periods, with higher travel speeds and shorter travel times saving time for road users, reducing vehicle costs and reducing greenhouse emissions. The revenue from congestion charges on existing roads should flow back to the community, initially to finance public transport in affected areas.

- Heavy vehicle charging would ensure that individual trucking operators pay their own specific costs and no longer cross-subsidise other operators. Truck operators would have incentives to avoid route choices and vehicle configurations that cause the highest costs, but would have access to roads and bridges where and when they are willing to pay. Revenue from road-wear charges would directly fund road maintenance.

- Negative spillovers not currently amenable to pricing would be addressed through regulations. The transport sector would pay for greenhouse emissions through an economy-wide scheme, not through ad hoc sector-specific taxes.

- In exchange for targeted charges, road users would pay less tax, including less fuel tax. Motor vehicle stamp duties would be abolished, compulsory third party insurance would be fairly priced, and taxi licence quantity restrictions that push up taxi fares would be removed.

- The revenue from efficient charges could help finance new urban transport infrastructure, and cover the cost of heavy vehicle damage. But these charges would not pay for the full cost of providing and operating the road network. The remaining costs could be funded from general tax revenue, or by retaining a network access charge (such as annual vehicle registration) or a variable charge (such as fuel tax) set to recover the efficient costs of road provision. Important non-economic community objectives would still be funded from general revenue through well-defined community service obligations.

- Spending on roads should match anticipated need. This should be determined strategically according to comprehensive and transparent benefit-cost analysis. This would help ensure new roads are built where needed, and roads are maintained to minimise total life-cycle costs, including costs to road users. Road users with specific needs could enter commercial agreements with road suppliers.

- Existing institutions have not led to the most efficient use and supply of roads. Prices are essential to making the best use of roads, but they must be coupled with improved governance that better serves the needs of road users, now and in the future. New investment based on economic criteria, and accountability for investment decisions would help ensure that roads are in place to address future needs.

- The challenge is formidable. It requires coordination across all levels of government. But reform would promote the best investment in and use of our roads, lift national productivity, and improve the lives of millions of Australians.

Source: *AFTS* p 373-374

Findings

- The existing structure of fuel tax, annual registration and other road-related taxes is designed primarily to raise revenue. These taxes more than cover the direct costs of providing road infrastructure, but are not capable of providing specific prices that vary according to location or time of use.

  Source: *AFTS* p 376

- Traffic congestion is concentrated in Australia's largest cities. Under a "business as usual" scenario, the avoidable costs of congestion may grow to around $20 billion in 2020. These costs are concentrated in specific locations, with levels of congestion varying throughout the day.

- Most other roads are uncongested virtually all the time, and many urban roads are uncongested at night. Vehicles on these roads impose negligible congestion costs.

  Source: *AFTS* p. 380

- In principle, greenhouse gas emissions are best dealt with through an economy-wide tool, such as the proposed Carbon Pollution Reduction Scheme.

  Source: *AFTS* p. 389

- The spillover costs of noise and air quality are locally concentrated and difficult to measure and value. Where these costs are closely related to congestion, they might be priced into congestion charges. Otherwise, they could be addressed, at least in part, through appropriate regulations.

  Source: *AFTS* p. 389

- Compulsory third party insurance premiums are not charged on the basis of individual risk or driving behaviour.

  Source: *AFTS* p. 390

- In Australia, different transport modes tend to complement each other rather than compete. However, on specific routes there is significant competition for freight between road and rail. Where access to rail is priced above its short-run marginal cost for cost recovery purposes, competition with road freight priced at marginal cost might lead to an inefficient allocation of freight between road and rail.

  Source: *AFTS* p. 391

- The road system as a whole has historically been excludable on the basis of motor vehicle registration requirements. In the future, specific roads or road systems may also be excludable using new technology.

- Charges designed only to encourage the most economically efficient use of roads would not recover their full costs. If governments intend to recover the cost of building, operating and maintaining roads from road users, it would be necessary to impose a combination of additional fixed or variable charges above short-run marginal cost. The efficiency costs of specific cost recovery taxes or charges should be weighed against the efficiency cost of raising revenue from general taxation.

  Source: *AFTS* p. 395

- There are arguments for and against recovering the total costs of the road system from road users. The social opportunity cost of the existing network is in general not subject to charging. Existing users could be charged explicitly for operating and maintenance costs, and for network improvement and expansion. The efficiency loss from raising the required revenue from income or other taxes must be compared with the efficiency loss from the most efficient, practical system of access and variable charges. The full information required to make all these assessments is not presently available.

  Source: *AFTS* p.397

- Stamp duty on the transfer of motor vehicles is a highly inefficient revenue source.

  Source: *AFTS* p.400

- Quantity restrictions on taxi licences are an implicit tax on taxi users, from which additional revenue flows to existing taxi plate holders and State governments.

  Source: *AFTS* p.401

- Provided charges reflect short-run marginal costs and are responsive to changing conditions, they can provide signals and data to assist planning for future investment. However, private commercial investment criteria are not suitable for infrastructure, as many economically beneficial roads would not be financially viable under the current framework. Economic analysis is indispensible to guiding investment and maintenance decisions. Strategic planning is essential for identifying investment projects to examine in more detail and for taking into account the network effects of investment decisions.

  Source: *AFTS* p.402

Principles

- Transport-specific taxes should only be imposed where they improve the way that people, businesses and governments make decisions. In general, this means that transport taxes should be designed to correct market failures in the transport sector — specifically, to ensure that users of transport make decisions based on the full costs of their activities on the community (including unpriced costs that spill over to others and the cost of consuming infrastructure).

  Source: *AFTS* p. 375

- Taxes or charges to improve efficient use of infrastructure should be imposed only where the benefits of improved resource allocation outweigh the additional administration and compliance costs. Compliance regimes should be designed to ensure that implementation and transaction costs are not disproportionate to the benefits.

  Source: *AFTS* p. 379

- Road investment and maintenance decisions that are taken for reasons of social policy, and are shown by cost–benefit analysis to be uneconomic, should be transparently identified as community service obligations and funded from general tax revenue.

  Source: *AFTS* p. 396

- Investment in major projects should be determined by transparent, well-informed analysis of costs and benefits. Investment in pavement durability and maintenance decisions should be made with the goal of minimising overall costs to society (that is, taking into account both the costs of maintenance and the costs to the road user).

Source: *AFTS* p. 403

A2.8. Taxes to improve the environment

Recommendation 58

- Once the Carbon Pollution Reduction Scheme (CPRS) is operational, additional measures which seek to reduce emissions (in sectors covered by the CPRS), and which are not justified on other grounds, should be phased out.

Recommendation 60

- The government should continue to monitor tax concessions aimed at supporting environmental outcomes, and consider replacing them with targeted spending programs where this would be a more effective and efficient method of achieving the appropriate environmental outcome.

Source: *AFTS* Part 2, E2-3 p 360

Key Points

- The quality of the environment is critical to the wellbeing of Australians, not least because it underpins our standard of living. This is particularly important since past and present generations of Australians, often guided or directed by government policies, have been degrading their water, land and air, losing many native species and contributing to global climate change.

- Many market activities damage the environment, but this damage is often not reflected in the market price of the goods or services these activities produce. These “spillover” costs are one form of market failure. Government intervention, may provide an effective mechanism for protecting the environment or for making people pay for the damage they do to the environment.

- Environmental taxes are among a range of options open to governments to address these spillover effects. Taxes can help deal with these problems by changing prices in a way that encourages people to reduce their contribution to pollution or to reduce their use of a natural resource. Where such corrective taxes are effective, they can be highly efficient — delivering greater environmental benefits for a given cost to the community than other forms of intervention.

- However, taxes of this type can be difficult to design and implement. In some cases, regulation or other market-based instruments may be superior.

- Once introduced, the Carbon Pollution Reduction Scheme (CPRS) will be the largest environmental policy intervention in Australia. Market-based mechanisms such as the CPRS are the most cost-effective way to reduce Australia's carbon emissions. The efficiency of the CPRS should be monitored, and opportunities taken to improve it, such as by recycling the permit revenue to reduce other taxes (where appropriate), removing supplementary measures, phasing out concessions such as free permits and broadening the scheme's application (as this becomes possible).

  Source: *AFTS* p 343

Principles

- Environmental taxes (or emissions trading schemes) should:
  - be used to address environmental objectives, rather than raise revenue;
  - have their revenue recycled to reduce the associated tax (and transfer) distortions,
  - should governments wish to avoid increasing the aggregate burden of tax; and
  - be integrated with existing taxes and transfers.
- An environmental tax is more likely to be appropriate in situations where:
  - environmental damage due to economic activity is relatively constant (so that a constant per-unit tax reflects the cost);
  - the factors causing the environmental damage are measurable/verifiable by both the tax authorities and the agent causing the damage, or there is an input or output proxy that is closely correlated with the damage being targeted;
  - the only cost-effective way the taxpayer can reduce their tax liability is to reduce the activity causing the damage (rather than, say, simply dumping waste illegally); and
  - other instruments (such as spending and regulation) have been considered and found to be more costly.

  Source: *AFTS* p 353
- There is no general case for hypothecating (that is, earmarking) environmental tax revenues to environmental spending programs. However, hypothecated user charges (as opposed to taxes) that reflect the true cost of providing a good or service can be an efficient means of funding environmental programs.

  Source: *AFTS* p 356
- In general, a single policy instrument should be used to target a single objective.
- Multiple instruments should be considered only where one instrument is not capable of achieving the desired objective, and where the instruments are complementary in nature.

  Source: *AFTS* p 356
- Since tax concessions with environmental objectives tend to lack transparency, be poorly targeted, impose costs on all the community rather than just polluters and reduce the efficiency of the taxation system, other more effective mechanisms should generally be preferred.
- The environmental impact of any other tax concession should be evaluated before it is introduced. Existing concessions should also be evaluated for their environmental consequences.

  Source: *AFTS* p 357

A2.9. Exemptions, concessions and rebates

Recommendation 41

- Consistent with the recommendations of previous inquiries, a national charities commission should be established to monitor, regulate and provide advice to all not-for-profit (NFP) organisations (including private ancillary funds). The charities commission should be tasked with streamlining the NFP tax concessions (including the application process for gift deductibility), and modernising and codifying the definition of a charity.

Recommendation 135

- The Australian government should ensure that the rules governing the development of the Budget encourage trade-offs between tax expenditures and spending programs. Budget decision-making processes should measure and treat tax expenditures and spending programs symmetrically, to ensure that there is no artificial incentive to deliver programs through one mechanism rather than another.

Recommendation 136

- The government should introduce legislation to amend the *Charter of Budget Honesty Act 1998* to recognise the publication of detailed information about tax expenditures in a Tax Expenditures Statement separate from the Mid-Year Economic and Fiscal Outlook (MYEFO). However, the Tax Expenditures Statement should continue to be released by the end of January in each year, or within six months of the last Budget, whichever is later.

Recommendation 137

- The government should ensure that reporting standards are independently developed for the identification and measurement of tax expenditures in the Tax Expenditures Statement. In addition, the standards should establish a basis for reporting the broader economic and distributional effects of tax expenditures in the periodic Tax and Transfer Analysis Statement.

Recommendation 138

- The Council of Australian Governments should examine the ways in which the states could uniformly report tax expenditures annually according to the independent standards developed under Recommendation 137.

Other recommendations

- In addition to the above, the *Australia's Future Tax System Report* made recommendations regarding specific Australian Government tax concessions. Although not directly relevant to state tax concessions, the recommendations were made to address particular concerns and these concerns may have general application. The recommendations are briefly described below – see the *AFTS*R for details:

– NFPs should be permitted to apply income tax concessions to their commercial activities (Recommendation 42); and

– FBT concessions should be replaced with direct government funding (to address concerns of competitive neutrality) (Recommendation 43).

Source: *AFTS* pp. 211, 729

Key points

- Not-for-profit organisations make a highly valued contribution to community wellbeing and receive government and community support for their activities.
- Much of the support provided to the NFP sector comes from tax concessions. This system of tax concessions is complex, and does not fully reflect current community values about the merit and social worth of the activities it subsidises.
- NFP organisations face inconsistent state and federal regulation, which may deter them from undertaking legitimate fundraising activities and may undermine public confidence in the sector.
- The High Court of Australia's 2008 decision in the Word Investments case has significantly increased the scope for NFP organisations to undertake commercial activities.
- The income tax and GST concessions generally do not appear to violate the principle of competitive neutrality where NFP organisations operate in commercial markets. However, the fringe benefit tax concessions provide recipient organisations with a competitive advantage in labour markets.
- These issues could be addressed through the establishment of a national charities commission to monitor, regulate and provide advice to all NFP organisations.
- Monitoring the tax and transfer system is essential to its long-term performance. Without government action, too little information will be collected about the operation of the system. This information is necessary to identify areas where particular transfers or taxes are not meeting their policy objectives. It can support research that improves understanding of the effects of the system, and guide policy responses to emerging problems.
- High standards of transparency and accountability should apply to all forms of taxation, transfers and government expenditure. However, despite their similarities, tax expenditures and spending programs are not created, maintained, reviewed or reported in the same way. This means that there is often less transparency and accountability in the use of tax expenditures. While this situation continues, programs should not be delivered as tax expenditures unless there is a clear countervailing benefit in terms of efficiency, equity, complexity, sustainability and policy consistency.

Source: *AFTS* pp. 205,719

Principles

- The tax concessions available to NFP organisations are complex and do not fully reflect community preferences.
- The regulatory framework for NFP organisations is inconsistent and opaque.
- Tax concessions for NFP organisations should be simple and transparent, reflect community needs and values, and encourage activities that provide broad public benefits. They should not undermine competitive neutrality where NFP organisations operate in commercial markets.

- The NFP income tax concessions do not generally violate the principle of competitive neutrality where NFP organisations operate in commercial markets.

- Where NFP clubs operate large trading activities in the fields of gaming, catering, entertainment and hospitality, the rationale for exempting receipts from these activities from income tax on the basis of a direct connection with members is weakened.

- The NFP GST concessions do not violate the principle of competitive neutrality where NFP organisations operate in commercial markets.

- The NFP FBT concessions provide recipient organisations with a competitive advantage in labour markets, by enabling them to pay the market wage at a lower cost.

- Tax expenditures should ideally be subject to the same levels of transparency and accountability as equivalent spending programs. Without such transparency and accountability, programs should not be delivered as tax expenditures, unless there is a clear countervailing benefit in terms of efficiency, equity, complexity, sustainability and policy consistency.

- While tax expenditures and direct spending programs are conceptually similar they are often designed in quite different ways. The design constraints on tax expenditures can significantly affect their efficiency, equity, complexity, sustainability and policy consistency.

- Determining whether the benefits of tax expenditures justify their costs depends on effective monitoring and scrutiny. Tax expenditures are currently subject to less comprehensive management and reporting than spending programs. This hampers the effective supervision of individual tax expenditures and means that, in many cases, it is not possible to work out whether objectives are being achieved.

  Source: *AFTS* pp.206, 208-211, 725, 728

Directions for reform

Establish a national charities commission

- Over the past two decades, the NFP sector has been the focus of a large number of reviews, which have consistently recommended the establishment of an independent national charities commission to address the complexity of the tax and regulatory arrangements for the NFP sector.

- The Review supports this recommendation. A national charities commission should be established to monitor, regulate and provide advice to all NFP organisations (including prescribed private funds). The commission should be tasked with streamlining the NFP tax concessions, and modernising and codifying the definition of a charity.

- In addition to reducing complexity and compliance costs for NFP organisations, the commission would facilitate the collection of comprehensive data on the sector. The data collected could be used to target government support for the sector better, and would help individual donors make more informed choices about their giving.

Permit NFP organisations to undertake commercial activities

- NFP organisations should have scope to conduct commercial activities freely. This approach would reduce costs associated with education, assistance, advice, disputes and litigation on the ATO's interpretation of a "charitable purpose", and would reflect the principles of the High Court of Australia's Word Investments decision.

Encouraging trade-offs between tax expenditures and spending programs

- Under the Budget process, tax expenditures are settled after spending measures. The two are not usually examined together. This means that tax expenditures are not directly compared with other policy priorities and new spending proposals. There are no formal processes to ensure that tax expenditures are prioritised against other spending or to assess the efficiency of a tax expenditure in achieving outcomes. This increases the risk that tax expenditures are not properly coordinated with spending programs in the same policy area.

- A more symmetrical treatment of tax expenditures and spending programs as part of the Budget process would encourage trade-offs between them and would help to ensure that policy objectives are pursued at least cost (see Recommendation 135). To do this, however, requires that expenditures and tax expenditures are measured on a consistent basis.

Reporting tax expenditures more effectively

- In contrast to direct government spending, which is generally scrutinised during the annual Budget process, tax expenditures often receive attention only at the time they are introduced. Systematic reporting of tax expenditures is therefore necessary to ensure they receive a similar degree of scrutiny as direct expenditures. This also makes it easier to compare tax expenditures and direct expenditures.

- A better means for managing tax expenditures is by ensuring they are examined in the same way as spending programs in the Budget process. Detailed estimates of tax expenditures need to be prepared far enough ahead of the Budget to allow them to inform government decisions.

Identifying tax expenditures

- In order to identify a tax expenditure, the tax treatment that would normally apply (the benchmark) needs to be identified.

- Not all concessional elements of the tax system are classified as tax expenditures. This is because some concessions are considered to be structural elements of the tax system and are incorporated in the benchmark. For example, the personal income tax system includes a progressive marginal tax rate scale, which results in individuals on lower incomes paying a lower marginal rate of income tax than those on higher incomes. This arrangement is a structural design feature of the Australian tax system and is therefore not identified as a tax expenditure. There may be different views on which structural elements to include in the benchmark. These benchmarks can vary over time and can sometimes be perceived as arbitrary.

- The purpose of reporting tax expenditures is so the community can understand how the tax system affects the economy and society more broadly. Benchmarks should allow an objective evaluation of the effects of government policy, rather than represent that policy. For example, if a tax concession is set

up to assist a particular industry the benchmark should not incorporate this objective, but should provide a basis for identifying and valuing the concession. This allows the community to judge whether this form of assistance is appropriate.

- Currently, many of the most important economic and distributional effects of taxes are incorporated in the benchmarks and so are not reported in the Tax Expenditures Statement. As noted above, a separate and broader Tax and Transfer Analysis Statement could include this kind of information about structural tax features. Even if this information is not reported annually in the Tax Expenditures Statement, the benchmark should be defined according to transparent and independently established standards.

Measuring tax expenditures

- Unlike direct spending by the government, tax expenditures represent the notional cost to government of not collecting revenue that would otherwise be collected. These notional costs can be difficult to estimate, and the estimates can sometimes be misinterpreted as the amount of revenue that could be raised if the tax expenditures were abolished. For these reasons, tax expenditure estimates need to be treated with some caution.

- **The revenue forgone approach** calculates the benefit of a tax expenditure to taxpayers, rather than the budgetary cost of the expenditure. Estimates calculated by the revenue forgone approach identify the financial benefit to taxpayers of receiving a tax expenditure relative to taxpayers that do not. It does not necessarily follow that there would be an equivalent increase to government revenue from abolishing the tax expenditure. This is largely because of changes in taxpayer behaviour that removing the tax expenditure would cause (for example, removing one concession may result in increased use of others).

- **The "revenue gain" approach** has sometimes been proposed as an alternative to the revenue forgone approach in order to produce tax expenditure estimates that are more comparable to budget revenue estimates (ANAO 2008). This would directly measure how much revenue would increase if a concession were removed. It involves making assumptions about the way taxpayers would respond to policy changes. It also requires assumptions about the order in which tax expenditures are removed. The revenue gain approach does not necessarily reflect the value of the concession to taxpayers. For instance, where an activity is highly sensitive to a concession, the increase in revenue from removing the tax expenditure could be very small. In these cases, revenue gain estimates give the impression that the tax expenditure has little impact, when in reality the recipients derive significant benefits. However, the revenue gain approach is useful when reviewing a tax expenditure since it indicates the revenue that could be realised for government if the expenditure were abolished. Revenue gain estimates for significant tax expenditures should continue to be published in the Tax Expenditures Statement.

- **The "outlay equivalence" approach** estimates how much direct expenditure would be needed to provide a benefit to a recipient — assuming the payment is subject to the usual tax treatment for that type of income — that is equivalent to the tax expenditure. The outlay equivalence method has the advantage of estimating tax expenditures on the same basis as spending programs, which may allow a better assessment of their comparative merits. Outlay equivalence

estimates are likely to be most useful when policy-makers are considering whether to deliver a program as a tax expenditure or a spending program.

Reporting State tax expenditures

- In order to give a comprehensive sense of the level of government assistance provided through the entire tax system, tax expenditures need to be measured for all taxes. The Australian government currently reports tax expenditures across its main taxes. However, there is no comprehensive or consistent reporting of tax expenditures by the states. In particular, the benchmarks used by states differ significantly, so it is not possible to make a direct comparison of tax expenditures between jurisdictions.

- To remedy this, reporting standards should be developed and applied across the range of State taxes in a uniform and thorough way. The Council of Australian Governments should examine the ways in which the states could uniformly report tax expenditures annually (see Recommendation 138).

Source: *AFTS* pp. 212,729-733

A2.10. Administration of state taxes

Key Points

- The Review of *Australia's Future Tax System* finds that if the states require additional fiscal autonomy, they could raise revenue from sharing a tax base with the Australian Government, such as the personal income tax base. The Review also discusses the possibility that greater administrative efficiency could be achieved through central administration of a shared tax base, as is already the case with the GST, which is administered by the Australian Taxation Office on behalf of the states. The Review does not make specific recommendations regarding the administration of state taxes.

- The Review's reform directions suggest a reduced role for the states in the administration of taxes in the future. The abolition of a number of state taxes with the replacement revenue largely coming from centrally administered taxes would mean that the states could devote fewer resources to tax administration.

- There is a possibility in the future that a single national body — the ATO or a successor organisation — could collect and administer all the taxes in the federation. This would reduce the costs of having separate administrations for each state and provide an opportunity to further reduce complexity in the overall tax system. However, if all state taxes were centrally administered, it would reduce the autonomy that states enjoy in raising their revenue. The states would need to decide if differences in taxes across the states are sufficient to warrant separate administrations. If in the future there were substantial convergence in the way states levied their taxes, the costs of maintaining separate administrations may outweigh the benefits.

- Longer-term reforms to the administration of taxes and transfers and changes in the way that people interact with the tax and transfer system are also relevant to state taxes. For example, an online client account could be used by all levels of government to give people up-to-date personalised information, including information about liability for state taxes and charges.

  Source: *AFTS* p. 683-684

A2.11. Other Government activities

Key Points

- Governments support people to improve their capabilities through the direct provision of public services such as health and education. The capacity of the tax and transfer system to deliver improvements to people's wellbeing is highly dependent on how governments fund and deliver these services.

  Source: *AFTS* p.617

Principle

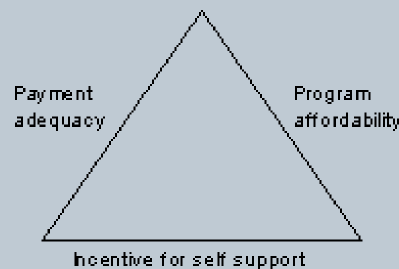
- Poverty alleviation is a national goal that should be financed by the national government. The Australian government should be responsible for funding those transfers that ensure that all Australians have access to a basic standard of living. State and local governments may choose to provide additional funding, reflecting area-specific concerns.

  Source: *AFTS* p 620

Box F1-1: Balancing adequacy, incentives and affordability

With any income support payment, there is an “iron triangle” associated with means testing (see Chart F1-1). The generosity of the payment (including the breadth of its coverage) needs to be balanced by how much it costs taxpayers, and the incentive for people to get off the payment by earning income. Improving one of these worsens one or both of the others.

Chart F1-1: Iron triangle of means testing



To improve incentives without reducing the payment level there are only two possible strategies:

- relax or remove some means tests — apart from raising inevitable questions of “middle class welfare” and “churning”, this would greatly increase the cost to taxpayers and jeopardise affordability; or

- reduce or remove the payments to some people on grounds other than income, such as age or an expectation that duration on income support will be short — this would reduce the total income of those people and may compromise adequacy.

Whether the pattern of incentives is changed by adjusting the means test or using a tax instrument such as an earned income tax credit does not affect this trade-off; it simply changes it from a question of welfare design to a question of tax design. Which is the better approach depends on other issues such as administrative practicalities, signalling effects (such as the weight given to work), and tax churning.

Source *AFTS* F1-1, p. 498

A3. Outcomes of other State Tax Reviews

This Appendix provides information on recent changes to, and previous reviews of, the State's taxes.

Recent changes to the State's taxes

Over recent years there have been a number of amendments and revisions to individual State taxes. Adjustments to the State's taxes are often required to maintain effectiveness, efficiency, equity and fairness in both individual taxes and in overall taxation.

A summary of recent changes to the State's taxes are shown below. For more information on individual taxes, see section 9 State own-source revenue.

Recently abolished State taxes

- The following duties were abolished between 2001 and 2008:
  - lease duty
  - rental duty
  - mortgage duty
  - debits duty
  - financial institutions duty
  - marketable securities duty
  - non-quoted marketable securities duty
  - non-real commerical property transfer duty
  - duty on the hire of goods
  - duty on public liability insurance
- In 2001, the electrity levy was abolished.
- In 2004, minor gaming taxes were abolished that related to lucky envelopes, instant draw bingo, sweepstakes, raffles and gratuitous gaming.

Recent amendments to State taxes

Land tax

- Changes to the land tax system were introduced from the start of 2010-11, which resulted in a lowering of the land tax rates for certain property holdings, more land being exempt from land tax, and the initiation of a review into the land revaluation system.
- Prior to these changes, the threshold at which land tax becomes payable has been increased twice in 2002-03 and 2005-06, providing further tax relief.

Gambling taxes

- Changes have recently been approved by Parliament to betting exchange taxes to support the retention of Betfair Pty Ltd's Tasmanian operations.
- Harm-minimisation measures to address problem gambling were legislated in 2009-10 and implementation is ongoing. Harm-minimisation changes are expected to impact on revenue and therefore reduce gambling tax receipts.

Payroll tax

- The rate that payroll tax is applied was reduced from 6.53 per cent to 6.1 per cent; and the value at which payroll tax becomes payable was been increased, over a number years from $606 000 to $1.01 million, providing tax relief.

Duty

- In 2005-06, duty concessions were introduced for first home owners for the purchase of their first home, or land on which to build their first home.

Motor vehicle taxes

- In 2007-08, motor tax for light vehicles and the transfer duty of heavy vehicle registrations were both reduced.

Have there been any previous State tax reviews published?

Further to the changes made to individual State taxes shown above, a comprehensive review of the State's taxes was completed by the Committee for the Review of State Taxes, as appointed by the Treasurer, in 1993. The findings of the Committee are summarised below.

Tax Reform in Tasmania Towards 2000, Today's Problem – Tomorrow's Opportunity, Committee for the Review of State Taxes and Charges, 1993

Committee membership

- Mr Valentine Smith, Senior Partner, Dobson Mitchell & Allport (Chairman)
- Mr Robert Campbell, General Manager, United Milk Tasmania
- Mr Robert Close, Director, Financial Policy, Department of Treasury and Finance
- Professor Cliff Walsh, Director, Centre for South Australia Economic Studies
- Mr Robert Woolley, Partner, Deloitte Ross Tohmatsu

Context

At the time of the review, Tasmania had significant debt and the State's taxation severity was the highest of all states. For information on the State's current taxation severity see Appendix A1.2.

Scope

The scope of the report was to review all State taxes, charges and fees and make recommendations to improve the efficiency, equity and simplicity of the State's tax system.

Findings

The Committee's recommendations were extensive and included:

- reducing the impact of taxes on business through changes to the tax mix;
- that payroll tax be imposed at a single rate, without further concessions for small businesses, religious institutions, schools, hospitals and local government, and the rate of payroll tax be reduced to 3.5 per cent;
- removing a large number of exemptions for various organisations and pensioners from land tax, and to review the Act governing the land tax system at that time (see review summarised below for further information);
- reducing the rate of conveyance duty, with revenue replaced by broadening the land tax base;
- that a number of duties be abolished;

- increasing the rate of duty on general insurance policies;
- combining and increasing motor tax and duty, removing exemptions, and increasing heavy vehicle taxes;
- the removal of fire service levies, offset by an increase in the rate of land tax;
- for government agencies to identify appropriate activities to introduce user-pays charges, and to review existing concessions and exemptions;
- reviewing existing concessions, benefits and exemptions to ensure uniformity, and transparency through grants/similar rather than exemptions/concessions; and
- that statutory authorities operate commercially and under competitively neutral conditions, achieve an acceptable rate of return, pursue pricing policies on a commercial basis, and make tax equivalent and dividend payments.

Land and Income Taxation Act 1910, Towards Competitiveness in Land Tax Provisions, Committee Inquiry 1997

In 1997, a Committee was formed by the Premier to review the land tax arrangements. The Committee's report is summarised below.

Committee membership

- The Hon Tony Fletcher MLC, Leader for the Government in the Legislative Council
- Mr Bob Cheek MHA, Parliamentary Secretary for Small Business

Context

At the time of the review, the State was seeking to reduce the level of taxation severity in Tasmania to below the average of all states and territories. For information on Tasmania's current taxation severity see Appendix A1.2.

Scope

The scope of the report was to review the land tax arrangements at that time, seeking to simplify and clarify arrangements; reduce the adverse impact of land tax on business; and to improve the equity with which land tax is applied.

Findings

The final report proposed:

- that measures be undertaken to inform taxpayers on aggregation, company grouping and land tax calculation;
- that the Valuer-General review adjustment factor methodology, reduce the period between revaluations to three years and review the taxpayer appeal processes; and
- amendments be made to the issue of land tax relating to apportionment, aquaculture, forestry and ability for taxpayers to pay through instalments.

Are State taxes subject to other types of review?

Treasury reviews

Periodically reviews are completed within Treasury to monitor the effecitveness of individual taxes. Such reviews are important to:

- review the effectiveness, efficency, equity and fairness of individual taxes and overall taxation;
- compare Tasmania’s taxation severity with those of other states and territories; and
- identify options for tax relief and the removal of certain taxes/duties.

Working with other jurisdictions

Inter-jurisdictional reviews and agreements can also lead to changes to State taxation arrangements. This has included the *Intergovernment Agreement on the Reform of Commonwealth-State Financial Relations*, which initiated the abolishment of a number of state duties as part of the introduction of the Goods and Services Tax.

The Australian Government’s *Australia’s Future Tax System Review* is anticipated to lead to further discussions and changes to state taxes through discussions and reviews undertaken in collaboration with the Australian, and state and territory, governments.

A4. Business Tax and Regulation Reference Group

In 2008, the State Government established a Business Tax and Regulation Reference Group to operate as a forum within which the views of the business community on business regulation and tax reform issues could be considered and then exchanged with the State Government. The Reference Group met six times. Significant achievements include:

- a submission to the Australian Government's review of *Australia's Future Tax System*;
- a discussion of planning reform issues in Tasmania; and
- the preparation of a paper on Best Practice Regulation Principles, which provided an overview of best practice regulation in Australia.

The two year tenure of the Reference Group expired on 30 June 2010.

Glossary of Acronyms

ABS	Australian Bureau of Statistics
AFTS	Report on *Australia's Future Tax System* presented to the Australian Treasurer, Wayne Swan, by the Review Panel.
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
CFT	Cash flow tax
COAG	Council of Australian Governments
CPI	Consumer Price Index
CPRS	Carbon Pollution Reduction Scheme
DIER	Department of Infrastructure, Energy and Resources
FBT	Fringe Benefits Tax
FHOS	First Home Owner Scheme
GDP	Gross Domestic Product
GPP	General Purpose Payments
GRA	General Revenue Assistance
GSP	Gross State Product
GST	Goods and Services Tax
GVA	Gross value added
HFE	Horizontal Fiscal Equalisation
IGA	Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations
IPART	Independent Pricing and Regulatory Tribunal (NSW)
MAIB	Motor Accident Insurance Board
MYEFO	Mid-Year Economic and Fiscal Outlook (Commonwealth)
NFP	Not-for-Profit
NPP	National Partnership Payments
SPP	Specific Purpose Payments
SRO	State Revenue Office
VFI	Vertical Fiscal Imbalance