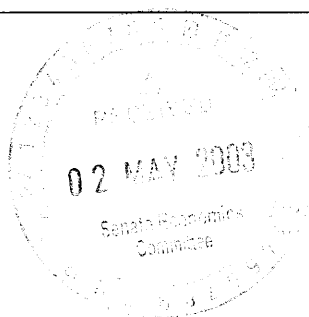




Premier of Victoria

30 APR 2003



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**The Secretary
Senate Economics References Committee
Room SG.64
Parliament House
CANBERRA ACT 2600**

Dear Secretary

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

Thank you for your letter of 13 December 2002 inviting the Victorian Government to make a submission to the Committee on this Inquiry.

As the Commonwealth exercises the majority of taxing powers and the States' tax bases are quite limited, the major focus of the analysis into taxation burdens should be Commonwealth taxes. Similarly, the key levers for distribution are controlled by the Commonwealth, which administers the social security system.

Given this focus, it is not the Victorian Government's intention to make a comprehensive submission to the Committee at this time. However, the Government would like to make the Committee aware of some harmful effects of existing tax arrangements, along with various reforms and developments in relation to key Inquiry issues. In particular, I would like to draw to your attention to:

- the significant reforms to Victoria's taxes announced throughout 2001 and 2002;
- research by Victoria's Department of Treasury and Finance into long-term pressures on State finances and the agreement by the Council of Australia Governments (COAG) to request the Productivity Commission to undertake a study into the impacts of an ageing population;
- the need for a comprehensive review of Commonwealth-State funding, along with further research into their policy interaction; and
- Section 51AD and Division 16D of the *Income Tax Assessment Act*, which discourage private sector investment in infrastructure.

Reforms to Victoria's taxes

The business tax changes announced in the 2001 *Better Business Taxes* (BBT) package were the most significant reforms to Victorian taxes in two decades. *Building Tomorrow's Businesses Today* (BTBT), released in 2002, extended these reforms.

BBT provided \$774 million in tax cuts over four years, by:

- reducing the payroll tax rate from 5.75 per cent to 5.45 per cent on 1 July 2001, with a further reduction to 5.35 per cent on 1 July 2003;
- increasing the payroll tax threshold from \$515 000 to \$550 000 from 1 July 2003;
- increasing the tax-free land tax threshold from \$85 000 to \$125 000 for the 2002 land tax year; and
- abolishing three stamp duties (on non-residential leases, unquoted market securities and mortgages).

BTBT provided an additional \$262 million in tax cuts over four years by:

- further reducing the rate of payroll tax to 5.25 per cent from 1 July 2003, with the reduction to 5.35 per cent in BBT brought forward to 1 July 2002;
- bringing forward the payroll tax threshold increase in BBT to 1 July 2002;
- increasing the land tax threshold to \$150 000 for the 2003 land tax year; and
- bringing forward the abolition of stamp duty on unquoted marketable securities in BBT from 1 July 2003 to 1 July 2002.

The increase in the land tax threshold, along with existing exemptions, means 91 per cent of regional properties and 84 per cent of metropolitan properties will not be liable for land tax. Similarly, fewer than 10 per cent of employers in Victoria will pay payroll tax from 1 July 2003.

These reforms have sought to improve the efficiency of Victoria's taxes, while maintaining a fair tax contribution from Victorians. The payroll tax reductions and stamp duty abolitions offer some relief to Victorian businesses from the burden of taxation; the threshold increases release a significant number of retirees, small business owners and rural landowners from the tax net.

The Government is also endeavouring to reduce administration costs faced by Victorian businesses. Technological upgrades as part of BBT allow for payments of up to \$1 000 to be made by credit card online to the State Revenue Office. In addition, the online payroll tax Annual Adjustments (eAA) system was introduced in 2002, allowing online submission of payroll tax information and instant calculation of tax liabilities or refunds. Objections to land tax assessments may also be lodged online, along with applications for Land Tax Clearance Certificates.

The Government will exempt paid maternity leave from payroll tax from 1 January 2003, to encourage Victorian employers to provide paid maternity leave. The exemption will apply to the equivalent of 14 weeks' full-time pay and is expected to save Victorian businesses around \$1 million per annum. The

Government views this initiative as an important first step towards a national scheme of paid maternity leave, funded by the Commonwealth.

Intergenerational issues

Victoria's Department of Treasury and Finance recently released *Shaping a Prosperous Future*, a discussion paper that considers long-term fiscal pressures on the Victoria Government. The paper notes that there are contrasting views within the community on the impact of an ageing population. The Commonwealth's *Intergenerational Report 2002-03* projects that the ageing of the population will place considerable pressure on government finances. However, there are a number of factors that could alleviate this concern; for example:

- the future aged population is generally expected to be healthier, which can increase its capacity to continue participating in the workforce and the community. This in turn will contribute to the generation of jobs and income for the younger population, as well as reducing the reliance of the aged population on support; and
- continued productivity growth and rising real incomes will mean that future generations are likely to be in a much better position to cope with the needs of elderly people.

Importantly, *Shaping a Prosperous Future* notes that *all* tiers of government face future fiscal pressures, including from an ageing population.

To improve understanding of the challenges and opportunities arising from the projected ageing of the population, on 6 December 2002 COAG agreed to request the Productivity Commission (PC) to undertake a research study into the future impact of ageing with a particular focus on:

- the productivity and labour supply implications; and
- the potential fiscal impacts on all levels of government.

COAG also agreed to develop further appropriate responses to the issues associated with an ageing Australia following receipt of the PC report. I understand the Commonwealth is currently consulting States and Territories on draft terms of reference for the study.

Commonwealth – State funding and policy interaction

A simple and transparent system of Commonwealth-State funding is fundamental to an effective and cooperative federal system. Despite the implementation of major economic and structural reforms in other areas, the Commonwealth, States and Territories have not agreed to a comprehensive review of the current system of grants. Australia's federal finances present a major microeconomic reform opportunity.

All States have their own concerns with particular aspects of the current system. Concerns that are shared by all States include:

- *the impact on public policy development*. There is an incentive for States to develop public policy with regard to potential grant share implications, to the detriment of efficient and productive outcomes;

- *the unsustainable and inconsistent level of detail required by the current equalisation system.* The current equalisation process requires extraordinary amounts of data. The resources invested in collecting this data are a significant cost to all States, and often detract from efficient and effective delivery of services;
- *the lack of transparency within the current system.* The level of detail of the current system and the complexity of its methodology reduce transparency; and
- *the inefficiencies created by specific purpose payments.* Specific purpose payments impose considerable administrative costs on both the Commonwealth and the States. They also blur accountability between levels of government and reduce the flexibility of States in providing services.

For these reasons, it is imperative that an independent body capable of developing a quality reform program reviews the current system. The review should commence as soon as possible.

A further issue deserving greater focus is the costs imposed on the States and the community from inadequately progressive Commonwealth policies. Two significant examples are the private health insurance rebate and the high level of Commonwealth funding for elite non-government schools. These transfers to narrow elements of the community could instead be directed to relieving pressure on public services or enhancing the overall quality of service provision. These opportunity costs are partly borne by the Commonwealth through the payment of grants, but they strongly reside with the States as service provider and because of the conditions attached to specific purpose payments from the Commonwealth.

The costs of these transfers extend to the broader community by increasing the States' reliance on narrow tax bases. Further investigation of this interplay would enable a fuller understanding of the policy interactions across the different tiers of government and contribute to more efficient policy-making.

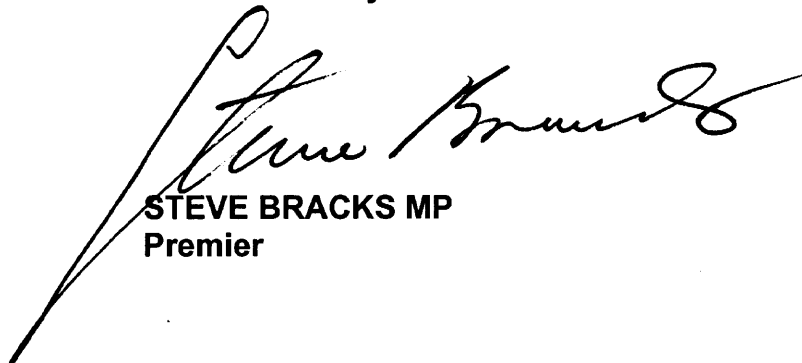
Private investment in infrastructure

Complicated and discriminatory taxation arrangements – in particular, section 51AD and Division 16D of the *Income Tax Assessment Act* – are a major regulatory impediment to the use of Public-Private Partnerships. These arrangements lack clarity and make the tax status of private sector investment in infrastructure uncertain. Tax deductions available to a state from such investments may be not accessible to the private sector, even if the private sector takes on significant risks.

The final report of the Commonwealth-commissioned Review of Business Taxation (Ralph Review, September 1999) recommended a complete overhaul of the current treatment of financing and leasing arrangements for infrastructure assets, including the removal of s51AD and adjustments to Division 16D. The Victorian Government is of the view that the development of key infrastructure in Australia is being held back by the Commonwealth Government's failure to introduce reforms to these laws.

I trust this letter will assist the Committee in its inquiry. I would appreciate the opportunity to provide further details to the Committee as appropriate at a later stage. To this end, I would appreciate receiving a copy of the draft report when it is available.

Yours sincerely

A handwritten signature in black ink, appearing to read "Steve Bracks". The signature is fluid and cursive, with a long, sweeping underline that extends to the left and then curves back under the name.

STEVE BRACKS MP
Premier