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Senator Jacinta Collins  
Senate Economics References Committee  
Parliament House  
CANBERRA ACT 2600

Dear Senator Collins

I refer to your letter of 12 December 2002. The focus of my submission is on the respective roles of the Commonwealth and the States in relation to the collection and distribution of taxation revenue and the impact of the tax regime on social and economic policy. These issues are particularly important for South Australia given our disproportionate share of public housing and income support recipients and the South Australian Government's commitment to social inclusion objectives.

*Recent developments relating to the introduction of the GST as reflected in the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations 1999 (IGA)*

From a State perspective it is useful to consider the performance, in a political economy sense, of the GST and associated arrangements in the following terms:

1. Access to a revenue stream which keeps pace with the economy
2. Control over the tax base, rate and administration
3. Extent to which the States or a State gain increased revenue flexibility or overall financial improvement.

*1. Access to a growing revenue stream*

A feature of the GST arrangements is the stronger growth path likely to be experienced by the GST tax base, if not completely in line with the economy generally, certainly as compared with State and Commonwealth taxes which the GST has replaced.

That said it can also be fairly observed that the base and rate settings of the GST are such that for many States any improvement in State revenues is greatly delayed. In South Australia's case, GST based grants are not expected to exceed the level of grants and revenues forgone from abolished taxes otherwise expected (the Guaranteed Minimum Amount), until 2006-07 on the basis of GST estimates contained in the 2003-04 Budget.

Of course the guarantee omits a number of impacts on State budgets, includes a number of adjustments of detriment to the States and has proved vulnerable to Commonwealth devices as in relation to petrol replacement revenue payments.

In addition to the foreshadowed abolition of Debits tax by 1 July 2005, included in the guarantee, the IGA provides for review of the need for retention of a number of business stamp duties by the States.

The Commonwealth has indicated that abolition of business stamp duties will not be endorsed until the impact would not give rise to a call on the guarantee. Nevertheless expectation of the abolition of such taxes either considerably extends the time before States are noticeably better off or greatly diminishes the long term quantum of benefit.

This is of course before consideration of the Commonwealth's intentions, a matter to which I return below.

## *2. Control over the tax base, rate and administration*

Clearly States have very limited control, or indeed influence, over development of the GST. Expectations on this score are appropriately modest having regard to the dominant fact that GST legislation is legislation of the Commonwealth Parliament.

State involvement in the management and administration of the GST is also greatly constrained as a practical matter.

Although the outcome may reflect intrinsic features it is also a fair evaluation against this criterion that States have very little control over the administration of the tax despite the fact that the States are paying for those administration costs.

## *3. State revenue flexibility/improvement*

The GST based financial arrangements with the States were presented as providing the States with greater revenue buoyancy. However, it was apparent that States would not be better off financially if the Commonwealth withdrew other forms of funding, bearing in mind that Commonwealth SPP grant funding still represented nearly half of total State grants.

The IGA is not strong enough in itself to ensure that the States will be better off.

Clause 5(v) of the IGA states that 'The Commonwealth 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.'

The Commonwealth should commit to ensuring that SPPs are maintained in real terms from year to year. However, the commitment needs to go further than that. If the Commonwealth maintains SPPs in real terms but increases the matching requirements associated with these SPPs it is effectively appropriating State revenues for Commonwealth policy purposes. Another danger is that the Commonwealth can effectively shift responsibilities to the States. There are a number of examples where the Commonwealth has encouraged States to set up jointly funded programs but then ceased their funding after 2 or 3 years. The State is then faced with making up the shortfall or cutting back or cancelling the program.

Through means such as this there is a very real potential that the extra revenue to the States from the GST will be effectively expropriated by the Commonwealth for its own policy purposes.

It is entirely plausible that the introduction of the GST will result in less budgetary flexibility for the States.

Thus, from the State perspective, the new GST arrangements are deficient in that while offering some benefit in terms of potential greater revenue buoyancy, this can only be expected to flow through to the States to the extent that the Commonwealth, as dominant revenue collector in the Australian Federation, is prepared to allow. The position faced by the States is indeed encapsulated by the Australian Health Care Agreement offer which introduces demanding growth funding matching requirements on the States while cutting Commonwealth payments as against forward estimates by \$918 million over four years.

#### *Impact of the tax regime on social and economic policy*

The following points are provided in relation to terms of reference (d).

Under the Commonwealth–State Housing Agreement, South Australia will be \$31.4 million worse off over the life of the new Agreement due largely to the cessation of GST compensation funding. However, the GST continues to impact heavily on the capital and operational costs of housing agencies. This is because housing agencies are "input taxed" and cannot reclaim input tax credits.

There is uncertainty about the future of the Commonwealth's First Home Owners Grant (first introduced to offset the increased cost of housing as a result of the GST) and the consequential impact on housing affordability and the level of demand on State housing and other subsidies.

The ageing of the South Australian population would suggest that the interactions between the taxation system, social security system and State Government support services warrants further investigation.

The interaction between Commonwealth taxation law and the social security system (i.e. the combined effect of marginal tax rates plus Centrelink and/or Family Assistance benefits) ought to be considered as it may provide disincentives to workforce entry or incentives for early retirement.

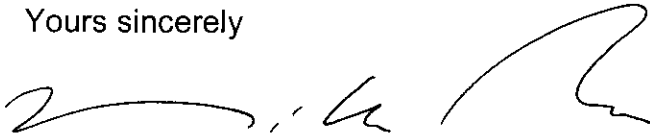
There are also other taxation related areas where the Commonwealth is effectively limiting funds for States such as the pensioner supplement introduced to offset the impact of the GST for pensioners which the Commonwealth has asked State housing agencies not to count as income when assessing rent levels. Another example is the proposed change to the definition of a charity that will affect the FBT status of a number of our non-hospital service delivery agencies, effectively increasing the Commonwealth's tax expenditure at the expense of the State.

The complexity of the GST provides an additional administrative burden and compliance cost for governments, and also non-profit bodies that assist the Government as partners in providing social outcomes. Examples include:

- Taxation of grants and subsidies – the complex ATO ruling GSTR2000/11 and its interaction with government appropriations in GSTR2000/4;
- Reduced spending power and/or increased costs for payment of various financial assistance payments and concessions for low income individuals and families. This is because the government cannot reclaim the additional GST cost charged by service providers as input tax credits where payments are subsidized on behalf of individuals;
- The impact of GST complexity on joint venture and community housing developments between State entities and charitable bodies;
- GST treatment of residential housing, particularly the disparity between the input taxed treatment for State housing bodies and the GST creditable treatment for charitable housing providers.

Thank you for the opportunity to comment on these issues.

Yours sincerely

A handwritten signature in black ink, appearing to read "Mike Rann". The signature is fluid and cursive, with a large, sweeping initial "M" and a distinct "R".

MIKE RANN  
**Premier**

7 / 8 / 2003