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TREASURER  
MINISTER FOR EMPLOYMENT

Senator Jacinta Collins  
Chair  
Senate Economics References Committee  
Parliament House  
CANBERRA ACT 2601

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Dear Senator Collins

### **INQUIRY INTO THE STRUCTURE AND DISTRIBUTIVE EFFECTS OF THE AUSTRALIAN TAXATION SYSTEM**

I refer to your letter of 12 December 2002 to the Premier, Jim Bacon, MHA, inviting the Tasmanian Government to make a submission to the above inquiry. I would like to make a few general comments, particularly in relation to the respective roles of the Commonwealth and the states and territories (states) in relation to the collection and distribution of taxation revenue.

The Australian Constitution, its interpretation over the years by the High Court and the Commonwealth's effective monopoly over income tax has shaped the respective roles of the Commonwealth and states in taxation. This has resulted in a fundamental imbalance between the revenue-raising powers and expenditure responsibilities of each level of Government. This vertical fiscal imbalance (VFI) has become worse as a result of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA) signed by all Heads of Government in 1999.

While the IGA has given states access to a stable and growing source of Commonwealth transfers, through a direct link with the goods and services tax (GST), the establishment of the GST, together with the abolition of a number of state taxes means that, in 2000-01, the Commonwealth raised 72 per cent of total public sector revenues, but had direct responsibility for functions that accounted for approximately 57 per cent of public sector outlays. In contrast, states had direct responsibility for 37 per cent of public sector outlays, but raised only 22 per cent of public sector revenue. The upshot of this is that, the states in general, but Tasmania in particular, now have a higher level of dependence on Commonwealth funding than ever before.

From a state perspective, the dependence on Commonwealth funding continues to result in funding uncertainty. It has also led to the over-reliance on administratively and economically inefficient state taxes.

The objectives of the IGA, as set down in that agreement, were:

- the achievement of a new national tax system, including the elimination of a number of inefficient taxes which were impeding economic activity;
- the provision to state governments of revenue from a more robust tax base that can be expected to grow over time; and
- an improvement in the financial position of all state governments, once the transitional changes have been completed, relative to that which would have existed had the previous arrangements continued.

The first of these objectives has been achieved in part, through the abolition of the wholesale sales tax and financial institutions duty and stamp duty on quotable marketable securities. However, the Commonwealth's position in recent negotiations on Specific Purpose Payments (SPPs), is putting the achievement of the other objectives of the IGA at risk.

The Commonwealth gave a commitment in the IGA that it:

*“... will continue to provide Specific Purpose Payments (SPPs) to the States and Territories and has no intention of cutting aggregate SPPs as part of the reform process set out in this Agreement, consistent with the objective of the State and Territory Governments being financially better off under the new arrangements.”*

In almost every major intergovernmental forum since 1999 over the various functional areas of government (health, education, transport, environment), Commonwealth officials and Ministers have observed that, given the additional GST revenue that the states are receiving, they can afford to contribute more to individual programs. Not only is this statement untrue - for example, Tasmania will not be significantly better off under the GST until 2006-07 - but it is contrary to the commitment which the Commonwealth gave under the IGA.

As indicated above, a major objective of the IGA was that states would be better off financially. However, a consistent theme of recent SPP negotiations is the positioning of the Commonwealth to withdraw funding as GST revenues to the states increase. This has taken the form of tightening the amount of SPP funds available either through overt reductions in funding over time, or through inadequate indexation of the funding base. The systematic reduction of SPP funding across the board calls into question whether the states will in fact be better off financially, notwithstanding the receipt of Commonwealth transfers tied to the expected growth over time in GST revenues.

The IGA provides for further reform of state taxes. Subject to review by the Treasurers' Conference debts tax is to be abolished on 1 July 2005, while the need for the retention of a number of stamp duties is also to be reviewed. Stamp duties which are to be reviewed include those applying to: non-residential conveyances; non-quotable marketable securities; leases; mortgages, bonds, debentures and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; and cheques, bills of exchange and promissory notes.

The Commonwealth and states have begun to consider how to conduct these reviews. The Commonwealth has indicated that it will not support the general abolition of business stamp duties at the Treasurers' Conference before the GST revenues are sufficient to support that abolition. That is, the Commonwealth will not agree to the abolition of business stamp duties until states are outside the guarantee period. It would then be a matter for each jurisdiction to


determine whether it wished to abolish any of the business stamp duties, as it would be a direct cost on a state's Budget. However, if the states are not financially better off as a result of the Commonwealth's systematic reduction in SPP funding, this calls into question the ability to achieve further tax reform as was intended under the IGA. Thus the arrangements may potentially act as an impediment to further tax reform.

At the March 2001 Treasurers' Conference, a paper clarifying the extent of the benefit to the states of the reforms to Commonwealth-State financial arrangements was presented by the Northern Territory Treasury and endorsed by Heads of Treasury. The paper made the following points:

- over recent years, growth in state revenue has been mainly due to increased revenue raising effort by the states;
- while the Commonwealth grants to the states have been growing in real terms, the rate of growth has been significantly less than the rate of growth in Commonwealth revenue; and
- states' shares of national revenue have been declining over a number of years. The new financial arrangements are only expected to slow the rate of decline, not reverse it.

It is clear from the above that, even under the revised arrangements, states do not have a sufficient share of tax revenue to meet their ongoing expenditure responsibilities, let alone undertake any reform of inefficient state taxes. If there is to be any further taxation reform, it is clear that the underlying level of Commonwealth funding to the states must be at least maintained, if not increased.

Yours sincerely



David Crean  
Treasurer