

Review of State Taxation

Report to the Treasurer

Other Industries — Draft Report
June 2008

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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by 11 July 2008.

We would prefer to receive them by email <ipart@ipart.nsw.gov.au>.

You can also send comments by fax to (02) 9290 2061, or by mail to:

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We may choose not to publish a submission – for example, if it contains confidential or commercially sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please indicate this clearly at the time of making the submission. IPART will then make every effort to protect that information, but it could be subject to appeal under freedom of information legislation.

If you would like further information on making a submission, IPART's submission policy is available on our website.

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1 Introduction and executive summary

In Australia, the Commonwealth government levies a small number of taxes, including income tax, excise and customs duty, and the Goods and Services Tax (GST). These taxes have large, broad bases, and enable the Commonwealth to raise more than 80 per cent of the total tax revenue collected in Australia – which is significantly more than it needs to meet its spending responsibilities.

In contrast, the States and Territories (the States)¹ levy a greater number of taxes, including payroll tax, gambling and betting taxes, stamp duties mainly related to the purchase of property and insurance, land tax, and environmental levies. Many of these taxes have small and relatively narrow bases. As a result, States raise only a small portion of the total revenue they require to meet their expenditure responsibilities – which include funding essential public services such as health, education, policing, transport, welfare and environmental protection services.

To address this mismatch between the respective taxation bases and spending responsibilities of different levels of government (known as vertical fiscal imbalance (VFI)), the Commonwealth shares some of the tax revenue it collects with the States, using a complex system of horizontal fiscal equalisation (HFE).

The Premier of NSW has asked the Independent Pricing and Regulatory Tribunal (IPART), under Section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992*, to undertake a review of the impact of the current Commonwealth-State revenue sharing arrangements on NSW revenue, and the relative efficiency of the taxes NSW is able to levy. The terms of reference for this review require IPART to:

- ▼ assess the impact of the current Commonwealth-State fiscal arrangements on NSW's revenue mix and ability to fund essential public services
- ▼ compare the efficiency of the taxes NSW is able to levy to that of taxes the Commonwealth can levy
- ▼ review the current NSW tax system, taking account of standard taxation principles and interstate competitiveness
- ▼ recommend options for improving the NSW tax system's performance against these principles, given the taxes the State is able to levy, and
- ▼ provide draft and final reports to the NSW Treasurer (see Appendix A for the full terms of reference).

¹ The term 'States' is used in this report to encompass the activities of both States and Territories.

IPART has completed the first stage of this review, following the review process outlined in Box 1.1. This draft report presents and explains its draft findings and draft recommendations to the Treasurer.

Box 1.1 Review process

IPART is undertaking this review under Section 9 of the *Independent Pricing and Regulatory Act 1992*. As part of its review process, it is conducting public consultation and its own analysis. To date, it has:

- ▼ released an issues paper and invited submissions from all interested parties (a list of those who made submissions is provided in Appendix B)
- ▼ conducted a Public Workshop on 14 December 2007 (a list of attendees is provided in Appendix C)
- ▼ considered all the submissions and analysed the information it received
- ▼ submitted this draft report to the Treasurer prior to making it publicly available.

IPART now invites submissions on its draft findings and recommendations, and will consider these submissions before it finalises its report and recommendations to the Treasurer by 31 August 2008. Please note that submissions must be received by 11 July 2008. Information about how to make a submission can be found on page iii, at the front of this report.

1.1 Overview of draft findings and recommendations

IPART approached this review by first looking broadly at the NSW tax system, and comparing it to those of the other States and the Commonwealth. Then, to help determine the scope for reform, it examined the constraints on NSW taxation and tax reform. Next, it undertook a detailed assessment of the major NSW taxes, taking into account:

- ▼ standard taxation principles, which include efficiency, equity, simplicity and transparency
- ▼ robustness, which is the tax system's ability to consistently raise sufficient revenue to fund essential public services, and
- ▼ interstate competitiveness.

Finally, based on the findings of the above analyses, IPART identified a range of improvements to the design and mix of State taxes that it believes NSW can make independently of the Commonwealth and other States. It also identified some broad options for improving the NSW tax system through cooperative Federalism, which NSW should pursue through the Council of Australian Governments (COAG).

IPART's draft recommendations for improving the NSW tax system independently of the Commonwealth and other States include short, medium and longer term actions. Its draft recommendations for improving the NSW tax system through

cooperative Federalism represent broad options for such reform, and require further consultation and analysis.

1.1.1 NSW tax system compared to other States and the Commonwealth

IPART found that NSW's own-source tax revenue represents only 39 per cent of its total State revenue. And while the State levies a large number of taxes, more than half of its own-source tax revenue comes from just two taxes: payroll tax and purchaser transfer duty.

NSW's total revenue, both as a proportion of Gross State Product (GSP) and per capita, is lower than in most other States. Its revenue from Commonwealth grants is also lower than most other States as a proportion of its total revenue. However, its own-source tax revenue is the highest of all States as a proportion of GSP, and third highest per capita.

Given that the Commonwealth Grants Commission's (CGC) relative tax effort index indicates that NSW's tax rates are close to the average for all States, its higher level of own-source tax revenue is largely due to larger tax bases rather than higher tax rates. In addition, NSW's lower revenue from Commonwealth grants reflects the effect of the current revenue sharing arrangements.

Compared to the Commonwealth, NSW's tax system is less robust: it is much smaller, and relies on a wider range of taxes that are less efficient, more narrowly based, and growing at a slower rate than Commonwealth taxes. Based on the Government's long term outlook,² IPART considers that the State tax system must be improved if NSW is to meet essential funding requirements without jeopardising its fiscal sustainability.

1.1.2 Constraints on NSW taxation and tax reform

IPART found that a range of institutional and practical constraints limit the options for tax reform in NSW, especially in the short term. First, as a result of the High Court's interpretation of the Constitution and Commonwealth government policy decisions, taxation powers in Australia are highly centralised at the Commonwealth level. The States' ability to impose income tax has been effectively removed, and their ability to impose other types of tax is severely limited. This centralisation of tax powers has led to the high level of VFI noted above, by constraining the States' ability to raise own-source tax revenue. It is also a major constraint on tax reform at the State level.

² NSW Treasury, Budget 2006-07, *Budget Paper No 6, NSW Long Term Pressures Report*.

Second, the current arrangements for addressing the VFI act as another major constraint on tax reform, and further constrain the States' fiscal autonomy. These arrangements involve the redistribution of Commonwealth tax revenue among the States in the form of:

- ▼ untied payments, or General Purpose Grants, using a complex HFE system
- ▼ tied payments, or Specific Purpose Payments (SPPs), that must be used for an agreed purpose and come with terms and conditions.

IPART considers that the HFE methodology used by the CGC to allocate General Purpose Grants creates fiscal incentives that inhibit State-level tax reform designed to improve the overall efficiency of the tax system. In addition, the conditions attached to SPPs in the past enabled the Commonwealth to use its funding contributions to control a significant portion of State government outlays. Further, the way in which the CGC uses the size of a State's General Purpose Grant allocation to balance out any difference between the State's revenue from all other sources (including SPPs) and the CGC's own assessment of a State's revenue requirements means that the CGC effectively controls the level of financial resources available to a State. This is regardless of the State's own efforts to improve its revenue base or Commonwealth policy on distributing Specific Purpose Payments.

Third, concerns about NSW's interstate competitiveness and the community's willingness to accept tax changes also constrain tax reform. The need for a State to maintain comparable tax rates due to concerns about state competitiveness limits its scope to increase its tax rates, and creates pressure to reduce rates that are higher than those in other States (even though these taxes may be a more efficient means of raising the State's required revenue). Tax changes impose transitional costs and this inevitably creates short-term winners and losers. This makes most revenue-neutral changes unpopular, despite the benefits they may create for the State and national economy.

IPART considers that the above constraints severely limit the extent to which NSW can achieve tax reform on its own. More substantive reform will require cooperation between the States, and between the States and the Commonwealth.

1.1.3 Assessment of current NSW taxes

IPART's assessment of NSW taxes found that payroll tax – which makes the largest contribution to the State's own-source tax revenue – is the highest ranking State tax in terms of performance against standard taxation principles. In its current form, payroll tax is one the most efficient State taxes, and importantly, there is scope to further improve its efficiency. It also scores well for robustness, simplicity and transparency, but scores poorly for equity.

Land tax, which contributes 10 per cent of NSW's own-source tax revenue, is another relatively efficient tax, with substantial scope to improve its efficiency. However, in its current form, this tax scores relatively poorly for equity, simplicity and transparency, and was ranked fourth among the State taxes overall.

For both payroll tax and land tax, the current tax base is considerably narrower than the potential tax base. The efficiency of these taxes could be substantially improved by broadening their bases through the reduction or removal of exemptions and concessions. This would also improve their equity, as the current exemptions and concessions place a disproportionately high tax burden on those businesses and individuals who are liable to pay the tax, and provide substantial benefits for those who are not. However, efforts to broaden these tax bases would be contentious and difficult to achieve.

Purchaser transfer duty – which is the second largest contributor to the State's own-source tax revenue – ranks among the worst of the major NSW taxes. It scores poorly for efficiency because it adds to the cost of real estate transactions and so can distort investment decisions, and because it applies to a narrow base (only those properties sold during the tax year). It also scores poorly for robustness, because the revenue it generates can change dramatically from year to year, depending on the property cycle.

Insurance duty and fire services funding contributions are the least efficient State taxes. Both these revenue sources penalise those who are prudent enough to take out insurance, and so encourage underinsurance and non-insurance. In addition, significant free-rider problems are associated with the fire services funding arrangements, where non-contributors benefit from the provision of fire services without contributing to the cost through insurance policies.

IPART's assessment of interstate competitiveness indicates that NSW's overall tax competitiveness ranks well compared to the other states except for Queensland. NSW collects more tax revenue as a proportion of GSP than any other State and more tax revenue per capita than all States except Western Australia and the ACT. However, as noted above this is due to larger tax bases rather than higher tax rates.

The composition of State taxes in NSW is also more efficient than in other States. NSW relies more heavily on payroll tax and land tax than the other States; as noted above, these taxes are among the most efficient State taxes in their current form and have potential to be substantially more efficient. NSW also relies less on purchaser transfer duty – a relatively inefficient tax – than most other States.

1.1.4 Reforming the NSW tax system independently of other States and the Commonwealth

IPART considers that its assessment of NSW taxes indicates that there is scope to improve the design and mix of NSW taxes, and to improve the efficiency of some of the most important taxes. In general, the NSW Government can improve the State's tax system, independently of changes to Commonwealth-State fiscal arrangements, by adopting the following guidelines:

- ▼ increasing reliance on broader based, simpler and more transparent taxes that facilitate modern business practices
- ▼ reducing reliance on inefficient, distorting taxes in favour of more neutral taxes
- ▼ using levies, for example environmental levies, that are carefully targeted, fair and transparent to achieve desired market interventions
- ▼ reducing the level of tax expenditures (ie, tax revenues forgone as a result of exemptions, concessions and rebates for certain taxes)
- ▼ improving the efficiency of the user pays model for charges levied by government
- ▼ strengthening the efficiency and effectiveness of tax administration in NSW.

IPART has identified a range of specific reforms related to the individual State taxes, tax expenditures, user charges and tax administration, in line with these guidelines. In doing so, IPART focused on improving the structure and composition of NSW taxes, rather than on possible increases or decreases in the overall tax burden. It also took account of stakeholder comments on current NSW taxes, and its own findings on the constraints on tax reform, the criteria for good tax design, and the potential consequences for Commonwealth-State revenue sharing under the CGC's current HFE system.

1.1.5 Recommendations for reforming NSW tax system independently of other States and Commonwealth

These draft recommendations emphasise the pursuit of improved economic efficiency by reducing those aspects of the current tax system that hinder and distort productive economic activity. In particular, IPART proposes that in the longer term NSW moves away from its current heavy reliance on transactions-type taxes on property transfers, motor vehicle transfers and the purchase of insurance products, and towards broader-based annual taxes on asset holdings or economic activity.

Payroll tax

Payroll tax is the State's largest tax and one of its most efficient. Rates in NSW are higher than in most other States, but a reduction in these rates that reduces payroll tax revenues and necessitates increases in other taxes would reduce the efficiency of the overall tax system. IPART's recommended reforms aim to improve the efficiency and competitiveness of payroll tax over time, while maintaining the revenue base:

1 In the short term:

- the tax free threshold for payroll tax should be reduced from \$600,000 pa to \$500,000 pa
 - the payroll tax rate should be reduced from 6.0 per cent to 5.75 per cent.
- 2 Over a two-year period, the payroll tax exemption for local councils should be removed and a corresponding increase in municipal rate-pegging limits should be phased in.
- 3 In the long term, the rate of payroll tax should be further reduced, with the long-term goal of achieving interstate parity in this rate.

As section 1.1.2 discussed, any changes to a State's taxes and the amount of revenue they raise can affect the level of grants it receives from the Commonwealth. However, based on the information available to it, IPART has not been able to quantify the effect of its recommended changes on NSW's grant allocation with any certainty. IPART considers that the complex interrelationships between changes to State taxes and Commonwealth grant distributions warrant careful analysis, before State tax reforms are implemented.

- 4 NSW Treasury should review in detail, before implementing the reforms recommended by this review, the interactions between the recommendations and the GST/CGC grant allocation to NSW. Where the outcome is detrimental to good State tax reforms, this issue should be referred to COAG as an impediment to State reform designed to improve national competitiveness.
- 5 NSW Treasury should develop a capacity to better manage the interaction between the State's tax and expenditure policies and the CGC's HFE methodology. This will involve a regular report to the NSW Government on the impact the HFE methodology has on State (and national) tax (and expenditure) reform, for tabling at the Treasurer's Conference and referral to COAG. All tax proposals should include an assessment of the impact on the allocation of Commonwealth grants.

Insurance taxes

Stamp duties on insurance and asset transactions are among the State's most inefficient taxes. IPART considers that in the short-term, NSW should seek to reduce existing exemptions to help fund reductions in the standard rate of these taxes. In the longer term, it should aim to either reduce its reliance on revenue from these taxes, or eliminate these taxes by placing more weight on other more efficient taxes. The extent to which these longer term reforms can be progressed will be constrained by the challenges of enhancing the revenue bases of other more efficient taxes.

- 6 In the short term, the stamp duty exemption for third party motor vehicle personal injury insurance should be abolished and that the standard rate of stamp duty for general insurance (Type A) be reduced from 9 per cent to 6 per cent.
- 7 In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in the contributions by local

councils, with a phased implementation and accommodating increases in the municipal rate cap.

Property taxes

NSW's major property taxes include land tax, which is a tax on undeveloped land values and raises almost \$2 billion per year, and purchaser transfer duty, which is a tax on the transfer of property and raises over \$4 billion per year. Land tax is potentially a highly efficient and equitable tax, but is currently levied on a narrow base and applied to investors but not residential owner-occupiers. In addition, the assessment of land tax liability based on the aggregated value of the taxpayer's land holdings is administratively complex and difficult to understand. Purchaser transfer duty is less efficient than land tax because it may distort investment decisions, and is levied on a narrow base (only those properties sold within the tax year).

IPART considers that in the short term, NSW should reduce its reliance on purchaser transfer duty and make this tax more equitable by adjusting the tax rates to account for 'bracket creep'. In the medium term, NSW should consider simplifying land tax by assessing land tax liability on the individual. In the long term, it should develop a strategy for increasing its reliance on land tax to fund further reductions in its reliance on purchaser transfer duty and insurance taxes. Practical constraints may require that the strategy focus on non-residential property.

- 8 In the short-term, the purchaser transfer duty should be reduced by replacing the existing first three rating levels with a single level for dutiable properties up to \$80,000 and reducing the duty payable up to this level to 1 per cent, with the details as shown in Tables 5.3 and 5.4.
- 9 In the short-term, the purchaser transfer duty rate scale should be indexed annually, based on an index of movements in all NSW property values.
- 10 In the medium term, consideration should be given to changing the tax unit for land tax from joint ownership to the individual, funded by a decrease in the tax-free threshold.
- 11 In the long term, the Government should develop a strategy for increasing property holding taxes (for example, broadening the land tax base, increasing the land tax rate and/or increasing municipal rates on land values) to fund substantial reductions in purchaser transfer duty and insurance taxes on a revenue-neutral basis. The strategy will need to consider carefully the impacts on the various taxpayers as well as the overall benefits to the community.

Taxes on the purchase and registration of motor vehicles

Motor vehicle registration (stamp) duty is a distortionary tax, as it acts as a disincentive for individuals and businesses to buy newer, more environmentally-friendly vehicles, and to replace their vehicles with more suitable ones as their needs and circumstances change. IPART considers that NSW should move to a more efficient but revenue-neutral annual tax on all cars. Stamp duty on the purchase of

caravans and camper trailers in NSW are higher than in other States, and should be abolished.

12 In the medium term, motor vehicle registration duty should be replaced with a revenue-neutral annual motor vehicle charge.

13 In the short term, stamp duty on purchases of caravans and camper trailers should be abolished.

Motor vehicle weight tax

Motor vehicle weight tax is a relatively efficient tax that also rates well for simplicity, transparency and robustness. It has some characteristics of a road user charge, in that it is based on the weight of the vehicle, which is an indicator of the wear and tear the vehicle places on road infrastructure relative to other vehicles. However, it does not take into account the extent to which the vehicle is used. IPART considers that the Government should consider replacing this tax (and potentially other existing vehicle usage taxes) with better designed road use and congestion charges.

14 In the medium term, after relevant transport policy issues have been resolved, consideration should be given to rationalising existing vehicle usage charges, including the motor vehicle weight tax, with well designed road use and congestion charges.

Possible new taxes

While the potential for NSW to introduce new taxes in the short term is limited, IPART considers that there may be merit in considering possible new or increased environmental taxes to redress damage from pollution. For example, road usage and congestion charges (discussed above) could reduce externalities associated with private vehicle usage, by changing behavioural patterns and contributing to a more rational framework for public transport pricing. Over time, there is considerable scope for other environmental levies (eg, levies to address market failures in private road transport and household energy usage) to play an increased role in the State tax system.

15 In the medium term, consideration should be given to increased use of environmental levies in the NSW tax system.

Tax expenditures

The various concessions and exemptions for particular special groups and activities are a prime source of inefficiency in the State's tax system. Often there are alternative direct expenditure and transfer policies that can achieve the same objectives, perhaps more efficiently. However, tax expenditures are not subject to the same level of scrutiny in the budget process as these alternatives. This means tax expenditures require regular review and evaluation against the alternative means of achieving their policy objectives.

16 In the short term:

- all tax expenditures should be brought on budget with an explicit appropriation shown and funded from the allocation for the relevant policy agency
- a 'sunset clause' should be specified for review of all tax expenditures, so that they lapse automatically unless Parliament agrees specifically to their renewal.

User charges

User fees and charges for services provided by government agencies and the use of government assets are an important source of State revenue, and a more direct means of raising revenue than taxes. They can also be more efficient, because they make providers and users more aware of the cost of the goods and services, and improve equity by ensuring that those who benefit from publicly provided goods and services pay for them. IPART considers that NSW could make better use of user fees and charges, by ensuring there are consistent guidelines and regular reviews or indexation.

17 In the short-term:

- NSW user fees and charges practices should be benchmarked with those in other States
- guidelines and principles for these fees and charges should be developed
- all NSW user fees and charges not currently subject to a periodic review or indexation arrangement should be indexed annually to movements in the CPI.

Tax administration

The systems and procedures used to collect taxes have an important bearing on the efficiency, equity, simplicity and transparency of any tax system. While good tax policy creates the potential for raising revenue, it is the efficiency and effectiveness of tax administration which ultimately determine the actual revenue collected. Good administration can also promote equity by ensuring consistent application of the tax laws and the equal treatment of taxpayers in similar circumstances. In addition, simple and transparent systems and procedures reduce the compliance burden on taxpayers.

Following discussions with the NSW Office of State Revenue (OSR), stakeholders and other State revenue agencies, IPART considers that improvements in four areas can maintain and improve the efficiency and effectiveness of tax administration in NSW.

18 In the short term, priority should be given to the following strategies to further strengthen the efficiency and effectiveness of tax administration in NSW:

- ongoing investment in the renewal and development of IT systems
- further improvements in data management and in data sharing with other NSW government agencies
- greater functional specialisation in some areas to address issues of high value or critical importance to revenue collection
- increased use of formal performance evaluation techniques such as performance benchmarking and tax gap studies.

1.1.6 Reforming the NSW tax system through cooperative Federalism

To overcome the various legal, institutional, policy and practical constraints on tax reform at the State level, NSW needs to seek to improve its tax system through cooperation with the other States, and between the States and the Commonwealth. IPART considers that expanding the reform agenda to the national level – which can only be done through cooperative Federalism³ – will create a wider range of more significant potential gains for all jurisdictions. IPART has identified four possible directions that this reform might take:

- ▼ Further expanding efficient Commonwealth taxes, and sharing the revenue this generates with the States in return for them further reducing or abolishing inefficient State taxes, to improve the overall efficiency of the national tax system.
- ▼ Reassigning some part of one or more efficient Commonwealth taxes to the States in return for them further reducing or abolishing inefficient State taxes, to improve overall efficiency and increase the States' level of fiscal autonomy. For example, one option would be to allow each State to impose a surcharge on the Commonwealth income tax levied on taxpayers within its borders.
- ▼ Improving the current arrangements for revenue sharing between the Commonwealth and the States, to improve the incentives for the both State and national level tax reforms. One option is to quarantine all Specific Purpose Payments from the CGC's horizontal equalisation process.
- ▼ Further harmonising State taxes, to remove constraints on State-level tax reform and improve the overall efficiency of the national tax system.

³ Cooperative Federalism is a concept of federalism in which national, state, and local governments interact cooperatively and collectively to solve common problems, rather than making policies separately but more or less equally or clashing over a policy in a system dominated by the national government.

Reform of NSW's tax system will provide benefits worthwhile to NSW. However, the full benefits of these reforms will require all States to cooperate further with each other and the Commonwealth in expanding the reform agenda to the national level. IPART considers that NSW can foster this through the following.

- 19 NSW should advocate that a joint Commonwealth-State review be undertaken of the options for further expanding efficient Commonwealth taxes to fund the reduction or abolition of inefficient State taxes.
- 20 The States and the Commonwealth should give further consideration to tax reassignment to the States, and/or revenue sharing to encourage and promote State tax reform.
- 21 NSW should seek a direction from the Treasurers' Conference to the CGC that HFE procedures be amended to quarantine fiscal transfers that are compensating adjustments for State tax reform.
- 22 NSW should seek amendments to the HFE methodology for national tax reforms or changes in grant sharing arrangements to ensure individual States have incentives to introduce tax reforms that are in the State and national interest. This could include quarantining some taxes in part or in full from the HFE process or allocating the revenue generated by some taxes on a per capita basis.
- 23 NSW should seek a direction from the Treasurer's Conference to the CGC to review the possibility of:
 - equalising less than 100 per cent of the difference in standardised per capita tax
 - removing some (current and future) taxes from HFE consideration
 - removing some part of each tax from HFE consideration
 - distributing less than 100% of the general revenue grants through the equalisation pool.
- 24 In the calculation of grant relativities, NSW should propose that the current COAG review of SPPs should consider quarantining out SPPs that meet a national objective or are performance based, if such a review is not already on the agenda for COAG.

1.1.7 Managing the reform process

The implementation of the recommendations outlined above will result in considerable benefits. However, the implementation process will need to be carefully managed to ensure the desired outcomes are achieved.

In relation to recommendations for reforming NSW tax system independently of other States and the Commonwealth, IPART considers that managing the implementation of the short to medium term reforms should be the joint responsibility of the Office of Financial Management (OFM) and OSR within NSW Treasury. It is expected that following consideration of the Final Report, the Treasurer may wish to nominate medium term policy priorities and reform strategies. It will be important that the implementation of these strategies is

monitored. To manage the implementation of the longer term recommendations, IPART considers that NSW should develop a process and research capacity that will enable it to make substantial improvements to the NSW tax system over time.

25 OFM and OSR should be jointly responsible for implementing the short to medium recommendations for change to the NSW taxation system that are endorsed by the Government. OFM should provide the implementation strategy, and report annually on progress against the strategy in the budget papers.

26 NSW Treasury should allocate funds to enable it to undertake or commission specific research to support future strategic directions for improving the tax system.

In relation to recommendations for further harmonisation of State taxes, IPART considers NSW should pursue the implementation of these recommendations through COAG with the groundwork being undertaken through the existing processes involving the Treasurers' Conference.

27 NSW should pursue further opportunities for the interstate harmonisation of State taxes through an appropriate national forum.

In relation to the broad options for improving the NSW tax system through cooperative Federalism, IPART considers that further consideration of these options and their implementation is a matter for COAG. However, NSW should be able to play a role in facilitating this process.

28 NSW should propose that COAG should foster initiatives between States in the area of intergovernmental fiscal arrangements.

1.2 Structure of this report

The following chapters explain IPART's draft findings and recommendations to the Treasurer in more detail:

- ▼ Chapter 2 provides a broad overview of the NSW tax system, and compares it with those of the other States and the Commonwealth.
- ▼ Chapter 3 discusses the institutional and practical constraints on NSW taxation and tax reform.
- ▼ Chapter 4 presents IPART's assessment of NSW taxes in terms of their performance against the standard taxation principles, their robustness, and their interstate competitiveness, and its assessment of the major Commonwealth taxes.
- ▼ Chapter 5 discusses specific improvements to the State tax system that NSW can implement independently of the Commonwealth and the other States.
- ▼ Chapter 6 looks at the broad options for reforming the State tax system through cooperation between the States and between the States and the Commonwealth.
- ▼ Chapter 7 discusses how the range of reforms recommended by this review could be managed.

2 Overview of NSW and Commonwealth tax systems

To begin to address the first two terms of reference for this review – assessing the impact of the current system of Commonwealth-State fiscal relations on NSW's revenue mix and ability to fund essential services, and comparing the efficiency of the taxes available to NSW and the Commonwealth – IPART examined the NSW tax system. It looked broadly at the key facts and features of NSW taxes, and compared them to those of the Commonwealth and other States. In addition, IPART assessed the adequacy of the current NSW tax system to meet the State's revenue needs in the future while remaining competitive, taking into account the institutional constraints on the State's tax system.

This analysis finds that:

- ▼ The Commonwealth Government raises the bulk of the total tax revenue collected in Australia, while the States raise less than one-fifth of this revenue.
- ▼ NSW's own-source taxation represents less than half its total State revenue.
- ▼ Over one-half of NSW's own-source tax revenue comes from two taxes: payroll tax and purchaser transfer duty.
- ▼ Compared to other States:
 - NSW's total State revenue is relatively low, both as a proportion of its GSP and per capita.
 - NSW's revenue from Commonwealth Government grants is also lower than most other States' as a proportion of total State revenue.
 - However, its own-source tax revenue is the highest as a proportion of total State revenue, and the third highest on a per capita basis.
 - This relatively high level of own-source revenue per capita appears to be due to NSW's larger tax base, rather than to higher tax rates.
- ▼ Compared to the Commonwealth:
 - the NSW tax system is less robust, because it relies on a wider mix of smaller, and generally less efficient and more narrowly based taxes
 - NSW tax revenue is growing at a slower rate.
- ▼ Without change, NSW tax system may not be able to raise sufficient revenue to meet the State's future expenditure requirements.

Together, these findings suggest that there is a need for NSW to reform its State tax system, and also to pursue reform of the current Commonwealth-State fiscal arrangements.

Each of the findings listed above is discussed in more detail below. The options for tax reform, and the constraints that need to be considered in relation to such reform, are explored in detail in the following chapters.

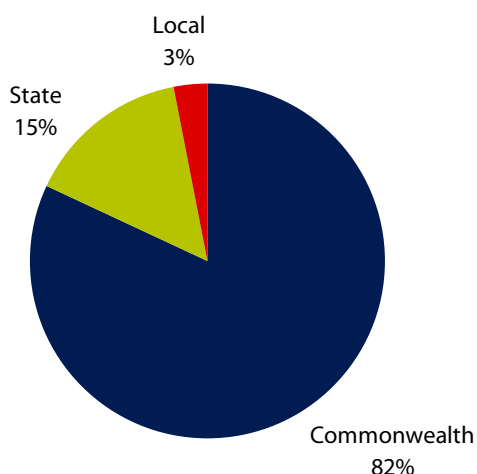
2.1 Total taxation revenue in Australia

Finding

- 1 The Commonwealth Government raises the bulk of the total tax revenue collected in Australia, while the States raise less than one fifth of this revenue.

The Commonwealth Government collects more than four-fifths of total tax revenue in Australia (Figure 2.1). In 2006-07, it raised \$262 billion⁴ in taxes, which represents 82 per cent of all taxes collected in Australia. Collectively, State Governments raised just \$49 billion, which represents 15 per cent of the total tax revenue collected. Local governments raised the remaining 3 per cent, mostly through property rates.

Figure 2.1 Total taxation revenue, Australia, 2006-07



Data source: Australian Bureau of Statistics, *Taxation Revenue 2006-07*, Cat No 5506.0.

IPART notes that not only is the Commonwealth Government's tax base considerably larger than that of the States, there is also an imbalance between revenue and expenditure at the Commonwealth level, with revenue being considerably greater than expenditure. In contrast, the States' own-source taxation revenue is much lower than their expenditure responsibilities. This issue is discussed further in Chapter 3.

⁴ Including GST which will now be recognised by the Commonwealth as a Commonwealth tax.

2.2 Composition of total State revenue in NSW

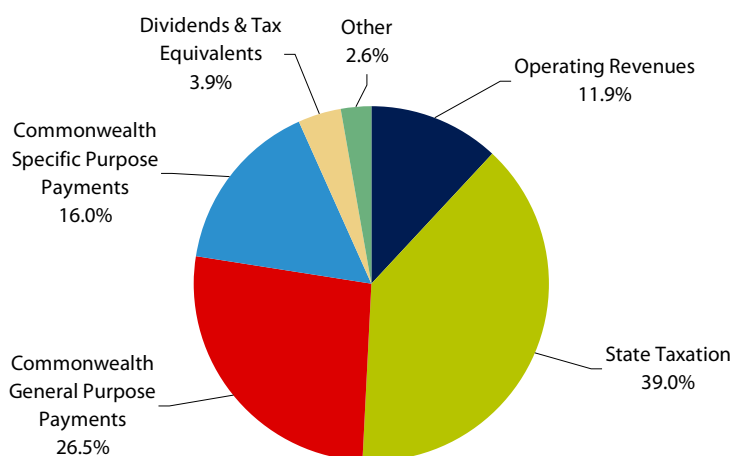
Finding

2 NSW's own-source taxation represents less than half its total State revenue.

In 2007-08, total State revenue in NSW is estimated at \$45.0 billion, while total expenses – that is, the costs of providing essential public services such as health, education, policing, transport, welfare and environmental protection – are estimated at \$44.6 billion.⁵

The NSW tax system is expected to raise \$17.6 billion in tax revenue this year.⁶ While this revenue is clearly inadequate to fund all public expenditures in NSW, own-source taxation is nonetheless a major source of revenue for the State. As Figure 2.2 shows, it represents 39.0 per cent of the State's total revenue.

Figure 2.2 Composition of total State revenue, NSW, 2007-08



Data source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No 2, p 3-3.

Grants from the Commonwealth Government are another major revenue source. These grants include General Purpose Grants sourced from the GST revenue and SPPs. NSW's General Purpose Grants are estimated to be \$11.9 billion in 2007-08 and SPPs are estimated to be \$7.2 billion in 2007-08. Together, they represent 42.5 per cent of the State's total revenue.

The remaining sources of NSW Government revenue are own-source revenues: they include operating revenues, dividends and tax equivalents from public trading enterprises, and 'other' sources such as the sale of goods and services and investment income. These sources of revenue are estimated to total \$8.3 billion in 2007-08, and represent 18.5 per cent of total revenue.

⁵ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, p 1-24.

⁶ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, p 3-19.

2.3 Composition of own-source taxation revenue in NSW

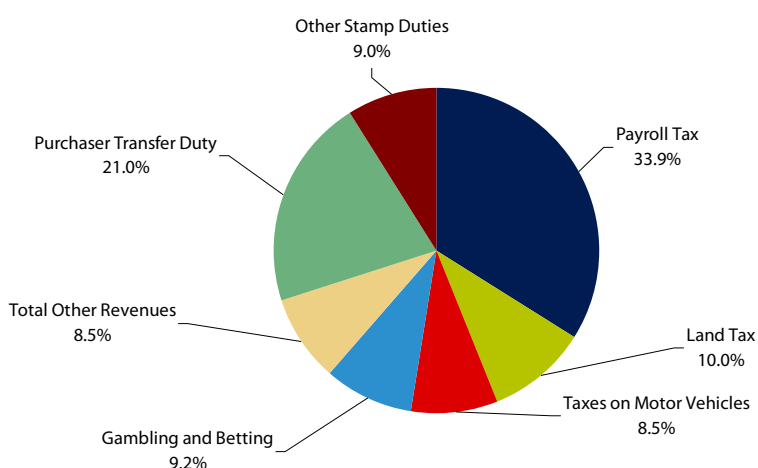
Finding

- 3 More than half of NSW's own-source tax revenue comes from two taxes: payroll tax and purchaser transfer duty.

Taxes on payrolls and property transfers are by far the most significant sources of own-source tax revenue in NSW (as well as in other States). Payroll tax is estimated to raise almost \$6.0 billion in NSW in 2007-08, and as Figure 2.3 shows, this represents 33.9 per cent of own-source tax revenue in NSW. Purchaser transfer duty is estimated to raise around \$3.7 billion, which represents 21 per cent.

The other major taxes include land tax, other stamp duties (ie, excluding purchaser transfer duty), gambling and betting taxes, and taxes on motor vehicle ownership and operation.

Figure 2.3 Composition of own-source tax revenue, NSW, 2007-08



Data source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No 2, p 3-17.

As Chapter 4 will discuss, some NSW taxes are relatively efficient, and have the potential to be made more efficient by modifying the tax design. However, other taxes are highly inefficient, and have limited scope for improvement.

Table 2.1 shows the budgeted revenue from each tax for 2007-08. Appendix E provides further details on individual taxes.

2.4 NSW total State revenue and own-source tax revenue compared with those in other States

Finding

- 4 Compared with other States, NSW's total State revenue is relatively low, both as a proportion of its GSP, and per capita. NSW's revenue from Commonwealth grants is also relatively low as a proportion of its total revenue. However, its own-source tax revenue is the highest as a proportion of total State revenue, and the third highest on a per capita basis. This relatively high level of own-source tax revenue per capita appears to be due to NSW's larger tax base, rather than higher tax rates.

IPART compared NSW's tax and revenue position with the other States' by examining:

- ▼ total State revenue as a proportion of GSP
- ▼ own-source tax revenue and Commonwealth grants as proportions of total State revenue
- ▼ total State revenue and own-source tax revenue per capita, and
- ▼ the CGC's index of the States' relative tax effort.

IPART's main findings from this analysis are summarised below.

2.4.1 Total State revenue as a proportion of Gross State Product

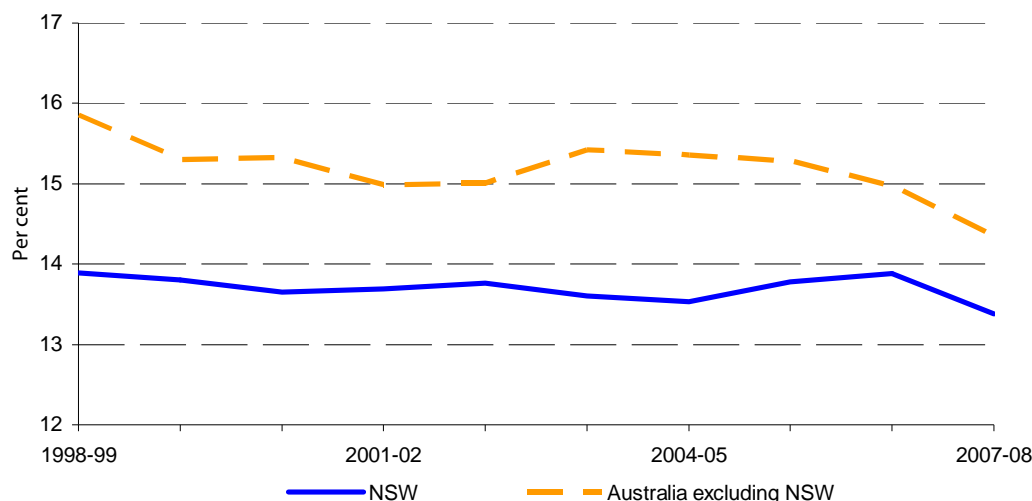
NSW's total revenue share as a percentage of GSP has been consistently lower than that for the rest of Australia (ie, the average for all States excluding NSW) for at least a decade. Figure 2.4 shows that in NSW, total State revenue as a percentage of GSP has been between 13 and 14 per cent for the last nine years, and between 15 and 16 per cent in the rest of Australia for most of this period.

Table 2.1 Own-source taxation revenue in NSW, 2007-08

	\$m	\$m
Stamp Duties		5,269
Purchaser Transfer Duty	3,695	
Other Stamp Duties		
Insurance	616	
Mortgages	243	
Marketable Securities	74	
Motor Vehicle Registration Certificates	582	
Hire of Goods	6	
Leases	51	
Other	2	
Payroll Tax		5,960
Land Tax		1,750
Taxes on Motor Vehicle Ownership and Operation		1,486
Weight Tax	1,176	
Vehicle Registration and Transfer Fees	280	
Other Motor Vehicle Taxes	30	
Gambling and Betting		1,609
Racing	160	
Club Gaming Devices	623	
Hotel Gaming Devices	438	
Lotteries and Lotto	293	
Casino	86	
Other Gambling & Betting	9	
Other Revenues		1,488
Health Insurance Levy	123	
Insurance Protection Tax	69	
Parking Space Levy	51	
Fire Brigades Levy	363	
Bush Fire Services Levy	146	
Waste and Environment Levy	214	
Government Guarantee of Debt	130	
Private Transport Operators Levy	12	
Pollution Control Licences	48	
Other Taxes	332	
Total Tax Revenue		17,562

Source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No 2, pp 3-18 and 3-19.

Figure 2.4 Total Revenue as a proportion of Gross State Product, NSW compared with average for rest of Australia, 1998-99 to 2007-08

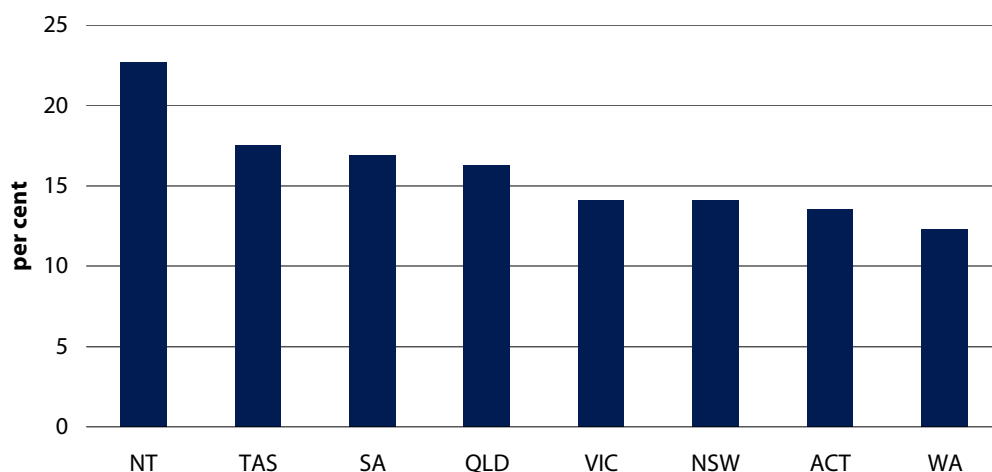


Note: Australia excluding NSW is a weighted average of the Total Revenue as a proportion of GSP.

Data source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No. 2, p 3-4.

In 2006-07 (the latest year for which consolidated ABS data are available) NSW's total State revenue as a share of GSP was lower than that of the Northern Territory, Tasmania, South Australia and Queensland, very similar to that of Victoria, but higher than the ACT and Western Australia (Figure 2.5).

Figure 2.5 Total State revenue as a share of GSP, 2006-07



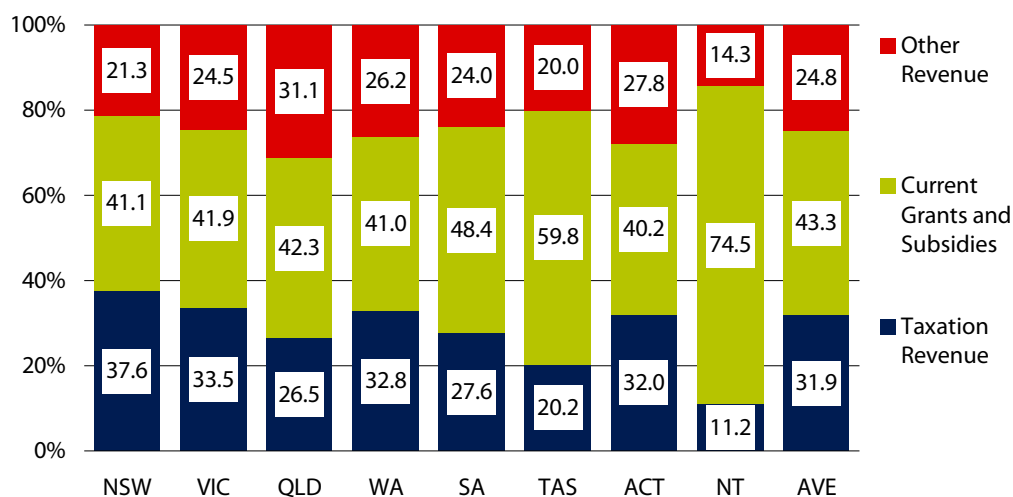
Data source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts 2006-07*, Cat No 5220.0.

2.4.2 Own-source tax revenues and Commonwealth grants as proportions of total State revenue

Figure 2.6 shows the relative contribution that each State's own-source tax revenue and Commonwealth grants and subsidies made to its total State revenue in 2006-07. The data indicate that NSW:

- ▼ Relies more heavily on own-source tax revenue than any other State or Territory. In 2006-07, own-source tax revenue made up 37.6 per cent of total State revenue in NSW, compared to 33.5 per cent in Victoria (which had the next highest percentage) and 11.2 per cent in the Northern Territory (the lowest).
- ▼ Has the third lowest share of Commonwealth grants and subsidies as a proportion of total State revenue. These grants and subsidies made up 41.1 per cent of total State revenue in NSW, compared to 40.2 per cent in the ACT (the lowest) and 74.5 per cent in the Northern Territory (the highest).
- ▼ Has the third lowest share of 'other' revenue as a proportion of total State revenue (21.3 per cent, compared with 14.3 per cent in the Northern Territory (the lowest) and 31.2 per cent in Queensland (the highest)).

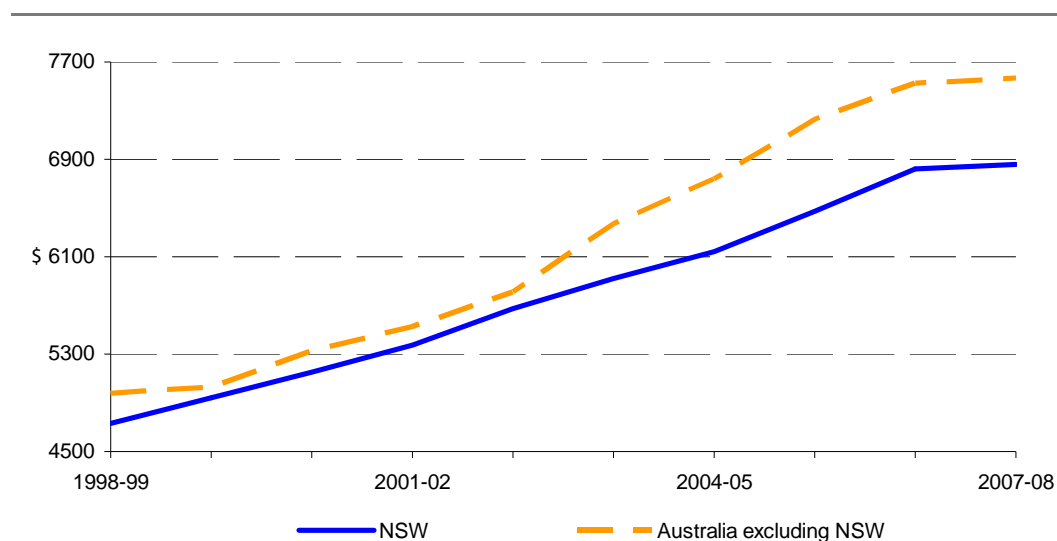
Figure 2.6 Own-source tax revenue and Commonwealth grants and subsidies as a proportion of total State Revenue, 2006-07



Data source: Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2006-07*, Cat No 5512.0.

2.4.3 Total state revenue and own-source tax revenue per capita

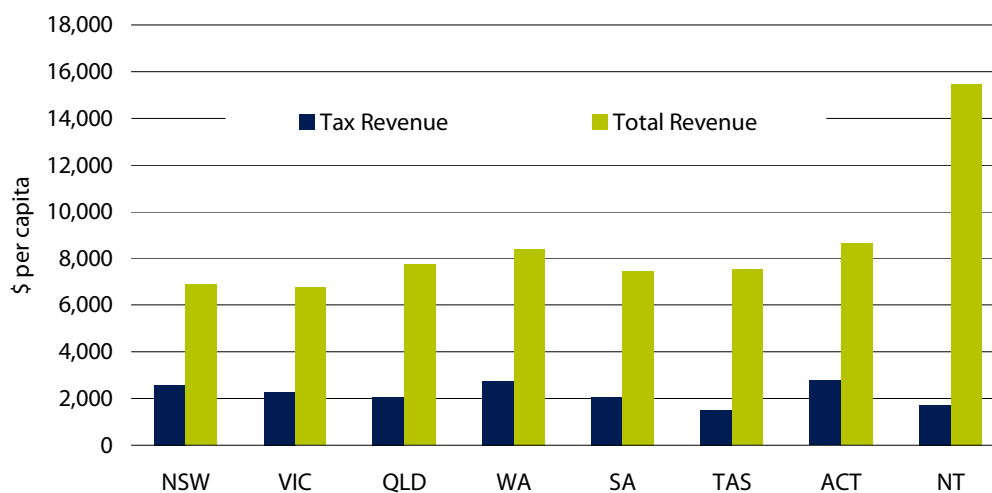
When we look at total State revenue on a per capita basis, NSW has had a lower level than the average for all the other States for at least the past decade (Figure 2.7). Over the last couple of years, NSW has had around \$712 less State revenue per capita than the average for the rest of Australia.

Figure 2.7 Total Revenue per Capita, NSW compared with average for rest of Australia

Data source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No. 2, p 3-5.

In 2006-07, NSW's level of total revenue per capita was lower than the level in all other States except Victoria (Figure 2.8). However, its level of own-source tax revenue per capita was higher than in all States except Western Australia and the ACT.

IPART considers that together, these findings suggest that NSW suffers a comparative disadvantage under the current system of Commonwealth-State financial transfers and complex HFE methodology. This methodology and its flaws are discussed in Chapter 3.

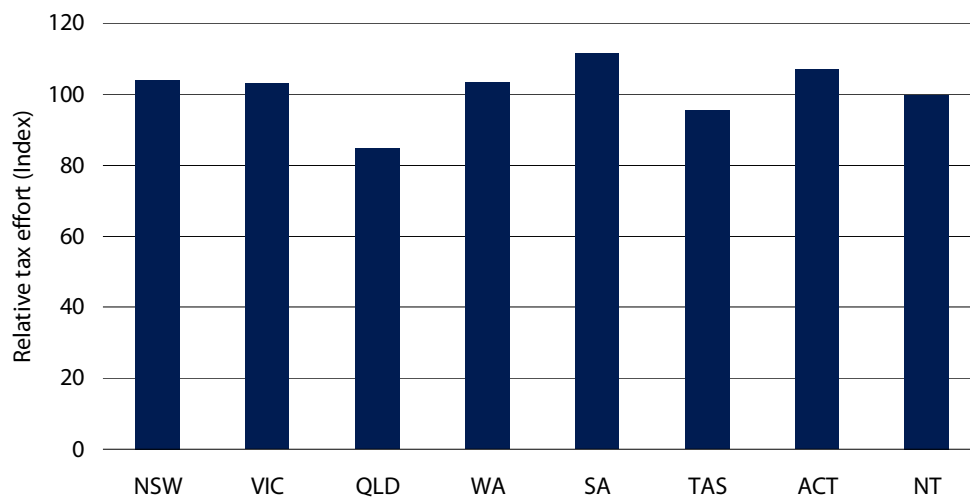
Figure 2.8 Total Revenue per Capita and Tax Revenue per Capita, 2006-07

Data source: Tax revenue data from ABS, *Taxation Revenue, Australia, 2006-07*, Cat No 5506.0. Total revenue from ABS, *Government Finance Statistics, Australia, 2006-07*, Cat No 5512.0. Population data from Commonwealth Treasury estimates used for GST calculations and 2007-08 Commonwealth Budget Estimates.

2.4.4 Tax effort index

To understand the source of NSW's higher level of own-source tax revenue per capita, IPART looked at the CGC's relative tax effort index for each State and Territory. This index compares each State's actual revenue from own-source taxes to the CGC's estimate of the revenue it would have raised if its tax rates were equivalent to the all-State average tax rates. An index above 100 suggests that a State's tax rates are above the all-State average, while an index below 100 suggests they are below this average.

For 2006-07, NSW's tax effort index was 4.0 above 100, which suggests its own-sourced tax rates are close to the average for all States (Figure 2.9). Indeed the relative tax efforts of NSW, Victoria and Western Australia are very similar. Queensland shows the largest variation in tax effort with an index of 84.6. However, the real issue for NSW is its greater share of the base of taxes. It is this greater share of the tax base (see section 2.5) that results in the CGC allocating less grant revenue to NSW.

Figure 2.9 Index of tax effort, 2006-07

Note: The CGC tax effort measure compares actual taxation collections to the estimated revenue that would have been raised if the State applied tax rates equivalent to all-State average tax rates – an index above 100 suggests a State taxes at above the all-State average, while an index below 100 suggests a State taxes at below the all-State average.

Data source: Commonwealth Grants Commission, *Relative Fiscal Capabilities of the States 2008*.

2.5 Comparison of the NSW and Commonwealth tax systems

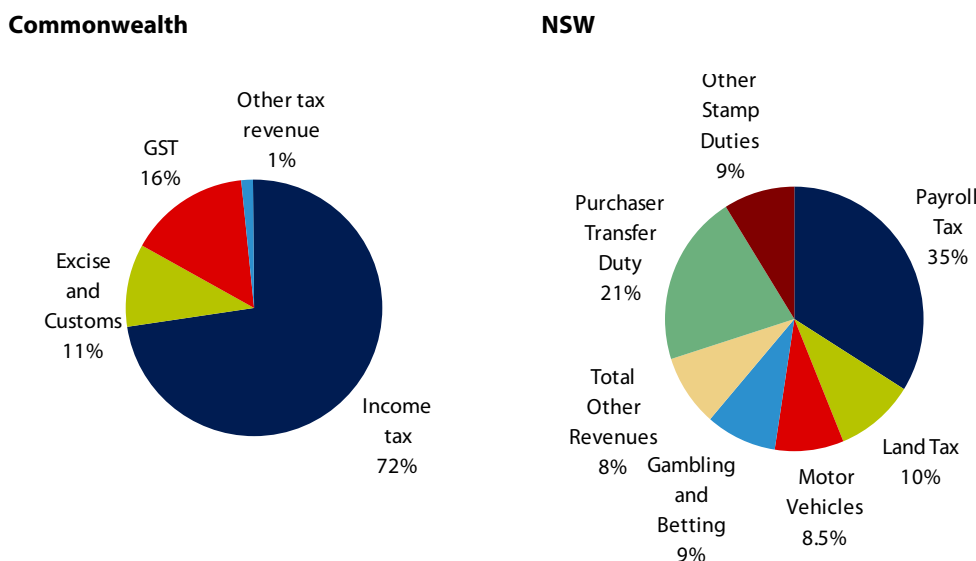
Finding

- 5 Compared to the Commonwealth, the NSW tax system is less efficient, because it relies on a wider mix of smaller, and generally less efficient and more narrowly based taxes. It is also less robust, because its own-source tax revenue is growing at a slower rate.

IPART compared the NSW and Commonwealth tax systems by looking at the structure and mix of taxes each government levies, and the rates at which the revenues raised by these taxes are growing.

2.5.1 Structure and mix of taxes

The Constitution restricts the States' ability to levy taxes (see Chapter 3). As a result, the structure and mix of taxes in NSW (and the other States) is substantially different from those of the Commonwealth. The Commonwealth's taxation base is large, and its tax revenue is almost entirely sourced from taxes on income and the provision of goods and services (see Figure 2.10).

Figure 2.10 Composition of Commonwealth and NSW Tax Revenues, 2007-08

Data source: Commonwealth Budget Papers 2007-08, Budget Paper No 1 and Budget Paper No 3. NSW Budget Papers 2007-08, Budget Statement, Budget Paper No 2, p 3-17.

Total Commonwealth tax revenue for 2007-08 is estimated at \$274.1 billion. This revenue is raised through a small number of taxes:

- ▼ Income taxes, including individual income tax, company tax, fringe benefits tax, superannuation taxation and petroleum resources rent tax, which account for \$198.5 billion, or 72 per cent of the total.
- ▼ Excise and customs duty, including duty on petroleum products, alcohol and tobacco, and on textiles, clothing and footwear, passenger motor vehicles and other imports, which account for \$28.9 billion, or 11 per cent.
- ▼ GST accounts for \$43.1 billion, or 16 per cent. All this revenue is transferred to the States in the form of general purpose GST revenue grants.
- ▼ 'Other' taxes, including wine equalisation tax, luxury car tax, agricultural levies and other minor taxes, which account for \$3.6 billion, or just over 1 per cent.

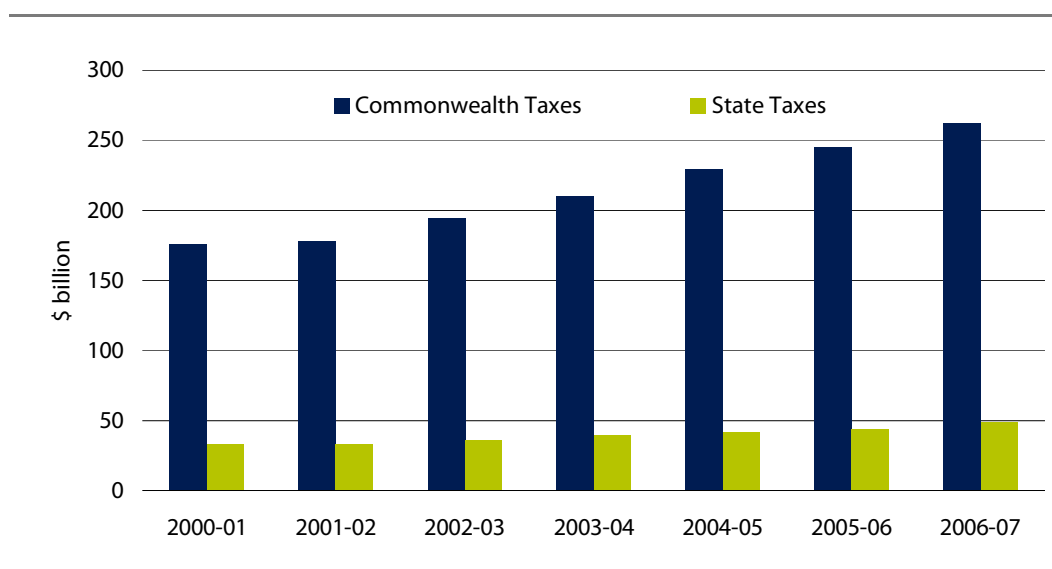
In contrast, NSW has a much smaller tax base, and relies on a wider range of taxes (see Figure 2.10). The NSW tax system is estimated to raise \$17.6 billion in 2007-08, which is equivalent to just 6.4 per cent of the revenue raised from the Commonwealth tax system. As shown in Figure 2.3, 55 per cent of this revenue is raised from two taxes: payroll taxes and purchaser transfer duty. The remaining 45 per cent is raised by a variety of taxes.

As Chapter 4 will discuss, the differences between the Commonwealth and NSW tax bases stem from the fact that the Commonwealth levies taxes that are more efficient than those levied by NSW (and the other States). This is because Commonwealth taxes generally have much larger, wider bases than State taxes.

2.5.2 Tax revenue growth

While there are several key differences between the Commonwealth and NSW tax systems, the revenue from each has grown at similar rates over the last few years. Figure 2.11 compares total taxation revenue of the Commonwealth and the States. Between 2000-01 and 2006-07, Commonwealth taxes grew by 48.9 per cent, from \$175.6 billion to \$262.0 billion. Over the same period, the States' taxes grew by 48.5 per cent, from \$32.7 billion to \$48.9 billion.

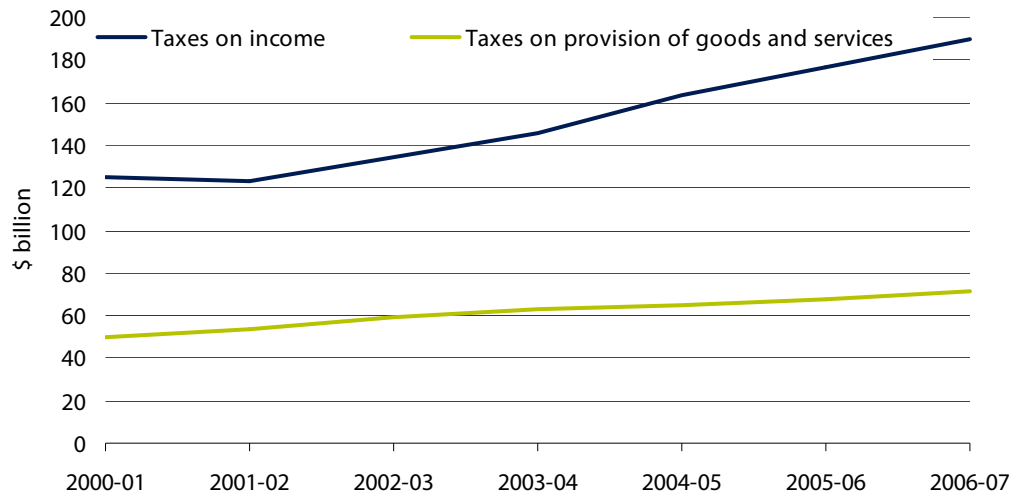
Figure 2.11 Growth in total taxation revenue, Commonwealth and States, 2000-01 to 2006-07



Data source: Australian Bureau of Statistics, *Taxation Revenue in Australia*, 2006-07, Cat No 5506.0.

As Figure 2.12 shows, most of the growth in the Commonwealth's tax revenue comes from income taxes. Revenue from these taxes grew substantially between 2000-01 and 2006-07, by approximately 52.0 per cent.

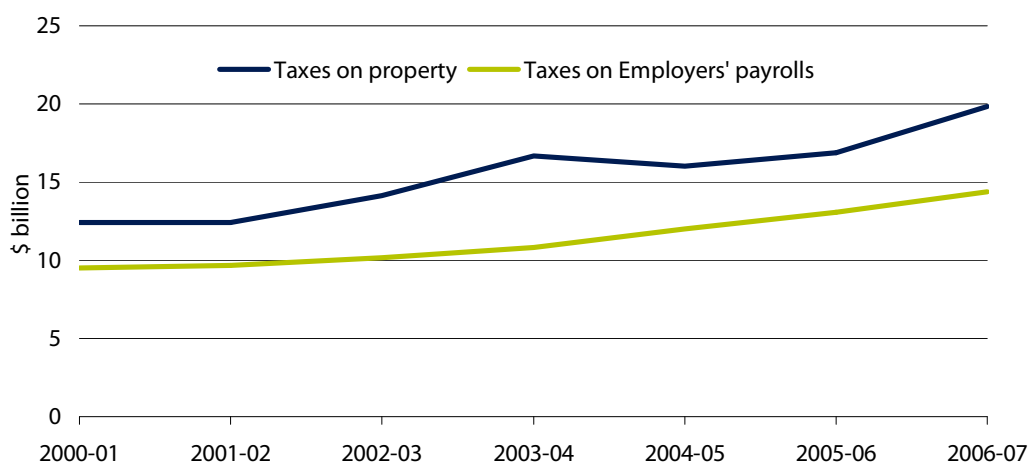
Figure 2.12 Growth in Commonwealth tax revenue from taxes on income and the provision of goods and services, 2000-01 to 2006-07



Data source: Australian Bureau of Statistics, *Taxation Revenue in Australia*, 2006-07, Cat No 5506.0.

Figure 2.13 shows the growth in the State's own-source tax revenue from two major taxes over the same period. Taxes on property (including land tax and stamp duty on conveyances which make property taxes the largest source of tax revenue for State governments in 2006-07) grew by a total of 60.0 per cent but were fairly volatile. Taxes on employers' payrolls (the next largest source) grew, by a total of 51.5 per cent over the same period.

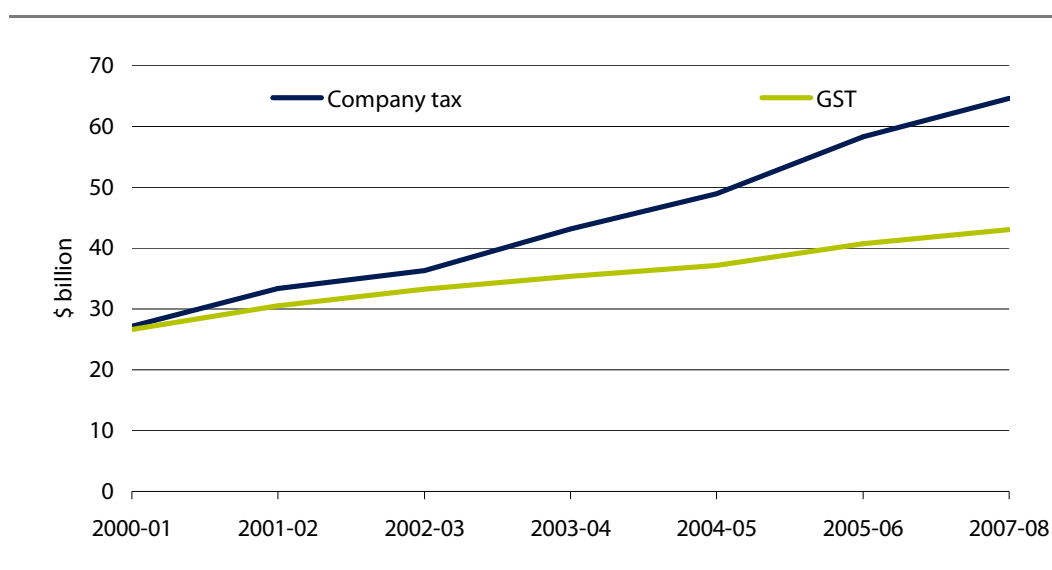
Figure 2.13 Growth in State Governments' taxation revenue from taxes on property and employers' payrolls, 2000-01 to 2006-07



Data source: Australian Bureau of Statistics, *Taxation Revenue in Australia*, 2006-07, Cat No 5506.0.

Figure 2.14 compares the growth in company tax revenue (which is collected and retained by the Commonwealth) with the growth in GST revenue (which is collected by the Commonwealth and transferred to the States) for the period 2000-01 to 2007-08. This figure shows that company tax has grown by 138 per cent while GST revenue has grown by only 61 per cent, giving the Commonwealth access to an extraordinary growth tax over this period.

Figure 2.14 Comparison of company tax revenue and GST revenue, 2000-01 to 2007-08



Data source: Commonwealth Government Budget 2007-08, and Commonwealth Government Final Budget Outcomes 2001 to 2005.

2.6 Adequacy of current NSW tax system to meet the State's future revenue needs

Finding

- 6 Without change, NSW's tax system may not be able to raise sufficient revenue to meet the State's future expenditure requirements.

The main purpose of taxation is to fund public programs.⁷ Along with other States, NSW faces a range of fiscal pressures in financing essential public programs. These pressures include the ageing population, the growing demand for services and the rising cost of those services.

To provide effective funding of public programs over time, taxes that grow in line with expenditure requirements are preferred. In practice, such taxes have a positive and stable relationship to the level of economic activity and population change. Conversely, taxes that are highly cyclical or unpredictable in nature can complicate Government financial management and are therefore less desirable.

⁷ Individual taxes, however, can also be intentionally structured to influence economic behaviour.

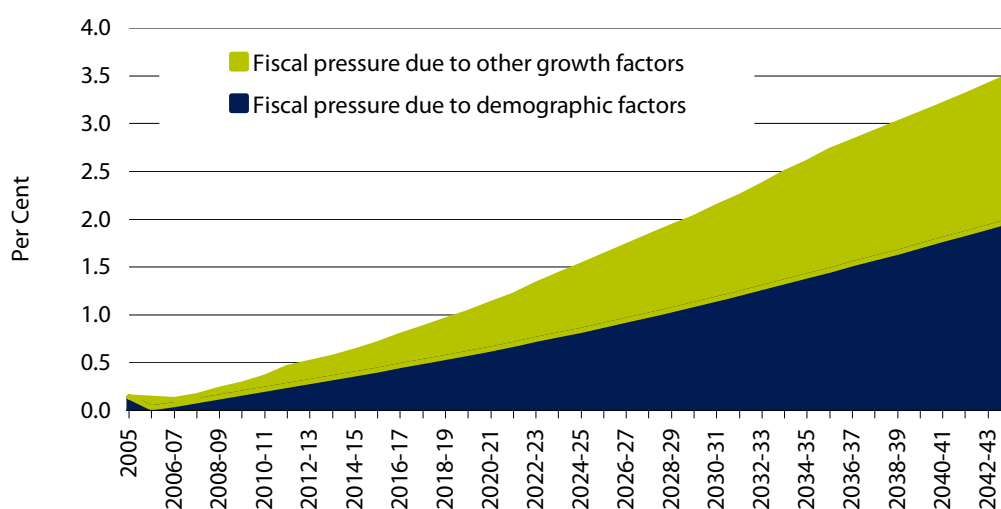
To assess the adequacy of the current NSW tax system, IPART examined the outlook for NSW's future revenue requirements and future total State revenue, compared the expected growth in total State revenue and expenditure, and considered the implications of its findings.

2.6.1 Outlook for NSW's future revenue requirements

The 2006-07 NSW Budget⁸ provided a benchmark estimate of the long-term fiscal pressures that NSW may face by comparing the actual budget outcomes for 2004-05 to the projected budget outcome for 2043-44. It was estimated that demographic and other pressures could lead to a fiscal gap⁹ of around 3.5 per cent of GSP over the 40 year horizon (Figure 2.15). The 2006-07 Budget Papers explain that:

Most of the fiscal gap is due to higher expenses growth, with total revenues slightly lower as a share of GSP. The ageing of the population accounts for around a third of the total fiscal gap,¹⁰ with the growth of the total population size accounting for a further 6 per cent of the total gap. This implies that demographic factors explain 40 per cent of the total fiscal gap, with other growth factors, if they continue to exert pressure as in the past, responsible for the remaining 60 per cent.¹¹

Figure 2.15 Projected NSW Fiscal Gap 2005 to 2044



Data source: 2006-07 NSW Budget, Budget Paper No.6, NSW Long-Term Fiscal Pressures Report, p 4-2.

⁸ NSW Treasury, Budget 2006-07, *Budget Paper No 6, NSW Long-Term Fiscal Pressures Report*.

⁹ The fiscal gap is the difference between the base period primary balance as a share of GSP and the primary balance as a share of GSP at the end of the projection period. The primary balance is the gap between spending and revenue excluding interest transactions but including net capital expenditure. A positive gap implies that fiscal pressures will be building over the projection period.

¹⁰ The ageing impacts are due to the change in the age structure of the population.

¹¹ NSW Treasury, Budget 2006-07, *Budget Paper No 6, NSW Long Term Fiscal Pressures Report*, p 4-1.

Increased expenditure on health services associated with the ageing population and the introduction of new capital-intensive medical technologies will be a major source of demands for public funding. Expectations that the quality and quantity of State government services generally will continue to improve, with service delivery costs likely to rise faster than inflation, and increased demand for infrastructure will also add to future fiscal pressures.

2.6.2 Outlook for NSW's future revenue

At the same time, GST revenue may decline as a share of GDP because the non-GST taxable components of private consumption (health services in particular) may grow faster than the taxable components.¹²

In terms of revenue, the 2006-07 Budget Papers¹³ observe that:

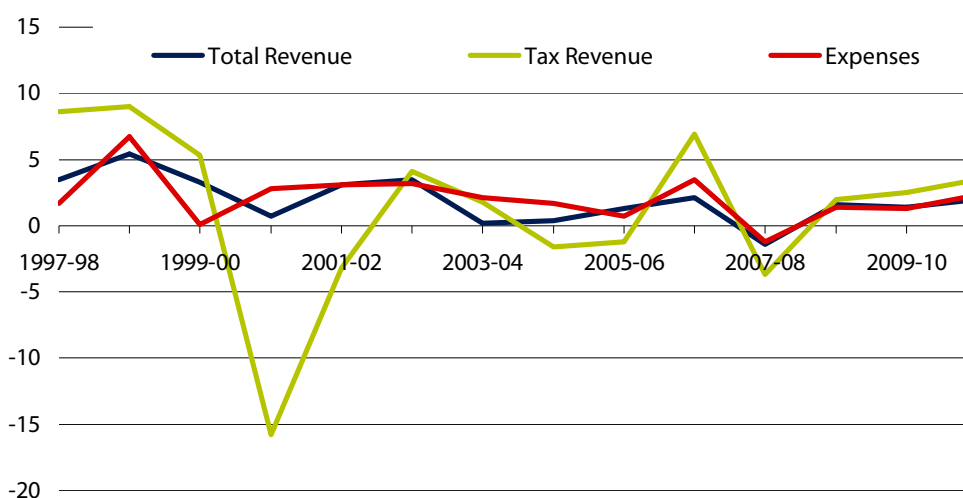
- ▼ Total revenues for NSW are projected to decline only slightly as a share of GSP over the 40 year horizon. However, the composition of revenue will change. Over the long-term, the GST tax base will decline in relative terms.
- ▼ Own-source tax revenue is projected to decline slightly in relative terms, mainly due to contracting tax bases for purchaser transfer duties.
- ▼ Non-tax own-source revenues are projected to increase their relative share of total revenue.
- ▼ NSW's portion of total SPPs from the Commonwealth is projected to decrease reflecting slower growth of the NSW population relative to the rest of Australia.
- ▼ The implications of a larger aged population for revenues dependent on asset markets are uncertain.

Figure 2.16 shows real growth rates in total State revenue and expenses from 1997-08 to 2010-11.¹⁴ The years 2000-01 and 2001-02 show considerable volatility for own-source tax revenue growth, but this is due to the abolition of various State taxes consistent with the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*.

¹² NSW Government (2004) submission to Productivity Commission Research Study into Economic Implications of an Ageing Population.

¹³ NSW Treasury, Budget 2006-07, *Budget Paper No 6, NSW Long-Term Fiscal Pressures Report*, pp 4-8 and 4-9.

¹⁴ Data for 1997-98 to 2005-06 are actual data; the remaining years are estimates.

Figure 2.16 Real growth in total revenue, tax revenue and expenses, NSW (%)

Data source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No 2, p 1-17.

Total revenue and expenditure growth are estimated by NSW Treasury to grow at a similar rate (ie, 3.8 per cent) over the budget and forward estimate period.¹⁵ (In the past, these have often but not always tracked quite closely.) Own-source tax revenue growth has tended to be more volatile and this is the result of the volatile nature of some State taxes, particularly purchaser transfer duty. NSW Treasury estimates that State tax revenue will grow at a marginally higher rate than expenses over the forward estimates.¹⁶ Since State taxes account for only 39.0 per cent of total revenue, it is less important that growth in State taxes track growth in expenses than growth in total revenue.

NSW Treasury¹⁷ has observed that:

Maintaining annual expense growth in line with the long-term growth in revenue means that services can be reliably delivered on an ongoing basis. However, if expenses ratchet up in response to short term increases in revenue there is a risk that service delivery cannot be sustained. This is because while the level of revenues can both rise and fall over the course of the economic cycle, expense levels tend only to increase, leading to periods of Budget deficit and increased government borrowings. Over the longer term, this imbalance is not sustainable and would require a curtailment of government services or higher taxes.

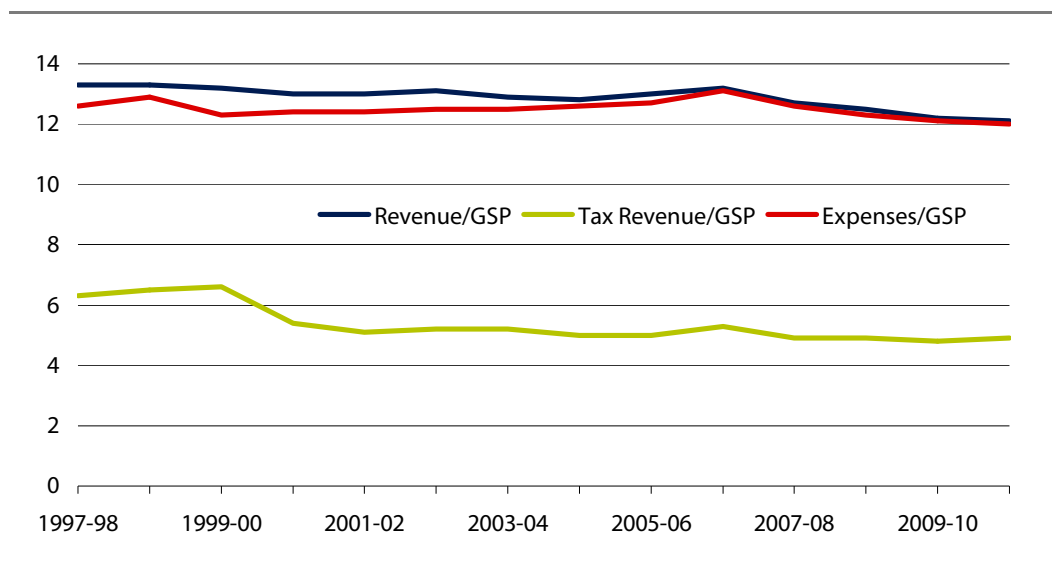
Figure 2.17 shows that for the period 1997-98 to 2009-10, total NSW revenue and expenses have been/are expected to be fairly steady as a proportion of GSP – at approximately 12-13 per cent. In the period since 2000-01, own-source tax revenue has been/is expected to be fairly steady at approximately 5 per cent of GSP.

¹⁵ NSW Treasury, *2007-08 Half-Yearly Budget Review*, p 2.

¹⁶ As shown in Figure 2.17, both will decline slightly as a percentage of GSP.

¹⁷ NSW Treasury, *2007-08 Half-Yearly Budget Review*, p 5.

Figure 2.17 Total State revenue, own-source tax revenue and expenses as a proportion of GSP, NSW, 1997-98 to 2009-10



Data source: NSW Budget Papers 2007-08, Budget Statement, Budget Paper No 2, p 1-17.

In general, revenue and expenditure have to be closely aligned due to difficulty in running deficits at a state level.

Figure 2.17, above, suggests that over the coming years, NSW budgets will be broadly in balance, with total revenue and expenditure as a proportion of GSP moving in parallel. However, Figure 2.16 shows that the total level of own-source tax revenue is highly volatile and is a small proportion of total revenue.

2.6.3 Implications for the future NSW tax system

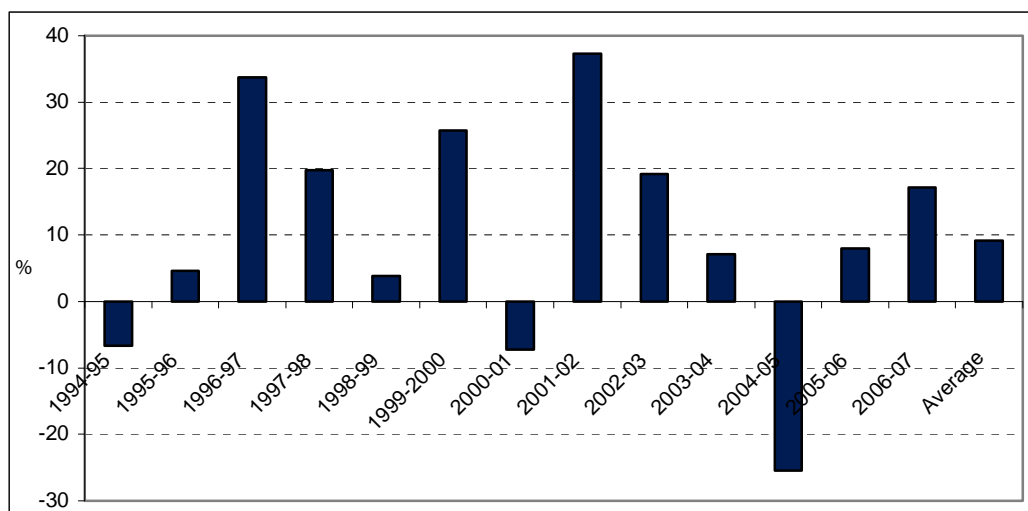
The above analysis highlights some of the deficiencies of own-source taxes in general and of purchaser transfer duty in particular. That is, the level of tax revenues is quite volatile, and revenue from one of the most important of them – purchaser transfer duty – may be subject to long-term decline. This relative decline in property transfer duty is due to slower growth in the population in the household formation stage.¹⁸

Figures 2.18 and 2.19 compare the volatility of the two most important own-source taxes in NSW – purchaser transfer duty and payroll tax over the period from 1994-95 to 2006-07. Figure 2.18 shows that transfer duty is a highly volatile revenue source, subject to wide positive (+37 per cent) and negative (-25 per cent) annual fluctuations, driven by movements in the property market. Reliance of taxes subject to such fluctuations is not desirable, as it makes budget management more difficult. In contrast, payroll tax is much less volatile with only positive variations up to 11 per

¹⁸ Property transactions (both investment in new homes and turnover of existing homes) are most frequent in this phase of the life cycle. See NSW Treasury, Budget 2006-07, *Budget Paper No 6, NSW Long Term Fiscal Pressures Report*, p 4-9.

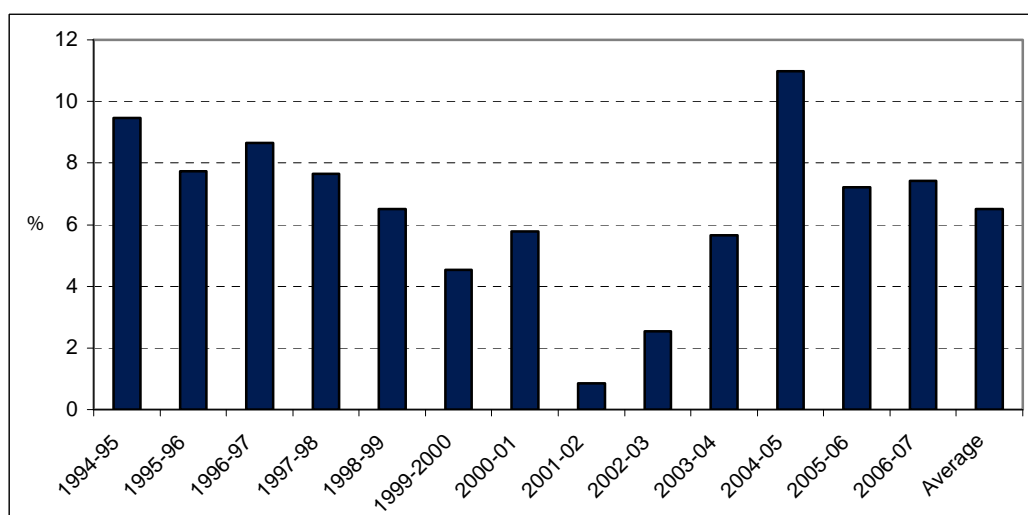
cent. This is at a time when the payroll tax grew at an average annual rate of 6.5 per cent and purchaser transfer duty, 9.2 per cent.

Figure 2.18 Purchaser transfer duty in NSW – annual change, 1994-95 to 2006-07



Data source: NSW Budget Papers 1993-94 to 2007-08.

Figure 2.19 Payroll tax in NSW – annual change, 1994-95 to 2006-07



Data source: NSW Budget Papers 1993-94 to 2007-08.

In summary:

- ▼ NSW's own-source tax revenue is projected to decline slightly as a proportion of total revenue over the coming decades
- ▼ NSW's tax system may not be capable of supporting the extent of revenue growth required to close the fiscal gap, and
- ▼ some policy adjustment is necessary if NSW is to meet essential needs without jeopardising its fiscal sustainability.

The volatility of purchaser transfer duty suggests there is a case for changing the way property is taxed in NSW, to ensure a steady and growing source of revenue that will meet future revenue needs.

3 Constraints on NSW taxation and tax reform

In IPART's view, the NSW tax system – like those of the Commonwealth, other States and local governments – is part of the 'national tax system' (although this phrase is seldom used). Because all taxes affect the allocation of resources within the Australian economy, the design of any part of the national tax system can affect the efficiency of the overall economy. This means that reforms to achieve a more efficient NSW tax system will contribute to a more efficient national tax system, and therefore should be recognised as part of the national reform agenda.

However, being part of the national tax system also means that the NSW tax system cannot be reformed in isolation from those of the Commonwealth or the other States. Before examining the options for reform, it is important to understand the various institutional and practical constraints on taxation and tax reform at the State level. It's also important to understand that cooperation between the States, and between the Commonwealth and the States, is critical to achieve substantive tax reform. As the Intergovernmental Agreement on the Reform of Commonwealth-States Financial Relations (IGA) recognises, this will require the creation of appropriate incentives for the States.

IPART has examined the context for NSW tax reform and identified a range of constraints that, together, limit the practical options for this reform, especially in the short term. These include:

- ▼ constraints due to the Australian Constitution and the way it has been interpreted by the Commonwealth and the High Court
- ▼ constraints associated with the arrangements for redistributing Commonwealth tax revenue, particular GST revenue, among the States
- ▼ constraints due to concerns about interstate competitiveness
- ▼ constraints due to the transitional costs of tax changes.

The sections below discuss each of these constraints, and their collective implications for tax reform in NSW.

3.1 Constraints due to the Constitution and its interpretation by the High Court and Commonwealth

Australia's Constitution originally distributed legislative power between the Commonwealth and the States in a highly decentralised way.¹⁹ In relation to taxation powers, the Constitution prohibited the States from imposing certain taxes, including the following:

- ▼ Customs and excise duties, which is an exclusive power of the Commonwealth under section 90
- ▼ Taxes that conflict with the guarantee enshrined in section 92, that "trade, commerce and intercourse among the States ... shall be absolutely free"
- ▼ Taxes on Commonwealth government property (under section 114) and on the Commonwealth government in general.

But the States had Constitutional access to all other taxes, including income tax.

However, over time, Commonwealth government policy decisions and the High Court's interpretation of the Constitution have effectively removed the States' ability to impose income tax and severely limited the other kinds of taxes they are able to levy. This has had the effect of centralising taxation powers at the Commonwealth level.

For example, as noted above, section 90 of the Constitution provides the Commonwealth with exclusive power to impose customs and excise duties. However, it does not clearly define excise duty. When this definition has been tested, the High Court's view of what constitutes an excise duty has expanded over the years. This view has prevented the States from imposing not just a narrow range of taxes on the production of goods (as most economists would interpret excise duties), but also a broad field of sales taxes.

In addition, section 96 of the Constitution provides the Commonwealth with the power to grant financial assistance to the States on the terms and conditions it sees fit. The way in which the Commonwealth has used this power – for example, by making 'tied grants' to the States, such as SPPs – has further expanded its own powers and reduced the States' fiscal autonomy and flexibility. This issue is discussed further in section 3.2 below. Appendix F provides further discussion and examples of the effect of High Court interpretation and Commonwealth policy decisions on the States' ability to levy taxes.

¹⁹ Sheehan, P and Grewal, B, 2003, *The Evolution of Constitutional Federalism in Australia: An Incomplete Contracts Approach*, Centre for Strategic Economic Studies (CSES) Working Paper No.22, Victorian University of Technology (Melbourne).

3.2 Constraints due to arrangements for redistributing Commonwealth tax revenue among States

As Chapter 2 discussed, NSW (like the other States) is not able to raise sufficient revenue through own-source taxation to meet its revenue requirements, largely due to the constraints discussed above. In contrast, the Commonwealth government raises much more tax revenue than required to fulfil its spending responsibilities. This situation – where there is a mismatch between the respective taxing powers of different levels of government and their spending responsibilities – is known as Vertical Fiscal Imbalance (VFI).

Governments can use a range of strategies to address VFI (see Appendix G). Currently, the Commonwealth government redistributes some of the tax revenue it collects among the States using two approaches:

1. It redistributes GST revenue to the States in the form of untied grants, based on fiscal equalisation (HFE) principles. These grants are known as General Purpose Grants.
2. It makes tied payments to the States that must be used for an agreed purpose, and come with terms and conditions. These payments are known as Specific Purpose Payments (SPPs).

However, the incentives created by the approach used to allocate General Purpose Grants constrain tax reform at the State level, while the conditions attached to SPPs to date have reduced the States' fiscal autonomy and flexibility.

3.2.1 Constraints due to General Purpose Grants

General Purpose Grants are sourced from the revenue raised through the GST, and distributed in line with the recommendations of the CGC. The CGC's objective is to ensure that each State government has the financial capacity to provide the same level of service to its residents. To do this, it distributes the pool of money available among the States according to the principle of HFE. The CGC's definition of this principle is set out in a recent review as follows:

State governments should receive funding from the pool ... such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the same capacity to provide services at the same standard.²⁰

However, the fiscal incentives created by the CGC's approach to HFE can influence a State's fiscal policies, and act as a constraint to tax reform. This is because a State's taxes and expenditures can affect the parameters of the CGC's grant formula. Therefore, the States can respond by changing their policies in such a way as to

²⁰ Commonwealth Grants Commission (CGC), 2008, *Report on State Revenue Sharing Relativities*, 2008 update, Commonwealth of Australia, Canberra, p 25.

maximise their grant.²¹ Alternatively, if they pursue policies that increase their own-source tax revenue base, the CGC's approach means that any benefits these policies create will be eroded by reductions in their General Purpose Grant (see Box 3.1 for an example of this effect).

The way in which the CGC assesses HFE as part of the grant formula further contributes to this problem. Within these assessments, the CGC weights the different kinds of taxes the States levy according to how much revenue each collects, in aggregate across all States. Therefore, if a State alters its tax system – for example, so it collects more from land tax and less from purchaser transfer duty – the relative weightings of those two taxes will automatically adjust to reflect their changed importance.²²

This relative weighting is important because the distribution of individual tax bases varies across States. If a State is relatively poorly endowed with a tax base that other States find quite lucrative (and hence is weighted relatively heavily), that State will receive greater compensation through the HFE process than if its tax base generated more revenue. Conversely, a State blessed with a large share of a tax base that generates a lot of aggregate revenue across the States will find that the HFE process takes away the benefits of that large share and redistributes it to the other States.

The important implication of this overall process is that if a large State such as NSW reforms its taxes so as to tax more heavily those tax bases with which it is relatively well endowed, the increased weighting placed on those taxes in the HFE process would see its share of the GST revenue reduced. On the other hand, if NSW reduced the revenue from those tax bases, their reduced weighting would see NSW's share of the GST increase.

The outcome of the CGC's current approach is to constrain the scope for tax reform in NSW. As a result of HFE, for every \$1 of GST revenue generated in NSW only about 83 cents is returned to the State. In aggregate, Treasury estimated that NSW will cross-subsidise the other States (excluding Victorian and Western Australia) by almost \$2.5 billion in 2007-08.²³ This loss of GST revenue is restricting both the timing and the extent to which inefficient taxes can be abolished in this State.

²¹ Warren, N and Dahlby, B, (2003) 'Fiscal Incentive Effects of the Australian Equalisation System', *Economic Record*, 79(249), pp 434-445.

²² This is particularly relevant in a large State like NSW. Because its tax revenue typically comprises around a third of all total State collections, any changes it makes will have a greater proportional influence on the total collection than changes made by a smaller State.

²³ NSW Treasury, NSW Budget Papers 2007-08, *Budget Paper No 2*, p 8-1.

Box 3.1 Example of perverse fiscal incentives created by CGC's approach to HFE

In recent years, the WA Government has committed \$160 million to upgrade infrastructure serving the Burrup Peninsula gas processing developments, and will commit more if a second development goes ahead. These investments will enable these developments to proceed and grow, thereby increasing WA's capacity to collect own-source tax revenue.

However, under its current approach to HFE, the CGC assumes that any increase in a State's tax revenue happens independently of the actions of the government. Therefore, if the increased developments generate an additional \$550 million in tax revenue per annum, as the WA Treasury has estimated, the CGC it would not take into account the \$160 million effort WA has made to generate this additional revenue.

Rather, the CGC's would take the \$550 million in additional available financial resources and reallocate it among all the States, by reducing the size of WA's General Purpose Grant to offset its additional own-source revenue. WA's share of the reallocation would be only \$100 million, leaving it with a net loss of about \$60 million.

Source: Government of Western Australia, Department of Treasury and Finance, 2006, *Discussion Paper on Commonwealth–State Relations, An Economic and Financial Assessment of How Western Australia Fares*, p 36.

3.2.2 Constraints due to SPPs

SPPs are made to the States to fund the provision of a particular service. They are usually distributed on the basis of need for the particular service, as determined by the relevant Commonwealth portfolio Minister, in consultation with Ministerial counterparts in the States.

However, as section 3.1 discussed, these payments are 'tied grants', which means that the State or Territory needs to meet specific conditions to qualify for the payment. These conditions usually relate to the inputs and resources to be consumed in providing the services, rather than the policy outcomes to be achieved – for example, requiring the State to provide a matching amount of funding from its own-source revenue.

Through these conditions, the Commonwealth is able to use its own funding contributions to control State government outlays. For example, NSW Treasury estimates that SPPs provide around 15 per cent of the State's total revenue, but the conditions attached to these payments control around 30 per cent of NSW budget outlays.²⁴

IPART also notes that while the process for allocating SPPs among the States can sometimes be extraordinarily complex, the allocation ultimately makes little difference to a State's total revenue.²⁵ This is because the CGC allocates General

²⁴ NSW Treasury, NSW Budget Papers 2006-07, *Budget Paper No 2*, p 8-14.

²⁵ As discussed in Chapter 6, some SPPs are quarantined from this process.

Purpose Grants so that any interstate differences in the States' financial resources are eliminated. It achieves this by using the size of the States' General Purpose Grants to balance out the difference between their revenue from all other sources (including most SPPs) and their revenue requirements, as determined by the CGC. Thus the CGC effectively controls the level of financial resources available to a State, regardless of the State's own efforts to improve its revenue base or Commonwealth policy on distributing SPPs (as discussed further in Chapter 6).

3.3 Constraints due to concerns about interstate competitiveness

Concerns about NSW's interstate competitiveness act as another constraint on tax reform – by limiting the scope to increase tax rates, and creating pressure to reduce rates that are higher than those in other States even though these taxes may be a more efficient means of raising the State's required revenue.

In broad terms, the States have fairly similar tax systems – most include a range of stamp duties, payroll tax, land tax, motor vehicle taxes, and gambling and betting taxes. But although the tax bases may be broadly similar, there is considerable variation in tax rates and thresholds which apply to those bases (see Chapter 4). This variation means there is an element of tax competition between the States to retain and attract investment.

Even where a State has the constitutional or legislative power to tax particular bases or introduce new taxes, in practice, the existence of interstate tax competition may prevent it from doing so. Any tax base that is potentially or actually mobile between the States is vulnerable to tax competition.

Tax competition among the States has its advantages and disadvantages. On one hand, the combination of mobile tax bases and interstate tax competition can act as a restraining influence on government in its pursuit of revenue and the impost made on the community. On the other hand, the combination of mobile tax bases and interstate tax competition can undermine a State's ability to fund services.

For instance, this can occur where there is a 'race to the bottom' in terms of reducing taxes to attract or retain business (eg, reducing payroll tax rates, introducing concessions, or providing tax holidays). In extreme cases, it can result in the elimination of some taxes where the actions of one State precipitates corresponding action by other States (eg, in the case of death duties).

Another disadvantage is that interstate competitiveness can make it more difficult for a State to unilaterally change its tax bases. This can occur where States have agreed to harmonise their legislated definition of the tax base (as with some stamp duties and the payroll tax in NSW and Victoria). However, IPART recognises that harmonisation has benefits, particularly in terms of compliance costs for businesses which operate across jurisdictions.

3.4 Constraints due to the transitional costs of tax changes

There are also some important practical restraints to tax reform, including the community's willingness to accept tax changes. The State's current taxes are factored into current asset prices and the decisions made by individuals and businesses on what to buy or supply and where to locate.

Making changes to these taxes will have transitional costs for these individuals and businesses. These transitional costs are real costs, and must be balanced against the benefits of tax reforms. In addition, these costs will fall more heavily on some groups than others, so there is also the prospect of transitional inequities. Community concern about transitional costs makes tax reform unpopular – hence the maxim “an old tax is a good tax”.

3.5 Implications of these constraints for NSW tax reform

As the sections above have discussed, the Commonwealth's highly centralised taxation powers give it exclusive abilities to raise the more efficient, broadly based taxes, including income and consumption taxes, while the States must rely heavily on relatively inefficient, narrowly based taxes.²⁶ (The relative efficiency of State and Commonwealth taxes is explored in detail in Chapter 4.)

The limitations on the States' taxing powers means they are not able to raise sufficient revenue from efficient taxes to meet their revenue needs, given their expenditure responsibilities. In contrast, the Commonwealth is able to raise much more than required for its expenditure responsibilities. As a result, there is a significant VFI, which Warren has noted is more severe than in other comparable federations.²⁷

In addition, the arrangements to address this VFI by redistributing Commonwealth collected tax revenue among the States according to a complex HFE system creates perverse incentives, and can encourage game playing and discourage reforms that would improve the efficiency of a State's, and therefore the national, tax system. Therefore it is important that States considering tax reform options take account of the impact of the limitations of the CGC's HFE process on their General Grant allocation. (Appendix G summarises the key limitations of the HFE process, and provides historical examples of how the revenue collected by various State sources has affected grant allocations.)

IPART considers that the current imbalances in the expenditure responsibilities, taxing abilities and revenue-sharing arrangements of the States and the Commonwealth severely limit the extent to which NSW can achieve tax reform relying solely on its own discretionary revenue raising powers. While useful

²⁶ Note however, that payroll tax and land tax are more efficient than the other state taxes.

²⁷ Warren, N, *Benchmarking Australia's Intergovernmental Fiscal Arrangements-Final Report*, May 2006, p 63.

improvements can be made to the NSW tax system (see Chapters 4 and 5), more substantive reform will require cooperation between the States, and between the States and the Commonwealth (Chapter 6). Further, the perverse incentives created by the Commonwealth's current approach to HFE suggest that reforms to this approach, and the creation of appropriate incentives for tax reform, may also be necessary.

In IPART's view, the constraints to substantive tax reform are considerable, but in this new period of cooperative federalism, they should not present insurmountable obstacles to tax reform in the national interest. Options for the reform of Commonwealth-State fiscal arrangements are discussed in Chapter 6.

4 Assessment of current NSW and Commonwealth taxes

To assist it in identifying the options for reforming the NSW tax system, IPART assessed the State's major taxes, taking into account:

- ▼ standard taxation principles, which include efficiency, equity, simplicity and transparency
- ▼ robustness, which is the tax system's ability to consistently raise sufficient revenue to fund essential public services, and
- ▼ interstate competitiveness.

In undertaking these assessments and comparisons, IPART took account of different taxes' suitability for assignment to either the national or subnational level of government (see Box 4.1). IPART also compared the efficiency, equity, simplicity and transparency of the major Commonwealth taxes, and compared them to NSW taxes.

The assessment of NSW's major taxes found that the tax that contributes most to the State's own-source tax revenue – payroll tax – also ranks equal first among the major State taxes in terms of its performance against standard taxation principles and robustness. In its current form, this tax is one of the most efficient State taxes, and importantly, there is substantial scope to further improve its efficiency. It also scores well for robustness, simplicity and transparency, but scores poorly for equity.

Land tax – another significant contributor to the State's own-source tax revenue – is also one of the most efficient State taxes, and also has substantial scope for efficiency improvements. However, this tax scores relatively poorly for equity, simplicity and transparency, and was ranked fourth among the State taxes overall.

For both payroll tax and land tax, the current tax base is considerably narrower than the potential tax base. The efficiency of these taxes could be substantially improved by broadening their bases by reducing or removing exemptions and concessions. This would also improve their equity, as the current exemptions and concessions place a disproportionately high tax burden on those businesses and individuals who are liable to pay the tax, and provide substantial savings for those who are excluded from the base.

Box 4.1 Assigning taxes to the national or subnational level of government

In assessing the NSW tax system against standard tax principles, robustness and interstate competitiveness, IPART took into account that some taxes are less suited to assignment at the subnational level (eg, the State level) and so are more effectively collected at the national level (ie, by the Commonwealth).

According to the traditional theory of fiscal federalism, for a tax to be suitable for assignment at the subnational level, it needs to meet the following criteria.^a

1. is easy to administer at the subnational level
2. can be imposed solely (or mainly) on residents of the State or local area concerned
3. does not raise problems of competition between subnational governments or between subnational and national governments.

Only a few taxes meet those criteria. These include property taxes; betterment levies or wealth taxes; personal income tax (usually as a flat rate tax 'piggy-backing' on the national personal income tax); some excise taxes; taxes on vehicles; and a variety of user fees.^b

Appendix I provides a brief analysis of a range of taxes' suitability for assignment to the subnational level of government.

^a See Martinez-Vazquez, J. and Boex, J. 2001, World Bank Institute Module, *The Design of Equalisation Grants Theory and Applications*, Washington DC: The World Bank.

^b Warren, N. 2006, *Benchmarking Australia's Intergovernmental Fiscal Arrangements, Final Report*, May 2006, p 60.

Purchaser transfer duty – which is the second largest contributor to the State's own-source tax revenue – ranks among the least efficient of the NSW taxes. It scores poorly for efficiency because it adds to the cost of real estate transactions and so can distort investment decisions, and because it applies to a narrow base (only those properties sold during the tax year). It scores poorly for robustness, because the revenue it generates can change dramatically from year to year, depending on the property cycle. It also scores poorly for equity and has an average score for simplicity.

Insurance duty and fire services funding contributions are arguably the least efficient State taxes. Both these revenue sources penalise those who are prudent enough to take out insurance, and so encourage underinsurance and non-insurance. In addition, significant free-rider problems are associated with the fire services funding arrangements, where non-contributors benefit from the provision of fire services without contributing to the cost through insurance policies.

IPART's assessment of interstate competitiveness indicates that NSW's overall tax competitiveness is reasonable. NSW collects more tax revenue per GSP than any other State, and more tax revenue per capita than all States except Western Australia and the ACT. However, NSW's relative tax effort index is close to the average for all States, which suggests that NSW tax rates are competitive. IPART's comparative analysis of the tax rates and thresholds for individual State taxes supports this view,

although payroll tax rates are higher than in other mainland states (excluding ACT and NT).

The assessment of NSW's reliance on individual taxes found that the composition of State taxes is more efficient in NSW than in other States. NSW relies more heavily on payroll tax and land tax than the other States, and these taxes are among the most efficient State taxes in their current form and have potential to be substantially more efficient. NSW also relies less on purchaser transfer duty – a relatively inefficient tax – than most other States.

The assessment of major Commonwealth taxes against standard taxation principles and robustness clearly shows that these taxes – which include personal income tax, company income tax, GST, and excise and customs duty – perform better than the major State taxes.²⁸ As Chapter 2 discussed, the Commonwealth relies on a smaller number of taxes than the States, and collects substantially more revenue. This is possible because the Commonwealth taxes are all more efficient than the State taxes, largely because they apply to broader bases. One exception is excise duty, which applies to a narrow range of items – petroleum products, alcohol and tobacco. However, taxation of these products is also designed to achieve other policy objectives.

IPART considers that the above findings, which are discussed in detail in the sections below, indicate that there is scope for reform of individual NSW taxes and the overall composition of these taxes. The options for such reform are discussed in Chapter 5. There is also a need for, and potential for, reform of the Commonwealth-State tax sharing arrangements. For example, sharing efficient Commonwealth tax bases with the States in return for eliminating or reducing certain inefficient State taxes, as was done with the GST, would provide an incentive for State tax reform and therefore for microeconomic reform in the national interest. The options for Commonwealth-State reforms are discussed in Chapter 6.

4.1 Assessment of NSW taxes against standard tax principles and robustness

To undertake its assessment of NSW taxes against the standard tax principles (efficiency, equity, simplicity and transparency) and robustness, IPART rated each criterion out of 5 (where 5 means the tax meets the criteria very well, and 0 means it barely meets it at all). IPART also applied a weighting system to the ratings for each criterion, based on their relative importance for the purpose of this analysis:

- ▼ efficiency has a weighting of 40 per cent
- ▼ robustness and equity each have a weighting of 20 per cent
- ▼ simplicity and transparency each have a weighting of 10 per cent.²⁹

²⁸ In theory, payroll tax could achieve comparable levels of efficiency to the GST but in practice it applies to only 8.5 per cent of businesses.

²⁹ IPART's analysis shows that the rankings are reasonably robust to changes in the weights.

It then calculated a weighted score for each tax, and ranked the taxes according to this score.

The findings of this analysis show that despite having abolished a number of inefficient taxes over recent years in line with its undertakings in the IGA, NSW still relies on a large number of taxes that are relatively inefficient.³⁰

Table 4.1 provides an overview of each tax's ratings, weighted score and overall ranking.

Table 4.1 Overview of IPART's assessment of NSW taxes against standard tax principles and robustness

Tax	Efficiency	Equity	Trans- parency ^a	Simplicity ^b	Robust- ness	Weighted Score	Ranking ^c
Payroll tax	3	2	4	4	4	3.2	1
Land tax	3	2	2	1	3	2.5	3
Purchaser transfer duty	2	2	4	3	1	2.1	8
Insurance duty	1	3	4	5	2	2.3	6
Motor vehicle registration duty	2	3	3	4	2	2.5	3
Motor vehicle weight tax	3	2	4	4	4	3.2	1
Fire services funding contributions ^d	1	2	3	3	4	2.2	7
Gambling taxes	3	1	1	4	3	2.5	3

^a Transparency has been assessed in terms of transparency to the person who ultimately bears the burden of the tax.

^b Simplicity includes administration costs and compliance costs.

^c In order from highest to lowest (ie 1 is highest ranked tax).

^d Fire Services Contributions in this assessment refers to the Statutory Contribution made by insurance companies.

This table shows that the weighted scores for NSW taxes range from 3.2 to 2.1 out of 5, and the efficiency ratings range from 3 to 1 out of 5. Payroll tax – the highest contributor to NSW own-source tax revenue was ranked equal first, along with motor vehicle weight tax – a relatively small contributor. Purchaser transfer duty – also a large contributor to own-source tax revenue – was ranked the lowest, being just below fire service funding contributions and insurance duty. Land tax, motor vehicle registration duty and gambling taxes ranked in the middle. (See Chapter 2 for an overview of the composition of own-source tax revenue in NSW.)

³⁰ Taxes abolished by the NSW Government since the introduction of the GST include financial institutions duty, debits tax, marketable securities duty on listed securities, vendor duty, mortgage duty on mortgages of owner-occupied residences, stamp duty on hire of goods and on leases. Transfer duty on non-land business assets is to be abolished from 1 July 2012.

However, the above assessment is based on the taxes as currently structured and implemented.

While all State taxes have various deficiencies, there is scope for improvement. As a guideline to reform, IPART has looked at the theoretical potential for improving the State's taxes against the criteria of efficiency, equity, robustness, simplicity and transparency. The analysis suggests that there is substantial scope for improving payroll tax and land tax. However, for taxes such as stamp duties, there is not much scope for improving their rating against the criteria, which indicates fundamental design flaws with these taxes.

The sections below explain each of the criteria IPART used in assessing individual NSW taxes, and provide an overview of its assessment for each tax.

4.1.1 Criteria used to assess NSW taxes

According to standard taxation principles, a well-designed tax system is characterised by efficiency, equity, simplicity and transparency. It must also be robust – that is, it must raise sufficient revenue to meet Government expenditure responsibilities, both now and in the future. In addition, in a federal system like Australia's, a State-level tax system must be competitive compared to those in other States, and the taxes levied must be suitable for assignment to the subnational level of government (see Box 4.1).

However, these criteria sometimes conflict. For example, measures to make the tax system more equitable may require complex legislation thereby reducing its simplicity and transparency; measures to improve interstate competitiveness may reduce the efficiency of an individual tax. Inevitably, compromises need to be made, based on each criterion's different degree of importance.

In addition, as Chapter 3 discussed, the NSW government has limited taxing powers compared to the Commonwealth, which means it can levy only a limited range of taxes. These taxes are not necessarily those that best meet the criteria for a good tax system. Importantly, they do not enable NSW to raise enough revenue through own-source taxation to meet its spending responsibilities on its own. Further, they make it more appropriate for the Commonwealth to pursue some of the important objectives for tax systems (see Box 4.2).

Box 4.2 Appropriate objectives for NSW tax system

Taxation is the mechanism by which resources are reallocated from the private sector (individuals, businesses and other non-government entities) to the public sector to fund public services. Therefore, the primary objective for any government's tax system is to raise sufficient revenue to fund the public services it is responsible for.

Governments may also have other economic and policy objectives for its tax system, such as redistributing income and wealth, reallocating productive resources, and assisting with macroeconomic stabilisation. However, in a federation like Australia, these other objectives are often better pursued through the Commonwealth government's tax system, rather than the States'.

In general, income and wealth redistribution objectives are not optimally pursued by State governments. The Commonwealth is responsible for the two most effective means of influencing income distribution – the social welfare system and income taxation. In addition, the greater mobility of State tax bases militates against an emphasis on redistribution objectives in State taxation.

Taxes can also be used to correct for failures in private markets. In this role, taxes can change relative factor or product prices in order to increase the efficiency with which productive resources are used. However, it is important to have a tax system which causes minimum unintended distortion in the allocation of productive resources.

In recent years, there has been increased interest world-wide in applying taxes for environmental objectives. For example, taxes may be used to correct for negative externalities such as pollution which, if left uncorrected, would lead to overproduction of some items and so over-utilisation of productive resources in certain areas. However, where externalities are not location specific, State taxes are generally not best suited for such objectives.^a In these cases, Commonwealth consumption taxes such as the GST and excise duties are better suited to these objectives.

Taxation is also an important, though often imprecise, tool of fiscal policy aimed at achieving macroeconomic stabilisation through its effect on aggregate demand. However, States seek to achieve a broadly balanced Budget, leaving fiscal policy to the Commonwealth. Hence the macroeconomic stabilisation objectives are not relevant to State taxation. Because of the States' broad objective of a balanced budget, State taxes should ideally be more insulated from economic fluctuation than Commonwealth taxes.

Given the above, it can be argued that the States should focus primarily on applying their taxes efficiently, rather than seeking to pursue other objectives that can be more effectively addressed at the Commonwealth level.

^a Whether state or national taxes are better suited to addressing an externality depends on the spatial dimension. National or international externalities, such as carbon emissions, are best addressed at that level. Congestion, however, is a prime example of an externality best addressed at the sub-national level.

Given this, IPART considers that a State tax system that adequately meets these criteria would have the following important characteristics:

- ▼ Its primary objective would be to raise revenue to finance essential public expenditure, such as health, education, transport and police.
- ▼ It would raise this revenue in a manner that imposes the least cost in terms of economic efficiency (ie, so that tax considerations would have minimal effect on the behaviour of producers and consumers).
- ▼ It would rely on tax bases that minimise the scope for avoidance or evasion.
- ▼ It would aim to avoid exacerbating existing inequities.
- ▼ It would generate revenue that grows steadily in line with requirements for essential public services.
- ▼ It would not impose undue compliance costs on taxpayers, or administrative costs on State tax authorities.
- ▼ It would not adversely affect the competitiveness of the State's industry.

The criteria for a good tax system – efficiency, equity, simplicity, transparency and robustness – are described in detail below. Interstate competitiveness is discussed in section 4.2.

Efficiency

All taxes will affect economic efficiency in some way. Therefore, the goal is to design a tax system that meets the required revenue raising objectives in a manner that minimises the extent to which the system influences taxpayers' economic choices. Efficient taxes are ones that minimise the distortion of economic decision making and therefore have relatively little impact on the overall allocation of resources in the economy. In an efficient tax system:

- ▼ the same business decisions are made regardless of tax considerations
- ▼ risk taking and innovation are not discouraged
- ▼ economic restructuring is not hindered
- ▼ the public sector is not given a competitive advantage over the private sector for service provision, based on taxation
- ▼ taxpayers have little incentive or opportunity to rearrange their financial affairs or to re-configure transactions to materially alter the tax consequences, and
- ▼ minimal resources are directed towards evasion, avoidance and enforcement.

Taxes can influence economic choices in a variety of ways, for example:

- ▼ tax-free thresholds and multiple tax rates may deter business taxpayers from expanding, while exemptions may artificially favour tax-exempt activities and encourage rent-seeking behaviour

- ▼ the imposition of tax in one state (eg, on purchase of caravans and camper trailers in NSW) distorts the allocation of resources between states (eg, caravan owners buy and register their caravans interstate, even if this is illegal for NSW residents).

This distortion of economic activity imposes a ‘deadweight cost’ on the economy – acting as a drag on economic activity and so reducing growth in jobs and incomes below potential – that must be balanced against the actual revenue raised by the tax. Taxes that minimise deadweight costs – ie, are efficient – are preferable.

In general, efficient taxes have two important characteristics:

1. **Broad bases with minimum concessions or exemptions.** Broad tax bases can minimise effects on relative prices especially within similar groups of goods, services or activities.³¹ Further, broad based taxes minimise opportunities for taxpayers to reduce tax liabilities by adjusting economic behaviour. In contrast, narrow tax bases can create such opportunities and thus encourage individuals and businesses to change their economic behaviour in pursuit of post-tax rates of return not closely related to real rates of return.
2. **Low, uniform tax rates.** As a general rule, low tax rates (relative to the item being taxed) reduce taxpayers’ incentive to avoid or evade liability by changing their behaviour. Single tax rates eliminate taxpayers’ opportunities to change their behaviour to exploit differential rates.

In some cases, the characteristics that make a tax efficient may lead to it not meeting other criteria for a good tax system. For example, a tax with a single rate will not have the equity benefits of one with a progressive rate scale. However, as Box 4.2 discusses, the taxes available to the States are generally not well suited for income redistribution. Therefore single tax rates are generally favoured over multiple rate tax structures for State taxes.

Similarly, tax bases with minimum concessions and exemptions may be inequitable. However, given that concessions and exemptions are effectively ‘tax expenditures’ – that is, subsidies to certain sections of the community provided by reducing their tax liabilities – it is generally considered more efficient to address equity concerns by increasing direct government outlays, rather than through the tax system.

In other cases, higher rates of tax on relatively narrow tax bases can be efficient. Provided the demand or supply of the taxed item is relatively unaffected by price (price inelasticity), the extra cost involved in payment of the tax will not significantly affect the decision to demand/supply the good or service.

³¹ Technically, the question is whether the price elasticity of the product taxed is high or low. The lower the price elasticity, the more efficient the tax. Some individual goods may be quite price inelastic, hence they may be a more efficient tax base than other goods with a great price elasticity. However, if a tax was levied on all goods equally there would be no changes in relative prices and the effects on relative consumption would reflect relative income elasticities only.

Further, some taxes that aim to change taxpayers' behaviour can be considered efficient. These include taxes that aim to achieve desired environmental or other outcomes by changing undesirable behaviour, such as polluting waterways, or driving cars into the city centre.

There is also an administrative aspect to efficiency. An administratively efficient tax has lower costs of collection and compliance. Taxes with comprehensive bases and uniform rates therefore have the additional advantage that they tend to minimise compliance costs to taxpayers and administration costs to revenue authorities.

Equity

Equity is concerned with the fairness of a tax. The fairness of taxes can be assessed in two dimensions: vertical equity and horizontal equity:

- ▼ Vertical equity refers to capacity to pay. Increases in income are considered to lead to a more than proportionate increase in capacity to pay. Therefore, according to the principle of vertical equity, lower income taxpayers should pay not only less tax but also a lower proportion of tax compared with those on higher incomes.
- ▼ Horizontal equity refers to equal treatment of taxpayers in similar circumstances. According to the principle of horizontal equity, taxpayers in comparable situations should pay equal tax.

The literature on assigning taxes within a federation suggests that the Commonwealth government is best placed to pursue equity objectives by redistributing income by setting progressive rate schedules³² for the income taxes it levies.³³ The primary focus for State governments in regard to equity is on minimising the extent to which their taxes contribute to inequities. Both the Commonwealth and States can pursue horizontal equity by setting broad based taxes, which do not target specific groups, and therefore promote equal treatment of taxpayers.

However, the extent to which a tax system is equitable is best assessed on the basis of the overall system, as not all individual taxes are well suited to influencing income distribution. For example, transaction taxes (such stamp duties) take little account of the taxpayer's ability to pay,³⁴ and fall more heavily on those who engage in transactions more frequently.

³² With progressive taxes the tax rates increase with the ability to pay.

³³ The traditional approach to tax assignment (Musgrave, R, 1983, 'Who should tax, where, and what?'. In Charles E. McLure (ed), *Tax Assignment in Federal Countries*, Canberra: Australian National University, Centre for Research on Federal Financial Relations) suggests that progressive taxes which are designed to achieve redistributive goals should be allocated to the highest tier of government.

³⁴ For instance, even though the rate at which purchaser transfer duty applies increases with the value of the property purchased, but there is no way of knowing whether low-value and therefore low-taxed property is being purchased by a high-income earner as an investment or low-income earner for residential purposes.

In addition, assessing the equity of an individual tax depends on knowing who actually bears the burden of a tax. In this sense a distinction needs to be made between who pays the tax (ie, legal incidence) and who bears the burden of the tax (ie, the economic incidence). The person or firm on whom the tax is levied may be able to pass it on, and so does not necessarily bear its burden. For example, payroll tax is imposed on firms but is generally passed on to the consumers who buy the goods or services those firms produce through higher prices. Thus, some economists see payroll tax as being comparable to a consumption tax.³⁵ Alternatively, businesses may pass on the cost of payroll tax to employees by offering lower wages than they would in the absence of payroll tax. In this situation, payroll tax would effectively act as an income tax.

4.1.2 Simplicity

Simplicity can lower the cost of taxation by minimising the waste of productive resources involved in transferring resources from the private sector to the public sector. Whereas efficiency is concerned with minimising the distortions in resource allocation caused by tax-induced changes in relative prices, simplicity relates to minimising the costs imposed by the tax system on taxpayers and tax administrators.³⁶

Simple taxes are preferred because they minimise the costs of compliance and administrative costs as far as possible. An efficient tax – ie, one that is broad-based and has uniform tax rate – is simpler both to comply with and administer, while exemptions and multiple rates create losses in administrative efficiency.³⁷

The major factors that affect taxpayers' compliance costs include:

- ▼ the complexity of calculating tax liabilities, for example, thresholds encourage taxpayers to rearrange their affairs so as to minimise their tax obligations
- ▼ the lack of clarity in legislation and the consequential need for external advisers
- ▼ staff time taken to ensure compliance for business operating in more than one State
- ▼ the degree of interstate harmonisation of tax bases and rates
- ▼ the extent of record keeping and systems requirements beyond normal management and accounting needs.

³⁵ See *The Case for Payroll Tax*, NSW Treasury Research and Information Paper, TRP 99-3, September 1999.

³⁶ See *Review of State Business Taxes*, State Business Tax Review Committee Final Report, Victoria, February 2001.

³⁷ Administrative efficiency refers to the costs of administration and compliance associated with the collection and payment of taxes.

Tax administration costs include:

- ▼ collecting the revenue, including maintaining and improving tax collection systems
- ▼ monitoring the tax regimes and advice to government
- ▼ educating and informing taxpayers
- ▼ processing returns and issuing assessments
- ▼ enforcement and debt recovery
- ▼ ancillary and support services.

Complex taxes that apply different tax rates to different entities or transactions, or to the same entity or transaction in different circumstances, can significantly complicate the tax system making it harder for taxpayers to comply with, and open up opportunities for increased tax avoidance. This imposes economic costs through the need for more complex recording of activities and the need for additional accounting and legal advice to ensure compliance with tax law.

4.1.3 Transparency

In a transparent tax system, the key features of a tax – such as its purpose and how it operates – are easily identified and are certain. The tax system needs to be transparent to the community as a whole and in particular to the taxpayers. The community and taxpayers can clearly understand what is being taxed, who is liable, and how their liability is calculated. Taxpayers can also clearly understand the scope and applicability of taxes and can plan with certainty their individual tax liability.

4.1.4 Robustness

As noted above, a tax system's robustness is its ability to raise the revenue required to fund essential public services. In general, a robust tax system is one that is:

- ▼ **Sustainable**, in that taxes generate revenues that grow in line with economic growth and population change. This is important, to provide effective funding of public programs over time. Such taxes have a positive and stable relationship to the level of economic activity and population change. They also make the task of government financial management easier.
- ▼ **Stable, in that tax revenues are not subject to wide fluctuations.** Taxes that generate revenues that are highly cyclical, unpredictable or volatile in nature can make the task of government financial management more difficult and are therefore less desirable. Governments tend to lock-in expenditures when revenue is high. This may result in deficits when revenue is lower as expenditures, once locked-in, are often difficult to reduce substantially.
- ▼ **Resilient to changes in market and industry structures**, with minimal incentives and opportunities for tax avoidance.

If the tax system does not have the above characteristics, there will be an ongoing need for the government to identify new sources of revenue to maintain its total tax revenue at the level required to fund essential services.

In general, broadly based taxes tend to provide a more stable revenue stream than narrowly based taxes. Taxes with immobile tax bases, such as land tax, are also important for the stability of a tax system, particularly at the State level, and are less easy to avoid. Payroll tax generates a more predictable amount of revenue than many other State taxes as it tends to grow steadily in line with wages and employment growth. In contrast, purchaser transfer duty, like all transaction taxes, is sensitive to transaction volumes which may change substantially from year to year.

In relation to the robustness of the NSW tax system, it is important to bear in mind that NSW, like the other States, has limited taxing powers and therefore is not able to raise sufficient tax revenue to fund even the majority of its revenue requirements (see Chapter 3). In addition, also like the other States, NSW's revenue requirements are increasing and are expected to continue to do so, due to a range of factors including the ageing population, growing demand for services, and the rising cost of those services, in particular health services.

4.2 Findings for key State taxes

The sections below summarise the findings of IPART's assessment of each State tax's performance against the criteria discussed above, and show its weighted score in a 'spider' graph.

4.2.1 Payroll Tax

Finding

- 7 Payroll tax is one of the most efficient of the State taxes in its current form, and there is significant scope to improve its efficiency and equity by reducing the tax-free threshold and the number of exemptions. It also performs well against the robustness, simplicity and transparency criteria.

Efficiency

In theory, payroll tax is one of the more efficient taxes available to State governments, due to its relatively broad base (which is a function of the businesses liable to the tax and the wages paid upon which the tax is assessed).

However, policy decisions by the State governments have eroded some of the positive theoretical aspects of payroll tax. Increases in the tax-free threshold have reduced its efficiency by narrowing the tax base. In addition, the establishment of numerous exemptions and concessions further narrow the payroll tax base and

therefore reduce efficiency. On efficiency grounds, payroll tax should have a broader base and a lower tax rate.

Some stakeholders criticise payroll tax on the grounds that it is a tax on employment and as such acts as a drag on economic activity. This is because the tax liability is based on employment and wages. However, in practice, the cost of paying the tax can be passed on either to employees (through lower wages) or to consumers (through higher prices). In either case, the impact of the tax is relatively efficient, being akin to that of either a flat rate income tax or broad-based consumption tax.³⁸

Equity

Payroll tax does not rate highly in terms of vertical equity. While the legal liability for payroll tax falls on employers, in the longer term it falls on employees and consumers without reference to their ability to pay or to their individual financial circumstances.

Payroll tax does not rate well in terms of horizontal equity because of concessions and tax free thresholds. Analysis of payroll data shows that there is a bunching of firms just below and just above the threshold. Thus some firms pay payroll tax, while others do not despite there being little difference between the firms.

Robustness

Payroll tax rates well against the robustness criterion. Unlike other taxes, payroll tax generates a predictable, stable level of revenue, due in some respects to the size of the tax base. Payroll tax revenue also grows broadly in line with growth in the economy – over the past 10 years it has grown by an annual average of 6 per cent.

Simplicity

Payroll tax is a relatively simple tax, from both an administrative and compliance perspective. The current tax-free threshold means that only 8.5 per cent of NSW businesses pay payroll tax.³⁹

In addition, NSW and Victoria have recently completed work to harmonise their payroll tax arrangements (with the exception of tax rates and thresholds). This will help lower compliance costs for businesses operating in both States, and is a major step in the right direction.

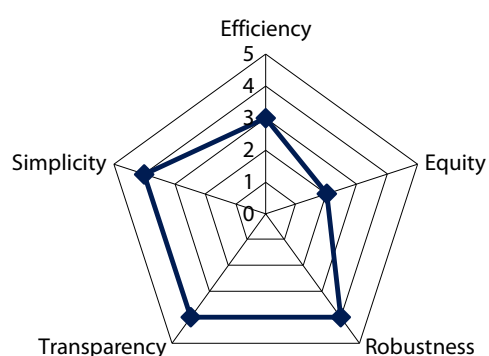
³⁸ See *The Case for Payroll Tax*, NSW Treasury Research and Information Paper, TRP 99-3, September 1999.

³⁹ IPART analysis and NSW Office of State Revenue.

Transparency

Payroll is also relatively transparent for those legally liable for the tax. All business with a total wages bill above \$600,000 are liable for the tax, which is levied at 6 per cent of total wages, and can be paid monthly. However, the economic incidence of the tax is not transparent.

Figure 4.1 Overview and conclusions for payroll tax



Payroll tax has a weighted score of 3.2 out of 5, which gives it an equal first overall ranking against the standard taxation principles. It scored well for robustness, simplicity and transparency. It is also one of the more efficient State taxes, even though policy decisions have narrowed its base by establishing a tax free threshold and various exemptions and concessions. However, it scored relatively poorly for equity.

4.2.2 Land tax

Finding

- 8 Land tax is one of the State's most efficient and robust taxes, and there is potential to increase its efficiency for example by reducing the level of the tax free threshold. This change would also improve its equity and simplicity.

Efficiency

In its current form, land tax is one of the more efficient State taxes. Because it is levied at a relatively low rate, it has minimal impact on investment and consumption choices and, unlike purchaser transfer duty, it does not impede the turnover of property. But land tax is less efficient than it could be, due to the wide range of exemptions that narrow its base and may encourage land to be devoted to exempt activities.

Equity

To some extent, land tax promotes vertical equity, in that taxpayers who own higher valued properties pay more tax.⁴⁰ However, it does not promote horizontal equity due to the exemption for owner-occupied properties and the tax-free threshold for investment property.

However, there is some uncertainty about who actually bears the burden of the tax, specifically in relation to investment properties where the property owners are legally liable for the tax but can potentially pass it on to tenants through higher rents.

If land tax is borne by property owners, those who choose to hold a majority of their assets in the form of their principal place of residence, exempt land, or securities do not pay a similar amount of tax as those with taxable land holdings. If it is passed on to tenants, those tenants are disadvantaged relative to those who own their own home (and who generally have higher average income and net wealth).

To some extent, land tax is a tax on wealth. Also, it allows the community to share in increases in wealth resulting from increased value of land, which in turn may result directly from public investment in surrounding infrastructure or amenity. However, land tax is also a discriminatory tax on wealth because it applies to only one dimension of wealth – ownership of land assets. Since tax obligations are not related to the revenue stream generated by the relevant assets, those liable to the tax may experience cash flow difficulties – asset-rich, income-poor taxpayers.

Robustness

Land tax performs relatively well in terms of robustness, because the tax base (ie, land) is immobile. Although the revenue from land tax grows generally in line with land values, land values themselves can be volatile. This means that revenue from the tax can also be volatile, but the volatility is much less than that of the purchaser transfer duty which depends on both property values and the number of transactions.

Simplicity

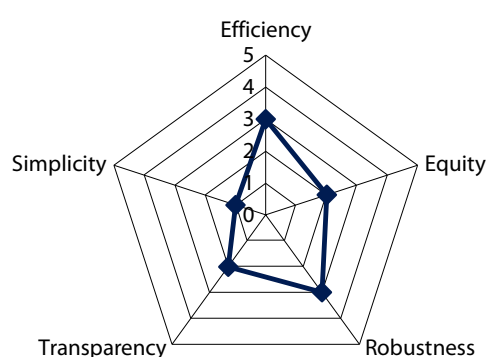
Land tax has a single marginal rate with a tax free threshold and so, *prima facie*, is quite a simple tax. However, it is complex to administer due to exemptions to the tax, indexing of the tax free threshold, the use of a three-year average of land value, and the definition of the 'unit' to which land tax applies. It is also relatively costly to administer, because the Valuer-General must assess the value of land, and the Office of State Revenue must identify taxable properties.

⁴⁰ Even with a flat tax rate, there is a high degree of vertical equity as higher valued properties are generally owned by taxpayers who are more able to pay the tax.

Transparency

As noted above, the value of land for land tax purposes is determined independently by the Valuer-General, and taxpayers can readily see the link between land value and tax paid. However, land tax performs poorly against the transparency criterion because taxpayers may not know when their land value exceeds the tax free threshold and they become liable for land tax. The arrangements for using a three-year average land value also reduce transparency. In addition, the economic incidence of land tax is not transparent.

Figure 4.2 Overview and conclusions for land tax



Land tax has a weighted score of 2.5 out of 5, giving it an equal third (out of 8) overall ranking. The efficiency of land tax is less than its potential, due to policy decisions to significantly narrow the base through the operation of the tax free threshold and various exemptions and concessions. But it is still one of the more efficient State taxes. It is also relatively robust, but performs poorly in terms of simplicity, transparency and equity.

4.2.3 Purchaser transfer duty

Finding

- 9 Purchase transfer duty is a major source of own-source tax revenue in NSW but its poor performance against both the efficiency and robustness criterion suggest that the State should seek to reduce its reliance on this duty over the long term.

Efficiency

In principle, purchaser transfer duty⁴¹ is relatively inefficient as it adds significantly to the cost of real estate transactions and can deter people and businesses from purchasing property. Furthermore, because it is a tax on improved value (market value) it can discourage property development for resale.

For the business sector, transfer duty adds to the cost of moving business capital to different ownership structures or investment opportunities.⁴² It may impede adjustment to changing market conditions; then the stock of business capital is used

⁴¹ Combined non-commercial and commercial property transfer duty as described in the appendices.

⁴² An exemption is provided for corporate reconstructions provided certain qualifying criteria are satisfied.

less efficiently than it could be. It may in particular impact new or growing businesses or development of new commercial property.

Exemptions could be given where the tax would unnecessarily impede restructuring but this introduces a significant degree of discretion in the administration of the tax.⁴³ Land-rich trusts can be used to avoid this tax and efforts to contain this risk add to the complexity of the tax and administration costs.

For households, transfer duty adds to the cost of moving their place of residence. It may impede labour mobility and spatial economic adjustment (ie, the shift in location where people live). It may deter home owners from moving to accommodation more suitable for their needs; resulting in less efficient use of the available housing stock.

The tax base for transfer duty is narrow, because it applies only to the small number of properties sold during the year. Thus its rate is higher than it would be if, for example, the tax applied annually to all properties. Further, as the duty rate brackets have not been indexed regularly – causing ‘bracket creep’ – the effective duty rate is no longer as low as it was 20 years ago when the current general schedule came into effect (see Appendix E).

However, it is also important to take into account that:

1. Transfer duty on property differs from other transaction taxes in that it can be capitalised. Transfer duty forms part of the overall financing requirement for a major asset, so borrowings can be increased to, in effect, pay the duty over time (albeit with an interest charge). For most households, borrowing capacity will be the balancing item in the purchase calculation after all capital and transaction costs are considered.
2. There is no strong quantitative evidence that transfer duty is having a negative impact on property sales.

Equity

IPART notes that the 1988 NSW Tax Task Force found that purchaser transfer duty had “an apparently favourable distributional impact.”⁴⁴ This impact relates to the sharing of the tax effort. The Tax Task Force acknowledged the progressive scale of transfer duty rates and observed that property values are likely to be directly correlated with income. A progressive scale of transfer duty rates may have a favourable equity impact if it succeeds in distributing more of the tax effort towards those who have a higher capacity to pay.

While the rate structure of purchaser transfer duty appears to make it progressive, other aspects of its structure reduce its equity from both vertical and horizontal

⁴³ Some concessions already exist for corporate reconstructions costing \$129 million in 2007-08 (see NSW Budget 2007-08, Budget Paper No 2, p E2).

⁴⁴ NSW Tax Task Force, *Review of the State Tax System*, August 1988, p 263.

perspective. The tax has a narrow base as it only applies to property transfers. As a result, less affluent taxpayers who move will pay more tax than affluent landowners who do not move. First home buyers are potentially adversely affected, but they are protected by concessions for the purchase of first homes. Others who may have to buy/sell property more frequently as they move jobs, change family status or simply cannot afford the home to meet their longer term needs are not protected. Overall IPART considers that purchaser transfer duty is both horizontally and vertically inequitable. Despite a progressive rate structure, Wood found purchaser transfer to be regressive in relation to annual income.⁴⁵

IPART also notes that:

- ▼ The redistributive effects of transfer duty on commercial and industrial properties are uncertain. Transfer duty payable by the business sector may be forward-shifted to consumers through higher prices, or backward-shifted to employees through lower wages and conditions, or borne by shareholders through lower dividends. However, its distributional impact is likely to be similar to any other tax collected from business.
- ▼ The First Home Plus and First Home Plus One schemes⁴⁶ account for much of the favourable distributional impact of the transfer duty regime for residential property transfers. To that extent, it supplants some concerns about vertical equity embodied in progressive duty rates.

Robustness

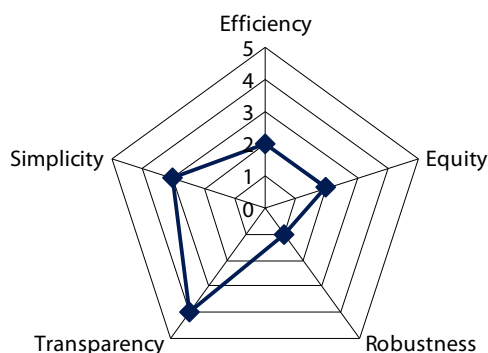
Purchaser transfer duty does not have a highly mobile tax base (property), but it is the most volatile source of State tax revenue. Unanticipated transfer duty receipts in good years can disrupt budget management if transfer duty revenue later falls but expenditure commitments do not. For this reason, IPART rates this tax quite lowly on this criterion. However, it notes that the trend growth in property values and the failure to index, or revise, the rate scale has resulted in strong revenue growth.

Simplicity and transparency

Transfer duty is relatively simple and is calculated by applying a tax scale to the purchase price of property. It is also transparent, because it is a well known tax, and a long standing part of the process for purchasing property, particularly land residential property. However, the rate scales are probably not well known and bracket creep reduces its transparency to some extent.

⁴⁵ Wood, GA. *The Distribution of the Stamp Duty Liabilities of Owner Occupiers*, Working Paper No 98, Department of Economics, Murdoch University, Murdoch, July 1993.

⁴⁶ First Home Plus provides all eligible first home buyers with a full exemption from transfer duty where the home is valued up to \$500,000 with a phase-out of the benefit between \$500,000 and \$600,000. First home buyers of vacant land receive a full exemption from duty on land valued up to \$300,000. The exemption phases out as land value increases to \$450,000. From 1 May 2007, duty concessions are also provided to eligible first home buyers taking part in shared equity arrangements in proportion to their share of equity in the home.

Figure 4.3 Overview and conclusions for Purchaser Transfer Duty

Purchaser transfer duty has a weighted score of 2.1 out of 5, giving it an eighth (and bottom) overall ranking against the criteria. It scores poorly for efficiency because it distorts investment decisions. It scores poorly for robustness because it is a highly volatile source of tax revenue, and for equity because it falls more heavily on those who transfer property more frequently. However, it is relatively simple and transparent.

4.2.4 Insurance duty

Finding

10 Insurance duty is a highly inefficient tax that creates disincentives for appropriate insurance. This suggests that the State should seek to reduce its reliance on this duty over the long term.

Efficiency

Insurance duty is a highly inefficient tax. By adding to the price of insurance, it encourages underinsurance and non-insurance in a market that already exhibits significant market failures. The effect on consumer and business behaviour is amplified because the duty is applied on top of the embedded fire services funding contributions and the GST. The Royal Commission into the collapse of HIH recommended governments throughout Australia review their taxes on insurance.⁴⁷

Equity

The *ad valorem* nature of insurance duty means that individuals with more assets to protect pay higher premiums, to the extent that the risk related to those assets is the same. However, risk plays a significant role in determining insurance premiums so the link is very weak. Furthermore the equity impacts are confused by the incentive to underinsure.

The vertical equity concept is less relevant to businesses, except that all businesses should face the same effective marginal tax rates. This is not the case for business where intellectual property forms a large part of its assets, because this property is not insured and therefore not taxed.

⁴⁷ HIH Royal Commission, Report, Recommendation 55.

Robustness

In principle the insurance duty should be a reasonably stable source of revenue – the changes in the revenue collected would largely reflect changes in the condition of insurance markets. However, in practice, it may be less robust due to the incentive to underinsure. Furthermore, tax rates have been subject to significant changes. For example, tight insurance markets after HIF's collapse and 11 September 2001 meant that higher premiums resulted in higher insurance duty revenue, and policy decisions by government to vary the tax rate.

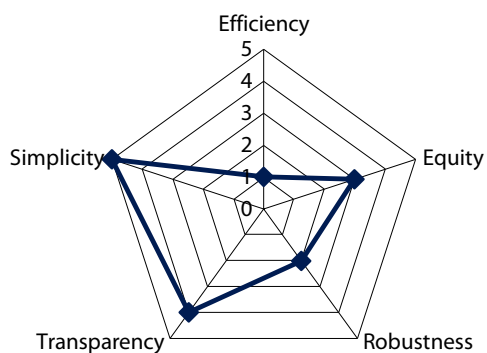
Simplicity

Insurance duty is very simple, because most often it is paid on policies issued by registered insurers with a smaller amount paid by brokers and those insuring offshore with unregistered insurers. The differing duty rates for general insurers should still be administratively simple given the sophistication of IT systems.

Transparency

Insurance duty is also relatively transparent, because insurance company invoices notify policyholders of the amount of duty paid.

Figure 4.4 Overview and conclusions for insurance duty



Insurance Duty has a weighted score of 2.3 out of 5, giving it a sixth (out of 8) overall ranking against the standard tax principles, making it one of the State's least desirable taxes. Insurance Duty is a highly inefficient tax that contributes to underinsurance and non-insurance. It is also not very robust, because fluctuations in premiums can affect revenue from this tax. However, it is transparent and simple to administer and comply with.

4.2.5 Motor vehicle Registration duty

Finding

- 11 Like other transfer duties, motor vehicle registration duty is not very efficient or robust, but it is relatively simple to administer.

Efficiency

Motor Vehicle Registration Duty is a relatively inefficient tax because it is a narrow, transactions-based tax that is likely to dampen purchases of motor vehicles relative to other goods and services.⁴⁸ The duty tends to discourage vehicle owners changing vehicles by increasing the price of vehicles, although the tax rate is a relatively small part of a large capital purchase. The duty tends to be disguised in new cars but is more evident in used vehicles, especially those sold through private sales.

Equity

The duty rate is higher for luxury cars (above \$45,000) so higher valued cars are taxed more highly. To the extent that motor vehicle registration duty can be considered a form of wealth turnover tax, it promotes vertical equity. However, because the luxury car threshold has not been indexed increasing numbers of purchases are subject to the luxury car rate.

Robustness

Motor vehicle registration duty is not very robust, because the level of revenue it generates depends on the performance of the motor vehicle market, which is closely linked with economic activity and consumer/business sentiment.

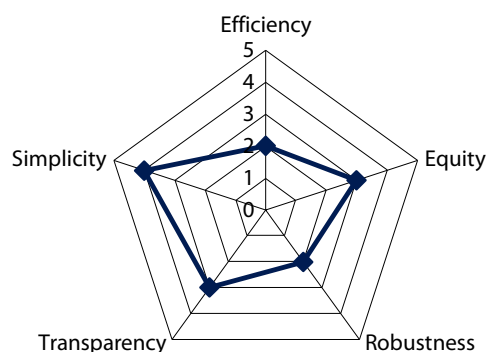
Simplicity

Motor vehicle registration duty is a simple tax to comply with and administer – it is collected by Roads and Traffic Authority at the time of initial registration and transfer of registration.

Transparency

Motor vehicle registration duty is a relatively transparent tax. The owner of the motor vehicle pays duty when affecting a transfer of ownership. However, the duty is less transparent when a new car is purchased as it is included in “Plus Statutory Charges and on Road Costs” or the purchase price is quoted as “No more to pay”.

⁴⁸ The elasticity of vehicle ownership with respect to price is estimated to be -0.4 to -1.0, meaning that a 10% increase in total vehicle costs reduces vehicle ownership by 4-10%. Todd Litman, *Transportation Elasticities, How Prices and Other Factors Affect Travel Behavior*, Victoria Transport Policy Institute, 31 March 2008, p 35 (<http://www.vtpi.org/elasticities.pdf>).

Figure 4.5 Overview and conclusions for motor vehicle transfer duty

Motor vehicle registration duty has a weighted score of 2.5 out of 5, giving it a third (out of 8) overall ranking against the standard tax principles, making it a mid range tax in terms of its ranking. It is relatively inefficient and not very robust. However, it is simple to comply with and administer, and is relatively transparent and equitable.

4.2.6 Motor vehicle weight tax

Finding

12 The motor vehicle weight tax is one of the most efficient of the existing State taxes, and is also robust, simple and transparent. However, it rates poorly for equity, because on balance it is slightly regressive.

Efficiency

Motor vehicle weight tax is reasonably efficient. To some extent, weight tax is akin to a user charge⁴⁹. While the motor vehicle weight taxes take into account the possible road and environmental damage, they are not fully utilised as environmental conservation measures.

Equity

To the extent that it is a tax (rather than a user charge), it is regressive. Vehicle mass is not a good indicator of the value of a vehicle or its owner's capacity to pay.

Robustness

Revenue from motor vehicle weight tax is very stable since the tax applies to the total stock of vehicles, which tends to grow at around 2 per cent per year.⁵⁰ Except for the rental car and commercial/industrial sectors and possibly for the areas along the State's borders, the tax base is fairly immobile.

⁴⁹ Vehicle ownership and operation makes use of publicly provided facilities (roads) and generates externalities/social costs (eg, congestion and pollution). Government imposes on motorists up to the level that accounts for road costs (construction, maintenance) plus social costs could be regarded as a user charge. Anything in excess of this level could be viewed as a tax.

⁵⁰ Australian Bureau of Statistics, *Motor Vehicle Census, Australia*, 31 May 2007, Cat No 9309.0.

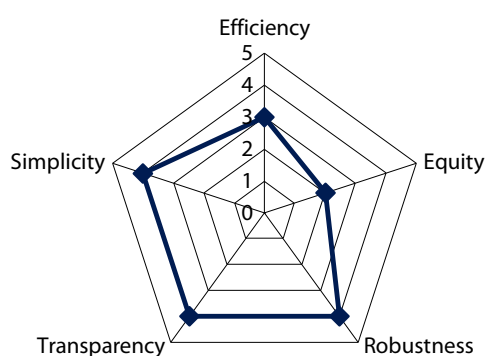
Simplicity

Weight tax is straightforward to administer as it is based on clear definitions (although there are minor 'grey' areas owing to the existence of exemptions and concessions). Nevertheless, collection costs are probably in the low range for State taxes, owing to the need to issue annual registration renewals. However, this process makes compliance costs for taxpayers fairly low – there is no element of taxpayer self-assessment and the associated need for record keeping.

Transparency

The charge for motor vehicle weight tax appears on a vehicle's annual registration papers so is transparent to motorists/taxpayers.

Figure 4.6 Overview and conclusions for motor vehicle weight tax



Motor vehicle weight tax has a weighted score of 3.2 out of 5, which gives it an equal first overall ranking against the criteria. Motor vehicle weight tax is reasonably efficient tax. It is also a robust and transparent tax that is straightforward to administer and comply with. However, it rates quite poorly against the equity principle.

4.2.7 Fire services funding contributions

Finding

13 The Fire Services Contribution by insurers is effectively a levy on insurance and creates disincentives for taking out appropriate insurance. On this basis, its removal should be a priority.

The Fire Services Contribution is the contribution that the insurance industry makes to fund the NSW Fire Brigades and Rural Fire Service.⁵¹ This is a funding levy not a tax and the amount of the levy is set by the Minister for Emergency Services in consultation with the Treasurer.

⁵¹ The insurance industry provides approximately 73 per cent of the costs with the balance being provided by local government and consolidated revenue.

Efficiency

Fire services funding contributions by insurers (known as the 'fire services levy' – FSL – by policy holders) is a relatively inefficient tax. The extent to which insurers pass through the cost of their contributions to policy holders acts as a disincentive to insure. This may lead to underinsurance and non-insurance in a market that already exhibits market failures. The effect on consumer and business behaviour is amplified because the FSL becomes part of the base premium to which the GST and insurance duty are applied.

Equity

The FSL may be seen to be neutral or progressive because it is based on property values (albeit indirectly through house values). However, the opportunities for avoidance and minimisation through underinsurance means its horizontal equity is poor. Those who underinsure or don't insure avoid contributing via insurance policies to the cost of operating the fire services while they still receive the benefit of these services in the event of fire affecting their property.

Robustness

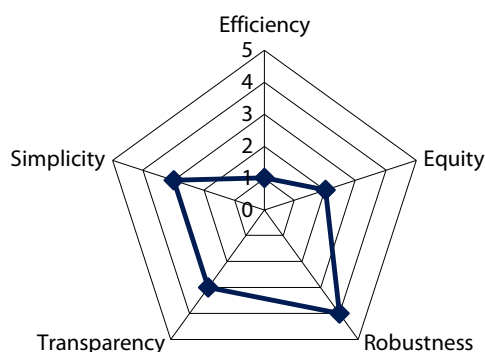
Contributions from the insurance sector match the statutory requirement so the revenue from this source meets expectations.

Simplicity

The calculation of insurance contributions is simple and is apportioned between a relatively small number of insurers. However, the method used by insurers to recoup their contribution is complex (see Appendix E).

Transparency

Even though insurers are required to list the fire services contribution on policy documents, it is only an estimate and is not necessarily reflective of the actual contributions to the fire services.

Figure 4.7 Overview and conclusions for fire services funding contribution

The fire services funding contribution has a weighted score of 2.2 out of 5, which gives this tax a seventh (and second last) overall ranking against the criteria. It is inefficient, because it adds to the cost of insurance and thus acts as a disincentive to taking out insurance. There is also a free-rider problem where the uninsured have equal access to fire services even though they do not contribute (via insurance) to the cost of providing those services.

4.2.8 Gambling taxes⁵²

Finding

14 Gambling taxes are fairly efficient and robust taxes, but rate poorly for transparency and equity. However, because most gambling tax rates have been set in long term agreements with the taxpayers or relevant industry bodies they are outside the scope of the review's recommendations.

Efficiency

Gambling taxes could be regarded as relatively efficient as changes to the tax rates do not significantly alter economic behaviour. Gambling exhibits reasonably inelastic demand, which means that gambling levels are not affected significantly by the imposition of tax.

Equity

The equity of gambling taxes depends on the extent to which gambling taxes lower profits to operators or reduce the payouts to gamblers. To the extent that they lower payouts to the gambler, gambling taxes are a relatively regressive tax in comparison to payroll tax or a broad based expenditure tax such as the GST. This is because gambling accounts for a higher proportion of both income and total expenditure for those on lower incomes.⁵³

⁵² Gambling taxes include taxes on racing, club gaming devices, hotel gaming devices, lotteries and lotto, and the casino.

⁵³ ABS, *Household Expenditure Survey* 2003-04, Cat No 6535.0. Households in the bottom two quintiles spend 1.4 per cent and 1.0 per cent respectively of the average weekly household income on gambling. Households in the top three quintiles spend 0.4 per cent, 0.5 per cent and 0.3 per cent respectively on gambling.

Horizontal equity is low for some gambling taxes as a result of the differential tax treatment of gambling within casinos, clubs and hotels, even though there is no substantial difference in the gambling product (in respect of poker machines, for instance).

Robustness

Gambling taxes are a relatively stable source of revenue. The propensity to spend on gambling is largely in line with gross disposable income so gambling taxes are likely to grow with the economy. However, mobility (particularly international) is likely to increase as a result of the spread of electronic gambling.

The rates for most gambling taxes have been set in long term agreements. This provides a high degree of certainty and stability but also means that changes are largely outside the scope of this review.

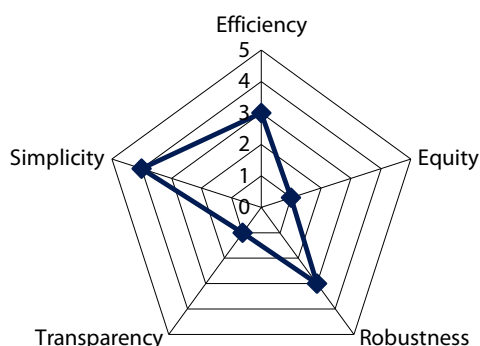
Simplicity

Gambling taxes are relatively simple to administer and comply with. The costs of collecting gambling revenue include the compliance costs for gambling operators – record keeping, assessing liability, making payments – and the costs to government of processing receipts and ensuring taxes are paid. They do not include the costs of regulating the activity or ensuring probity, as these are costs that will be incurred regardless of taxation arrangements.

Looked at in this way, the administration costs of collecting most gambling revenue appear to be quite low. Taxes are collected from relatively few sources compared to most state taxes and remittance processes can be automated.

Transparency

While the existence of gambling taxes is probably well known, few gamblers would be aware of the rates of tax applied to various gambling activities, thereby significantly reducing the transparency of gambling taxes for gamblers.

Figure 4.8 Overview and conclusions for gambling taxes

Gambling taxes have a weighted score of 2.5 out of 5, which gives this revenue source an equal third (out of 8) overall ranking. Gambling taxes provide a fairly robust and efficient source of revenue and are quite straightforward to pay and administer. However, gambling taxes are not very transparent and rate poorly against the equity principle.

4.3 Assessment of NSW taxes' interstate competitiveness

In addition to meeting standard taxation principles and being robust, a well designed State tax system should increase – or at least not decrease – the State's economic competitiveness compared to other States (and other countries).⁵⁴

The differences in tax rates and exemptions between States can influence the decisions business and individuals make about where to locate, and so can have either an expansionary or restrictive impact on the State economy. The structure and level of taxes also influence other factors, such as market access, market share, access to raw materials and labour, and these factors have a big influence on business decisions. For this reason, it is important that NSW is broadly tax competitive with other States.

However, this does not mean that NSW should necessarily have the lowest tax rates and/or the highest tax free thresholds, or the most generous concessions or widest exemptions on any given tax base. It is important that the tax system achieves a balance between robustness (ie, the ability to raise sufficient revenue to fund essential public services over time) and interstate tax competitiveness.

It's also important to recognise that the use to which tax revenue is put within a State can also be a key influence on businesses' investment location decisions, and thus a key source of interstate competitiveness. For instance, a State that has invested in infrastructure and education and so has high-quality, efficient infrastructure and a well-educated workforce is likely to attract more business investment than it would if its infrastructure was poor and its workforce not well-educated.

⁵⁴ An important difference between this criterion and the others is that whereas the potential efficiency or equity of one tax will vary from another because of its inherent features, all taxes can satisfy the interstate competitiveness criteria in principle.

IPART examined NSW's overall tax competitiveness by assessing and comparing the relative tax burden in each State. It also looked at the extent to which NSW relies on individual taxes compared to the other States, and compared the NSW tax rates and/or tax free thresholds for payroll tax, land tax, purchaser transfer duty, insurance duty and motor vehicle registration duty with those of other States. IPART's key findings are discussed below.

4.3.1 Findings on NSW's overall tax competitiveness

Finding

15 In terms of overall tax competitiveness, NSW ranks well compared to most other States, except Queensland.

Overall tax competitiveness can be assessed by looking at the relative tax burden in each State. IPART considered each State's performance against three basic measures of this burden:

- ▼ Total own-source tax revenue as a share of GSP.
- ▼ Total own-source tax revenue per capita.
- ▼ CGC's relative tax effort index. (As Chapter 2 discussed, this index compares the actual tax revenue each State collects to the estimated revenue it would have raised if the State had tax rates equivalent to the all-State average tax rate. An index above 100 indicates a State's tax rate is above the all-State average, while an index below 100 indicates it is below this average.)

Table 4.2 provides an overview of IPART's findings, and ranks the States' performance from highest to lowest (1 to 8, shown in brackets). This table shows that:

- ▼ In terms of own-source tax revenue as a share of GSP, NSW is the highest ranking State.
- ▼ In terms of own-source tax revenue per capita, NSW is the third highest ranking State (behind WA and the ACT).
- ▼ In terms of the CGC's relative tax effort index, NSW is the third highest taxing State. However, NSW's relative tax effort index – at just over 100 – is close to the all-State average. Only Victoria's index is closer to this average, and the indices of Queensland and SA are significantly above or below this average. As Chapter 2 discussed, this indicates that NSW's relatively high levels of tax revenue per GSP and per capita are due to its larger tax bases, rather than higher tax rates. This issue is discussed further in section 4.2.3, below.

Together, these findings suggest that NSW's overall tax competitiveness is reasonable.

Table 4.2 Comparison of the States' relative tax burden, 2006-07

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
As % GSP								
Own-source tax revenue	5.3 (1)	4.7 (2)	4.3 (4)	4.0 (6)	4.7 (2)	3.5 (7)	4.3 (5)	2.5 (8)
Total State revenue	14.1 (6)	14.1 (6)	16.3 (4)	12.3 (8)	16.9 (3)	17.5 (2)	13.5 (7)	22.7 (1)
As \$ per capita								
Own-source tax revenue	2,584 (3)	2,265 (4)	2,053 (6)	2,748 (2)	2,063 (5)	1,521 (8)	2,761 (1)	1,731 (7)
Total State revenue	6,879 (7)	6,754 (8)	7,740 (4)	8,386 (3)	7,461 (6)	7,515 (5)	8,634 (2)	15,474 (1)
Relative Tax Effort Index	104.0 (3)	103.0 (4)	84.6 (8)	102.7 (5)	112.6 (1)	95.5 (7)	105.9 (2)	101.6 (6)

Source: Tax revenue data from ABS, *Taxation Revenue, Australia, 2006-07*, Cat No 5506.0. Total revenue data from ABS, *Government Finance Statistics, Australia, 2006-07*, Cat No 5512.0. Population data from Commonwealth Treasury Estimates used for GST calculations and 2007-08 Commonwealth Budget estimates. Gross State Product data from ABS, *Australian National Accounts: State Accounts, 2006-07*, Cat No 5220.0. Relative tax effort index from Commonwealth Grants Commission, *Relative Fiscal Capacities of the States 2008*.

For comparison, Table 4.2 also shows each State's total State revenue as a share of its GSP and per capita. Although NSW generates more own-source tax revenue as a share of GSP than all other States, its total State revenue as a share of GSP is among the lowest of all the States due to the lower level of grants from the Commonwealth. In addition, its total State revenue per capita is lower than that of all other States except Victoria.

4.3.2 Findings on NSW reliance on particular taxes compared to other States

Finding

16 NSW relies more than other States on taxes that have the potential to be efficient, including payroll tax and land tax.

IPART assessed the extent to which NSW relies on particular kinds of tax – including payroll tax, land tax, purchaser transfer duty, motor vehicle taxes, insurance taxes and gambling taxes – compared to other States by looking at the contribution each tax makes to total State revenue (Table 4.3 and Figure 4.9).⁵⁵

This analysis indicates that:

- ▼ NSW relies more heavily on payroll tax and land tax than all other States (with the exception of the Northern Territory in the case of payroll tax). As section 4.2 discussed, these taxes are the most efficient State taxes.

⁵⁵ IPART relied on the data published in *Interstate Comparison of Taxes 2007-08*, NSW Treasury, Research and Information Paper, TRP 07-2, November 2007.

- ▼ NSW relies less on purchaser transfer duty – a relatively inefficient State tax – than any other State except South Australia and Tasmania.
- ▼ However, it relies more on insurance taxes – one of the least efficient taxes – than all other States except Victoria and South Australia.
- ▼ NSW relies on gambling taxes less than all other States except Western Australia and the ACT, and its reliance on gambling taxes is slightly less than the State average.

Table 4.3 Major State Taxes as a Share of Taxation Revenue, 2006-07

	Tax Revenue	Payroll Tax	Land Tax	Transfer Duty	Gambling Taxes	Motor Vehicle Taxes	Insurance Taxes
	\$m	%	%	%	%	%	%
NSW	17,713	32.0	11.5	23.5	9.3	11.2	8.1
VIC	11,702	29.7	8.5	25.3	12.9	10.9	9.4
QLD	8,484	26.3	5.7	30.0	9.7	13.9	5.0
WA	5,718	28.1	6.8	37.7	2.9 ^a	14.4	5.9
SA	3,250	26.0	10.2	22.2	13.0	12.2	9.3
TAS	748	29.1	8.3	21.0	11.5	16.4	6.8
ACT	929	24.2	7.2	26.0	5.2	10.3	4.6
NT	368	34.8	0.0 ^b	29.1	17.7	10.9	6.3
Average, all States	6,114	29.4	8.9	26.7	9.8	12.1	7.6

^a WA does not permit gaming devices outside the casino.

^b Northern Territory does not levy land tax.

Source: Australian Bureau of Statistics, *Taxation Revenue, Australia*, 2006-07, Cat No 5506.0.

Figure 4.9 Major State taxes as a share of State tax revenue, 2006-07 (%)

Data source: Australian Bureau of Statistics, *Taxation Revenue in Australia*, 2006-07, Cat No 5506.0.

4.3.3 Findings on interstate competitiveness of individual taxes

IPART assessed the interstate competitiveness of the major individual NSW taxes – including payroll tax, land tax, purchaser transfer duty, insurance duty, and motor vehicle registration stamp duty⁵⁶ – by comparing their tax rates and/or tax free thresholds with those in other States. In summary, IPART found that:

- ▼ the interstate competitiveness of NSW tax rates for individual taxes is mixed
- ▼ analysis of individual taxes supports the finding based on the CGC's relative tax effort index that NSW's higher tax revenues as a share of GSP and per capita reflect higher tax bases than tax rates (see section 4.2.1, above)
- ▼ the composition of taxes in NSW is relatively more efficient than in other States.

IPART's assessment of each tax's interstate competitiveness is summarised below. A more detailed interstate comparison of taxes is set out in Appendix E.

Payroll tax

Finding

17 The NSW nominal payroll tax rate is higher than in the neighbouring states of Victoria, Queensland and South Australia.

The nominal payroll tax rate in NSW is 6 per cent. This is higher than the rate Queensland, Victoria, Western Australia and South Australia, but lower than the rate in Tasmania, Northern Territory and the ACT. The NSW payroll tax threshold of \$600,000 is lower than that in the ACT, Northern Territory, Tasmania and Western Australia, but higher than that in Victoria and South Australia.

Direct comparisons with Queensland's payroll tax rate and threshold are less straightforward, as Queensland operates a 'deduction system' for payroll tax whereas all other States operate with a single marginal tax rate. Under Queensland's deduction system the tax free threshold reduces progressively – it falls by \$1 for every \$3 of wages over the \$1,000,000 threshold. There is no tax free threshold for payrolls of \$4 million and above. The deduction system means that the effective rate of payroll tax for firms with payrolls between \$1 million and \$4 million is higher (6.3 per cent) than the nominal rate of 4.75 per cent.

⁵⁶ Gambling taxes were excluded from this analysis because the various gambling products – including racing, club gaming devices, hotel gaming devices, lotteries and lotto, and casinos – are taxed differently.

**Table 4.4 Interstate comparison of payroll tax rates and thresholds
(from 1 July 2007)**

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Tax Rate (%)	6.0	5.05 ^a	4.75	5.5	5.25 ^b	6.1	6.2 ^c	6.85
Threshold (\$'000)	600	550	1,000	750	504	1,010	1,250	1,250

^a The rate in the Victoria will reduce to 4.95% from 1 July 2008.

^b South Australia's tax rate will reduce to 5.0% from 1 July 2008.

^c The rate in the Northern Territory will reduce to 5.9 per cent form 1 July 2008.

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

Land tax

Finding

18 NSW has the simplest land taxes with a single threshold and one of the lowest top marginal rates. The State's higher land tax revenues also reflect higher property values.

Land tax in NSW operates with a single marginal rate, whereas other States (except the NT) operate with a progressive rate scale as shown in Table 4.5. NSW's land tax rate was reduced from 1.7 per cent for the 2007 land tax year to 1.6 per cent for the 2008 land tax year.

NSW has one of the lowest top marginal land tax rates (only the ACT has lower rates, and the Northern Territory does not impose land tax). The NSW land tax rate of 1.6 per cent for the 2008 land tax year compares with the following **highest** marginal rates:

- ▼ Victoria – 2.5 per cent on land valued at or above \$2.7 million⁵⁷
- ▼ Queensland – 1.675 per cent for resident individual with land holdings between \$2 million and \$3 million and 1.5 per cent on land valued at or above \$2 million for companies, trustees and non-residents
- ▼ Western Australia – 2.3 per cent on land valued at or above \$10 million
- ▼ South Australia – 3.7 per cent on land valued at or above \$1 million
- ▼ Tasmania – 2.5 per cent on land valued at or above \$750,000
- ▼ ACT – 1.4 per cent on residential land valued at or above \$275,000 and 1.59 per cent on commercial land valued at or above \$275,000.

However, in most States the higher marginal rates only apply to high land values (eg, Tasmania has a higher rate than NSW for land values of \$350,000 while in SA land values are \$1 million before a higher rate than in NSW takes effect). Table 4.6 compares the tax payable on properties with values of \$500,000 and \$1 million in each of the States.

⁵⁷ From the 2009 Land Tax year the maximum rate will be 2.25 per cent.

The NSW tax free threshold of \$359,000 for the 2007 land tax year is the second highest of the States. In NSW the threshold is a three year average and is indexed annually according to movements in State-wide property prices. However, the basic (uniform) rate in NSW is higher than the rates that apply to the first rate blocks in other states.

**Table 4.5 Interstate comparison of land tax rates and thresholds
(from 1 July 2007)**

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Tax Rate (%)								
Min	1.6%	0.2%	0.7%	0.15% ^b	0.3%	0.55%	No tax	0.60%
Max		2.5% ^a	1.675%	2.3%	3.7%	2.5%		1.4%
Threshold (\$'000)	359	225	600	250	110	25	No tax	0

^a From the 2009 Land Tax year the maximum rate will be 2.25 per cent and the threshold will increase to \$250,000.

^b For 2008-09, the minimum rate will be 0.10 per cent and the threshold for WA will increase to \$300,000.

Note: These rates are for individuals. In most states different rates apply for companies and trusts – see Appendix E and TRP07-02 for details.

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

**Table 4.6 Interstate Comparison of Land Tax Paid on Selected Property Values
(as at 1 April 2008)**

	NSW	VIC	QLD	WA ^a	SA	TAS	NT	ACT
Tax Paid on Property value of \$500,000	2,356	800	Nil	825	1770	4,837	No Tax	3,150
Tax Paid on Property value of \$1,000,000	10,356	3,480	5,875	3,225	11420	16,087	No Tax	10,150

^a Includes Metropolitan Regional Improvement Tax.

Source: IPART calculations based on NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

Purchaser transfer duty

Finding

19 NSW purchaser transfer duty rates are comparable with those in the neighbouring States, although the top marginal rate is significantly less than the top marginal rate in the ACT.

NSW purchaser transfer duty rates are generally comparable or below those of other States. The marginal rate of 5.5 per cent at \$1,000,000 compares with the top rate of:

- ▼ 5.5 per cent at \$870,000 in Victoria
- ▼ 5.4 per cent at \$500,000 Western Australia

- ▼ 5.5 per cent at \$500,000 in South Australia, and
- ▼ 6.75 per cent at \$1,000,000 in the ACT.

Table 4.7 Interstate Comparison of Purchaser Transfer Duty Paid on a \$500,000 Property^a

	NSW	VIC	QLD ^b	WA	SA	TAS	NT	ACT
Duty Paid	17,990	25,660	15,975	20,700	21,330	17,550	26,750	20,500

^a Not including first home buyers.

^b Principal place of residence.

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

Insurance duty

Finding

20 NSW insurance duty rates are lower than those in most other States.

As shown in Table 4.8, NSW's general insurance duty rate of 9 per cent is below the rates in South Australia (11 per cent) and Victoria, Western Australia, Northern Territory and the ACT (each 10 per cent). Only Queensland (7.5 per cent) and Tasmania (8 per cent) have a lower rate than NSW.

Table 4.8 Interstate Comparison of General Insurance Duty

NSW ^{a,b}	VIC	QLD ^{c,d}	WA	SA	TAS	NT	ACT
9% of the premium	10% of previous month's premiums	7.5% of the premium	10% of gross premiums	\$11 per \$100 or part thereof of premiums (Including compulsory 3rd party premiums)	8% of premiums \$6 flat on 3rd party motor vehicle insurance	10% of premiums (including indemnity insurance)	10% of gross premium

^a Concessional 5 per cent of premium payable on aviation, consumer credit, disability, directors liability, motor vehicle, professional indemnity.

^b Concessional 2.5 per cent of premium paid on crop and livestock.

^c 5 per cent 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.

^d 10 per cent of premiums on compulsory 3rd party insurance for motor vehicles.

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

Motor vehicle registration stamp duty

Finding

21 NSW motor vehicle registration duty rates are comparable with those in other States.

NSW's motor vehicle registration duty rates – 3 per cent on passenger motor vehicles valued up to \$45,000 – are comparable with most other States.⁵⁸

Most other States operate a progressive rate scale calculated on the vehicle's value. However, Queensland applies tax according to the number of cylinders in the engine, while the Northern Territory applies a flat rate of 3 per cent on the vehicle's value.

⁵⁸ NSW has an additional duty for vehicles whose dutiable value is in excess of \$45,000.

Table 4.9 Interstate Comparison of Motor Vehicle Registration Stamp Duty for Passenger Vehicles

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
\$3.00 per \$100, or part, except for Passenger Vehicles with dutiable value more than \$45,000; ^a	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 or steam vehicles: 3.0% 5 or 6 cylinders or 3 rotors: 3.5% 7 or more cylinders: 4.0% Hybrid/Electric: 2.0%	New and Used Other than Heavy Vehicles^b \$0-\$20,000: 2.75% \$20,001-\$45,000: ^c 2.75%-6.50% Over \$45,000: 6.50% flat.	\$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.	Passenger vehicles Under \$600: \$20.00 \$600-\$34,999: \$3.00 per \$100 or part. \$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.	\$3.00 per \$100 or part.	Passenger Vehicles Under \$45,000: \$3.00 per \$100 or part thereof. \$45,000 or over: \$1,350+\$5 for each \$100 or part thereof in excess of \$45,000.

^a 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.

^b All (upper and lower) thresholds will increase by \$5,000 from 1 January 2009.

^c There is a sliding rate scale between \$20,000 and 45,000.

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

Motor vehicle weight tax

Finding

22 NSW annual motor vehicle taxes are not comparable with those in other States. Most other States use either engine capacity or number of cylinders.

NSW and the ACT base their annual motor vehicles taxes on the weight of the vehicle. Other States either apply annual motor vehicle taxes on the basis of engine capacity or number of cylinders as shown in Table 4.10.

Table 4.10 Interstate Comparison of Annual Motor Vehicle Tax

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Motor Vehicles Private: 0-975Kg: \$162.00 976-1154Kg: \$182.00 1155-1504Kg: \$211.00 1505-2504Kg: \$322.00 Motor Vehicles Business:0-975kg: \$262.00 976-1154kg: \$294.00 1155-1504kg: \$343.00 1505-2504kg: \$517.00 The rate varies in many steps up to \$1,501 at 4,500kg.	Flat Fee: \$168.60	No. of Cylinders 1,2 & 3: \$163.95 4: \$208.55 5 & 6: \$320.50 7 & 8: \$448.80 9-12: \$526.40 No. of Rotors 2: \$208.55 3: \$320.50	\$15.46 per 100kg. Discount for the registration of 'Family' vehicles \$58.00 for 12- month period or \$29.00 for a 6- month period	For passenger carrying vehicles the fee is based on the number of cylinders. to 4 cyl.: \$92.00 5 to 6 cyl.: \$186.00 7 and over: \$271.00 Rotary or electric: \$92.00	3 cyl. or less: \$93.00 4 cyl.: \$109.00 5 or 6 cyl.: \$136.00 7 or 8 cyl.: \$187.00 Over 8 cyl.: \$210.00 Rotary or electric: \$109.00	Engine Size Less than or equal to 4 cylinders 0-500: \$15.00 501-1000: \$30.00 1001-1500: \$48.00 1501-2000: \$64.00 2001-3000: \$70.00 Greater than 4 cylinders 2001-2500: \$90.00 2501-3000 \$108.00 3001-3500: \$133.00 3501-4000: \$152.00 4001-4500: \$180.00 4501-5000: \$200.00 5001-5500: \$231.00 5501-6000: \$252.00 6001-7000: \$294.00 7001-8000: \$301.60	For a passenger and goods carrying vehicle with a GVM not exceeding 4.5 tonnes, where the vehicle weighs: For Business Use 975kg or less:\$298.00 976-1154: \$330.00 1155-1504: \$380.00 1505-4500: \$556.00 For Private Use 975kg or less:\$197.00 976-1154: \$218.00 1155-1504: \$247.00 1505-2504: \$359.00 2505-2794: \$547.00 2795-4500: \$556.00

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-02.

4.5 Assessment of Commonwealth taxes against standard tax principles and robustness

To allow the major taxes that the States levy to be compared to those that the Commonwealth levies, particularly in terms of their efficiency and robustness, IPART assessed the most important Commonwealth taxes against the standard tax principles and robustness. These taxes include personal income tax, company income tax, GST and excise and customs duties.

Table 4.11 provides an overview of each tax's ratings, weighted score and overall ranking. This assessment clearly shows that Commonwealth taxes perform better against the standard tax principles than do State taxes (see Table 4.1). Importantly, all Commonwealth taxes except company income tax are more efficient than the most efficient State taxes (payroll tax, land tax and motor vehicle weight tax), largely because they have broad bases. In addition, the Commonwealth taxes that contribute the most tax revenue – income tax and GST – are very robust.

Table 4.11 Overview of IPART's assessment of Commonwealth taxes against standard tax principles and robustness

Tax	Efficiency	Equity	Trans- parency ^a	Simplicity ^b	Robust- ness	Weighted Score	Ranking
Personal Income tax	4	5	4	3	5	4.3	1
Company Income tax	3	4	3	2	3	3.1	3
GST	4	3	5	3	4	3.8	2
Customs and Excise Duty	4	2	4	3	3	2.9	4

^a Transparency has been assessed in terms of transparency to the person who bears the legal burden of the tax.

^b Simplicity includes administration costs and compliance costs.

IPART's assessment is consistent with Warren,⁵⁹ which found that the Commonwealth government levies the more efficient, broadly-based taxes, while the State governments must rely on relatively inefficient, narrowly-based and sometimes highly cyclical transactions based taxes.

IPART's assessment on each of the major Commonwealth taxes is summarised below.

⁵⁹ Warren, N, 2006, *Benchmarking Australia's Intergovernmental Fiscal Arrangements, Final Report*, May 2006.

4.5.1 Personal income tax

Personal income taxes are assessed on the incomes of individuals, based on wages and salaries along with other sources of income including interest, dividends, rent, and capital gains. Personal income tax is progressive with multiple marginal tax rates and a tax free threshold.

Efficiency

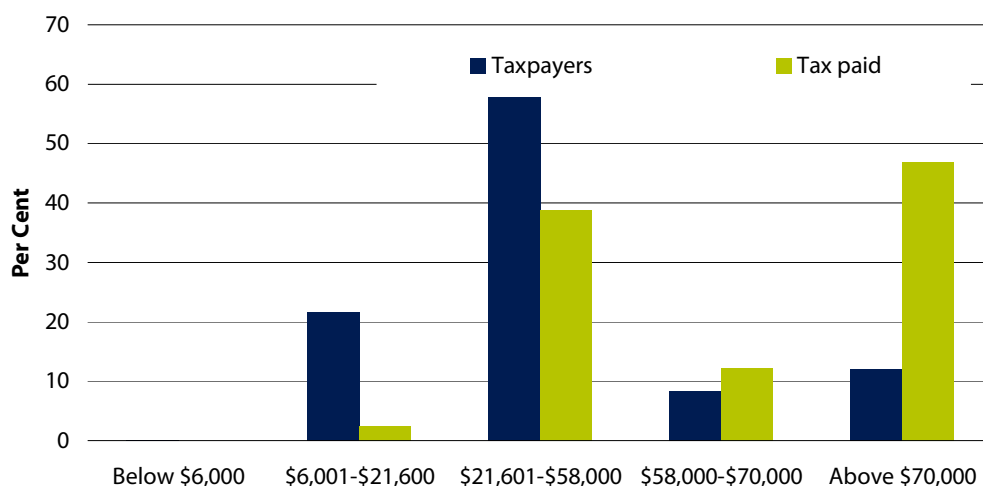
Personal income taxation has a comprehensive base and is considered relatively efficient. Recent reductions in marginal tax rates, especially at higher income levels, have reduced the negative impacts on incentives to work and earn income. However, current marginal rates may still have a significant effect. Inefficiencies arise through the various exemptions and concessions. The main tax expenditures are imputed rent associated with owner occupied housing and the Low Income Tax Offset. Tax evasion and avoidance also give rise to further inefficiencies.

Equity

The personal income tax system is the main instrument in the Australian tax system for achieving vertical equity objectives. It is progressive with multiple tax rates so that a larger share of the tax is borne by those individuals who are best placed to bear it, while those individuals who have limited means bear relatively little or no tax.

Figure 4.10 shows that, for the 2004-05 income year, 47 per cent of personal income tax was collected from the 12 per cent of taxpayers who were in the top marginal tax bracket, while 2.5 per cent was collected from the 22 per cent of taxpayers in the lowest taxable income bracket.

Figure 4.10 Personal income tax distribution for 2004-05



Data source: Commonwealth Budget 2007-08, Budget Paper No 1.

Furthermore, the Medicare Levy is based on an individual's taxable income, and low income individuals may be exempt. The Low Income Tax Offset (LITO) also addresses equity concerns by providing targeted tax relief to low income earners reducing their tax liability.

Robustness

Personal income tax is robust, as the tax base is comprehensive and the revenue it generates grows faster than incomes due to the progressive tax rate schedule. Periodic adjustments are made to tax bracket thresholds and the marginal tax rates to account for inflation and bracket creep.

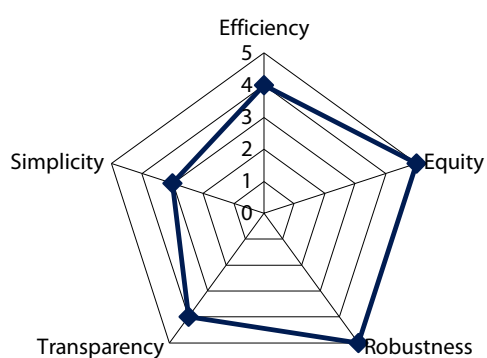
Transparency

Personal income tax is a transparent tax. Tax is deducted at source for salary and wage earners, who receive a clear statement of their gross income, tax paid and net income. However, not everyone may be aware of all the deductions and concessions available that can reduce income tax liabilities.

Simplicity

The Pay As You Go (PAYG) withholding system reduces compliance and administrative costs. Most revenue is collected through this system. However, compliance costs are increased when individuals have to self-assess their tax liabilities. The simplicity or otherwise of personal income tax really depends on an individual's personal circumstances and the complexity of their financial affairs.

Figure 4.11 Overview and conclusions for personal income tax



Personal income tax has a weighted score of 4.3 out of 5, and is the highest ranking tax among both Commonwealth and State taxes. Its comprehensive base makes it an efficient tax and it scores highly in terms of equity as it is used for income redistribution. It also provides a very robust source of tax revenue for the Commonwealth.

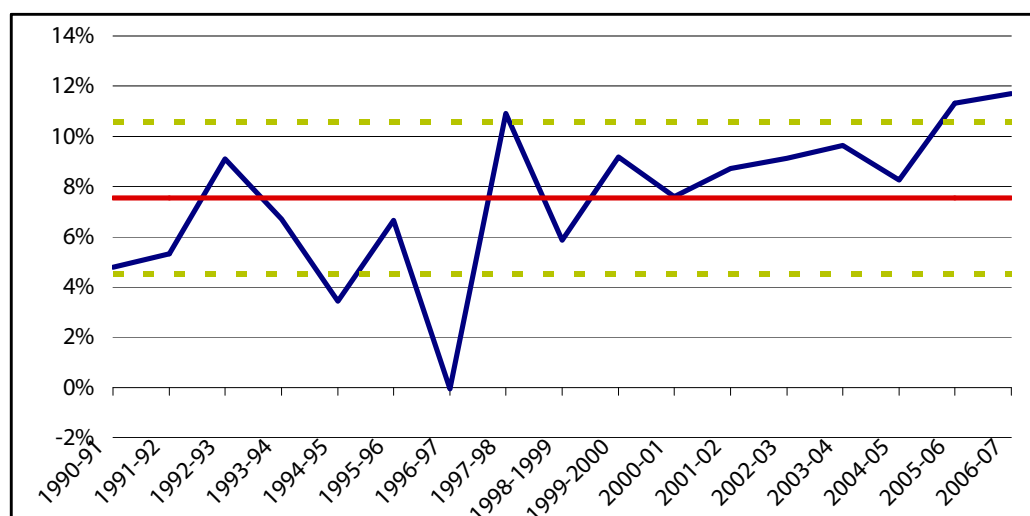
4.5.2 Company income tax

Company income taxes cover all income taxes paid by companies, including incorporated and unincorporated associations, limited partnerships and some corporate unit trusts and public trading trusts. Generally, every resident company that derives assessable income (including capital gains), whether sourced within or outside of Australia, and every non-resident company that derives assessable income from Australian sources is required to pay company tax. However, IPART notes that company income tax is a withholding tax for Australian residents.

Efficiency

Taxation of company income is relatively less efficient than other income taxation, as the base, while broad, tends to be volatile and subject to cyclical fluctuations. This is demonstrated in Figure 4.12, which shows the annual change in Gross Operating Surplus.

Figure 4.12 Growth in gross operating surplus, all Australian corporations, 1990-91 to 2006-07



Note: The red line is the mean while the dotted green line is the standard deviation.

Data source: Australian Bureau of Statistics, Cat No 5204.0.

Equity

Company income taxes perform relatively well against the equity criterion. However, the fact that effective tax rates vary for corporations according to funding source (debt, equity and retained earnings), payout strategy (domestic shareholders, overseas shareholders, retained earnings) and source of activity (Australia or overseas) means it is somewhat inequitable.⁶⁰

⁶⁰ Freebairn, J, 2003, 'Tax Reform: An Unfinished Agenda?', in Peter Dawkins and Paul Kelly (eds), *Hard Heads, Soft Hearts, A New Reform Agenda for Australia*, Allen and Unwin, Sydney, pp 185-187.

The introduction of dividend imputation has improved the equity of the Commonwealth tax system, by removing the double taxation of company profits through company income taxes and personal income taxes. Company tax is now a withholding tax where the final tax liability is assessed to shareholders.

Robustness

Revenue from company income tax has shown remarkable growth over recent years. However, because the revenue from this tax is volatile and moves with the business cycle, company tax's performance against the robustness criterion is among the lowest of the Commonwealth taxes (but is nevertheless higher than the performance of several NSW taxes, including purchaser transfer duty).

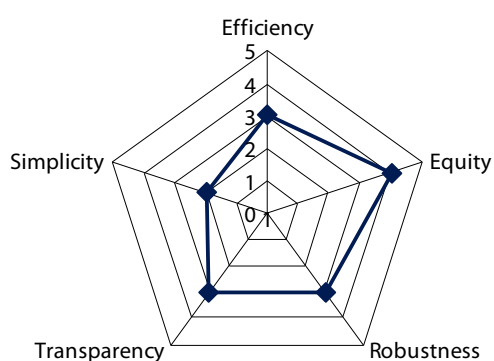
Transparency

Company tax is a relatively transparent tax, although the operation of the dividend imputation system reduces its transparency.

Simplicity

In its current form, company tax scores very poorly against the simplicity criterion. It has a single marginal rate and no tax free threshold, so may appear to be a simple tax. However, the differential treatments for different funding sources, payout strategies and source of activity that reduce this tax's equity also significantly reduce its simplicity. In addition, opportunities for tax avoidance and evasion also increase its administrative costs, and complex legislation is needed to deter these activities.

Figure 4.13 Overview and conclusions for company income tax



Company income tax has an overall weighted score of 3.1 out of 5, and is the third ranking of the four Commonwealth taxes. Nevertheless, its weighted score is higher than almost all of the State taxes. Its efficiency and robustness are reduced because its base, though broad, is volatile and subject to cyclical fluctuations. It scores very poorly for simplicity, because of its differential treatment of companies' different funding sources, payout strategies, and sources of activity.

4.5.3 GST

GST is levied on a broad range of goods and services across the economy at a rate of 10 per cent. Some goods and services (such as basic food, education and health services) are exempt. Others (such as financial supplies and residential accommodation) do not attract GST on their final sale, but the GST that has been paid on their inputs is not refundable.

The Commonwealth Government administers the GST on behalf of the States and all GST revenue is distributed among the States in accordance with the principle of HFE (see section 3.2). Although all GST revenue is provided to the States, it is classified as a Commonwealth tax, and now acknowledged by the Commonwealth as such.⁶¹

Efficiency

The GST is a broad-based consumption tax and is a relatively efficient tax, although its efficiency is reduced by some significant exclusions from the base, particularly food, health and education.

Equity

GST is regressive as it affects those on lower incomes disproportionately compared to those on higher incomes, like all consumption taxes.

Robustness

GST is relatively robust, as the revenue it provides is stable and grows in line with economic growth.

Transparency

GST is a transparent tax as the community is generally aware that most goods and services are taxable, and the GST component is shown on most invoices and receipts. However, taxpayers may not know about the exemptions that apply.

Simplicity

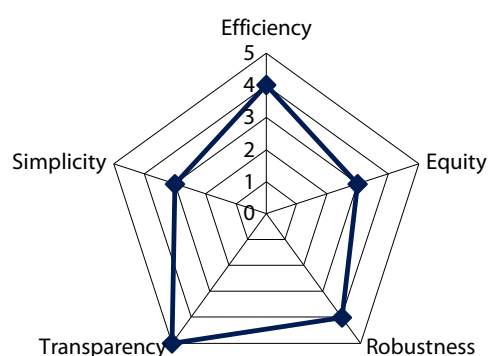
GST is relatively simple to administer. In 2005-06, the ATO incurred \$603.8 million in GST-related administration costs, or less than 2 per cent of GST revenue.⁶² The States compensate the Commonwealth for the agreed costs of GST administration.

⁶¹ Constitutionally, the GST is a Commonwealth tax as it is imposed and administered under Commonwealth legislation. However, until recently the Commonwealth Government had considered GST as a State Tax. Even so, the Australian Bureau of Statistics treated GST revenue as a tax of the Commonwealth in government finance statistics, with the distribution of GST revenues to the State governments treated as grants (see Australian Bureau of Statistics, 2000, Information Paper, *Accruals-based Government Finance Statistics*, Cat No 5517.0).

⁶² Australian Government, Budget 2007-08, *Budget Paper No 3*, p 14.

Compliance costs for business relate to completing Business Activity Statements and running the information systems which feed into those statements. The exclusions from the base increase the complexity of the tax.

Figure 4.14 Overview and conclusions for GST



GST has a weighted score of 3.8 out of 5, and ranks second among the four Commonwealth taxes. This score is also higher than all State taxes. Revenue from GST has been growing steadily and it is a relatively efficient and transparent tax. However, it is a regressive tax like all consumption taxes, which reduces its equity.

4.5.4 Excise and customs duty

Excise duties are taxes levied on a specified good, or range of goods, intended for domestic consumption. The major categories of excisable products are petroleum and other fuel products, crude oils, oils and lubricants, tobacco and alcoholic beverages (other than wine). Customs duty is imposed as a percentage of the value of an imported good and/or on a volumetric basis for excise equivalent products.

Efficiency

Excise and customs duty score moderately in terms of efficiency.⁶³ For example, taxes on petroleum and other fuel products may be justified as a form of user charge for government provided road infrastructure, or as a tax on the negative externalities associated with pollution. In this case, the distortions arising from the imposition of the taxes would actually improve its efficiency by aligning the private costs of consumption and production with the social costs. However, some economists consider such arguments to be tenuous. To improve economic efficiency, the tax base should be a measurable sum close to the externality and the rate should be set to reflect the marginal external cost.⁶⁴

⁶³ Most of the excise and customs duties have a high deadweight loss suggesting that they are relatively less efficient taxes. See for example Productivity Commission, *Directions for State Tax Reform*, May 1998, p 238; Gabbitas O and Eldridge D, 'Reforming State Taxation', *Policy*, Autumn 1999, p 22.

⁶⁴ Freebairn, J, 2002, 'Opportunities to Reform State Taxes', *Australian Economic Review*, 35(4), pp 405-422.

Taxes on the consumption of tobacco and alcoholic beverages may also be used to target negative externalities associated with the consumption of such goods. The inelastic demand for excisable goods increases the efficiency of excise duty.

Equity

Excise and customs duties are regressive, like most consumption taxes, as those on a lower income spend a higher proportion of their income on consumption. These taxes are more narrowly-based than GST. Excise duties are more regressive than GST as their economic incidence falls comparatively higher on lower income groups who spend a higher proportion of their income on the goods subject to the duty (eg, petrol, cigarettes and alcohol).⁶⁵

Robustness

Revenue from petroleum excise duties grows with overall demand for fuel and is affected by continuing substitution from petroleum and diesel to other blended fuel products. Revenue from crude oil excise duty also varies with the level of production in the relevant fields. Excise revenue from tobacco and alcoholic beverages tends to be more stable. Customs duty revenue grows with imports, which generally grows in line with gross disposable income.

Transparency

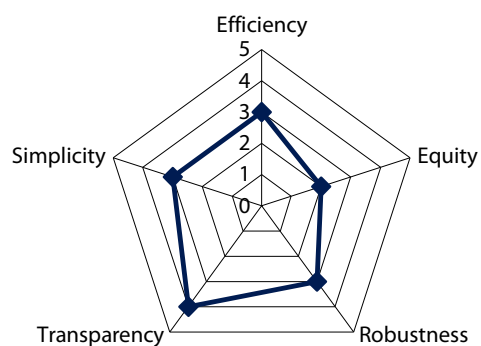
Excise and customs duties are transparent for those legally liable to the duties, though less transparent for consumers.

Simplicity

Differential excise duty rates increase the complexity of this tax. For example, the rate of excise on crude oil varies according to the quantity sold, the sale price, and the dates of discovery and development of certain oil fields. Excise on beer depends on whether it is for personal consumption, while excises imposed on tobacco products apply on a per stick basis for some and per kilogram basis for others. Varying tariff rates under preferential trade agreements increase costs.

⁶⁵ ABS, *Household Expenditure Survey* 2003-04, Cat No 6535.0, Table 2. Households in the bottom two quintiles spend 11.1 per cent and 8.6 per cent respectively of the average weekly household income on petrol, alcohol and tobacco. Households in the top three quintiles spend 7.1 per cent, 5.6 per cent and 4.1 per cent respectively on these products.

Figure 4.15 Overview and conclusions for excise and customs duty



Excise and customs duty have a weighted score of 2.9 out of 5. This score means these taxes rank fourth out of the four Commonwealth taxes assessed, but still perform better than many of the State taxes. Excise duties are relatively efficient, robust and transparent, but are quite regressive.

5 Reform of current NSW taxes

As Chapter 4 discussed in detail, IPART's assessment of NSW taxes against the criteria for good tax design – efficiency, equity, simplicity, transparency, robustness and interstate competitiveness – found that these taxes perform relatively poorly against some or all of these criteria. Most importantly, from an economic perspective, none of these taxes are very efficient in their current form. However, two of the most important taxes from a revenue-raising perspective have the potential to be significantly more efficient than they currently are.

These findings clearly demonstrate that there is scope to improve the design and mix of NSW taxes in general, and that there is scope to improve the efficiency of some of the most important taxes. Quantification of the incidence and economic benefits of tax changes is difficult and can be controversial. However, IPART is confident that the recommendations below will make a positive economic contribution. IPART would stress though that the major benefits are likely to come from reform through Commonwealth-State cooperation rather than reform within a single State where the options for reform are limited.

5.1 The need for reform

IPART's findings indicate that NSW taxes are not as efficient as they could be, and that NSW relies more heavily on inefficient taxes than it could. This means the burden of taxation on businesses and individuals is greater than it needs to be. In addition, the burden of taxation is not distributed among individuals and families as equitably as it could be. Taxes can distort economic decision-making by individuals and businesses and divert economic resources away from their optimal usage. While taxes are essential for funding valuable government services an important aim of taxation is to minimise distortions. The consequences of a sub-optimal tax mix include lower economic growth, reduced standards of living, avoidable inequities, and missed opportunities.

The assessment of the efficiency of the tax system raises questions such as whether:

- ▼ The State's stock of commercial properties and residential dwellings is being used to its full potential.
- ▼ High rates of insurance taxes act as an incentive for individuals and businesses to under-insure or not insure.

- ▼ Differences in payroll tax rates between States distort decisions about business location, and so reduce employment opportunities in NSW. (NSW's 6 per cent payroll tax is significantly higher than in the neighbouring States of Queensland (4.75 per cent) and Victoria (5.05 per cent).)
- ▼ NSW's land tax rate may compound the effect of high NSW land values on business property costs.

Examples of how the current tax system's inequities may lead to unfairness and reduced standards of living include:

- ▼ The selective and uneven application of State taxes. Major NSW taxes have narrow bases with extensive exemptions: for instance, only around one in every nine properties in NSW is liable for land tax, and only around one in every 12 businesses is subject to payroll tax.
- ▼ While investment property owners can pass on all or some of this tax burden on to their tenants through rents, owner-occupiers are largely exempt. As well, there is a completely different tax treatment for owner-occupiers and investors.⁶⁶
- ▼ Purchaser transfer duty acts as a deterrent on moving house. Although most first home buyers are exempt, the burden of purchaser transfer duty falls most heavily on those who move more often, and as people age, it discourages them from moving to a house that is better suited to their changed circumstances and needs.
- ▼ Taxes on insurance act as an incentive for individuals and businesses to under-insure or not insure. The burden of these taxes falls on those who prudently take out insurance, while the uninsured who do not contribute often receive public assistance.

While NSW has limited flexibility to change the types of tax it levies, due to the constraints discussed in Chapter 3, IPART considers that the NSW Government can improve the State's tax system, independently of changes to Commonwealth-State fiscal arrangements. In this review, IPART has focused on improving the structure and composition of NSW taxes, rather than on possible increases or decreases in the overall tax burden. In general, it considers that improvements can be achieved by adopting the following guidelines:

- ▼ increasing reliance on broader based, simpler and more transparent taxes that facilitate modern business practices
- ▼ reducing reliance on inefficient, distorting taxes in favour of more neutral taxes
- ▼ using levies, for example environmental levies, that are carefully targeted, and are fair and transparent to achieve desired market interventions
- ▼ reducing the level of tax expenditures (ie, tax revenues forgone as a result of exemptions, concessions and rebates for certain taxes)
- ▼ improving the efficiency of the user pays model for charges levied by government

⁶⁶ Investors pay income tax on the net income from the investment property. Owner-occupiers do not pay tax on the imputed rent from their property.

- ▼ strengthening the efficiency and effectiveness of tax administration in NSW.

IPART has identified a range of specific reforms related to the individual State taxes, tax expenditures, user charges and tax administration, in line with these guidelines. In doing so, it has taken account of the current constraints on tax reform (discussed in Chapter 3), the criteria for good tax design (discussed in Chapter 4), and stakeholder comments on each tax (discussed in the sections below). It has also considered the fact that, as section 3.2.2 discussed, the CGC's current approach to HFE means that tax reforms at the State level may have financial consequences in the form of a reduced share of GST revenue.

A major thrust of IPART's recommended reforms is the pursuit of improvements in economic efficiency by reducing those aspects of the current tax system that hinder and distort productive economic activity. In particular, IPART's proposes that NSW moves away from the heavy reliance in the current tax system on transactions-type taxes on property transfers, motor vehicle transfers and the purchase of insurance products, and towards broader-based annual taxes on asset holdings.

Put simply, IPART's recommended strategy is to improve individual taxes by broadening tax bases and reducing rates, and improve the mix of taxes by placing greater weight on taxes that are more broadly based, transparent, simple, and have less adverse impact on behaviour. IPART considers that these changes have the potential to generate significant economic benefits for NSW.

The following sections discuss IPART's recommended strategy in detail:

- ▼ Sections 5.2 to 5.8 outline the options and recommendations for reform of payroll tax, insurance taxes, property taxes, road and vehicle taxes, gambling taxes and some possible new taxes. The recommendations include specific, short to medium-term actions, and longer term directions for reform
- ▼ Section 5.9 discusses the current tax expenditures in NSW, and sets out recommendations for reform in this area
- ▼ Section 5.10 focuses on user fees and charges, and makes recommendations for reform
- ▼ Section 5.11 discusses tax administration issues, and recommends measures to improve NSW's performance in this area
- ▼ Section 5.12 provides an overview of the recommendations made in this chapter, and presents the estimated revenue impacts of the short and medium-term recommendations.

Appendix E provides an overview of the important features of each of the State taxes discussed in this chapter.

5.2 Payroll tax

In submissions to this review, stakeholders raised the following issues in relation to payroll tax:

- ▼ the NSW payroll tax rate – 6 per cent – is relatively high
- ▼ payroll tax is a tax on employment, and so acts as a disincentive to business growth, particularly around the payroll tax-free threshold
- ▼ payroll tax is payable regardless of employers' economic circumstances
- ▼ payroll tax raises labour costs, if it cannot be offset by lower wages, and this lowers the demand for labour
- ▼ for primary producers, who are typically 'price-takers' in export markets, payroll tax can reduce margins and discourage exports.

As Chapter 4 noted, although employers are liable for payroll tax, in practice, they are able to pass its cost on either to consumers (through higher prices) or to employees (through lower wages). In this case, the economic effect of a broadly-based payroll tax is similar to a broad consumption tax or a flat-rate income tax respectively. Therefore, the commonly held view that 'payroll tax is a tax on employment'⁶⁷ is not supported by the evidence.

As Chapter 4 discussed, IPART's assessment of State taxes found that payroll tax is one of the most efficient current taxes. Therefore, there is a case for increasing NSW's relative dependence on this tax. However, as stakeholders noted, NSW's current payroll tax rate (6 per cent) is substantially higher than that of its neighbouring States (Victoria 5.05 per cent; Queensland 4.75 per cent).⁶⁸ Any increase in the payroll tax rate will raise concerns about NSW's interstate competitiveness.

IPART notes that there have been long-term differences in the payroll tax rates of different States, but there is little evidence that this has affected employment levels in those with the highest rates. Nevertheless, the terms of reference for this review highlight the Government's strong concern to improve the competitiveness of the NSW tax system. Given this, IPART does not recommend an increase in payroll tax rates even though this could allow NSW to reduce its reliance on less efficient taxes.

Rather, IPART considers that in the long term, there is a strong case to reduce the payroll tax rate to a level similar to that in Victoria and Queensland (eg, around 5 per cent). This would neutralise any adverse locational incentives and remove relative cost disadvantages of businesses operating in NSW. In the short to medium term, there is scope to broaden the payroll tax base to enable both a modest first step towards reducing the tax rate to a more competitive level and a contribution to improving overall efficiency.

⁶⁷ See *The Case for Payroll Tax*, NSW Treasury Research and Information Paper, TRP 99-3, September 1999.

⁶⁸ In its 2008-09 Budget Victoria reduced its Payroll Tax Rate to 4.95 per cent effective from 1 July 2008.

IPART considered three options for this shorter term reform of payroll tax:

- ▼ 'clawing back' the tax free threshold and reducing the tax rate by a modest amount
- ▼ reducing the tax free threshold and reducing the tax rate by a modest amount
- ▼ reducing the current exemptions.

The sections below discuss the options for shorter and longer term reform of payroll tax, IPART's recommendations, and the possible consequences of these recommendations for Commonwealth-State revenue sharing.

5.2.1 Payroll tax threshold clawing back and rate reduction options

Under a payroll tax threshold 'clawback' scheme, the tax free threshold would be gradually withdrawn so that the tax would be payable on the whole payroll once the size of the payroll exceeds a certain point (the upper taper limit). Various States, including NSW, have operated payroll tax clawback schemes in the past. However at present, Queensland is the only State operating such a scheme. All other States have a single marginal rate scheme.

In the Queensland scheme, businesses with payrolls of less than \$1,000,000 are exempt. For businesses with payrolls between \$1,000,000 up to \$4,000,000, there is a deduction of \$1,000,000 reducing by \$1 for every \$3 that the payroll exceeds \$1,000,000. There is no threshold for payrolls of \$4,000,000 or more.

Table 5.1 presents estimates of various threshold clawback and rate cut options. The estimates suggest that:

- ▼ introducing a threshold clawback scheme (with a taper rate of 33.33 per cent per annum and an upper taper limit of \$2,400,000 per annum) will yield additional revenue of \$500 million per annum
- ▼ such a threshold clawback scheme could approximately fund a reduction in the nominal payroll tax rate from the current 6.0 per cent to around 5.5 per cent
- ▼ the combination of such a threshold clawback scheme and a reduction in the nominal rate from 6.0 per cent to 5.0 per cent is estimated to cost around \$640 million per annum.

Table 5.1 NSW payroll tax threshold clawback options

	Threshold	Upper taper limit	Taxpayers within taper range			Nominal tax rate (%) ^a	Maximum marginal rate (%) ^b	Change in revenue (\$m pa) ^c
			Number	% of total taxpayers	% of total businesses			
1	600,000	2,400,000	21,119	76.95	6.57	6.00	8.00	500
2	600,000	2,400,000	21,119	76.95	6.57	5.50	7.33	-71
3	600,000	2,400,000	21,119	76.95	6.57	5.00	6.67	-642

a Beyond taper range.

b Within the taper range.

c Change in revenue is the estimated change from the status quo.

Notes: The clawback taper rate is 33.33 per cent. Estimates are for 2008-09.

Source: Model estimates.

While the introduction of a payroll tax threshold clawback scheme would clearly raise more revenue, such a scheme would have a number of disadvantages. In particular, it would increase:

- ▼ the competitive advantage of smaller firms over their medium-sized rivals
- ▼ the disincentive for some smaller firms to grow
- ▼ marginal tax rates within the taper range
- ▼ administrative and compliance costs.

The NSW Tax Task Force was critical of the former NSW payroll tax threshold clawback scheme, and recommended that it be converted to a marginal rate method.⁶⁹

5.2.2 Reducing the tax free threshold and tax rate

The current tax free threshold exempts around 91 per cent of NSW businesses from payroll tax. It is more significant than other payroll tax exemptions that apply in NSW, such as those for hospitals and local councils. It may encourage firms to plan their affairs to stay below the threshold, perhaps by influencing the way they engage extra resources. It also creates a significant bias in the treatment of firms based on their size.

Table 5.2 presents estimates of various payroll tax free threshold and rate cut options. The estimates suggest that:

- ▼ reducing the threshold from \$600,000 to \$500,000 per annum would yield additional revenue of \$205 million per annum
- ▼ reducing the rate from 6.0 per cent to 5.75 per cent would reduce revenue by \$264 million per annum (assuming no change in the threshold)

⁶⁹ New South Wales Tax Task Force, (1988), *Tax Reform and NSW Economic Development: Review of the State Tax System*, (D. Collins, Chairman) NSW Government Printer, Sydney, p 209.

- ▼ reducing the threshold from \$600,000 to \$400,000 per annum would yield additional revenue of \$450 million per annum, which could fund a rate reduction from 6.0 per cent to around 5.6 per cent.

Another option would be to leave the tax free threshold unchanged in nominal terms, which would lead to small reductions over time in real terms.

Table 5.2 NSW payroll tax threshold and rate reduction options

	Threshold (\$ pa)	Nominal tax rate (%)	Number of taxpayers	% of total businesses	Change in revenue (\$m pa)
Current	600,000	6.00%	27,446	8.5%	
Option 1	600,000	5.75%	27,446	8.5%	-264
Option 2	600,000	5.50%	27,446	8.5%	-529
Option 3	600,000	5.00%	27,446	8.5%	-1,059
Option 4	500,000	6.00%	32,441	10.1%	205
Option 5	500,000	5.75%	32,441	10.1%	-69
Option 6	500,000	5.50%	32,441	10.1%	-342
Option 7	400,000	6.00%	39,618	12.3%	450
Option 8	400,000	5.60%	39,619	12.3%	-3
Option 9	300,000	5.40%	50,752	15.8%	46
Option 10	0	4.10%	321,330	100.0%	13

Notes: Estimates are for 2008-09. Change in revenue is the estimated change from the status quo.

Source: Model estimates.

Lowering the tax free threshold will increase the tax burden on a significant number of businesses in NSW. It can be argued that the administrative and collection costs involved in extending payroll tax to very small businesses would be high in relation to the potential revenue gain. However, the economic basis for exempting businesses with annual payrolls equal to or higher than \$500,000 is less clear.

In IPART's view, the benefits of a payroll tax reform package that is broadly revenue-neutral and involves broadening the base and reducing the rate will more than offset the disadvantages associated with increased compliance costs for the following reasons:

- ▼ a reduction in the tax free threshold would enhance economic efficiency by increasing NSW's competitive neutrality and reducing the extent of distortions for a wider range of businesses
- ▼ improving the balance between the number of businesses that are liable and the number that are exempt would improve equity
- ▼ a reduction in the marginal rate of payroll tax would improve interstate competitiveness.

Recommendations

1 In the short term:

- the tax free threshold for payroll tax should be reduced from \$600,000 pa to \$500,000 pa
- the payroll tax rate should be reduced from 6.0 per cent to 5.75 per cent.

5.2.3 Reducing the current exemptions

As Chapter 4 noted, the large number of exemptions from payroll tax narrows the tax base, and thus reduces its efficiency. The major exemptions and the resulting estimated revenue forgone in 2007-08⁷⁰ are as follows:

- ▼ public hospitals and area health services - \$453m
- ▼ schools and colleges - \$120m
- ▼ religious institutions - \$10m
- ▼ charitable institutions - \$38m
- ▼ local councils - \$180m
- ▼ private hospitals and nursing homes - \$14m
- ▼ home care service - \$8m
- ▼ apprentices - \$19m
- ▼ trainees - \$10m
- ▼ redundancy payments - \$6m
- ▼ maternity leave - \$5m.

The removal of these exemptions would create a more 'level playing field' and help signal the true relative costs of the goods and services that the currently exempt organisations provide. IPART recognises that where these organisations are State government departments and instrumentalities – eg, public hospitals and area health services – the imposition of payroll tax is likely to be accompanied by demands for increased budgetary funding, resulting in a fiscal 'churning' with little net benefit.

However, IPART considers that the current exemption of local councils from payroll tax is difficult to justify. It acknowledges that the removal of this exemption would lead to pressure to increase council rates to fund the additional tax liability, and that this might be perceived as a 'zero sum' game. However, there are potential efficiency gains from levelling the playing field between the provision of goods and services by local council and other providers, and in the relative tax efficiency of the local council rate base. Moreover, the removal of the local council exemption from payroll tax would increase the importance of council rates (which are relatively efficient property-based taxes derived from a broad base) and broaden the payroll

⁷⁰ NSW 2007-08 Budget Papers, *Budget paper No 2*, Appendix E, pp E-17 – E-19.

tax base (also a relatively efficient tax), and thus contribute to a more efficient tax system in NSW.

IPART estimates that an increase of around 6 per cent in local council rates would be required to compensate for the removal of the payroll tax exemption⁷¹. This could be phased in over a two-year period. The State Government's rate-pegging limits would need to be increased to accommodate this change.

Recommendation

- 2 Over a two-year period, the payroll tax exemption for local councils should be removed and a corresponding increase in municipal rate-pegging limits should be phased in.

5.2.4 Longer term reform of payroll tax

If the NSW payroll tax rate were reduced to 5.75 per cent (Recommendation 1), this rate would still be substantially higher than that of neighbouring States. In the interests of improving interstate harmonisation of taxes and neutralising competitive disadvantages for NSW businesses, it would be desirable for NSW to set a longer run target of achieving interstate parity in the payroll tax rate. Currently, this would mean a rate of around 5 per cent.

However, this will not be easy to achieve. With the exception of land tax, most other State taxes have comparatively narrow bases and/or are comparatively inefficient. Therefore, a reduction in the State's reliance on payroll tax would reduce the overall efficiency of the tax system (and impair the competitiveness of the State economy) if this were achieved by increasing other taxes. If increased compliance efforts can strengthen the various tax bases, the additional revenues, once received, could be used to reduce the rate. However, achievement of parity is likely to require:

- ▼ further reductions in the payroll tax free threshold
- ▼ greater access to revenue from Commonwealth taxes (see Chapter 6), or
- ▼ further State fiscal reform.

Recommendation

- 3 In the long term, the rate of payroll tax should be further reduced, with the long-term goal of achieving interstate parity in this rate.

5.2.5 Consequences for Commonwealth-State revenue sharing

As Chapter 3 discussed, any change to a State's taxes and the amount of revenue raised can affect the level of grants it receives from the Commonwealth. GST revenue grants are distributed among the States according to the principle of HFE. This has been defined by the CGC as providing each State with the capacity to

⁷¹ Based on ABS, *Taxation Revenue 2005-06*, Cat No 5506.0, Table 9.

provide the same standard of service, if each operated at the same level of efficiency and made the same effort to raise revenue.

The CGC assesses each State's capacities to collect payroll tax based on its private sector payrolls above a threshold of \$650,000.⁷² In 2006-07, NSW was assessed as having a capacity to collect payroll tax of 10.7 per cent above the per capita all-States average.⁷³ This was mainly due to the higher levels of wages and salaries in NSW, but the relatively higher proportion of wages paid by employers over the threshold was also a factor. The CGC assessed that if NSW imposed the payroll tax at the average all-States rate, then NSW could have raised an additional \$505m⁷⁴ from this tax in 2006-07. Since it did not, the CGC effectively redistributed this \$505m to the other States as a result of the way it distributed the GST based grants.

What would happen if there was a reduction in the NSW payroll tax rate? Any reduction in this rate would reduce the States' aggregate payroll tax collections, and hence reduce the weight of this tax in the HFE process. It would result in NSW's above average capacity being assessed as able to yield less revenue when taxed at the average rate. This would reduce the size of the \$505m redistribution to other States. In the extreme, if all States were to abolish payroll tax and their deficits increased accordingly, NSW's share of the GST would increase by the full \$505m, since its above average share of payrolls would have no taxable value, and would no longer figure in the CGC's calculations.

The net effect of a reduction in the payroll tax rate would depend on how NSW replaced the revenue forgone as a result of this reduction. But as Chapter 3 noted, the CGC's current approach to HFE can create an incentive for States to reduce an efficient tax and increase an inefficient tax.

As subsequent sections will discuss, there are similar interactions between changes to other State taxes and Commonwealth grants. The consequences of these interactions for NSW's grant allocation can be difficult to quantify with any certainty. These complex interrelationships between changes to State taxes and Commonwealth grant distributions warrant careful analysis, before State tax reforms are implemented.

Recommendations

- 4 NSW Treasury should review in detail, before implementing the reforms recommended by this review, the interactions between the recommendations and the GST/CGC grant allocation to NSW. Where the outcome is detrimental to good State tax reforms, this issue should be referred to COAG as an impediment to State reform designed to improve national competitiveness.

⁷² Commonwealth Grants Commission, *2008 Update Report, Working Papers, Volume 2, Payroll Tax*, p 9. Gross earnings/wages and salaries of \$550,000 are considered by the CGC to be equivalent to 'compensation of employees' of around \$650,000.

⁷³ Commonwealth Grants Commission, *Relative Fiscal Capacities of the States 2008*, Table E-1, p 340.

⁷⁴ Commonwealth Grants Commission, *Relative Fiscal Capacities of the States 2008*, Table D-37, p 268. The per capita all-state average was \$688.62 and NSW's assessed revenue was \$762.37.

- 5 NSW Treasury should develop a capacity to better manage the interaction between the State's tax and expenditure policies and the CGC's HFE methodology. This will involve a regular report to the NSW Government on the impact the HFE methodology has on State (and national) tax (and expenditure) reform, for tabling at the Treasurer's Conference and referral to COAG. All tax proposals should include an assessment of the impact on the allocation of Commonwealth grants.

5.3 Insurance taxes

5.3.1 Stamp duty on general insurance

Submissions to the review advocated reform of general insurance taxation as a priority for NSW on both efficiency and equity grounds. Stakeholders noted the poor design features of general insurance taxes, and claimed that the high levels of duty on insurance create incentives for non-insurance and under-insurance. (The Board of Airline Representatives of Australia also raised some very specific concerns about the insurance taxes on the aviation industry; these issues, and IPART's response, are discussed in Box 5.1.)

IPART considers that on economic efficiency grounds, there is a compelling case for abolishing stamp duty on insurance and making up the revenue forgone from consolidated revenue⁷⁵ or other sources. However, there are severe constraints on the State's fiscal capacity to do this in the short term.

The standard rate of duty on general insurance is 9 per cent (Type A). A concessional rate of 5 per cent (Type B) applies to certain aviation, consumer credit, disability, directors and officers' liability, personal accident, professional liability and motor vehicle insurance. A lower concessional rate of 2.5 per cent (Type C) applies to certain blood stock, crop and livestock insurance.

There are significant concessions and exemptions in the application of duty on various insurance products, which narrow the base and place a disproportionate burden on non-concessional taxpayers. The major concessions and exemptions and the resulting revenue forgone in 2007-08⁷⁶ are as follows:

- ▼ concessional rates for motor vehicle, aviation, disability income, occupational indemnity, crop and livestock insurance – \$142 million
- ▼ exemptions for third party motor vehicle personal injury insurance (CTP, or the 'green slip') – \$150 million
- ▼ exemptions for marine and cargo insurance – \$20 million
- ▼ exemptions for WorkCover premiums – \$198 million.

⁷⁵ Consolidated revenue is the account into which taxes and other revenues are deposited, and from which funds are withdrawn in order to pay for public services.

⁷⁶ NSW 2007-08 Budget Papers, *Budget Paper No 2*, Appendix E, p E 8.

In IPART's view, there is merit in broadening the tax base and lowering the standard rate of duty on general insurance.

All States except NSW and the ACT impose either insurance stamp duty or a small levy on third party motor vehicle personal injury insurance. Removal of this exemption would reduce a bias in the treatment of different insurance products and contribute to a reduction in the standard rate of duty on general insurance. Since third party motor vehicle insurance is compulsory, removal of this exemption would not have adverse behavioural effects (ie, it would not encourage under-insurance or non-insurance).

Abolishing the stamp duty exemption for third party motor vehicle personal injury insurance would yield significant additional revenue (around \$150 million in 2007-08 with a tax rate of 9 per cent).⁷⁷ This could be applied towards funding a reduction in the standard rate of stamp duty for general insurance (Type A) from the current 9 per cent to 6 per cent, resulting in the NSW rate being the lowest standard rate of general insurance among the States. As Chapter 4 discussed, insurance taxes rate very poorly in terms of efficiency. Reducing the rates of duty on general insurance will therefore deliver economic efficiency gains.

Recommendation

6 In the short term, the stamp duty exemption for third party motor vehicle personal injury insurance should be abolished and that the standard rate of stamp duty for general insurance (Type A) be reduced from 9 per cent to 6 per cent.

Because stamp duties on general insurance are among the most inefficient of State taxes, there is a strong case for abolishing them entirely over time, as other more efficient revenue sources are developed. There are opportunities to further reduce stamp duties on general insurance as part of a long-term reform strategy for property taxes (see below) and to complete their phased abolition as part of a national tax reform (see Chapter 6).

Consequences for Commonwealth-State revenue sharing

The CGC assesses each State's revenue base from insurance stamp duty in two parts:

- ▼ the compulsory third party (CTP) component is assessed using revenue from CTP premiums as the revenue base
- ▼ the general and life insurance component is assessed as the revenue base premiums from general and life insurance excluding CTP, less:
 - premiums from employers' liability insurance
 - premiums from reinsurance, and

⁷⁷ The revenue gained from removing this exemption would, however, be less if the rate of duty is reduced. For example if the general insurance duty is reduced from 9 per cent to 6 per cent would reduce the cost the CTP exemption from \$150m to \$100m (escalated to \$104m in 2007-08 as shown in Table 5.12).

- revenue from fire insurance levies.

NSW is assessed as having a larger than average revenue base for insurance stamp duty. The HFE process redistributes the benefits of the above-average amount of the revenue base to other States. These benefits are measured as the revenue that could be yielded from the above-average part of the revenue base, if it were taxed at average rates. If NSW were to abolish taxes on insurance premiums, the Australian average rate of tax would fall. As a result, the tax advantage ascribed to NSW from its above-average share of the base would be reduced, and there would be a reduction in the size of the redistribution to other States. In other words, if NSW were to abolish or reduce insurance duty, the weighting placed on this tax within the CGC's assessments would reduce, leading to an increase in NSW's share of the GST.

Box 5.1 Specific issues raised in relation to insurances taxes on aviation industry

In its submission to the review, the Board of Airline Representatives of Australia raised three specific concerns about the insurance taxes levied on the aviation industry. IPART consulted the NSW OSR on these concerns. Each concern and OSR's response is summarised below:

- 1 There are inconsistencies in the stamp duties on insurances levied on the aviation and maritime industries.** OSR has committed to consult Treasury on this apparent anomaly.
 - 2 In relation to the insurance duty, the method of apportionment should be based on time relative to risk.** OSR considers that the current method of apportionment is fair and reasonable. It is based on the airline's number of take-offs and landings relative to all take-offs and landings (international and domestic).
 - 3 No other jurisdiction imposes stamp duties on airline insurance policies.** OSR notes that all States impose stamp duty on airline insurance policies. It also notes that even if this were not the case, it would not be sufficient grounds on its own for the removal of these duties: different jurisdictions often have unique taxes.
-

5.3.2 Fire services levy

Funding for the NSW Fire Brigades and Rural Fire Service is determined each year by the Minister for Emergency Services in consultation with the Treasurer. Statutory contributions are made by the insurance industry (the largest contributor), local councils, and the State's Consolidated Fund (see Appendix E).

The insurance industry contribution (the 'fire services levy') is determined by the market shares of insurance companies issuing policies for fire, industrial-specific risks, contractors, home and vehicle insurances. The fire services levy, as it is described on insurance policies, is not a NSW Government tax but a surcharge that general insurers impose on their customers to recoup the cost of their contribution to the fire services. Insurance companies determine if and how they will recover

their contributions – in most if not all cases, this is through a levy on policy holders based on their insurance premiums.

The fire services levy adds to the multiple layers of taxation on insurance, discouraging households and businesses from acquiring an appropriate level of insurance cover. This has implications for the efficient allocation of resources within the economy.

The Local Government Association of NSW has advocated a property valuation based levy model, to replace the existing fire services levies on local government and the fire services levy on the insurance industry. Queensland and South Australia operate a property-based levy to fund fire services. Western Australia has replaced its former fire services levy with a new levy that varies by property type and by region, and is collected by local government authorities.

In NSW, the issue of replacing the fire services funding contributions with a property-based levy was considered in a public inquiry conducted by the Public Accounts Committee of Parliament (PAC) in 2004. This inquiry found that while there were benefits in replacing the current system with a levy on property in the residential sector, there were many small and large businesses that might be worse off under a property levy. The PAC considered that it was not prudent to introduce a new, administratively complex system for the residential sector alone and therefore recommended against a move to a property levy at that time. The NSW Government accepted this finding of the inquiry.

IPART considers that the fire services levy could be replaced by a corresponding increase in the current contribution from local government. Local government would, in turn, increase rates to recover the cost. IPART proposes a phased introduction with appropriate increases in the rate cap to accommodate the shift in funding arrangements. Effectively, this would increase the contribution from all property owners via local government rates. It would achieve the benefits identified by the PAC, without the need to introduce a new tax. In addition to its administrative simplicity, this approach enhances both economic efficiency (by greater use of the comparatively efficient municipal tax base) and equity (by reducing the free-rider feature of the current predominantly insurance-based system).

Recommendation

- 7 In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in the contributions by local councils, with a phased implementation and accommodating increases in the municipal rate cap.

Consequences for Commonwealth-State revenue sharing

The CGC's assessment of revenue from the NSW fire service levy is included in the category 'Public Safety User Charges'. This category comprises all revenues associated with fire insurance levies, including statutory contributions for fire brigades from insurance companies and local government authorities. Other user charges included in the category are fees from installation of smoke alarms, false alarm charges and fines.

NSW is assessed as having an above-average capacity to collect revenue from fire service levies, and hence the assessment of these user charges results in a redistribution of GST revenue from NSW to the other States.

However, if as IPART proposes, the fire service levy on insurance is replaced by an increase in local government contributions to fund fire services, there may be no impact on NSW's share of GST revenue. The current CGC methodology does not distinguish between these funding sources for fire services – as noted above, both fall into the category 'Public Safety User Charges'. This is obviously anomalous, and would be an issue if NSW moves away from the fire services levy on insurance premiums. This example demonstrates that while comparability across States is a key driver for the CGC methodology, this can result in the base for a State's 'assessed revenue' being different from the actual base.

5.4 Property taxes

NSW property taxes are a major source of economic inefficiency, and stakeholders expressed many concerns about purchaser transfer duty and land tax during the review's public consultation. Several submissions advocated fundamental reform of property taxation. However, the practical constraints on such reform are substantial:

- ▼ There is currently a very heavy dependence on purchaser transfer duty – which comprises the bulk of property tax revenue – within the State budget. Furthermore, given the progressive rate schedule of this duty, its replacement with other (less progressive) potential revenue sources raises important equity issues.
- ▼ Land tax is a more controversial tax, and causes considerable public concern and debate. Any proposed changes to land tax can be expected to be keenly contested.
- ▼ Changes in property taxation can affect the value of an individual's primary assets, and activity in the property market. For this reason alone, it needs to be approached cautiously. IPART considers that several steps can be undertaken to improve current taxes in the short term, but more fundamental reform is needed over the long run.

5.4.1 Property tax issues raised in submissions

The predominant property taxes are purchaser transfer duty and land tax. Most of the comments on property taxes in submissions to this review focused on land tax. A few stakeholders expressed positive views about this tax. For example, some noted that it is an efficient tax because it does not affect the supply of land and thereby minimises the scope for avoidance and associated distortions. Others commented that it can be a relatively simple tax if a flat rate of tax applies (with or without a threshold).

In addition, some stakeholders advocated the introduction of betterment taxes in relation to land values. They argued that the ‘unearned’ incremental value of land – as opposed to increases in value attributable to property improvements by the landowner – belongs to the community and therefore should be taxed.

However, many more stakeholders expressed considerable concern about aspects of land tax, including the following:

- ▼ While land tax is simple and efficient in principle, in practice, the current NSW tax is unfair and inefficient because of the poorly directed exemptions.
- ▼ Land tax is not equitable; in practice, it imposes different tax burdens on owner-occupiers and tenants with the same net worth.
- ▼ Land tax is not transparent.
- ▼ Land tax is not broad-based: it unfairly taxes a small proportion of properties.
- ▼ The complexity of land tax creates opportunities for avoidance and evasion.
- ▼ Basing a taxpayer’s liability on the aggregated value of their land holdings is unfair.
- ▼ Land tax adds to the high costs of rent in NSW, making NSW rental accommodation less competitive relative to other States.

Stakeholders also expressed the view that purchaser transfer duty is an inefficient tax as it is based on transactions, is a barrier to entry to the property market, is a strong disincentive to invest in the residential property market, and unfairly taxes a range of ‘land rich’ entities (unit trusts and company structures).

In addition, the Joint Accounting Professional Panel and the Property Council of Australia made some very specific proposals related to property taxes. These proposals and IPART’s response are discussed in Box 5.2.

Based on its consideration of stakeholder views and its own assessments of property taxes, IPART considers that steps should be taken in the short term to improve the current property tax arrangements. In addition, it also considers that more fundamental reform is needed over the longer term.

In the short to medium-term:

- ▼ there is scope to reduce the tax rates on purchaser transfer duty and to rationalise the rate schedule
- ▼ the purchaser transfer duty tax rate scale should be indexed annually, to reduce inefficiency due to 'bracket creep'
- ▼ consideration should be given to taxing land owners on a 'individual tax unit' to improve simplicity.

In the longer term, IPART considers that the Government should develop a strategy for increasing property holding taxes, to fund substantial reductions in its reliance on purchaser transfer duty and insurance taxes.

The sections below discuss these short and longer term options for reforming property taxes, and discuss the consequences of the proposed reforms for Commonwealth-State revenue sharing. IPART's views on the specific proposals made by stakeholders are discussed in Box 5.2.

5.4.2 Reduction in purchaser transfer duty

Purchaser transfer duty has been identified as one of the most inefficient State taxes. For this reason, some reduction in transfer duty is proposed in the short term, consistent with a strategy of changing the mix away from inefficient taxes.

The current general schedule of transfer duty rates was introduced in 1987 and has remained unchanged since then. The lowest value range in the schedule ("up to \$14,000") dates from the introduction of decimal currency in 1966 when the duty rates were converted from pounds to dollars.

It is proposed that the purchaser transfer duty schedule be amended as follows:

- ▼ The first three steps in the present rate scale be amalgamated to form a range of "\$0 to \$80,000".
- ▼ The rate of duty in this value range be reduced to \$1.00 per \$100 (down from \$1.25, \$1.50 or \$1.75 per \$100 at present depending on the value of the transfer).

These changes result in a substantial percentage reduction in the duty rate for transaction up to \$80,000 and a flat rate reduction of \$490 for all transfers of \$80,000 and higher.

The proposed changes are shown in the following tables.

Table 5.3 General Schedule (for all dutiable property other than residential property above \$3 million)

Value of Dutiable Property	Current Transfer Duty Payable	Proposed Transfer Duty Payable
Up to \$14,000	\$1.25 per \$100 or part (minimum \$2)	
\$14,0001 to \$30,000	\$175 plus \$1.50 per \$100 (or part) above \$14,000	\$1.00 per \$100 or part (minimum \$2)
\$30,0001 to \$80,000	\$415 plus \$1.75 per \$100 (or part) above \$30,000	
\$80,0001to \$300,000	\$1,290 plus \$3.50 per \$100 (or part) above \$80,000	\$800 plus \$3.50 per \$100 (or part) above \$80,000
\$300,0001 to \$1,000,000	\$8,990 plus \$4.50 per \$100 (or part) above \$300,000	\$8,500 plus \$4.50 per \$100 (or part) above \$300,000
Over \$1,000,000	\$40,490 plus \$5.50 per \$100 (or part) above \$1,000,000	\$40,000 plus \$5.50 per \$100 (or part) above \$1,000,000

Table 5.4 Premium Property Duty (residential property valued above \$3 million)

Value of Dutiable Property	Transfer Duty Payable	Proposed Transfer Duty Payable
\$3,000,000 and over	\$150,490 plus \$7.00 per \$100 (or part) above \$3,000,000	\$150,000 plus \$7.00 per \$100 (or part) above \$3,000,000

The benefits of the changes in Tables 5.3 and 5.4 are:

- ▼ The first two value ranges are anachronistic.
- ▼ Bracket amalgamation at the lower end of the schedule simplifies the rate scale by reducing the number of separate rates.
- ▼ The aggregate reduction in purchaser duty is modest but is a reduction in one of the most inefficient State taxes.

IPART estimates that the changes to purchaser transfer duty rates shown in Tables 5.3 and 5.4 will cost the Government \$86 million in revenue forgone in 2008-09.

Recommendation

- 8 In the short-term, the purchaser transfer duty should be reduced by replacing the existing first three rating levels with a single level for dutiable properties up to \$80,000 and reducing the duty payable up to this level to 1 per cent, with the details as shown in Tables 5.3 and 5.4.

5.4.3 Indexing the purchaser transfer tax rate scale

The current general schedule of purchaser transfer duty rates was introduced 20 years ago, and incorporates a progressive rates scale (see Appendix E). The nominal rates included in the schedule have not been changed in this time, except for the introduction (from 1 June 2004) of a higher rate on the transfer of residential property valued above \$3 million.

However, the effective duty rate has increased as a result of rising property values. For example, over the 20 years to June 2007 the transfer duty payable on the median house price in Sydney has increased from 1.9 per cent of the property value to 3.6 per cent of this value.⁷⁸

In 1988, the Collins Tax Task Force recommended that the value brackets in the schedule of transfer duty rates should be indexed.⁷⁹ This recommendation has not been implemented. IPART considers that the purchaser transfer duty rate scale should be indexed annually to avoid ‘bracket creep’, and thus increase the efficiency of this tax. It estimates that indexing these tax rates will cost the Government \$27 million in revenue forgone in 2008-09.

Recommendation

- 9 In the short-term, the purchaser transfer duty rate scale should be indexed annually, based on an index of movements in all NSW property values.

5.4.4 Assessing land tax liability on the individual as the tax unit

Land tax is currently imposed as a flat rate of tax (1.6 per cent plus \$100) on the value of the taxpayer’s aggregated land holdings in excess of the \$359,000 tax free threshold.⁸⁰ In the case of jointly owned property, tax is levied in the first instance on the joint owners as a single entity (or taxpayer). That is, land tax is calculated on the joint ownership of property, prior to assessing the individual taxpayer’s secondary interests in land. This creates an administrative complexity in the case where a joint owner also owns additional property in their own right. Each individual is then also separately assessed on all their interests in land, including the jointly owned properties which have already been assessed. A ‘secondary deduction’ is allowed in the individual’s assessment based on the proportion of the jointly assessed tax to prevent double taxation.

The calculations are administratively very complex, difficult to explain to taxpayers, and the source of a disproportionate number of enquiries and complaints. An administratively simpler approach would be to move the tax unit to the individual, as is the case in Queensland. Under this system, land tax is paid by every owner of

⁷⁸ Real Estate Institute, NSW Treasury.

⁷⁹ New South Wales Tax Task Force, (1988), *Tax Reform and NSW Economic Development: Review of the State Tax System*, (D. Collins, Chairman) NSW Government Printer, Sydney, p 264.

⁸⁰ The threshold is zero for non-concessional companies and special trusts.

land upon the taxable value of all the land owned by the owner. Joint owners of properties are not separately assessed unless there are greater than five owners⁸¹. This approach negates the need for the secondary deduction calculations, which is a major source of client complaint. This will lead to a reduction in compliance and administrative costs, as well as making the tax more transparent and easier to understand.

IPART estimates that the change would result in revenue forgone of \$145 million per annum.⁸² The primary beneficiary of the change would be individuals with small to medium-sized holdings. To neutralise the revenue loss from the change, the tax-free threshold could be reduced by a corresponding amount.

Recommendation

10 In the medium term, consideration should be given to changing the tax unit for land tax from joint ownership to the individual, funded by a decrease in the tax-free threshold.

Box 5.2 Stakeholders' specific proposals for property tax reform

Stakeholders made specific proposals about changes to property taxes in NSW. In particular:

- ▼ The Joint Accounting Professional Panel suggested that the transfer of business real property to superannuation funds be exempt from transfer duty where the owners of the property are members of the fund.
- ▼ The Property Council of Australia suggested that the Duties Act, 1997 be amended to provide an exemption from purchaser transfer duty where the trustee of a unit trust scheme acquire all of the shares in a company or all the units in a trust under a transaction that would qualify as a roll-over under subsection 124-Q of the Income Tax Assessment Act.
- ▼ The Property Council of Australia also proposed that land rich duty definitions and corporate reconstruction exemptions related to stamp duty be harmonised across the States.

IPART considered these specific proposals and consulted the OSR on the issues they raised. In relation to the Joint Accounting Professional Panel's proposal, the presence of Commonwealth policy to encourage transfers of this type is noted. OSR pointed out that the proposal may have significant revenue implications and should be referred to Treasury and the Government for comment.

In relation to the Property Council of Australia's suggestion about amending the Duties Act, the OSR agreed in principle. It noted that it is in the process of making a recommendation to the Treasurer.

In relation to Property Council of Australia's view that certain definitions and exemptions related to land rich duty be harmonised, the OSR responded that it is currently consulting with other jurisdictions and industry bodies to improve national consistency in this area.

⁸¹ Where a joint assessment is raised (after satisfying certain conditions), the proportional assessment on the shares in the land is not added to the individual assessments of the joint owners.

⁸² Source: NSW Office of State Revenue.

5.4.5 Longer term reform options

IPART considers that substantial, longer term reform of property taxes is desirable, to increase the efficiency of the NSW tax system. In particular, it considers that the State's reliance on land tax should be increased, and the additional revenue should be used to fund a reduction in reliance on purchaser transfer duty and insurance taxes. IPART considered four options for longer term reform:

- ▼ broadening the base and reducing the rate of land tax
- ▼ increasing the State's reliance on revenue from land tax and reducing its reliance on purchaser transfer duty
- ▼ focusing on the reform of property tax arrangements for commercial and industrial property, and leaving the arrangements for residential properties unchanged, and
- ▼ introducing betterment taxes on the land values, as proposed by some stakeholders.

Each of these options is discussed below. Box 5.3 provides an overview of IPART's preferred longer term options for reforming property taxes, and outlines an approach for implementing these options.

Broadening the base and reducing the rate of land tax

Many of the concerns expressed during IPART's public consultation have their origins in the rapid growth in land tax liabilities over recent years (which corresponded with rapid and large increases in land values), and with the administrative systems for land valuation. Many advocates of land tax reform argued that the land tax base should be broadened and the rate of tax reduced. They considered that this would improve the equity of the tax, by reducing the current large cross-subsidy from owners of properties that are liable for land tax to owners that are exempt.

However, a simple extension of the land tax base to include owner-occupiers, farmers and owners of properties below the current tax free threshold would have major redistributive impacts. It would constitute a substantial shift in the tax burden, with potentially relatively large increases in tax payable by a large number of individuals, without regard to their capacity to pay and other financial circumstances. The impact on owner-occupiers would be compounded by the fact that, unlike business owners, they cannot 'pass on' the tax to tenants, or access income tax deductions for land tax payments.

On the other hand, using the proceeds of base broadening to fund a reduction in the rate of land tax would result in a substantial gain for those currently liable for land tax. Some stakeholders suggested that lowering land tax would benefit lower-income individuals and families in the private rental market (in the form of lower rents). However, there were conflicting views on the ultimate incidence of land tax and hence on the extent of this benefit. Current taxpayers might also benefit by windfall gains in the market values of their properties, to the extent that the market capitalises the expected lower future land tax liabilities.

In IPART's view, the economic efficiency advantages of the simple base broadening/rate reduction option are outweighed by the highly regressive redistributive impacts of this option unless it is co-ordinated with reform of other taxes such as purchaser transfer duty.

Increasing reliance on land tax and reducing reliance on purchaser transfer duty

As Chapter 4 discussed, land tax (which is a property holding tax, based on the unimproved value of the land) is potentially a very efficient tax, while purchaser transfer duty (which is a transaction tax, based on the improved value of the property) is relatively inefficient. Therefore, the overall efficiency of the NSW tax system could be improved by increasing the State's reliance on land tax revenue and reducing its reliance on purchaser transfer duty revenue. This would also reverse the increasing reliance on purchaser transfer duty that has occurred over the last 20 years as a result of bracket creep, rather than a conscious policy decision (see section 5.4.2).

The benefits of such an option are well-recognised. They were discussed by classical economists in the 19th century,⁸³ and more recently in the Productivity Commission's report on first homeownership.⁸⁴ This option would not increase the overall tax burden on property owners (including owner-occupiers) but would raise the revenue more efficiently and fairly.

Under this option, the revenue forgone by abolishing or reducing purchaser transfer duty would be replaced by a combination of increasing the land tax rate for current taxpayers, abolishing the tax free threshold for land tax, and reducing or removing the exemptions from this tax. In principle, this might be achieved without any significant net change in the incidence of the taxes: on average, tax payers would outlay the same amount as at present via an annual holding tax on land as they would over time via a transaction tax on property purchases. Potentially, the abolition or reduction of transactions-type taxes on insurance products could also be funded by these changes to land tax.

⁸³ Mill, John Stuart (1849-1872) *Principles of Political Economy with Some of their Applications to Social Philosophy*, Toronto Edition, 1965, Edited V. W. Bladen Book 5, Chapter 5, Section 1, pp 858-859. (Quoted in Dwyer, T. 2004, *Untaxing Shelter Submission to the Inquiry into First Home Ownership* p. 3).

⁸⁴ Productivity Commission, *First Home Ownership*, Inquiry Report No 28 March 2004. Available from www.pc.gov.au/_data/assets/pdf_file/0016/56302/housing.pdf.

During the public consultation process, two tax bases were suggested for an expanded land tax:

- ▼ The existing land tax base could be retained, and additional revenue could be raised by reducing the current exemptions.
- ▼ Alternatively, the municipal rates base could be used, and additional revenue for the State could be raised by, for example, adding an additional percentage to the rates collected by local councils.

The use of the municipal rates base was proposed to avoid various problems experienced in the administration of land tax in NSW. However, IPART notes that municipal rates can be applied differentially, vary among Councils, and are subject to State government 'rate-pegging' limits. This raises a number of issues that would need to be carefully addressed before adopting this approach.

The Productivity Commission has estimated, on a nation-wide basis, that to replace purchaser transfer duty with expanded land taxes (in a revenue-neutral way), land taxes would need to be applied at a rate of approximately 1 per cent of 'unimproved land values', and be levied on all land holders, including owner-occupiers.⁸⁵

A stakeholder who made a submission to this review estimated that a new tax levied at a uniform rate of 1.82 times municipal rates would be sufficient to replace both land tax and purchaser transfer duty in NSW.⁸⁶

Focusing on the reform of property tax arrangements for commercial and industrial property only

Another long-term option for reforming property taxes would be to focus on commercial and industrial properties only. Purchaser transfer duty on the sale of such properties could be gradually phased out, and the land tax rate increased. This would increase the efficiency of commercial and industrial property taxation and reduce the disincentives to develop such property. It would also leave the taxation of residential property untouched.

However, this option would increase the distinction between residential (rental and owner-occupied) and commercial and industrial property. The economic effects of this and the potential impacts on tax administration and the robustness of the tax base would need to be considered carefully.

Introducing a betterment tax on land values

As noted above, some stakeholders advocated introducing betterment taxes on the 'unearned' increment in land value. They argued that this incremental value – which may arise when demand for land in a particular area increases, perhaps due to the development of new infrastructure, or because of growth in the community – belongs

⁸⁵ Productivity Commission 2004, *First Home Ownership*, Report no. 28, Melbourne, p 100.

⁸⁶ David Singer submission to IPART Inquiry into Review of State Taxation, p 23.

to the community, as it cannot be attributed to property improvement by the landholder. Therefore it is a suitable subject for taxation.

IPART considered this proposal. As Chapter 4 discussed, betterment taxes are one of the few taxes that meet the criteria for assignment to the sub-national level of government. However, betterment taxes may potentially inhibit investment in buildings and, where based on realisation, a lag in receipt of revenue. IPART considers that the current land tax and municipal rates, being based on unimproved capital values, already incorporate some aspects of a betterment tax on 'unearned' land values. On balance, IPART considers that it is preferable to continue to use these existing taxes, as they are easier to administer, and to some extent are already understood and accepted by the community.

Recommendation

- 11 In the long term, the Government should develop a strategy for increasing property holding taxes (for example, broadening the land tax base, increasing the land tax rate and/or increasing municipal rates on land values) to fund substantial reductions in purchaser transfer duty and insurance taxes on a revenue-neutral basis. The strategy will need to consider carefully the impacts on the various taxpayers as well as the overall benefits to the community.

Box 5.3 Overview of longer term options for reforming property tax

Some options for an expanded land tax system to fund reductions in purchaser transfer duty and insurance taxes are summarised below. The options are set out in very broad terms and would need to be further researched and developed. In particular, they require detailed analysis and modelling to quantify the distributional effects, to establish appropriate levels for the tax rates and other parameters and to optimise the benefits of the reform.

Broadening the land tax base

Review remaining land tax exemptions to determine whether they continue to meet a clear policy objective.

Reduce tax free threshold to zero.

Continue to base tax on the unimproved capital value of the land holding (as taxing improved capital values is a disincentive to improvements).

Adjusting the land tax rates to fund the removal of less efficient taxes

For businesses:

- ▼ Increase the current flat land tax rate to fund reductions in business purchaser transfer duty and insurance taxes.
- ▼ Use the proceeds of abolishing the tax free threshold to reduce the land tax rate.
- ▼ Set land tax rate for farms below the standard business rate, given that the purpose of increasing the standard business rate is to replace other taxes only and in recognition of farms' typically higher land-to-total property value ratios.

For owner-occupiers:

- ▼ Levy land tax at a concessional rate (compared with businesses), but establish a progressive rate schedule on equity grounds that takes into account the fact that the purchaser transfer duty rate schedule being replaced is highly progressive.
- ▼ Establish a minimum fixed dollar tax to be levied where the land value is below a certain threshold, to ensure a fair revenue contribution from low land-to-total property value dwellings (eg, apartments).
- ▼ Ensure that changes are revenue-neutral for the household sector in aggregate.

Implementing reforms over time

Adopt a phased implementation approach, to minimise transitional impacts (including asset price adjustments and possible 'winners and losers' from the shift to increased reliance on land values as a tax base).

Use a system of tax rebates during the transition period – eg, for purchaser transfer duty on recent purchases.

Establish additional safety net and concessional arrangements to address adverse equity and transitional impacts.

5.4.6 Consequences for Commonwealth-State revenue sharing

The CGC's assessment of the States' capacity to collect land tax revenue is quite similar to its assessment of the capacity to collect purchaser transfer duty. In both cases, the CGC assumes that because property in NSW is more highly valued than in other States, NSW has the capacity to collect more revenue from these taxes. In addition, the CGC assumes that in both cases, the 'average policy' of the States is to apply progressive tax rates so more highly valued land holdings/property transactions are taxed at higher rates. This means it assumes that NSW, with an above average proportion of highly valued land holdings/property transactions, should be able to tax them at above average rates.

Given these similarities, if NSW were to collect more revenue from land tax and less from purchaser transfer duty, the changes in each assessment would affect NSW's grant share in opposite directions. However, it is unlikely that they would offset each other exactly.

The CGC assesses the States' capacity to collect land tax on residential land and commercial and industrial land separately. If NSW were to increase its land tax revenue by increasing the tax rate for commercial and industrial land (which accounts for 70 per cent⁸⁷ of the total land tax revenue it collects), this would increase the weighting placed on this tax in the HFE process.

In addition, because commercial land in NSW tends to be valued more highly than in other States, an increase in the land tax rate applying to this land in NSW would have a disproportionate effect on the average tax rate for very highly valued land. As a result, NSW would be assessed as having the capacity to yield more land tax revenue from commercial land. And, because it has relatively more highly valued land, it would be assessed as being able to tax this land at even higher rates. Both of these developments would result in a reduced share of the GST for NSW.

On the other hand, if NSW were to use the proceeds of increased land tax revenue to abolish purchaser transfer duty for commercial and industrial property, across all States the average revenue collected from this source would decrease. In addition, the average tax rate applied to very highly valued property transfers would decrease. Both of these changes would work in NSW's favour.

At present, the CGC's assessments do not provide enough detail to allow IPART to calculate the exact size of these opposing effects, so it is not clear whether the combined result of this proposed reform would be to increase or reduce NSW's GST grant share. However, the implications of such reforms for the CGC methodology are significant and the reforms should not proceed without a detailed review of how the current CGC HFE methodology might impact on its financial feasibility.

⁸⁷ Commonwealth Grants Commission, *2008 Update Report*, Working Papers, Volume 2, Land Tax, Table 5, p 7. The CGC uses a figure of 70 per cent as the proportion of land tax revenue derived from the commercial and industrial sector.

5.5 Motor vehicle registration duty and other motor vehicle levies

Motor vehicle registration duty (payable on the first registration of a new vehicle and on the transfer of a second hand vehicle) is a distortionary tax. It acts as a disincentive for individuals and businesses to buy newer, more environmentally-friendly motor vehicles, and to replace their motor vehicles with more suitable ones as their needs and circumstances change.

IPART considers that this tax could be replaced with an annual fee, which could be either:

- ▼ a flat rate fee, or
- ▼ based on the market-value of the vehicle or another relevant characteristic of the vehicle.

A flat rate fee would be simple, but regressive. A fee based on the market-value of the vehicle would be more complex, and thus would inevitably increase collection costs and may reduce transparency. However, the current availability of on-line market value data suggests that this cost is manageable. In IPART's view, a market-value based fee would offer more benefits, because of its greater equity but, in the absence of some form of offset, would discourage upgrades to new environmentally friendly cars.

Recommendation

12 In the medium term, motor vehicle registration duty should be replaced with a revenue-neutral annual motor vehicle charge.

As noted at the beginning of this chapter, NSW's stamp duty and registration taxes on the purchase of caravans and camper trailers are higher than in other States. To improve interstate competitiveness, IPART considers that stamp duty on purchases of caravans and camper trailers should be abolished. The annual cost of this reform in terms of revenue forgone is estimated to be less than \$7m.

Recommendation

13 In the short term, stamp duty on purchases of caravans and camper trailers should be abolished.

5.6 Motor vehicle weight tax

As Chapter 4 discussed, motor vehicle weight is a relatively efficient tax that also rates well for simplicity, transparency and robustness. It has some characteristics of a road user charge, in that it is based on the weight of the vehicle, which is an indicator of the wear and tear the vehicle places on road infrastructure relative to other vehicles. However, it does not take into account the extent to which the vehicle is used. IPART considers that the Government should consider replacing this tax (and potentially other existing vehicle usage taxes) with better designed road use and congestion charges.

Traffic congestion is a particular source of inefficiency in larger cities, and governments are increasingly looking at taxes and road pricing to reduce congestion. A 2003 review of sustainable transport in NSW, the Parry Inquiry,⁸⁸ supported the introduction of road use charges on the grounds that motorists do not directly bear all the costs associated with their decision to make a journey by private vehicle. This subsidisation adversely affects public transport because motorists do not get the same price signals from road pricing that public transport users get from fares for a parallel journey. This subsidisation contributes to greater use of private vehicles and under-use of public transport.

The Parry Inquiry noted that NSW motorists already pay substantial amounts for using motor vehicles. It is important to distinguish between general motoring charges (including taxes) and specific road use charges. The Inquiry argued that the current taxation of motorists needs to be rationalised if road use pricing is introduced, including addressing the well-documented problems and inefficiencies of the current fuel excise. This is likely to result in some portion of the general motoring payments being replaced with road use pricing.

More recently, in 2006, the Victorian Competition and Efficiency Commission reviewed options for managing traffic congestion in Melbourne. The Commission found that a comprehensive Melbourne road charging study would be useful, to help understand the benefits of road use charging in a future environment where congestion may be increasing, and to permit a comparison of these benefits with the costs of this form of demand management.

In IPART's view, road use charges will be an area of increasing focus in the future. However, further research and analysis is necessary before appropriate charges and taxes can be meaningfully developed.

Recommendation

14 In the medium term, after relevant transport policy issues have been resolved, consideration should be given to rationalising existing vehicle usage charges, including the motor vehicle weight tax, with well designed road use and congestion charges.

⁸⁸ New South Wales Government, 2003, *Ministerial inquiry into sustainable transport in New South Wales A framework for the future* (Parry Inquiry).

5.7 Gambling taxes

As Chapter 4 noted, most gambling tax rates are set in long-term agreements with the taxpayers or the relevant industry body, so changes to these taxes are outside the scope of this review's recommendations. However, IPART notes that gambling taxes can play a useful role in:

- ▼ redistributing the scarcity rents from supply restrictions, and
- ▼ internalising the external costs associated with problem gambling.

In NSW, there is a case for rationalising the many tax rates that apply to different forms of gambling. However, feasible reform options in the short to medium term are constrained by the following existing commitments to current rate schedules and arrangements:

- ▼ Hotel Gaming Machine Tax - new rate schedule locked in until 2011
- ▼ Club Gaming Machine Tax - MOU on rates to 2012
- ▼ Casino Tax - new rates set from 2008 to 2017
- ▼ Totaliser Tax (TAB) - new commission rates from 1 Jan 2008
- ▼ Keno Tax - recent review (including extension of Keno into hotels) limits scope to change arrangements in the short run
- ▼ Lotteries & Lotto - rates have recently been combined into a single rate.

IPART also notes that a separate review is currently examining the role of on-line gambling and Betfair in NSW.

5.8 Possible new taxes

The potential for NSW to introduce new taxes in the short term is limited. As Chapter 3 discussed, the taxing powers of the States are constrained by the Constitution and its interpretation by the High Court and Commonwealth government policy decisions. In addition, taxpayers' resistance to new taxes imposes practical constraints on new taxes. For example, there is likely to be considerable opposition to the introduction of wealth or inheritance taxes.

However, IPART considers that there may be merit in considering possible new or increased environmental taxes to redress damage from pollution. For example, road usage and congestion charges (discussed in section 5.7 above) could reduce externalities associated with private vehicle usage, by changing behavioural patterns and contributing to a more rational framework for public transport pricing.

While there is considerable scope for environmental levies to play an increased role in the State tax system, various policy issues need to be resolved before the revenue-raising aspects can be properly considered.

Recommendation

15 In the medium term, consideration should be given to increased use of environmental levies in the NSW tax system.

5.8.1 Consequences for Commonwealth-State revenue sharing

If NSW were to introduce taxes that are not levied in any other State, the CGC would be unlikely to specifically assess these taxes. The CGC's principle of 'internal standards' means that it takes its lead from what the States do - that is, it focuses on the 'average policy' among the States. If NSW were to introduce a tax that no other State levied, this would not be seen as the 'average State policy' and so it is likely that the CGC would quarantine from its assessments any revenue raised by the new tax.

However, if more States followed NSW's lead in introducing such a new tax, the CGC would be more likely to include revenue raised by the tax in its assessments. In the past, the CGC has indicated that the critical threshold for introducing an assessment for a new tax is when the tax is levied in most of the States or in sufficient States to affect most of the Australian population.

If a new assessment were to be introduced for a new tax, any redistribution that it generated would depend on the States' relative endowments of the tax base:

- ▼ if NSW were relatively well-endowed with the new tax base, the assessment would redistribute part of the revenue away from NSW by reducing its share of the GST
- ▼ if NSW were relatively poorly endowed with the new tax base, the assessment would result in NSW receiving a greater share of the GST.

Thus, this approach to assessing new taxes, like the CGC's processes in general, acts as a disincentive for NSW to introduce or increase taxes on those assets and activities that are relatively abundant in this State, and as an incentive to introduce or increase taxes on those assets and activities that are relatively scarce.

5.9 Tax expenditures

In designing taxes and in setting tax rates, governments often provide concessions to particular groups to achieve policy goals. These concessions are referred to as 'tax expenditures' because they have a similar policy and fiscal impact as general program expenditures.

Tax expenditures involve granting certain taxpayers, activities or assets more favourable tax treatment than applies in general. These concessions can take several forms, including exempting certain taxpayers from paying the tax, applying lower rates of tax, providing rebates or reductions, or deferring the time for payment of a tax liability. Examples of concessions include exempting first homebuyers from

purchaser transfer duty, and exempting religious and charitable organisations from many taxes.

The effect of tax expenditures is often to narrow the tax base, and thus place an increased tax burden on those taxpayers still included in that base. That is, those who remain in the base often pay a higher rate of tax than they would if there were no tax exemptions and other concessions.

Tax expenditures differ from concessional charges in that the latter involve the sale by government agencies of goods or services to certain users at a lower charge than applies to the wider community. One example of a concessional charge is lower public transport fares for pensioners and senior citizens.

Tax expenditures have a substantial cost in terms of revenue forgone. In 2007-08, NSW tax expenditures are estimated at \$3,960 million, equal to 22.5 per cent of NSW's total own-source tax revenue.⁸⁹ As Table 5.5 shows, in 2007-08, the highest value tax expenditures are related to payroll tax, purchaser transfer duty, and general and life insurance. Together, the tax expenditures for these taxes represent around 57 per cent of total measurable tax expenditures.⁹⁰ Tax expenditures for payroll tax are the largest category of total measurable tax expenditures, and represent around 22 per cent (or an estimated \$863 million) of this total. This is due largely to the high cost of exempting public hospitals, area health services and local councils from this tax and this does not include the cost associated with the threshold for payroll tax.⁹¹

Table 5.5 also shows that there has been a modest reduction in the total value of tax expenditures over the last couple of years. The main factors driving the reduction in 2007-08 are lower tax expenditures for land tax and mortgage duty. However, this reflects the reduction in the land tax rate for the 2008 land tax year (from 1.7 per cent to 1.6 per cent) and the abolition of mortgage duty on owner-occupied residences, rather than a policy decision to reduce tax expenditures.

⁸⁹ As discussed later in this section, it is often difficult to quantify the amount of the tax expenditures.

⁹⁰ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, p 7-1.

⁹¹ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, p 7-5.

Table 5.5 Major tax expenditures by type of tax

	2005-06		2006-07		2007-08	
	\$m	% of tax revenue	\$m	% of tax revenue	\$m	% of tax revenue
Purchaser transfer duty	731	23.3	766	19.2	767	20.8
Vendor transfer duty	143	155.4	5	500.0	Nil	Nil
General and life insurance duty	522	99.8	589	98.2	609	98.9
Mortgage duty	346	106.8	365	102.8	290	119.3
Marketable securities duty	156	339.1	101	107.4	103	139.2
Payroll tax	767	14.8	809	14.5	863	14.5
Land tax	530	30.9	536	26.2	517	29.5
Taxes on motor vehicles	299	15.8	289	14.7	305	14.7
Parking space levy	17	37.8	21	40.4	22	43.1
Gambling taxes	488	32.1	489	29.7	484	30.1
Total	3,999	25.1	3,970	22.3	3,960	22.5

Source: NSW Government, *Budget Paper No 2, 2007-08*, p 7-5.

Tax expenditures can contribute to the achievement of public policy objectives, so their cost to revenue needs to be weighed against the social benefits associated with the concessions. For example, the gambling tax concessions provided to registered clubs is associated with community benefits provided by those clubs.⁹²

Tables 5.6 and 5.7 compare the total value of the tax expenditures provided in NSW with those in other States, as a percentage of own-source revenue and per capita. In considering these comparisons, it is important to recognise that the data are taken from State Budget Papers and are likely to be partial and inconsistent. This is because the States often cost tax expenditures differently (for example, some States exclude the value of tax free thresholds from the costing, while others include it). In addition, coverage of tax expenditures by States is variable (eg, some States do not attempt to cost expenditures that possibly have a wide margin for error). There is also an element of judgment in deciding what constitutes a tax expenditure and what constitutes a structural feature of the underlying taxation or service delivery system. The data shown on these tables have been adjusted for comparability where information permits.

⁹² It should be noted that IPART is currently undertaking a separate review of the role and performance of registered clubs including the community benefits that clubs provide.

Table 5.6 State tax expenditures as a percentage of own-source tax revenue, 2001-02 to 2006-07

	2001-02 %	2002-03 %	2003-04 \$	2004-05 %	2005-06 %	2006-07 %
New South Wales	23.8	21.1	22.7	23.8	25.6	24.8
Victoria	33.7	34.6	19.7	21.7	25.4	23.4
Queensland	20.7	16.9	16.0	23.7	23.5	na
Western Australia	8.8	7.2	9.1	11.0	14.7	na
South Australia	12.2	15.4	15.6	18.4	22.2	na
Tasmania	na	12.1	10.4	11.9	13.3	14.3
Australian Capital Territory	na	na	na	na	na	na
Northern Territory	na	na	42.6	37.0	32.6	40.0

Note: The Australian Capital Territory does not produce a tax expenditure statement.

na – not available.

Source: State Budget papers.

Table 5.7 State tax expenditures per capita, 2001-02 to 2006-07 (\$)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
New South Wales	476	448	509	542	599	605
Victoria	617	661	404	453	541	500
Queensland	272	251	278	420	431	na
Western Australia	136	126	192	239	369	na
South Australia	176	246	286	352	428	na
Tasmania	na	144	137	169	183	212
Australian Capital Territory	na	na	na	na	na	na
Northern Territory	na	na	565	553	601	625

Note: The Australian Capital Territory does not produce a tax expenditure statement.

na – not available.

Source: State Budget papers; population estimates based on Australian Bureau of Statistics, 2006, 'Australian Demographic Statistics', Cat. No. 3101.0 (September 2006).

With the above caveats in mind, the interstate comparisons suggest that NSW tax expenditures are higher than in all other States except the Northern Territory, both as a percentage of own-source tax revenue and per capita. In 2005-06 (the last year for which comparative data are available) NSW tax expenditures were \$599 per person, which is 31 per cent above the average of all other States (\$456 per person).⁹³

NSW could improve its tax revenue position if it were to reduce its tax expenditures to the level of the other States. For example, reducing NSW tax expenditures per

⁹³ For comparative purposes the average has been calculated by excluding NSW from the dataset. The average for other States has been calculated by dividing the total tax expenditures for the other States by the total population of those States.

capita to a level equal to the average level of other States⁹⁴ could raise around \$970 million in additional revenue per year.

As the previous sections have discussed, IPART recommends abolishing the payroll tax exemption for local council and the stamp duty exemption for third party motor vehicle insurance. In addition, IPART considers that the review processes and accountability arrangements for other tax expenditures should be strengthened.

Tax expenditures and concessional charges have similar budgetary and welfare effects as direct outlays. However, they are less visible than direct outlays because their cost is in revenue forgone rather than dollars spent. In addition, unlike direct expenditures, tax expenditures are not subject to annual scrutiny through the budget process, and the attention that that process receives through Parliament. Furthermore, the government does not actually have to extract revenues prior to awarding these concessions and they are not shown in expenditure budgets.

In principle, both direct spending and spending on tax expenditures should have to compete with other government spending priorities when the government makes its budget decisions. However, in practice, tax expenditures usually do not have to compete on a level playing field with other public spending. Tax expenditures are evaluated differently from other spending areas in some very important ways:

- ▼ Tax expenditures are usually open-ended: they often have no built-in cost limits and generally there is no annual appropriation or oversight process. Anyone who meets the eligibility criteria can receive the subsidy.
- ▼ Direct spending usually requires a government agency to weigh the worthiness of an application from any potential beneficiary. In contrast, most tax expenditures require no action other than doing the paperwork associated with paying the tax. This means that the benefits of these tax breaks may inadvertently be extended to beneficiaries who might otherwise be deemed unworthy or ineligible.
- ▼ Tax agencies typically have limited incentives to ensure that tax-expenditure programs are working as they were intended to. In contrast, government agencies usually look closely at the effectiveness of their direct spending initiatives.
- ▼ Basic facts about who benefits from tax expenditures, and what they do with the subsidies, are often hidden behind the cloak of tax return secrecy. In contrast, the beneficiaries of conventional spending programs are usually easy to identify.

As a result, tax expenditures can become expensive subsidy programs for which there is little oversight and review. Once a tax expenditure is introduced, it usually stays there indefinitely, even though the original objectives for its introduction may become less important. Further, little is known about the public benefits of the expenditure. Thus, tax concessions are largely a non-transparent form of assistance. This lack of transparency makes less visible the effect of tax concessions on the budget and reduces accountability. It also increases the likelihood that poorly targeted concessions remain available.

⁹⁴ This analysis assumes that there is no behavioural change on the part of taxpayers.

Tax expenditures granted for a specific situation can continue well after the need for government assistance has diminished or disappeared. Therefore, it is important that the government reviews tax concessions regularly to ensure that they continue to reflect the State's policy priorities.

Recommendations

16 In the short term:

- all tax expenditures should be brought on budget with an explicit appropriation shown and funded from the allocation for the relevant policy agency
- a 'sunset clause' should be specified for review of all tax expenditures, so that they lapse automatically unless Parliament agrees specifically to their renewal.

5.10 User fees and charges

User fees and charges – which comprise fees and prices charged by government agencies in the course of their normal trading activities, and charges for the use of government assets – are an important source of State revenue. Compared with taxation, user charges are a more direct means of raising revenue. They can also be more efficient, because they make providers and users more aware of the cost of the goods and services. In addition, user charges can improve equity by ensuring that those who benefit from publicly provided goods and services pay for them. Greater application of user charges – where this is appropriate and in accordance with economic principles for price-setting – can provide opportunities to rebalance the revenue mix away from the current high dependence on taxation.

NSW government agencies levy close to 900 individual fees and charges. Many of these are exempt from the GST (by the Federal Treasurer's Determination under Division 81 of the GST Act).

Table 5.8 indicates that in practice, user charges are a significant source of revenue for States and that their contribution to total revenue varies across States.

Table 5.8 Interstate comparison of user charges per capita, 2004-05^a (\$)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Ave
School Education	13	90	4	65	13	67	30	20	37
Post Secondary Education	31	77	32	38	46	39	52	5	45
Admitted Patients ^b	64	158	1	0	0	2	179	17	64
Community and Other Health Services	41	43	35	39	183	49	100	68	52
Welfare and Housing Services	9	15	1	6	0	2	6	22	8
Services to Communities	3	47	5	52	8	0	37	12	20
Justice Services	54	34	33	29	47	50	14	58	41
Public Safety	2	4	5	4	3	7	16	5	4
Roads	57	61	71	44	31	18	65	21	56
Other Transport	0	0	0	0	0	0	0	0	0
Services to Industry	18	21	86	74	55	24	7	91	41
Other Services	106	21	159	67	277	72	215	130	106
Total user charges	397	572	433	418	665	330	720	448	474

^a No PTE-type user charges are included.

^b Fees paid by private patients are not included. Includes other hospital user charges only.

Source: Australian Bureau of Statistics, *Government Finance Statistics*, 2004-05, Cat No 5512.0 and Commonwealth Grants Commission.

Although NSW Treasury has issued user charges guidelines for significant commercial and semi-commercial operations,⁹⁵ the NSW government does not have an overarching user charges policy or an overarching cost recovery policy. General government user charges are not indexed or reviewed consistently across government. In many cases, information is not collected centrally and so overall monitoring and review can be patchy.

Tables 5.9 and 5.10 show that NSW raises less revenue from the sale of goods and services, both per capita and as a share of total State revenue, than most other States. In 2005-06, NSW raised the lowest revenue per capita from sales of goods and services of all States -- around \$450 less than the ACT (which raised the highest revenue), about \$50 less than WA (which raised the second lowest revenue), and around \$180 (or 27 per cent) below the average for all State and Territories. In addition, NSW raised 7.7 per cent of its total State revenue from sales of goods and services, compared to an average for the rest of Australia of 9.5 per cent.

Although NSW has the lowest revenue from the sale of goods and services, it has the third highest growth rate in revenue from these services – only Victoria and Queensland have higher growth rates.

⁹⁵ See for example, NSW Treasury, *Service Costing in General Government Sector Agencies, Policy & Guidelines Paper*, TPP07-03.

Table 5.9 Total State revenue per capita from sales of goods and services, 2000-01 to 2005-06 (\$)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	Ave Growth Rate (%)
NSW	402	408	440	448	462	497	4.3
VIC	593	637	693	700	734	740	4.5
QLD	486	501	523	547	606	644	5.8
WA	457	473	511	480	493	549	3.7
SA	651	595	655	762	809	885	6.3
TAS	570	678	668	479	512	613	1.5
ACT	870	843	744	804	844	946	1.7
NT	494	404	403	493	516	551	2.2

Source: Australian Bureau of Statistics, *Government Financial Statistics*, 2004-05; 2005-06, Cat No 5512.0; population estimates based on Australian Bureau of Statistics, *Australian Demographic Statistics*, 2006, Cat No 1301.0 and Commonwealth Budget 2007-08.

Table 5.10 Share of total State revenue from sales of goods and services, 2005-06 (%)

NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Average, all States	Average, all except NSW
7.7	11.7	8.6	6.9	12.1	8.4	11.5	3.8	8.9	9.5

Source: Australian Bureau of Statistics, *Government Financial Statistics*, 2005-06, Cat No 5512.0.

According to CGC data, NSW has raised the second lowest per capita revenues from user charges over the period 2001-02 to 2005-06, with only the NT raising a lower amount.

However, it is not clear whether NSW's user charge revenue is lower than that of other States because individual NSW user charges are lower than in other States or because NSW does not have as extensive a range of user charges as other States.

Recommendations

17 In the short-term:

- NSW user fees and charges practices should be benchmarked with those in other States
- guidelines and principles for these fees and charges should be developed
- all NSW user fees and charges not currently subject to a periodic review or indexation arrangement should be indexed annually to movements in the CPI.

5.10.1 Consequences for Commonwealth-State revenue sharing

The CGC's treatment of user charges revenue is similar to its treatment of own-source tax revenue. It measures the differences in States' relative abilities to raise revenue from user charges, by assessing the levels of chargeable activities in each State. It does this for the seven main categories of user charges:

- ▼ hospital patient fees
- ▼ law and order fees and fines
- ▼ property titles
- ▼ housing user charges
- ▼ public safety user charges
- ▼ National Parks and Wildlife Services user charges
- ▼ general public service user charges.

User charges for education and for services to indigenous communities are too small for the CGC to warrant a separate assessment, so they are simply netted off the relevant expenditure. There is also an 'other user charges assessment'; however the CGC assumes that States have equal capacity to collect other user charges, so these do not influence States' grant shares.

5.11 Tax administration

The systems and procedures used to collect taxes have an important bearing on the efficiency, equity, simplicity and transparency of the NSW tax system. While good tax policy creates the potential for raising revenue, it is the efficiency and effectiveness of tax administration which ultimately determine the actual revenue collected. Good administration can also promote equity by ensuring consistent application of the tax laws and the equal treatment of taxpayers in similar circumstances. In addition, simple and transparent systems and procedures reduce the compliance burden on taxpayers.

The OSR is the primary tax collection agency within NSW. Following discussions with OSR, stakeholders and other State revenue agencies, IPART has identified improvements in four areas that it considers important for maintaining and promoting efficient and effective tax administration. These areas include:

- ▼ information and technology systems
- ▼ data access and management systems
- ▼ functional specialisation
- ▼ performance evaluation.

5.11.1 Information technology systems

IT systems are one of the key driving forces for improvements in the efficiency of tax administration. OSR's computer system, known as RECOUPS, has been in operation since 1999. In the short term, OSR has identified areas of reliability and functionality within this system that can be enhanced with various technical updates⁹⁶.

In the longer term, it is essential that OSR look beyond the operational life of RECOUPS and plan for the eventual replacement of that system. Given the long lead times involved and the importance of a seamless transition between systems for both taxpayers and tax administrators, it is important that work commence over the coming five years to analyse available options, develop a preferred strategy and to map the transitioning to a new system.

5.11.2 Data access and management systems

Improving OSR's access to data held by other NSW government agencies can materially assist in detecting non-compliance with taxes.

OSR is currently involved in several joint initiatives with other State and Commonwealth agencies that have considerable potential to improve the efficiency and effectiveness of data exchange between these various government and non-government organisations. These initiatives include Standard Business Reporting (SBR), National Electronic Conveyancing System (NECS), and Analytical Work Bench (AWB)⁹⁷. It is important for OSR to continue to work together with these various agencies to ensure the data is sufficient to meet the various needs of all stakeholders.

5.11.3 Functional specialisation

Whereas tax administration has traditionally been organised around tax instruments, there is an increasing trend for administrators to move toward a structure based on functions. Tax administrators are also focusing on specific types of taxpayers. It has been recognised that the compliance behaviour of the taxpayer varies, depending on their size/type. Focusing on particular types of taxpayer enables agencies to more effectively target their specific non-compliance behaviours.

OSR has a dedicated unit within its organisational structure to target the compliance behaviours of its largest taxpayers. The Victorian State Revenue Office (SRO) has responded in a similar way in relation to land rich duty⁹⁸. It has a dedicated unit to deal with land rich transactions, which has proven successful. This unit provides

⁹⁶ To address this issue, OSR proposing a modernisation of RECOUPS which is expected to extend its life for another 5 years.

⁹⁷ See OSR *Annual Report 2006-07* for further information.

⁹⁸ Land rich duty provisions apply to complex commercial transactions where acquisitions of units and shares in entities have substantial land holdings and thus may be subject to conveyance duty ("Land rich" transactions).

specialist services to taxpayers and practitioners in this area and acts as a one-stop-shop. Given the cost and complexity of the land rich provisions in NSW, and in light of the success of the Victorian SRO's approach, IPART considers that the OSR should explore the scope for a dedicated Land Rich Unit within its organisational structure.

Unlike all other Australian revenue offices, the NSW OSR's organisational structure combines two separate functions - taxpayer service and audit - into one division, Operations. Taxpayer service and audit are typically separated because of the different cultures that underpin each function. Also, the nature of the tasks and different skills required generally divides the functions. That is, taxpayer service requires a lower skill level with the goal of servicing the client to ensure timely lodgement without review. In contrast, the audit function requires a strong skill set to thoroughly and accurately review lodgements and to investigate cases of non-compliance.

Combining the two separate functions has enabled OSR to improve efficiency through a reduction in duplication and an enhancement of the working relationship between staff in these two areas. However, IPART considers that a critical challenge for OSR is to maintain the optimal balance between client service and compliance.

In addition, while acknowledging that the current structure allows the Operations unit to provide a high standard of services to taxpayers, IPART considers that OSR should consider placing additional emphasis on enforcement in certain circumstances. By publicising its compliance program and highlighting prosecution cases, OSR can increase the profile of its compliance activities and achieve a more effective balance between client services and enforcement activities.

5.11.4 Performance evaluation

Performance measurement and benchmarking are important tools in driving improvements in the efficiency of tax administration. An effective performance measurement system is based on the organisation's objectives, mission and strategic plan and sets standards on what the organisation should achieve and how this is to be carried out in practice. Benchmarking these performance measures against criteria that is considered best practice by international standards⁹⁹ can assist organisations to identify areas where its performance can be enhanced.

Two basic types of key performance indicator can be useful in benchmarking the performance of a revenue administration: efficiency and effectiveness measures. Efficiency measures indicate the relationship between the resources used by the revenue administrator and the output produced. Such measures are useful in establishing trends in the organisations performance against targets and similar

⁹⁹ See for example: Organisation for Economic Cooperation and Development (OECD), 2001, Principles of Good Tax Administration-A Practical Note, Centre for Tax Policy Administration, Tax Guidance Series.

organisations. Effectiveness measures indicate how effectively the revenue administrator is achieving its intended objectives or outcomes¹⁰⁰.

OSR currently monitors a number of key efficiency and effectiveness performance indicators for the purpose of benchmarking its performance against other State revenue agencies. However, not all possible measures are analysed and few are publicly available. Moreover, the performance benchmarking compares OSR against the averages of the other State revenue offices. IPART considers that more comprehensive and more rigorous benchmarking of performance may be useful in guiding further improvements in revenue collection.

‘Tax gap’ studies can play a useful role in improving the efficiency of the tax compliance function. The tax gap, which is equal to the shortfall between the theoretically correct revenue and the actual revenue collected, is attributable to non-compliance with the tax laws. Audit activity, in combination with the other functions of revenue administrations, aims to reduce the tax gap. Quantification of tax gaps helps identify risk areas to revenue to which audit activity should be directed. Although tax gap analysis allows the organisation to focus on large amounts of lost revenue, random audits are also required to produce optimal results. IPART considers that tax gap analysis would be an important complement to the OSR’s current compliance strategy.

Recommendation

18 In the short term, priority should be given to the following strategies to further strengthen the efficiency and effectiveness of tax administration in NSW:

- ongoing investment in the renewal and development of IT systems
- further improvements in data management and in data sharing with other NSW government agencies
- greater functional specialisation in some areas to address issues of high value or critical importance to revenue collection
- increased use of formal performance evaluation techniques such as performance benchmarking and tax gap studies.

5.12 Overview of recommendations for improving the NSW tax system and revenue impacts

This chapter has recommended a package of short to medium-term actions and long-term directions designed to improve the performance of individual NSW taxes against the criteria for good tax design, and thus improve the overall effectiveness of the NSW tax system.

¹⁰⁰ For examples of efficiency and effectiveness indicators see; Jit.B.S.Gill, A Diagnostic Framework for Revenue Administration, World Bank Technical Paper No 472, The World Bank, Washington and Baurer, L, 2005, Tax Administrations and Small and Medium Enterprises (SME’s) in Developing Countries, World Bank Group.

The package of reforms is designed to be broadly revenue-neutral for the NSW Government,¹⁰¹ and to reduce the State's dependence on revenue collected by the least efficient State taxes. One of the key emphases of the reforms is broadening the bases of NSW taxes to enable reductions in the rates of these taxes. In particular, the reforms include:

- ▼ expanding the payroll tax base by reducing the tax-free threshold and abolishing the payroll tax exemption for local councils
- ▼ expanding the insurance duty base by abolishing the stamp duty exemption for third party motor vehicle personal injury insurance.

The additional revenue raised as a result of these actions will enable:

- ▼ a reduction in the payroll tax rate, from 6 per cent to 5.75 per cent
- ▼ a reduction in purchaser transfer duty and annual indexation of the purchaser transfer duty rate scale
- ▼ the removal of the fire services levy from insurance policies
- ▼ a reduction in the standard rate of stamp duty for general insurance, from 9 per cent to 6 per cent
- ▼ the removal of duty on the purchase of caravans and camper trailers.

An additional benefit of these measures will be to significantly reduce the tax burden on insurance, and thus remove the incentives created by the current tax system for under-insurance or non-insurance.

For the longer term, the recommendations focus on making greater use of property holding taxes that, over time, will reduce the State's dependence on purchaser transfer duty.

In addition, the package of reforms will lead to increased utilisation of the relatively efficient municipal rates base, following the changes to the fire services levy and the abolition of the payroll tax exemption for local government.

Table 5.11 summarises IPART's recommendations for reforming the NSW tax system and indicates the proposed timing for implementation.

¹⁰¹ Revenue shortfall of \$50 million on current estimates. Amending the proposed reduction in insurance duty to from 6 per cent to 6.75 per cent would reduce the net revenue impact to nil.

Table 5.11 Recommendations for reforming the NSW tax system, by time horizon**Short term*****Payroll tax***

In the short term:

- the tax free threshold for payroll tax should be reduced from \$600,000 pa to \$500,000 pa
- the payroll tax rate should be reduced from 6.0 per cent to 5.75 per cent. (Recommendation 1)

Over a two-year period, the payroll tax exemption for local councils should be removed and a corresponding increase in municipal rate-pegging limits be phased in. (Recommendation 2)

Stamp duty - insurance

In the short term, the stamp duty exemption for third party motor vehicle personal injury insurance should be abolished and that the standard rate of stamp duty for general insurance (Type A) should be reduced from 9 per cent to 6 per cent. (Recommendation 6)

Purchaser transfer duty

In the short-term, purchaser transfer duty should be reduced by replacing the existing first three rating levels with a single level for dutiable properties up to \$80,000 and reducing the duty payable up to this level to 1 per cent with the details as shown in Tables 5.3 and 5.4. (Recommendation 8)

In the short-term, the purchaser transfer duty rate scale should be indexed annually, based on an index of movements in all NSW property values. (Recommendation 9)

Stamp duty - caravans and camper trailers

In the short term, stamp duty on purchases of caravans and camper trailers should be abolished. (Recommendation 13)

Commonwealth-State revenue sharing

NSW Treasury should review in detail, before implementing the reforms recommended by this review, the interactions between the recommendations and the GST/CGC grant allocation to NSW. Where the outcome is detrimental to good State tax reforms, this issue should be referred to COAG as an impediment to State reform designed to improve national competitiveness. (Recommendation 4)

NSW Treasury should develop a capacity to better manage the interaction between the State's tax and expenditure policies and the CGC's HFE methodology. This will involve a regular reporting to the NSW Government on the impact the HFE methodology has on State (and national) tax (and expenditure) reform, for tabling at the Treasurer's Conference and referral to COAG. All tax proposals should include an assessment of the impact on the allocation of Commonwealth grants. (Recommendation 5)

Fire services levy

In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in the contributions by local councils, with a phased implementation and accommodating increases in the municipal rate cap. (Recommendation 7)

Tax expenditures

In the short term:

- all tax expenditures should be brought on budget with an explicit appropriation shown and funded from the allocation for the relevant policy agency.
- a 'sunset clause' should be specified for review of all tax expenditures, so that they lapse automatically unless Parliament agrees specifically to their renewal. (Recommendation 16)

Table 5.11 (ctd) Recommendations for reforming the NSW tax system, by time horizon***User charges***

In the short-term:

- NSW user fees and charges practices should be benchmarked with those in other States
- guidelines and principles for these fees and charges should be developed
- all NSW user fees and charges not currently subject to a periodic review or indexation arrangement be indexed annually to movements in the CPI. (Recommendation 17)

Tax administration

In the short term, priority should be given to the following strategies to further strengthen the efficiency and effectiveness of tax administration in NSW:

- ongoing investment in the renewal and development of IT systems
- further improvements in data management and in data sharing with other NSW government agencies
- greater functional specialisation in some areas to address issues of high value or critical importance to revenue collection
- increased use of formal performance evaluation techniques such as performance benchmarking and tax gap studies. (Recommendation 18)

Medium term***Land tax***

In the medium term, consideration should be given to changing the tax unit for land tax from joint ownership to the individual, funded by a decrease in the tax-free threshold. (Recommendation 10)

Other taxes

In the medium term, motor vehicle registration duty should be replaced with a revenue-neutral annual motor vehicle charge. (Recommendation 12)

In the medium term, after relevant transport policy issues have been resolved, consideration should be given to rationalising existing vehicle usage charges, including the motor vehicle weight tax, with well designed road use and congestion charges. (Recommendation 14)

In the medium term, consideration should be given to increased use of environmental levies in the NSW tax system. (Recommendation 15)

Long term***Payroll tax***

In the long term, the rate of payroll tax should be further reduced, with the long-term goal of achieving interstate parity in this rate. (Recommendation 3)

Property taxes

In the long term, the Government should develop a strategy for increasing property holding taxes (for example, broadening the land tax base, increasing the land tax rate and/or increasing municipal rates on land values) to fund substantial reductions in purchaser transfer duty and insurance taxes on a revenue-neutral basis. The strategy will need to consider carefully the impacts on the various taxpayers as well as the overall benefits to the community. (Recommendation 11)

Table 5.12 provides a summary of the estimated net revenue impacts of the short and medium term recommendations presented in this chapter. The longer term land tax reform proposal – which is intended to be revenue-neutral – has not been costed for this purpose.

The estimates in Table 5.12 represent the direct or first round revenue impacts of the proposals on the State budget (assuming 2008-09 values). They do not include a range of indirect effects such as those arising from the economic stimulus and efficiency gains flowing from the reforms. Similarly, no allowance has been made in these estimates for possible changes in the level of Commonwealth grants to NSW, which could arise from the methodology used by the CGC for HFE, as a consequence of implementing the recommendations.

Table 5.12 Summary of estimated net revenue impacts of short and medium term recommendations

Recommended change	Revenue effect (\$m pa 2008-09) (excl impact on C'wealth grants)
Payroll tax	
Reduce payroll tax-free threshold to \$500,000 & reduce payroll tax rate to 5.75%	-69
Remove the payroll tax exemption for local councils (tax rate 5.75%)	184
Insurance taxes	
Reduce standard rate of stamp duty for general insurance (Type A) to 6.00%	-149
Abolish stamp duty exemption for third party personal injury motor vehicle insurance (tax rate 6.00%)	104
Remove 'fire services levy' contributions in the from insurance companies 'Fire services levy'	-534
Additional contribution from local councils	534
Property tax	
Reduction in purchaser transfer duty and amendments to rate schedule	-86
Index property transfer duty rate scale	-27
Adopt 'single holding' basis of assessment / reduce tax-free threshold	-a
Road & vehicle taxes	
Replace registration duty with an annual motor vehicle charge	-
Abolish duty on purchase of caravans & camper trailers	- 7
Net change in revenue	-50^b

a The revenue effect is zero as IPART has assumed that the two changes offset each other.

b Amending the proposed reduction in insurance duty to 6.75 per cent rather than 6 per cent would reduce the net revenue impact to nil.

Notes: Estimates are 2008-09 values and are direct or first round effects only.

Source: IPART estimates.

The reforms discussed in this chapter are limited to those that NSW can pursue on its own; even so, careful consideration will need to be given to their consequences for Commonwealth-State revenue sharing before they are implemented. Chapter 6 focuses on the need for tax reforms at the 'national' level, and sets out IPART's recommendations for pursuing such reforms.

6 Reforming the NSW tax system through cooperative Federalism

As Chapter 3 discussed, the extent to which NSW can benefit from tax reform by relying solely on its own discretionary revenue raising powers is limited. For example, without access to the larger, more efficient taxes that currently only the Commonwealth can levy, it will be difficult for NSW to significantly reduce its reliance on inefficient transactions-based taxes and thus greatly improve the overall efficiency of its tax mix. In addition, because there is a risk that unilateral changes in NSW tax policies and revenues will lead to a reduction in its Commonwealth grant allocation or its interstate competitiveness, it will be difficult for NSW to realise substantial revenue benefits through such changes. Furthermore, because of the narrowness of many existing State tax bases, the options for reforming these taxes often have significant potential redistributive impacts and transitional inequities. This potential for creating short-term ‘winners and losers’ can undermine community acceptance of those reforms, even when they are in the community interest over the longer term.

To overcome the various legal, institutional, policy and practical constraints on tax reform at the State level, NSW needs to seek to improve its tax system through cooperation with the other States, and between the States and the Commonwealth. IPART considers that expanding the reform agenda to the national level – which can only be done through cooperative Federalism – will create a wider range of more significant potential gains for all jurisdictions. IPART notes that such a national tax reform agenda would be consistent with the new Commonwealth government’s stated tax policy goals of maximising individual incentives, enhancing workforce participation, and improving Australia’s international tax competitiveness.¹⁰²

IPART has identified four possible directions that this national reform might take, facilitated by cooperative federalism. These directions include:

- ▼ Further expanding efficient Commonwealth taxes, and sharing the revenue this generates with the States in return for them further reducing or abolishing inefficient State taxes, to improve the overall efficiency of the national tax system.

¹⁰² A Tax Plan For Australia’s Future, ALP Media Statement 18 October 2007, <http://www.alp.org.au/media/1007/msloo181.php>

- ▼ Reassigning one or more efficient Commonwealth taxes to the States in return for them further reducing or abolishing inefficient State taxes, to improve overall efficiency and increase the States' level of fiscal autonomy. For example, one option could be to allow each State to impose a surcharge on the Commonwealth income tax levied on taxpayers within its borders.
- ▼ Improving the current arrangements for revenue sharing between the Commonwealth and the States, to improve the incentives for the national-level tax reform discussed in this chapter, and the State-level reforms discussed in Chapter 5. One option that deserves serious consideration is quarantining further SPPs from the CGC's horizontal equalisation process.
- ▼ Further harmonising State taxes, to remove constraints on State-level tax reform and improve the overall efficiency of the national tax system.

The sections below discuss the broad objectives for national tax reform and these four broad directions for achieving these objectives in more detail. The discussion of tax reform options in this chapter is limited to general revenue taxes. It does not consider possible reforms to those taxes specifically designed to address externalities or to pursue other market interventions.

6.1 Broad objectives for a national tax reform agenda

IPART considers that any fundamental reform of Australia's national tax arrangements should aim to improve the national tax system's performance against the benchmarks for effective tax assignment and the principles of good tax design. Ideally taxes for any level of government should be sufficient to meet its current and future expenditure responsibilities, and the overall tax system should minimise its distorting effect on efficient economic decision-making.

6.1.1 Benchmarks for effective tax assignment

In 2006, Professor Warren compared and benchmarked Australian and international arrangements for allocating taxation powers and expenditure responsibilities between central and subnational governments, and the mechanisms used to transfer tax revenues between these governments.¹⁰³ Warren identified three benchmarks for effective tax assignment within a federation:

1. Tax assignment should align with the expenditure responsibilities of the different levels of government.
2. Tax assignment should take account of economic efficiency of tax assignment. In particular, subnational governments should not rely on taxes with mobile bases.
3. Tax assignment should take account of fiscal need. In particular, the revenues of the taxes assigned to a level of government should be able to expand in line with the growth in its expenditure needs.

¹⁰³ Warren, N, *Benchmarking Australia's Intergovernmental Fiscal Arrangements - Final Report*, May 2006.

IPART considers that the current allocation of taxes between the Commonwealth and States does not meet these benchmarks. Specifically, as Professor Warren concluded and previous chapters have discussed, the Australian tax system is characterised by an exceptionally high degree of VFI. This is because, in general, the large, broad-based taxes are assigned to the Commonwealth, and this enables it to collect more revenue than it needs for its expenditure requirements. In contrast, the States rely on smaller, less efficient and more narrowly based taxes that only raise a small proportion of their required revenue.

In addition, as Chapter 2 discussed, the taxes assigned to the Commonwealth – particularly income tax – tend to grow steadily in line with growth in the economy, whereas some of the taxes the States rely on – particularly purchaser transfer duty – tend to be volatile, and subject to wide fluctuations driven by movement in the property market.

6.1.2 Principles for good tax design

As Chapter 4 discussed, good tax systems are generally characterised by efficiency, equity, simplicity and transparency. IPART considers that significant benefits can be realised by reducing reliance on less efficient taxes and expanding the role of more efficient taxes in the national tax system. For general revenue purposes, economic efficiency can be improved by placing greater reliance on:

- ▼ Personal and company income taxes – administered by the Commonwealth
- ▼ GST – administered by the Commonwealth
- ▼ Land tax – administered by States.

State-based payroll tax is another potentially efficient tax, but its role in a reformed national tax system is problematic. While it can be argued that payroll tax has the characteristics of a broad based tax that tends to grow in line with growth in the economy, and is similar in incidence to the GST, the actual efficiency of current State payroll taxes is reduced because significant tax free thresholds and wide-ranging exemptions narrow the bases on which they are levied.

The States should be able to improve their payroll taxes – by pursuing interstate harmonisation and addressing the current inefficiencies in the structure of these taxes (see Chapter 5). However, if they cannot, there may be a case for payroll taxes to be replaced with more efficient taxes such as the GST. Indeed, IPART considers that in terms of economic efficiency payroll taxes cannot rival income taxes or the GST.

On the other hand, the States need to maintain sufficient fiscal autonomy and that limits the extent to which inefficient State taxes can be replaced by more efficient Commonwealth taxes. After all, the States are responsible for providing key services – such as education and health. This involves choices about the level/quality of services to be provided. However, to be able to make such choices, the States require commensurate discretion over revenues that are within their control and be held

accountable for the use of that discretion. If there are too few taxes available to the States, it will be impractical for them to vary their tax rates and revenues sufficiently to achieve the desired expenditure discretion and accountability – especially if the State tax bases are mobile or there are strong competitive pressures that limit the divergence in tax rates.

6.2 Further expanding efficient Commonwealth taxes to reduce or replace inefficient State taxes

With the introduction of the GST in 2000, the States and Commonwealth demonstrated a willingness to abolish certain inefficient State taxes in return for revenue from a broader and more efficient tax base. As part of the IGA that accompanied the introduction of this tax, the Commonwealth and the States agreed that the Commonwealth would share the revenue generated by the GST with the States, and that the States would use some of this revenue to fund the abolition or reduction of certain inefficient State taxes.¹⁰⁴

IPART considers that a number of further opportunities are available – with the agreement of the Commonwealth and the other States – to make similar reforms to the role of State taxes in the national tax system. The revenue raised by the expansion of one or more of the efficient taxes levied by the Commonwealth could be used to reduce or abolish some of the least efficient taxes levied by the States. This would improve the efficiency of the national tax system as a whole.

However, as for the State-level reforms recommended in Chapter 5, the financial impact of this kind of reform on individual States would depend on the revenue sharing arrangements in place.

The attractiveness of these options for the States will depend upon:

- ▼ The net balance between the additional revenue from the Commonwealth taxes and the reduced revenue from State taxes.
- ▼ The basis for the calculation of the revenue shares of the Commonwealth taxes.
- ▼ The impact of the reduction in State taxes on the existing revenue grants.

Therefore these arrangements would also need to be re-examined to ensure that the desired financial outcomes for the various jurisdictions are achieved (see section 6.4).

For example, under the CGC's current HFE processes, the impact of reducing reliance on inefficient State taxes will depend on which taxes are reduced, the relative importance of these taxes for the individual State, and the basis on which the additional revenue raised by the Commonwealth tax is shared.

¹⁰⁴ These taxes include financial institutions duty, stamp duty on quoted marketable securities, debits tax, and bed tax.

As section 3.2.1 discussed, the CGC's current processes compensate States that have relatively small shares of a tax base that is important at an aggregated State level, by redistributing funds from the States that have large shares of this tax base. But if the importance of that tax were reduced – eg, because the States reduced or abolished it as part of a national reform agenda – it would become relatively less important within the CGC calculations. This would mean that the redistributive effect that tax currently has would be wound back as the tax is reduced. If it were abolished altogether, it would have no redistributive effect in the CGC's calculations as the tax is now removed.

If the resulting shortfall in the States' finances due to the removal or abolition of a State tax were to be addressed through an increased share of GST revenue through their General Purpose Grant allocation, this of itself would have no impact on the amounts currently redistributed by the CGC after the reforms. In effect, the additional GST would be distributed on a per capita basis so there would be no net redistribution between States. This is because a uniform increase in per capita GST grants would create no further financial differences between State Governments.

Recommendation

19 NSW should advocate that a joint Commonwealth-State review of options should be undertaken to further expand efficient Commonwealth taxes to fund the reduction or abolition of inefficient State taxes.

6.3 Reassigning one or more efficient Commonwealth taxes to the States to improve their efficiency and fiscal autonomy

The alternative to increased tax sharing is a reassignment of taxes. Like further expanding Commonwealth taxes and sharing the resulting revenue, this approach would enable the States to reduce their reliance on inefficient taxes and thus improve the overall efficiency of the national tax system. However, it is likely to be preferable from the States' perspective, as it would also give them greater fiscal autonomy.

A risk with this approach is that political and competitive pressures may result in changes to tax that reduce their efficiency.

IPART notes that the States have previously levied income taxes, and more recently were given the opportunity to introduce a State based surcharge to the Commonwealth regime.¹⁰⁵ However in 1989, the Commonwealth Government legislated to ban States from introducing an income tax surcharge. One difficulty with an income tax surcharge, is that two governments would then share the same tax base, which can lead to an unhealthy 'blame game' as governments compete for revenue. IPART notes that the GST does not have this problem.

¹⁰⁵ In 1978 the Commonwealth Government legislated to allow States to introduce an income tax surcharge.

Again, the likely financial impact of this option on the different States' overall fiscal position would depend on the revenue sharing arrangements that were in place. For example, if States were given the option of imposing such a surcharge in return for a commitment to reform inefficient State taxes, then its effect will depend on whether the revenue they raise through the surcharge are included in the CGC's HFE processes.

This can be explained by using the example of a possible optional income tax surcharge. In practice, an optional State-based surcharge would only be effective if the revenue were to be returned to the State in which it had been collected. It could not be sensibly included in the pool of grants distributed by the Commonwealth according to the CGC's recommendations. If this were the case, the CGC would be likely to incorporate it in its calculations as though it were a new State tax.

As is the case for any new State tax, the CGC's treatment of the surcharge would then depend on how many States choose to impose the surcharge – that is, if it were the policy of the 'average State'. In the past, the CGC has stated that the average policy is one that applies in a majority of States, or to a majority of the Australian population.

If the option to introduce a surcharge were to be taken up by all States, the CGC would introduce a new assessment. Like its assessments of existing State taxes, the aim of the new assessment would be to equalise the benefits of the new tax base across States. Put another way, the CGC would neutralise the relative advantage enjoyed by any State with an above average share of the income tax base, by redistributing the benefits to States with below average shares. As previous chapters have discussed, the CGC's existing assessments already do this by redistributing to other States the benefits of NSW's greater share of tax bases such as land tax and payroll tax.

If only NSW and Victoria were to introduce a surcharge, the CGC might determine that a surcharge was the policy of the average State, and so include the income tax surcharge in its assessments. If this were the case, the CGC would ensure that the potential financial benefits of this new source of State revenue were evenly distributed across the States. It would achieve this by increasing the General Purpose Grant allocations of States with below average income tax bases and reducing the allocations to States with above average income tax bases.

For a State with an above average share of the income tax base to retain the benefits of that above average share, the Commonwealth government would need to explicitly request the CGC in its terms of reference not to include the surcharge in its assessment. IPART notes that this would represent a significant departure from existing policy and would be contentious.

If the option were taken up by so few States that the CGC did not consider it was the policy of the 'average State', the CGC's treatment would be different. If the 'average policy' were not to impose a surcharge, then those States that did so would be

making an 'above average' revenue effort. The CGC allows such States to retain the benefits of their above average efforts, so there would be no offsetting changes to the General Purpose Grants allocation.

Recommendations

- 20 The States and the Commonwealth should give further consideration to tax reassignment to the States, and/or revenue sharing to encourage and promote State tax reform.
- 21 NSW should seek a direction from the Treasurers' Conference that HFE procedures be amended to quarantine fiscal transfers that are compensating adjustments for State tax reform.

6.4 Improving the current arrangements for revenue sharing between the Commonwealth and States

As Chapters 3 and 5 discussed, the current arrangements for sharing Commonwealth taxation revenue between the States – particularly the CGC's complex HFE processes, and its treatment of revenue from SPPs within these processes – create disincentives for State-level tax reform that will improve the efficiency of the national tax system. As indicated in the sections above, these arrangements also affect the incentives for tax reform at the national level.

There are several possible approaches for improving the current arrangements for revenue sharing to improve incentives for tax reform at both the State and national levels. These include:

- ▼ amending the CGC's current HFE processes, including quarantining SPPs from these process, and
- ▼ changing the basis for allocating Commonwealth tax revenues to the States.

6.4.1 Amending the CGC's current HFE processes

One of the complications of further expanding efficient Commonwealth taxes to reduce or abolish inefficient State taxes is that this strategy will further exacerbate Australia's already high level of VFI. However, given the Australian Constitution and current Commonwealth-State expenditure responsibilities, it is inevitable that there will be a trade-off between the overall efficiency of the tax system and the fiscal autonomy of the States.

Given this, it is critical that the arrangements for sharing Commonwealth tax revenue among the States do not act to inhibit State tax reform, for example by preventing the States that undertake such reform from realising the financial benefits. IPART considers that the current HFE processes do inhibit such reform because:

- ▼ to the extent that any additional revenue raised as a result of tax reform is subject to the CGC's HFE calculations, the distribution of this revenue may be distorted

and unattractive to some jurisdictions despite potential gains in national economic welfare, and

- ▼ even per capita grants to the States in compensation for tax reform can lead to unintended biases as a result of their impact on HFE calculations.

As Professor Warren noted,¹⁰⁶ while the scope for equalisation-induced non-neutralities in Australia is fairly similar to that in other countries, other countries have:

- ▼ less reliance on an array of both tax and expenditure variables where equalisation principles are employed
- ▼ less complexity in their equalisation allocation mechanism
- ▼ less distribution of general revenue grants through the equalisation pool (whereas Australia distributes 100 per cent of these grants through the pool), and
- ▼ more reliance on a mix of exogenous variables (eg, population, GSP) than on endogenous variables (capacity and specific expenditure costs).

IPART considers that the States and Commonwealth should consider four possible policy options to address some of the problems associated with the current HFE processes, including:

1. equalising less than 100 per cent of the difference in standardised per capita tax
2. removing some (current and future) taxes from HFE consideration
3. removing some part of each tax from HFE consideration
4. distributing less than 100 per cent of the general revenue grants through the equalisation pool.

Recommendation

22 NSW should seek amendments to the HFE methodology for national tax reforms or changes in grant sharing arrangements to ensure individual States have incentives to introduce tax reforms that are in the State and national interest. This could include quarantining some taxes in part or in full from the HFE process or allocating the revenue generated by some taxes on a per capita basis.

23 NSW should seek a direction from the Treasurer's Conference to the CGC to review the possibility of:

- equalising less than 100 per cent of the difference in standardised per capita tax
- removing some (current and future) taxes from HFE consideration
- removing some part of each tax from HFE consideration
- distributing less than 100 per cent of the general revenue grants through the equalisation pool.

¹⁰⁶ Warren, N, *Benchmarking Australia's Intergovernmental Fiscal Arrangements-Final Report*, May 2006, pp 89-91.

6.4.2 Quarantining SPPs from the HFE processes

The Commonwealth government can direct the CGC through its terms of reference to quarantine certain SPPs¹⁰⁷ from its HFE processes. However, as Chapter 3 discussed, the CGC treats most SPPs as though they are general revenue payments available to meet any of the States' expenditure responsibilities.

The CGC uses guidelines for determining its treatment of SPPs. Under these guidelines, SPPs are considered to be included within the CGC's assessment if they are for recurrent and capital payments paid to the States for State type services and have a direct impact on the State budget. Viewed in this way they are just another source of funds, so the CGC adjusts States' grant shares to take account of the level of SPPs a State receives.¹⁰⁸ That is, if a State receives an above average share of SPPs, the CGC will reduce its recommended grant share. Conversely, if a State receives a below average share of SPPs its grants share will be increased. Thus the CGC overrides the underlying interstate distribution of SPPs by the Commonwealth Government.

Under the guidelines, SPPs may be either quarantined or unquarantined from the assessment process. Where SPPs are included in the assessment, a State ends up in the same net fiscal position irrespective of its actual level of SPPs. If, for example, it received a \$100 per capita increase in SPPs, the State's revenue from grants would go down by \$100 per capita. In contrast under the quarantined approach, if a State received an extra \$100 per capita in an SPP, its grants would only go down to the extent it alters average SPPs per capita.

The Commonwealth government already quarantines a number of SPPs from the HFE process. Box 6.1 lists the SPPs that were quarantined from the HFE process for 2008. However, there is no clear and obvious rationale underlying why some SPPs are quarantined and some not quarantined. The suspicion is that the Commonwealth instructs the CGC to quarantine those SPPs that are directed to achieving a Commonwealth purpose that might be jeopardised if the payment were not quarantined.

¹⁰⁷ There are three types of SPPs: (i) payments 'to' state governments – these are made direct to state governments for funding expenditures by the states; (ii) payments 'through' state governments – payments to state governments to be passed on to other bodies or individuals. The main payments in this category relate to higher education, non-government schools and local government general purpose assistance; and (iii) SPPs made direct to local government. Most SPPs paid 'to' the states (about 60 per cent of the total) are on the condition that policy objectives set by the Commonwealth or national policy objectives agreed between the Commonwealth and the states, are met. It is because of the conditions attached to SPPs that they are sometimes called 'tied grants'. The Commonwealth can attach conditions to these SPPs to reflect policy objectives in programme areas, and often include requirements for certain levels of spending by the states.

¹⁰⁸ Garnaut, R and V Fitzgerald, *Issues on Commonwealth- State Funding*, 2002, p 5. (http://rspas.anu.edu.au/economics/publish/papers/garnaut/2002_0311_Commonwealth.pdf)

Box 6.1 Specific Purpose Payments Quarantined by Commonwealth Grants Commission for 2008

The CGC's terms of reference asked it to quarantine the following SPPs paid to States:

- ▼ National Competition Payments
- ▼ payments to the States to reimburse them for revenue lost as a result of the establishment of a national scheme of companies, securities and future regulation
- ▼ payments which were funded from the Natural Heritage Trust of Australia and the Regional Telecommunications Infrastructure Fund
- ▼ payments for the Fringe Benefit Tax Transitional Grants for the public and not-for-profit hospitals
- ▼ payments for the Extension of the First Home Owners Scheme
- ▼ payments for the Roads to Recovery program
- ▼ Australian Government payments to the Sinking Fund on State Debt
- ▼ payments for the Victorian Cytology Service made under the Public Health Outcome Funding Agreements
- ▼ Residual Adjustment Amounts
- ▼ payments to Tasmania under the Supplementary Tasmanian Regional Forestry Agreement
- ▼ payments to the Northern Territory for Royal Darwin Hospital: Equipped, Prepared and Ready.

The terms of reference also asked the CGC to prepare its assessments so that the following components of the Australian Health Care Agreements do not directly influence the per capita relativities:

- ▼ payments in relation to mental health
- ▼ payments in relation to the National Health Development Fund
- ▼ payments in relation to the Pathways Home Initiative
- ▼ all payments under an adjustment module, including those related to the Critical and Urgent Treatment (CUT) Waiting List Initiative
- ▼ compliance payment arrangements (in this case including the maximum available compliance payments in the assessments)
- ▼ payments to South Australia for the administration and management of the hospital at Woomera
- ▼ payments to Queensland in recognition of the cost associated with the movement of Papua New Guinea's citizens across the Torres Strait.

Source: Commonwealth Grants Commission, 2008, *Report on State Revenue Sharing Relativities*, 2008 Update, Working Papers Volume 1, Canberra, pp 3-4.

If all SPPs were quarantined, a State's revenue grant would rise (or fall) according to whether the State's actual SPPs are greater than (or less than) the average SPPs for all States. If all States' SPPs increased by \$100 per capita, then all States' grants would go down by \$100 per capita as the actual revenue from SPPs would be the same as the average revenue from SPPs.

In the case of the CGC estimates using 2006-07 data for NSW,¹⁰⁹ the practical effect for NSW of quarantining SPPs is quite small. The net benefit to NSW would be about \$18m because there is less than \$3 difference between actual SPPs per capita for NSW (\$472.45) and the average across the States (\$469.82). Indeed NSW SPPs per capita are much closer to the average than any other States. Victoria, with actual SPPs per capita of \$425.59, and the ACT (\$370.80) would lose most from quarantining with all other States benefiting - the biggest winner being NT which would benefit by \$509.17 per capita as its actual SPPs per capita are \$978.99.

While the effect on NSW is only small in the current period, it has been relatively volatile for all States over time (see Table 6.1). Although the impacts are small for NSW in the current year, the principles remain.

Table 6.1 SPPs treated by inclusion - Difference from Average per capita (\$)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
2002-03	-8.6	-28.0	9.5	-7.9	24.9	57.1	-28.3	588.5	0.0
2003-04	10.5	-44.2	4.3	-10.8	23.0	28.8	-52.1	604.5	0.0
2004-05	10.6	-36.7	-6.3	-3.5	23.2	55.0	-51.8	485.4	0.0
2005-06	9.4	-39.9	-3.4	23.3	-4.7	56.2	-66.7	516.6	0.0
2006-07	2.6	-44.2	11.2	24.9	14.6	28.8	-99.0	509.1	0.0

Source: Commonwealth Grants Commission, Update Report 2008, Table B-10.

IPART considers that where an SPP meets a national objective or where payment is performance based, there is a strong case for quarantining SPPs from the HFE processes. This approach would be more consistent with the objectives of SPPs (see Box 6.2) which focus on ensuring that Commonwealth policy objectives are met. For example, the Commonwealth tends to make SPPs where it wants to achieve an outcome, and does not want to have the States' incentive for this outcome reduced by the CGC processes. In addition, this approach would be more appropriate where Commonwealth payments are (wholly or partly) performance-related, and therefore should not be 'equalised away'. IPART notes that the performance related focus of SPPs is likely to increase.

Recommendation

24 In the calculation of grant relativities, NSW should propose that the current COAG review of SPPs should consider quarantining out SPPs that meet a national objective or are performance based, if such a review is not already on the agenda for COAG.

¹⁰⁹ Commonwealth Grants Commission, 2008, *Report on State Revenue Sharing Relativities 2008 Update*, Canberra, Table B-10. Table B-10 has been reproduced in Appendix G (Table G.1).

Box 6.2 Objectives for Specific Purpose Payments

The Commonwealth government uses SPPs rather than 'untied' funding mechanisms:

- ▼ to pursue Commonwealth policy objectives where it does not have constitutional power to legislate
 - ▼ to meet joint Commonwealth-State policy objectives in areas that are constitutionally a State responsibility
 - ▼ to promote national standards, for example in public health and vocational education and training
 - ▼ to pay States for the delivery of Commonwealth programs or initiatives
 - ▼ to comply with international obligations, for example management of World Heritage areas.
-

IPART notes that there is not universal support for removing SPPs from the equalisation process. For example, the WA Government has previously indicated that excluding SPPs from the equalisation process would require consideration of the net position when negotiating SPPs and the renegotiation of existing SPP agreements.

Instead of quarantining SPPs, the Commonwealth could replace SPPs with higher General Purpose Grants. However,

- ▼ States are heavily reliant on funding from SPPs (in 2006-07 34.3 per cent of total grants to States)¹¹⁰
- ▼ unlike the General Purpose Grants, SPPs are not funded from the GST pool
- ▼ from a Commonwealth perspective this would mean that the Commonwealth would lose an important instrument for setting and achieving agreed national objectives.¹¹¹

Short of replacing SPPs with untied grants, another option that is being actively pursued is to replace an approach using input controls with one that focuses on outcomes and results. An outcomes approach provides States greater flexibility in the allocation of federal funds leading to an improved use of state resources. It can also provide incentives to raise efficiency and can enhance transparency and

¹¹⁰ Australian Government, Budget 2007-08, *Budget Paper No 3, Federal Financial Relations 2007-08*, Table 1, p 5.

¹¹¹ The conditions pertaining to SPPs are in a number of forms: (i) general policy conditions (eg, that the states provide free public hospital access for Medicare patients in return for funding under the Health Care Agreements); (ii) expenditure conditions (eg, SPPs for schools may be spent on teacher salaries and curriculum development); (iii) input control requirements, in the form of 'maintenance of effort' and 'matching funding' arrangements (ie, the states are required to maintain funding levels and/or match the federal funding in a programme area); (iv) a requirement for states to report performance and financial information; and (v) due recognition conditions (ie, the states are required to publicly acknowledge the Commonwealth's funding). Australian Government, Budget 2005-06, *Budget Papers No 3*, p 25.

accountability. These benefits of an outcomes approach can only be achieved if performance in service delivery can be measured.

Since the Rudd Government came to power in late 2007, it has been considering its approach to SPPs. On 14 January 2008, Commonwealth and State Treasurers agreed to in-principle reforms of SPPs (see Box 6.3). State Treasurers indicated their commitment to focus on outcomes and outputs when determining SPP arrangements. In addition, they gave in-principle support to the Commonwealth issuing incentive payments to drive reforms in key sectors of the economy. The reforms could mean that when granting SPPs, the Commonwealth will set performance targets. If the Commonwealth considers it important that the States achieve those performance targets, those that do should be rewarded and not see this reward 'equalised' away by the CGC processes. Therefore the current COAG review of SPPs should consider the treatment of SPPs in the calculation of grant relativities.

At its recent meeting (26 March 2008), COAG adopted sweeping reforms to the architecture for Commonwealth-State funding arrangements (see Box 6.3). The key elements, which will be finalised in a new Intergovernmental Agreement on Commonwealth-State financial arrangements, will enable States to deploy SPPs more efficiently and creatively, enhance public accountability and sharpen the incentives for reform through new national Partnership agreements. The new framework will:

- ▼ be based on a small number of national SPP agreements for the delivery of core government services
- ▼ focus on agreed outputs and outcomes
- ▼ include a new performance and assessment framework.

Box 6.3 COAG reform agenda for Specific Purpose Payments

On 14 January 2008, Commonwealth and State and Territory Treasurers agreed to in-principle reforms of Specific Purpose Payments, the grants provided to the States and Territories for specific recurrent and capital purposes.

The Treasurers agreed to rationalise the number of SPPs, reducing their number by at least three-quarters, without reducing their value. This will minimise wastage, avoid duplication and yield greater administrative efficiencies, freeing up resources for frontline services.

Treasurers also reaffirmed their commitment to focus on outcomes and outputs when determining SPP arrangements. In addition, they gave in-principle support to the Commonwealth issuing incentive payments to drive reforms in key sectors of the economy.

Since SPPs are a significant source of funding, supporting almost all areas of State service delivery effort, reform of SPPs will be a complex and difficult task that will require cooperation on all sides.

At its March meeting COAG made a commitment to a comprehensive new microeconomic reform agenda for Australia. COAG adopted sweeping reforms to the architecture for Commonwealth-State funding arrangements that will enable States to deploy SPPs more efficiently and creatively, enhance public accountability and sharpen the incentives for reform through new National Partnerships agreements.

The new financial framework will result in a significant rationalisation of SPPs, primarily through combining many into a smaller number of new national SPP agreements, without a reduction in total Commonwealth funding for these activities. This reform will see a reduction from the current 92 SPPs to five or six new national agreements for delivery of core government services – health, affordable housing, early childhood and schools, vocational education and training, and disability services.

COAG noted that these reforms will clarify roles and responsibilities, reduce duplication and waste and enhance accountability to the community. The objectives and outcomes for each of the new agreements will replace input controls in current agreements.

The new agreements will focus on agreed outputs and outcomes, providing greater flexibility for jurisdictions to allocate resources to areas where they will produce the best outcomes for the community. New NP arrangements will provide incentives for reforms, or for funding for specific projects, in areas of joint responsibility, such as transport, regulation, environment, water and early childhood.

A new performance and assessment framework will be developed to support public reporting against performance measures and milestones. Funding for, and the details of, the new agreements will be negotiated during the balance of this year, with the final Intergovernmental Agreement to be considered by COAG in December 2008.

To enhance accountability and promote reform, COAG agreed a new and expanded role for the COAG Reform Council (CRC). When requested by COAG, the CRC will report to the Prime Minister on the publication of nationally-comparable performance information for all jurisdictions in relation to individual national SPPs and the independent assessment of predetermined milestones and performance benchmarks under the proposed NP arrangements.

Source: Ministerial Council Meeting, 14 January 2008, Communiqué, Brisbane and COAG Meeting, 26 March 2008, Communiqué, Adelaide.

6.4.3 Reconsidering the basis for allocating revenues to the States

Any strategy involving a reduction in inefficient State taxes, which is to be funded by an increase in efficient Commonwealth taxes, raises the issue of how the additional revenue raised by the Commonwealth taxes should be shared among the States. One approach would be to seek to have the additional revenue included within the current GST revenue sharing arrangements overseen by the CGC. However, given the concerns about these arrangements discussed in this report, this is not likely to be the best approach. IPART notes that even the CGC itself believes that a far-reaching review of its HFE processes, including their underlying purpose and objectives, is necessary.¹¹²

IPART has identified two possible alternative bases for sharing additional Commonwealth tax revenue among the States. The first is returning the tax revenue to the State in which it was collected. The second is distributing the tax revenue among the States on a per capita basis.

Returning additional tax revenue to its State of origin

Returning the additional Commonwealth tax revenue to the State of origin would be a transparent system with minimal administration costs. However, IPART considers that any proposal to return tax to the state in which it was collected should not include company tax as such an arrangement would work to the disadvantage of all States except NSW and Victoria (due to the proportion of companies with their head offices in these two states).

Under the current arrangements, the Commonwealth may already choose to adopt a different method of distributing additional grants to the States. For example, where the increase in Commonwealth grants has been funded from a particular revenue source, such as income tax, the Commonwealth may opt to distribute the revenue to the States in a way that returns the revenue to its State of origin so as to provide a useful nexus between a State Government's labour costs and its capacity to collect revenue. This basis would also be the most conducive to the introduction of State-based income tax surcharge (discussed above).

However, the CGC's current HFE processes would ensure that the overall outcome was no different from including the additional grants in the pool of funds subject to its recommendations. For example, if income taxes were expanded and the resulting additional revenue was shared among the States so as to return it to its State of origin, the CGC's processes would ensure that the overall outcome would be the same as if the additional revenue were simply distributed according to the HFE principle. As with most existing SPPs, the CGC would simply reduce the General Purpose Grant allocation of any State which received an above average share of the income tax revenue. Conversely, States with a below average share of this revenue would have their grant allocation increased to compensate for this.

¹¹² Commonwealth Grants Commission, 2004, *Report On State Revenue Sharing Relativities 2004 Review*, Canberra, pp 87-88.

It would make no difference to the outcome for an individual State whether the additional income tax revenue was explicitly distributed by the CGC, or distributed on another basis and then offset by the CGC in its HFE processes. The impact of the distribution of the existing pool of HCG provides an example of this effect. This funding pool is currently distributed according to the differing need for health services in each State, but the CGC adjusts the States' General Purpose Grant allocations to ensure that the final outcomes for each State are consistent with HFE, regardless of these differing needs.

Per capita distribution of additional revenue

Distributing additional revenue on a per capita basis, so that each State's share of the revenue was the same as its share of the national population, would be even simpler, and also reasonably equitable. For example, if the additional revenue was raised by expanding income taxes, the States with above average incomes would subsidise States with below average incomes.

Perhaps surprisingly, whether any additional grants to the States were to be explicitly distributed by the CGC or distributed by the Commonwealth on some other basis, the result would be the same as if the additional grants were distributed on a per capita basis. As noted in Chapter 3, it does not make much difference if a State's revenue source is explicitly distributed by the CGC—like the GST—or merely incorporated in its calculations, like SPPs. The overall outcome for a State is unchanged, although the individual components may vary.

This is because the amounts currently redistributed by the CGC's existing process already fully eliminate the financial differences that—according to the CGC's assessments—exist between State governments. Any extra Commonwealth funds available to the States would not alter those fundamental differences, therefore the CGC would distribute them on a per capita basis.

This is not to say that the current relativities would remain unchanged. A larger pool would require relativities to be more closely grouped in order to achieve the same absolute redistribution. On the other hand, if additional grants were to be distributed on the basis of the State of origin of the underlying tax source, the distribution of the GST revenue may need to change significantly in order to accommodate the new payments.

However, at the end of the day, after all the distributions, redistributions and counter-distributions, the financial outcomes for the States will be as though the additional Commonwealth grants had been distributed on an equal per capita basis.

The only way to prevent the CGC having the final say over a revenue source is for the CGC's terms of reference to explicitly instruct it to quarantine this revenue source from its HFE considerations. Currently, this occurs in relation to only a relatively small number of funding sources.¹¹³

6.5 Further harmonising State taxes

Tax competition among the States and the lobbying of individual States by vested interests are important barriers to State tax reform. Over time, the States have tended to respond to these pressures by offering concessions and exemptions, narrowing their taxes and making them less efficient. Part of the problem is that the most efficient taxes tend to be the most visible, and hence the most susceptible to lobbying and tax competition. Examples include the progressive narrowing of the payroll and land tax bases, the abolition of death and gift duties in the late 1970s, and the halving and subsequent abolition of taxes on share transactions in the 1990s.

Following the successful agreement by Victoria and NSW to harmonise their payroll tax legislative and administrative arrangements from 1 July 2007, there are further opportunities to harmonise both policy and administrative aspects of other State taxes. A national forum is the preferred means of pursuing gains from greater tax harmonisation.

¹¹³ National Competition Payments; payments to the States to reimburse them for revenue lost as a result of the establishment of a national scheme of companies, securities and future regulation; payments which were funded from the Natural Heritage Trust of Australia and the Regional Telecommunications Infrastructure Fund; payments for the Fringe Benefit Tax Transitional Grants for the public and not-for-profit hospitals; payments for the Extension of the First Home Owners Scheme; payments for the Roads to Recovery program; Australian Government payments to the Sinking Fund on State Debt; payments for the Victorian Cytology Service made under the Public Health Outcome Funding Agreements; Residual Adjustment Amounts; payments to Tasmania under the Supplementary Tasmanian Regional Forestry Agreement; and payments to the Northern Territory for Royal Darwin Hospital: Equipped, Prepared and Ready. (CGC Report on *State Revenue Sharing Relativities 2008 Update Working Papers Vol 1*, pp 3-4.)

7 Managing the reform process

In Chapters 5 and 6 of this report, IPART has recommended a range of short to medium term actions and longer term strategic directions to improve the overall efficiency, equity, simplicity, transparency, robustness and interstate competitiveness of the NSW tax system. These reforms aim to:

- ▼ improve the design and mix of NSW taxes
- ▼ increase the harmonisation of taxes across the States
- ▼ improve the efficiency of the national tax system by some combination of expanding Commonwealth taxes, reassigning Commonwealth taxes to the States, and improving Commonwealth-State revenue sharing arrangements.

The implementation of the recommendations outlined above will result in considerable benefits. However, the implementation process will need to be carefully managed, to ensure the desired outcomes are achieved. The sections below outline IPART's recommended approach to implementing each of the various types of reform.

7.1 Reforms for improving the design and mix of NSW taxes

IPART has recommended a range of short to medium term and longer term measures to improve the design and mix of NSW taxes. As Chapter 5 discussed, IPART considers that NSW can implement these measures independently, without the involvement of other States or the Commonwealth.

IPART has not considered the implementation issues associated with these recommendations in detail. Should the Government accept the recommendations, it will need to manage the implementation process carefully, to ensure that there are checks and balances in place to achieve the outcomes that the Government desires.

7.1.1 Implementing short to medium term measures

In the short to medium term, IPART has recommended that the NSW Government make changes in a number of taxes, for example in relation to payroll tax, purchaser transfer duty, insurance taxes and the Fire Services Levy.

IPART considered whether it would be necessary to establish an independent body to oversee the implementation of these changes, including considering the detailed implementation issues. However, it decided that this process can be managed effectively within NSW's current institutional framework.

Under the existing framework, the implementation of the short to medium term reforms would be the responsibility of the NSW Treasury including both OFM and OSR. IPART considers that OFM should be responsible for impact analysis, implementation mapping, communication and consultation. Together with the OSR, it should guide associated changes to tax administration and legislation.

In particular, for each of the short and medium term recommendations that the Government accepts, the Treasury should:

- ▼ ensure that the recommended change is included within the budget
- ▼ prepare a comprehensive (Commonwealth) grant impact statement that is included within the budget
- ▼ report annually on progress towards implementing the recommendation within the budget papers.

It is expected that following consideration of the Final Report, the Treasurer may wish to nominate medium term policy priorities and reform strategies. It will be important that the implementation of these strategies is monitored. To manage the implementation of the longer term recommendations, IPART considers that NSW should develop a process and research capacity that will enable it to make substantial improvements to the NSW tax system over time.

Recommendation

25 OFM and OSR should be jointly responsible for implementing the short to medium recommendations for change to the NSW taxation system, that are endorsed by the Government. OFM should provide the implementation strategy, and report annually on progress against the strategy in the budget papers.

7.1.2 Implementing the longer term recommendations

To implement the longer term recommendations, IPART considers that the Government should develop a process for making substantial improvements to the NSW tax system over time. This will require the NSW Government to develop a research capacity that enables it to maintain a strategic view of potential changes to the tax system. Development of this research capacity is needed so that shorter term priorities do not crowd out longer term research.

In particular, to assist in the development of longer term strategies for improving the tax system, the NSW Treasury should develop a research capacity and should have a dedicated pool of funds for this purpose. For example, one option might be to provide funds to Treasury so it can commission relevant research.

Recommendation

26 NSW Treasury should allocate funds to enable it to undertake or commission specific research to support future strategic directions for improving the tax system.

7.2 Reforms for increasing the harmonisation of taxes across the States

IPART recommends several changes that need to be made in conjunction with the other States. The most important of these involve further harmonisation of State taxes (including further harmonisation of payroll tax). IPART considers that NSW should pursue the implementation of these recommendations through COAG. In the first instance the existing processes involving the Treasurers' Conference may need to do the groundwork and report back to COAG.

Recommendation

27 The NSW Government should pursue further opportunities for the interstate harmonisation of State taxes through an appropriate national forum.

7.3 Reforms for improving the efficiency of the national tax system and Commonwealth-State revenue sharing arrangements

Chapter 6 of this report outlines some broad options for improving the efficiency of the national tax system by some combination of expanding Commonwealth taxes, reassigning Commonwealth taxes to the States, and improving Commonwealth-State revenue sharing arrangements. Further consideration of these options and their implementation is a matter for COAG. However, NSW should be able to play a role in facilitating this process.

Many of the recommendations for changing the current revenue sharing arrangements will require high-level cooperation between all State and the Commonwealth governments to implement. Given the quite diverse interests and aspirations of these governments, such cooperation will not occur unless there is:

- ▼ a well articulated need or goal for change
- ▼ a champion for change
- ▼ a process for implementing and managing change, and
- ▼ appropriate incentives for change.

Well articulated need or goal for change

The Australian Federation is simply a collection of States, and these States are highly dependent on each other and on the Commonwealth. Therefore, the actions of any one State impact directly on others and the nation as a whole, and significant change to the arrangement that affect all levels of government cannot be achieved without a high level cooperation between all those levels.

This cooperation could be turned to a national objective such as to have an equitable and efficient national tax system. To begin to foster this cooperation in relation to tax reform, NSW should take the lead in convincingly articulating the need for substantial national tax reform and the benefits of this change for all jurisdictions.

A champion for change

Constructive efforts to overcome significant challenges to national tax reform will not occur without a champion for change. In the past, various States or groups of States have come together to advocate and champion change. For example, NSW, Victoria and WA initiated the 2002 Garnaut/Fitzgerald Review of Commonwealth State Funding. NSW and Victoria also agreed to harmonise their payroll taxes when agreement across all States proved impossible.

NSW should actively champion national tax reform, and seek to involve other States in this role.

A process for implementing and managing change

No champion can promote and deliver on their cause without a support framework. In the case of the National Competition Policy (NCP), the National Competition Council (NCC) was established by all Australian governments in November 1995 to act as a policy advisory body to oversee their implementation of National Competition Policy (NCP).¹¹⁴ The NCC reported to all Australian States through COAG.

In February 2006, all governments agreed to work together to deliver a substantial new National Reform Agenda embracing human capital, competition and regulatory reform streams. This initiative was to be delivered through the COAG process and the creation of the COAG Reform Council.

In relation to changes to current intergovernmental fiscal arrangements, this issue falls within the scope of the Treasurers' Conference (Ministerial Council for Commonwealth-State Financial Relations¹¹⁵). However, any departure from the current arrangements that focus only on the GST would require a new intergovernmental agreement and the establishment of a new Ministerial Council. For example, if a proposal suggests a change in States' autonomy in relation to any

¹¹⁴ See the National Competition Council's website <http://www.ncc.gov.au>.

¹¹⁵ For a description of COAG, see www.coag.gov.au/ministerial_councils.htm.

new tax base, this change may need to be tempered by a Ministerial Council, chaired by the Commonwealth. With this approach, the implications for all States and for CGC process could be countenanced.

At the national political level, COAG has a fundamental role to initiate, develop and monitor the implementation of policy reforms that are of national significance and which require cooperative action by Australian governments. IPART considers that NSW should be proactive in ensuring that COAG is given a clear focus to foster initiatives between States in the area of tax harmonisation and intergovernmental fiscal arrangements.

Recommendation

28 NSW should propose that COAG should foster initiatives between States in the area of intergovernmental fiscal arrangements.

At an operational level, the COAG Secretariat, and the COAG Reform Council, should work closely with State Treasuries and OSRs to ensure necessary cooperation and coordination.



Appendices

A Terms of Reference

TERMS OF REFERENCE FOR IPART TO INQUIRE INTO STATE TAXATION

I, Morris Iemma, Premier of New South Wales, under Section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992*, refer the following matters to the Independent Pricing and Regulatory Tribunal:

- Given the existing GST agreement, assess the impact of the current system of Commonwealth-State fiscal relations on NSW revenue mix and the ability of NSW to fund essential public services.
- Compare the efficiency of the taxes available to NSW and the Commonwealth.
- Review the existing NSW tax system according to standard taxation principles (that is, efficiency, equity, simplicity and transparency) as well as the interstate competitiveness of NSW taxes.
- Recommend options to improve the efficiency, equity, interstate competitiveness, simplicity and transparency of NSW tax system, given the taxes available to it.

The Tribunal is to provide a draft report to the Treasurer by 14 March 2008. The Tribunal is to provide a final report to the Treasurer by 31 May 2008.

Background

The Australian system of Commonwealth-State fiscal relations is characterised by high vertical fiscal imbalance and a complex system of horizontal fiscal equalisation.

The Commonwealth Government collects around 82 per cent of national taxation revenue (including the GST), but is responsible for only around 54 per cent of own-purpose expenses.

The States and Territories collect around 15 per cent of national taxation revenue and account for around 40 per cent of own-purposes expenses. In 2007-08, Commonwealth grants are estimated to account for 42.5 per cent of NSW's total budget revenue while State taxation revenue is estimated account for 39.0 per cent of total budget revenue.¹

In addition to being more dependent on fiscal transfers from the central government than in most other federations, the range of taxes available to the States is generally inefficient and narrowly based. The base became narrower after the introduction of the GST following the required abolition of certain State taxes. This will be more so after further State taxes are abolished given the Commonwealth's interpretation of the GST agreement.

GST revenue grants are distributed among the States and Territories according to the principle of horizontal fiscal equalisation (HFE). This is currently defined by the Commonwealth Grants Commission as providing each State with the capacity to provide the same standard of service, if each operated at the same level of efficiency and made the same effort to raise revenue.

¹ Based on the latest available data from ABS, Government Finance Statistics, Cat No 5512.0, 2005-06.

This system is highly complex and data intensive. The Commonwealth Treasurer makes the final determination of the GST relativities.

Under the current HFE system, NSW is estimated to cross subsidise the other States (except for Victoria and Western Australia) by around \$2.4 billion in 2007-08.

The Warren report found that "State governments in Australia are forced to rely on relatively inefficient, narrow-based and sometimes highly cyclical transactions based taxes rather than on more efficient broadly-based consumption and income taxes which in Australia are central government taxes. They are forced into such tax systems through very tight constitutional constraints on their tax powers, Commonwealth policies and interjurisdictional tax competition."²

² Warren, N. Benchmarking Australia's Intergovernmental Fiscal Arrangements, Final Report. NSW Government, 2006.



Premier of New South Wales
Australia

Dr Michael Keating AC
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

12 MAR 2008

Dear Dr Keating

I am writing regarding the Independent Pricing and Regulatory Tribunal's letter of 6 March 2008 requesting an extension to the reporting date for the Tribunal's current Review of NSW State Taxation.

I hereby approve a variation to the Terms of Reference for this review. The Tribunal is to provide a draft report to the Treasurer by 23 May 2008. The Tribunal is to provide a final report to the Treasurer by 31 July 2008. In accordance with section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992*, I approve of the Tribunal continuing to provide services until 31 July 2008.

I have also approved a further appointment of Professor Neil Alastair Warren as a temporary part-time member of the Independent Pricing and Regulatory Tribunal from 1 July 2008 until 31 August 2008 to assist the Tribunal in undertaking the review. Please find enclosed a copy of Professor Warren's instrument of appointment.

If your officers wish to discuss these matters, they should contact Mr Paul Elton, Policy Manager, Natural Resources and Economic Development Branch, at the Department of Premier and Cabinet on 9228 5493.

Yours sincerely


Morris Iemma MP
Premier

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**Premier of New South Wales
Australia**

21 MAY 2008

Dr Michael Keating AC
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

Dear Dr Keating

I am writing regarding the Independent Pricing and Regulatory Tribunal's current Review of NSW State Taxation. I am advised that it has been agreed between officers that the reporting dates for the Review should be extended.

I hereby approve a variation to the Terms of Reference for this review. The Tribunal is to provide a draft report to the Treasurer by 5 June 2008. The Tribunal is to provide a final report to the Treasurer by 31 August 2008. In accordance with section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992*, I approve of the Tribunal continuing to provide services until 31 August 2008.

If your officers wish to discuss these matters, they should contact Mr Paul Elton, Director, Natural Resources and Economic Development Policy, at the Department of Premier and Cabinet on 9228 5493.

Yours sincerely

John Watkins MP
Acting Premier

B Consideration of Terms of Reference

Term of reference	Chapter	Finding/Recommendations
Assess the impact of Commonwealth-State fiscal relations on NSW revenue mix and ability of fund essential services	3, 5 and 6	State Tax revenues are inadequate for their expenditure responsibilities. Hence grants are a major component of State revenues but the formula used for the calculation of grants can create disincentives for tax reform.
Compare the efficiency of NSW and Commonwealth taxes	4	<p>On balance, Commonwealth taxes are more efficient, equitable and less affected by the economic cycles.</p> <p>The States rely upon a wide range of taxes, many of which are inefficient (eg, insurance duties) or have highly variable revenues (eg, transfer duties).</p> <p>The Commonwealth primary taxes – income tax (including company tax) and GST – are relatively efficient and broadly based. Income tax is the most effective existing tax for achieving equity goals.</p>
Review the existing tax system according to standard tax criteria (efficiency, equity, simplicity and transparency) and interstate competitiveness	4	In principle the State's most efficient taxes are payroll tax and land tax, but each has large exemptions that reduce efficiency and equity and cannot be readily addressed.
Recommend options to improve the efficiency equity, interstate competitiveness, simplicity and transparency of the NSW tax system given the taxes available to it	5 and 7	<p>The report makes a number of recommendations to improve the efficiency, equity and competitiveness of the NSW taxes and the administration of taxes.</p> <p>These reforms concentrate on broadening the existing tax bases, lowering rates and shifting the burden from less efficient taxes (eg, insurance duties and transfer duties) to more efficient taxes (eg, payroll tax and land tax).</p> <p>At a State level the options are tightly constrained by the existing Commonwealth-State fiscal relations and revenue sharing arrangements. More fundamental and effective reform requires cooperation between the Commonwealth and States.</p>

C Submissions

The following tables provide details of the submissions received for the review.

Submitter	Date Received
David Landa Stewart Lawyers	6 November 2007
DLA Phillips Fox	14 November 2007
The Vacluse Progress Association	14 November 2007
University of Wollongong Faculty of Informatics	15 November 2007
Tenants Union of NSW	20 November 2007
Action for Public Transport (NSW)	20 November 2007
J Paterson	21 November 2007
Association for Good Government	21 November 2007
NCOSS	22 November 2007
Caravan & Camping Industry Association NSW	22 November 2007
Insurance Australia Group (IAG)	22 November 2007
J.Buchanan	23 November 2007
ClubsNSW	23 November 2007
Shelter NSW	23 November 2007
Mr. S A Whan	23 November 2007
NSW Business Chambers	23 November 2007
Prosper Australia	23 November 2007
Insurance Council of Australia	23 November 2007
Housing Industry Association Limited (HIA)	26 November 2007
Local Government Association of NSW	26 November 2007
Anonymous	27 November 2007
NSW Farmers Association	27 November 2007
Risk & Insurance Consulting Services Pty Ltd	27 November 2007
Anonymous	28 November 2007
NSW Urban Taskforce	28 November 2007
Property Council of Australia	28 November 2007
TTF Australia (Tourism & Transport Forum)	28 November 2007
Joint Accounting Profession Panel	29 November 2007
Business Council of Australia	30 November 2007
Board of Airline Representatives of Australia	30 November 2007

Submitter	Date Received
Beyond Financial Group	3 December 2007
Australian Industry Group	3 December 2007
Total Environment Centre Inc	6 December 2007
Land Tax Targets Tenants	7 December 2007
National Insurance Brokers Association	12 December 2007
Investment and Financial Services Assoc.	14 December 2007
B.M.G Remond	20 December 2007
Merimbula Home Nursing Service	4 January 2008
TTF Australia (Tourism & Transport Forum) (Submission unavailable due to confidentiality)	29 January 2008
David Landa Stewart Lawyers	31 January 2008

D Public Workshop

IPART held a Public Workshop at the Wesley Centre, Sydney on 14 December 2007. Participants in the roundtable discussion included:

Greg Farmilo	Beyond Financial Group
David Singer	David Landa Stewart Lawyers
Darrylen Allan	Housing Industry Association Limited
Ron Switzer	Joint Accounting Profession Panel
John Afford	FCA Joint Accounting Profession Panel
Paul Orton	NSW Business Chambers
Gavin Putland	Prosper Australia
Evan Hall	Tourism and Transport Forum
Alix Bean	Caravan & Camping Industry Association NSW
Eddie Ahn	DLA Phillips Fox
Alex Sanchez	Insurance Council of Australia
Alison Peters	NCOSS
Paul Ritchie	NSW Business Chambers
Cheryl Thomas	Property Council of Australia
Gino Renzella	Risk & Insurance Consulting Services Pty Ltd
Craig Johnston	Shelter NSW
Aaron Gadiel	NSW Urban Taskforce
Yvonne De Michael	Individual
John Paterson	Individual
John Buchanan	Individual
Louise O'Hara	Individual
David Wellfare	Insurance Australia Group
Megan Lynch	Total Environment Centre and Australian Conservation Foundation
Philip Laird	University of Wollongong Faculty of Informatics

E Major Taxes in NSW

The major taxes in NSW are listed below together with a description of their base, rate and any thresholds that apply.

E.1 Payroll tax

E.1.1 Definition, base, rate and thresholds

Payroll tax is levied under the *Payroll Tax Act 2007* with the administrative framework set out in the *Tax Administration Act 1996*. Payroll tax is a tax on employers and is calculated on wages paid or payable to employees. Payroll tax is levied at a rate of 6 per cent with a tax free threshold of \$600,000.

The term 'wages' means any wages, remuneration, salary, commissions, bonuses, or allowances paid or payable (whether at piece work rates or otherwise and whether paid or payable in cash or in kind) to an employee.

Wages, remuneration and salary include any ordinary earnings, penalty rates, overtime and leave payments in relation to the provision of services to an employer. The term wages also includes:

- ▼ payments to Crown officeholders of the state of NSW
- ▼ payments for labour under certain contracts
- ▼ directors' fees
- ▼ commissions
- ▼ payments under an employment agency contract to a service provider
- ▼ grants of shares or options
- ▼ fringe benefits
- ▼ employment termination payments
- ▼ superannuation benefits.

E.1.2 Exemptions and cost

Major exemptions from the payment of payroll tax include (with 2007-08 estimated cost):

- ▼ public hospitals and area health services - \$453m
- ▼ schools and colleges - \$120m
- ▼ religious institutions - \$10m
- ▼ charitable institutions - \$38m
- ▼ local councils - \$180m
- ▼ private hospitals and nursing homes - \$14m
- ▼ home care service - \$8m
- ▼ apprentices - \$19m
- ▼ trainees - \$10m
- ▼ redundancy payments - \$6m
- ▼ maternity leave - \$5m.

A number of smaller exemptions are listed in the Budget Papers.¹¹⁶

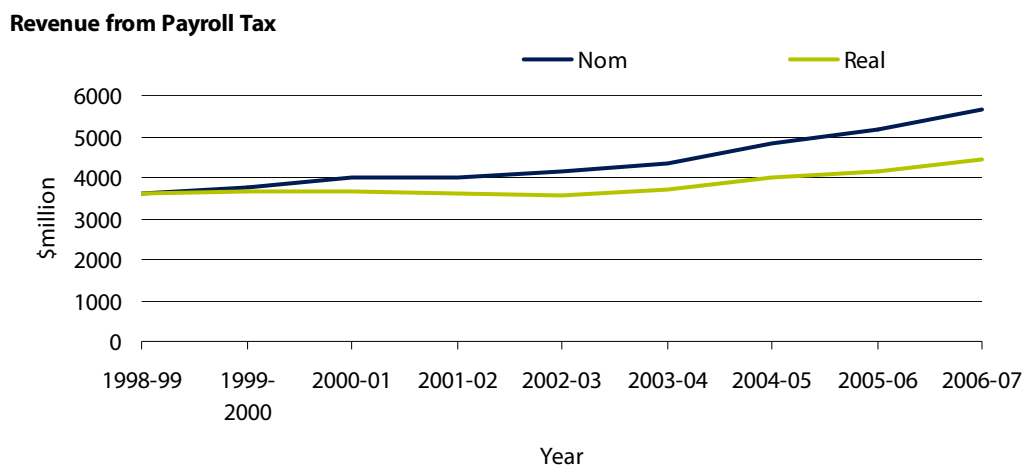
E.1.3 Revenue collected 1998-99 to 2007-08

Table E.1 Revenue collected from Payroll Tax, 1998-99 to 2007-08

Year	\$m
1998-99	3,605
1999-00	3,769
2000-01	3,986
2001-02	4,021
2002-03	4,123
2003-04	4,356
2004-05	4,837
2005-06	5,180
2006-07	5,664
2007-08(est)	5,960

Source: Various NSW Treasury Budget Papers.

¹¹⁶ Refer to Budget Paper 2 – Budget Statement 2007-08, p E-19 for other minor exemptions.

Figure E.1 Revenue from Payroll Tax

E.1.4 History of rates and thresholds

Table E.2 Rates and thresholds for Payroll Tax

Period Ended	Threshold	Rate
30 June 1995	550,000 (from 1-1-95)	7%
30 June 1996	600,000 (from 1-1-96)	7%
30 June 1997	600,000	6.85%
30 June 1998	600,000	6.85%
30 June 1999	600,000	6.85%
30 June 2000	600,000	6.4%
30 June 2001	600,000	6.2%
30 June 2002	600,000	6.2%
30 June 2003	600,000	6.0%
30 June 2004	600,000	6.0%
30 June 2005	600,000	6.0%
30 June 2006	600,000	6.0%
30 June 2007	600,000	6.0%

Source: NSW Treasury.

E.1.5 Benchmark against other States

Table E.3 compares the rates and thresholds for Payroll Tax across the States. The rate in NSW is the highest of the larger mainland States but lower than Tasmania, ACT and NT. However, the payroll tax threshold, which benefits small business, is higher than South Australia and Victoria.

Table E.3 Comparison of Payroll Tax with other States

	NSW	VIC	QLD	WA	SA	TAS	NT ^b	ACT
Current Tax Rate (%)	6.0	5.05	4.75	5.5	5.5	6.1	6.2	6.85
Tax Rate – 1 July 08	6.0	5.0	4.75	5.5	5.0	6.1	6.2	6.85
Current Threshold (\$'000)	600	550	1,000	750	504	1,010	1,250	1,250

Source: NSW Treasury.

E.1.6 Harmonisation with Victoria

On 26 February 2007 the New South Wales and Victorian Treasurers announced that both jurisdictions would harmonise their payroll tax legislative and administrative arrangements from 1 July 2007. This initiative will significantly reduce red tape and regulation for around 8,000 businesses with operations in both New South Wales and Victoria.

Businesses will benefit through reduced compliance costs, allow for the use of common payroll tax forms and revenue rulings and will also provide common definitions in areas such as grouping provisions, contractor arrangements and fringe benefits treatment.

From 1 July 2007 the following specific exemptions from payroll tax were introduced:

- ▼ adoption and maternity leave payments
- ▼ contributions made by employers to a portable long service leave scheme, provided they are not taxable for fringe benefits tax purposes; and
- ▼ non-monetary superannuation contributions.

In order to achieve consistency between New South Wales and Victoria, a number of other exemptions needed to be removed. They include:

- ▼ Removal of an exemption paid to financial planners under relevant contract provisions. Most financial planners should continue to receive an exemption under other general exemptions.
- ▼ Removal of an exemption paid to employment agents that on-hire staff with wages below the \$600,000 threshold.

- ▼ Removal of the exemption for payments under a contract exceeding \$800,000, as well as amending the exemption for contractors rendering services to the public to specifically refer to limiting the exemption to contractors providing services to the public generally “in that financial year”.

From 1 July 2008 New South Wales will remove the payroll tax exemption for single employer apprentices/trainees and apprentices/trainees employed under a group for-profit training organisation, and replace it with a rebate. Apprentices/trainees employed under a group not-for-profit training organisation will continue to receive a payroll tax exemption.

E.2 Land tax

E.2.1 Definition, base, rate and thresholds

Land Tax is levied under the *Land Tax Act 1956* and *Land Tax Management Act 1956*.

Land tax is assessed annually. For the 2008 land tax year a single tax rate of 1.6 per cent applies to aggregate land holdings above the threshold, currently \$359,000. There is also an administrative fee of \$100 (applied to all land tax payers). Liability for payment of land tax normally falls on the owner of qualifying land as at midnight 31 December of the immediate past year.

The threshold is indexed to average movements in State-wide property prices for industrial, commercial and residential property. The threshold is also averaged using the same three years that apply to land value assessments.

Land values for land tax assessments are based on the average value of land as determined by the Valuer-General over the previous three years, eg, assessments issued in early 2008 are based on the land values of 30 June 2005, 2006 and 2007.

Most assessments are issued in January and February – where land holdings are simple and generally unchanged. Assessments for more complex holdings are issued progressively over the year.

Land tax applies to all industrial, commercial and residential investment properties subject to the exemptions listed below.

E.2.2 Exemptions and cost

The following exemptions to land tax and their costs (for 2007-08 and based on a tax rate of 1.6 per cent).

- ▼ Principal places of residence – uncertain because it is not known how many residences below the threshold are used as principal residences or investment properties.
- ▼ Threshold – uncertain because of similar reason as above.
- ▼ Primary production - \$346 million.
- ▼ Retirement villages - \$92 million.
- ▼ Public Cemeteries - \$12 million.
- ▼ Co-operatives - \$8 million.
- ▼ Boarding houses - \$6 million.

A number of smaller exemptions are listed in the Budget Papers.¹¹⁷

¹¹⁷ Refer to Budget Paper 2 – Budget Statement 2007-08, p E-21 for other minor exemptions.

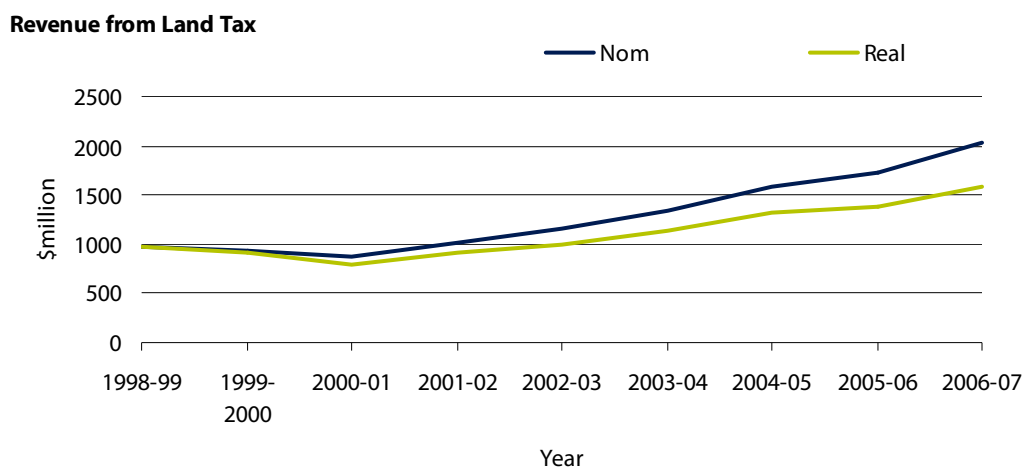
E.2.3 Revenue collected 1998-99 to 2007-08

Table E.4 Revenue collected from Land Tax, 1998-99 to 2007-08

Year	\$m
1998-99	966
1999-00	931
2000-01	865
2001-02	1,010
2002-03	1,154
2003-04	1,339
2004-05	1,586
2005-06	1,720
2006-07	2,036
2007-08(est)	1,968

Source: NSW Treasury.

Figure E.2 Revenue from Land Tax



E.2.4 History of rates and thresholds

In May 2004 the Government broadened the base by removing the threshold and introduced three marginal rates for the 2005 land tax year as shown in Table E.5. The exemption for Principal Place of Residence still applied, thus Land Tax was levied primarily on commercial and rental property.

Table E.5 Land Tax Rates for 2005

Value of Dutiable Property	Rate
Up to \$400,000 ^a	0.4%
\$400,000 - \$500,000	\$1,600 +0.6% above \$400,000
Over \$500,000	\$2,200 +1.4% above \$500,000

^a assessments of under \$100 were waived implying a threshold of \$25,000.

Source: NSW Treasury.

At the same time the Premium Property Tax (PPT) was removed and replaced with a surcharge of 2 per cent on the top transfer duty rate on residential properties valued in excess of \$3 million. The PPT applied to principal places of residence at the rate of 1.7 per cent above the threshold of \$317,000 with land values exceeding \$1,970,000 for the 2004 land tax year. There was a cap of 0.2 per cent of the total number of owner-occupied properties that could be charged the PPT.

The broadening of the tax base met with considerable taxpayer resistance and the reforms were overturned for the 2006 land tax year when the government reinstituted the single marginal rate with a threshold of \$330,000.

In January 2006, the government made a one off increase in the threshold from \$330,000 to \$352,000 for the 2006 land tax year. The threshold has since been indexed from this new base (process described above).

The government introduced three year averaging of land values and the threshold from the 2007 land tax year.

The government has cut the land tax rate from 1.7 per cent to 1.6 per cent from the 2008 land tax year.

In October 2005, the NSW Ombudsman released a report that examined ways to improve operational processes and systems to address gaps in the existing valuation process.

The report concluded:

The methodology employed to produce land valuations in New South Wales, the component system of mass valuation, was generally sound. A component system of valuation examines a 'benchmark' property with comparable property values all expected to move together. The consistency of the comparables with 'benchmarks' needs to adjust for the time since the particular comparable sale. The report indicates in many cases this has not been done.

The Ombudsman recommended a number of changes to address identified weaknesses in the implementation of the quality assurance framework, many of which have been put in place by the Valuer-General.

The Ombudsman reported that there was inadequate time to undertake valuations and to ensure the quality of data. This relates to the shortness of time between the base date and analysis of component factors impacting determination of valuations. To address this, the report recommended moving the valuation base date back four months to 1 March.

However, recent enhancements have diminished the need for an earlier valuation date. The valuation review process now spreads the checking and audit process over the full year, thereby reducing the need to finalise valuations at the end of the valuation cycle.

The Valuer-General also conducted extensive consultation with various stakeholders on changing the valuation date to either 1 March or 1 May. Feedback indicated that the majority of stakeholders saw little benefit from any change to the valuation date.

Furthermore, Treasury estimated that moving to an earlier land valuation date would adversely impact land tax revenue on an ongoing basis by approximately \$40 million a year from 2009-10 without significantly improving accuracy of Budget estimates.

On 12 September 2006, Cabinet accepted the Valuer-General's recommendation to retain the current valuation date of 1 July.

E.2.5 Benchmark against other states

NSW has the simplest land tax arrangements with a single threshold and one of the lowest top marginal rates.

Table E.6 Interstate comparison of land tax rates and thresholds (from 1 July 2007)

State	Tax Schedule	
NSW ^a	\$0-\$359,000:	Nil
	Over \$359,000:	\$100 + 1.6% of value over \$359,000.
VIC ^b	Less than \$225,000:	Nil
	\$225,000-\$539,999:	\$250 + 0.2%
	\$540,000-\$899,999:	\$880 + 0.5%
	\$900,000-\$1,619,999:	\$2,680 + 0.8%
	\$1,620,000-\$2,699,999:	\$8,440 + 1.3%
	\$2,700,000 and over:	\$22,480 + 2.5%
QLD ^c	Less than \$600,000:	Nil
	\$600,000 to \$749,999:	\$1,200 + 0.70c in \$ over \$600,000.
	\$750,000 - \$1,249,999:	\$2,250 + 1.45c in \$ over \$750,000.
	\$1,250,000 - \$1,999,999:	\$9,500 + 1.50c in \$ over \$1,250,000.
	\$2,000,000 - \$2,999,999:	\$20,750 + 1.675c in \$ over \$2,000,000.
	\$3,000,000 and over:	1.25c of full value.
WA ^d	\$0-\$250,000:	Nil
	\$250,001-\$875,000:	0.15%
	\$875,001-\$2,000,000:	\$938+0.75%
	\$2,000,001- \$5,000,000:	\$9,375+1.3%
	\$5,000,001- \$10,000,000:	\$48,375+1.55%
	Over \$10,000,000:	\$125,875+2.30%
SA	\$0-\$110,000:	Nil
	\$110,000-\$350,000:	0.30%
	\$350,000-\$550,000:	\$720 + 0.70%
	\$550,000-\$750,000:	\$2,120 + 1.65%
	\$750,000-\$1,000,000:	\$5,420 + 2.40%
	Over \$1,000,000:	\$11,420 + 3.70%
TAS	\$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%
NT	Not imposed	
ACT ^e	Up to \$75,000:	0.60%
	\$75,001-\$150,000:	0.89%
	\$150,001-\$275,000:	1.15%
	Over \$275,000:	1.40%

^a 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 per cent.

^b General Rate. Special trusts: are taxed at higher rates – see Appendix E.

^c Rates for Individuals. For Companies, trustees and absentees are taxed at a higher rate with different thresholds – See Appendix E.

^d The Metropolitan Region Improvement Tax is levied on the unimproved value of land situated in the metropolitan region at the rate of 0.18c per \$1 for land valued at over \$250,000.

^e Based on Average Unimproved Value, which includes the 2005, 2006 and 2007 Unimproved Land Values. Commercial Properties are taxed at a higher rate with different thresholds – See Appendix E.

Source: NSW Treasury, NSW Treasury Research Papers, Interstate Comparison of Taxes 2007-08, TRP07-02.

Table E.7 Comparison of Land Tax with other States

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
\$0-\$359,000: Nil	General:	individuals:	\$0-\$250,000: Nil	\$0-\$110,000: Nil	\$0-\$24,999:	Not imposed	Marginal Rates
Over \$359,000:	Less than	Less than	\$250,001-	Exceeding	Nil		Up to \$75,000:
\$100 + 1.6% of	\$225,000:	\$600,000:	\$875,000:	\$110,000-	\$25,000-\$349,999:		0.60%
value over	Nil	nil	0.15%.	\$350,000: 0.30%	\$50.00+0.55%		\$75,001-\$150,000:
\$359,000.	\$225,000-	\$600,000 to	\$875,001-	Exceeding	\$350,000-		0.89%
The threshold is a	\$539,999:	\$749,999:	\$2,000,000:	\$350,000-	\$749,999:		\$150,001-
three year average	\$250 + 0.2%	\$1,200 + 0.70c of	\$938+0.75.	\$550,000:	\$1837.50+2%		\$275,000:
and is indexed	\$540,000-	each \$ in excess of	\$2,000,001-	\$720 + 0.70%	\$750,000 or more:		1.15%
annually according	\$899,999:	\$600,000.	\$5,000,000:	Exceeding	\$9,837.50+2.50%		Over \$275,000:
to movements in	\$880 + 0.5%	\$750,000 -	\$9,375+1.3%.	\$550,000-			1.40%
State-wide	\$900,000-	\$1,249,999:	\$5,000,001-	\$750,000:			Based on Average
property prices.	\$1,619,999:	\$2,250 + 1.45c of	\$10,000,000:	\$2,120 + 1.65%			Unimproved Value,
The threshold	\$2,680 + 0.8%	\$ in excess of	\$48,375+1.55%.	Exceeding			which includes the
cannot fall. The	\$1,620,000-	\$750,000.	Over \$10,000,000:	\$750,000-			2005, 2006 and
minimum land tax	\$2,699,999:	\$1,250,000 -	\$125,875+2.30%.	\$1,000,000:			2007 Unimproved
payment is \$100.	\$8,440 + 1.3%	\$1,999,999:	The Metropolitan	\$5,420 + 2.40%			Land Values.
Non-concessional	\$2,700,000 and	\$9,500 + 1.50c in	Region	Over \$1,000,000:			Commercial
companies and	over:	excess of	Improvement	\$11,420 + 3.70%			Properties
special trusts are	\$22,480 + 2.5%	\$1,250,000.	Tax is levied on the				Marginal Rates
taxed at the flat	Special trusts:	\$2,000,000 -	unimproved value				Up to \$150,000:
rate of 1.6%.	Less than \$20,000:	\$2,999,999:	of				0.89%
Premium Property	Nil	\$20,750 + 1.675c in	land situated in the				\$150,001-
Tax was abolished	\$20,000-\$224,999:	excess of	metropolitan				\$275,000:
from the 2005 land	\$75 + 0.375%	\$2,000,000.	region				1.25%
tax year	\$225,000-	\$3,000,000 and	at the rate of 0.18c				Over \$275,000:
	\$539,999:	over:	per \$1 for land				1.59%
							Based on Average

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
	\$844 + 0.575%	1.25c of full value.	valued				Unimproved Value, which includes the 2005, 2006 and 2007 Unimproved Land Values.
	\$540,000-\$899,999:	For Companies, trustees and absentee:	at over \$250,000.				
	\$2,655 + 0.875%	Less than					
	\$900,000-\$1,619,999:	\$350,000:					
	\$5,805 + 1.175%	nil					
	\$1,620,000-\$2,699,999:	\$350,000 to \$749,999:					
	\$14,265 + 0.76% (a)	\$2,250 + 1.50c for every \$ in excess of \$350,000.					
	\$2,700,000 and over:	\$750,000 - \$1,249,999:					
	\$22,480 + 2.5% (a) Surcharge on special trusts effectively phased out for land holdings valued above \$1,620,000; Above \$2.7 million, no surcharge applies	\$8,250 + 1.65c for every \$ in excess of \$750,000.					
		\$1,250,000 - \$1,999,999:					
		\$16,500 + 1.80c for every \$ in excess of \$1,250,000					
	Since 1 July 2004 land tax has been payable on electricity transmission easements (from 2007, with a top rate of 5%	\$2,000,000 and over:					
		1.50c of full value.					

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
	<p>instead of 3%)</p> <p>The Metropolitan Parks Charge is levied annually on all metropolitan properties via water bills. It is calculated by multiplying the property's 1990 Net Annual Valuation by a rate in the dollar.</p> <p>The minimum yearly Parks Charge in 2006-07 is \$53.84.</p>						

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-2, pp 31-33

E.3 Transfer duty

E.3.1 Definition, base, rate and thresholds

Purchaser Transfer Duty (also called 'Contracts and Conveyances Duty') is a stamp duty imposed under the *Duties Act 1997* on the transfer of ownership of real property by individuals and businesses, as well as on the transfer of land use entitlements, statutory licenses, partnership interests, intellectual property and goodwill.

Transfer duty is payable when a transfer of ownership of dutiable assets occurs. It is payable by the purchaser of a dutiable asset based on the dutiable value, usually the sale price or its unencumbered value, whichever is higher. The tax base for transfer duty is often described as 'narrow'.

The current general schedule of transfer duty rates was introduced in 1987 and has remained unchanged since then. It is a progressive scale of rates, as follows:

Table E.8 General Schedule (for all dutiable property other than residential property above \$3 million)

Value of Dutiable Property	Transfer Duty Payable
Up to \$14,000	\$1.25 per \$100 or part (minimum \$2)
\$14,0001 to \$30,000	\$175 plus \$1.50 per \$100 (or part) above \$14,000
\$30,0001 to \$80,000	\$415 plus \$1.75 per \$100 (or part) above \$30,000
\$80,0001 to \$300,000	\$1,290 plus \$3.50 per \$100 (or part) above \$80,000
\$300,0001 to \$1,000,000	\$8,990 plus \$4.50 per \$100 (or part) above \$300,000
Over \$1,000,000	\$40,490 plus \$5.50 per \$100 (or part) above \$1,000,000

Source: NSW Treasury, TRP07-2.

From 1 June 2004, an additional step imposed higher duty on residential property transfers valued above \$3 million.

Table E.9 Premium Property Duty (residential property valued above \$3 million)

Value of Dutiable Property	Transfer Duty Payable
\$3,000,000 and over	\$150,490 plus \$7.00 per \$100 (or part) above \$3,000,000

Source: NSW Treasury, TRP07-2.

While nominal duty rates in the general schedule remained constant in the past twenty years, the effective duty rate has increased as inflation of property values pushed transactions into higher tax brackets. For example, in June quarter 1987, the median house price in Sydney was \$92,100 (Real Estate Institute) and transfer duty payable on it was \$1,713 or 1.86 per cent of the median house price. In June quarter 2007, the median house price in Sydney was \$525,500 (Real Estate Institute) and

transfer duty payable at that price was \$19,137 or 3.64 per cent of the median house price. The effect is known as “bracket creep”.

The 1988 Tax Task Force headed by David Collins recommended that the value brackets in the schedule of transfer duty rates should be indexed. This recommendation was never implemented.

E.3.2 Exemptions and cost

The major exemptions (with estimated cost in 2007-08 in parentheses) are:

- ▼ First Home Plus and First Home Plus One (\$456 million).
- ▼ Transfers of residences between spouses (\$39 million).
- ▼ Transfers of matrimonial property following divorce (\$106 million).
- ▼ Intergenerational rural transfers (\$15 million).
- ▼ Purchases by charitable and benevolent institutions (\$13 million).
- ▼ Certain corporate reconstructions (\$129 million).

The exemption given for corporate reconstructions, provided certain qualifying criteria are met, is readily justified on efficiency grounds. Most other major exemptions are readily justified on equity grounds.

E.3.3 Revenue collected 1998-99 to 2007-08

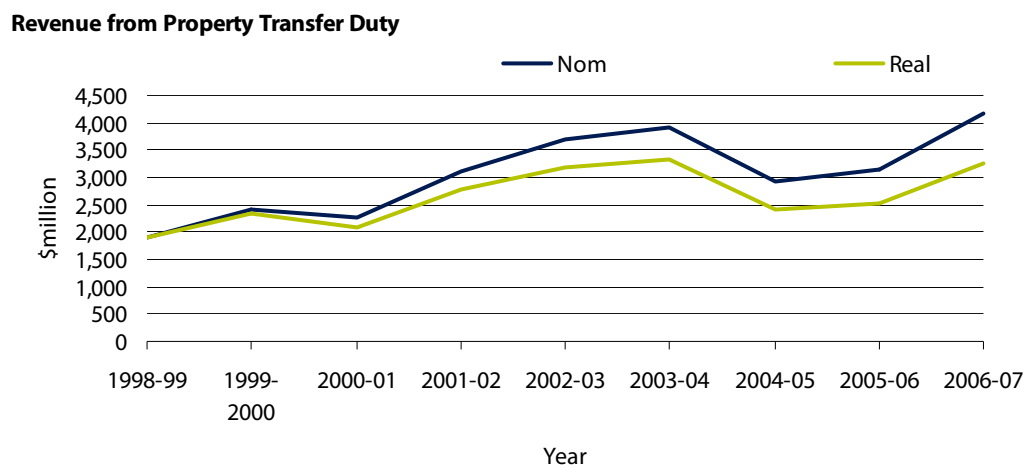
Table E.10 Revenue collected from Property Transfer Duty, 1998-99 to 2007-08

Year	\$m
1998-99	1,915.8
1999-00	2,406.0
2000-01	2,266.6
2001-02	3,118.5
2002-03	3,677.2
2003-04	3,916.1
2004-05	2,911.2
2005-06	3,144.3
2006-07 ^a	4,163.0
2007-08 ^b	4,206.0

^a Actual for 2006-07 includes one assessment issued for \$420 million on Sydney Airport transfer.

^b Estimate from 2007-08 Half-Yearly Budget Review.

Source: NSW Treasury.

Figure E.3 Figure Revenue from Property Transfer Duty

E.3.4 History of rates and thresholds

Stamp duty, including duty on a transfer or agreement for sale of property, was first introduced in New South Wales on 1 July 1865.

At the introduction of decimal currency, the duty rates applied to contracts and conveyances were as follows:

Table E.11 Purchaser Transfer Duty from 14/2/66 to 17/12/74

Value Range	Marginal Tax Rate
Up to \$14,000	\$2.50 per \$200
Over \$14,000	\$3.00 per \$200

Source: NSW Treasury.

A progressive schedule was introduced from 18 December 1974 as follows:

Table E.12 Purchaser Transfer Duty from 18/12/74 to 10/12/85

Range	Marginal Tax Rate
Up to \$14,000	\$1.25 per \$100
\$14,0001 to \$30,0000	\$1.50 per \$100
\$30,0001 to \$50,0000	\$1.75 per \$100
\$50,0001 to \$100,0000	\$2.00 per \$100
\$100,0001 to \$250,0000	\$2.25 per \$100
Over \$250,000	\$2.50 per \$100

Source: NSW Treasury.

The scale of rates was re-structured from 11 December 1985 to give a 20 per cent tax cut on properties valued between \$40,000 and \$120,000 (first home buyers), with an increase in duty on values above \$300,000:

Table E.13 Purchaser Transfer Duty from 11/12/85 to 30 November 1986

Range	Marginal Tax Rate
Up to \$14,000	\$1.25 per \$100
\$14,0001 to \$30,0000	\$1.50 per \$100
\$30,0001 to \$80,0000	\$1.75 per \$100
Over \$80,000	\$1,290 plus \$3.50 per \$100

Source: NSW Treasury.

The current general scale (Table E.6) took effect from 1 December 1986. This scale added two steps with higher marginal rates at the top end of the previous scale.

In the 1986-87 Budget, liability was extended under the scale to include any contents conveyed with real property.

In early June 1986, two anti-avoidance measures were introduced to prevent the following contracts and conveyancing tax avoidance schemes:

- ▼ ‘Claytons’ contracts – which are oral contracts without a dutiable document.
- ▼ Transferring ownership in a company – by transferring shares, so as to transfer property ownership to another company.

The New South Wales Tax Task Force recommended in *Review of the State Tax System*, that the progressive tax rate scale should continue to apply and that ‘New South Wales should not lightly abandon one of the very few progressive tax instruments to which it currently has access’. They also recommended that the rate scale should be indexed annually on the basis of an index of average changes in property values in New South Wales, to be supplied by the Valuer General’s Department. The recommendation to index the rate scale was never implemented.

Several measures were introduced to protect the revenue base against the use of companies and unlisted unit trusts to avoid paying transfer duty on the acquisitions of interest in land (land rich base protection). Amendments to the land rich provisions of the Act took effect from 14 November 2003 – the date the *Duties Amendment (Land Rich) Act 2003* was introduced in Parliament.

The main amendments were:

- ▼ **The acquisition threshold** – duty applies to the acquisition of a minimum of 50 per cent of the shares in companies/units in wholesale trusts and a minimum of 20 per cent of the units in private unit trusts. No duty on the acquisition of units in a public unit trust.

- ▼ Previously, duty applied only to the acquisitions of more than 50 per cent of units/shares in a 'land rich' unit trust/company.
- ▼ **The land rich test** – duty applies to acquisitions above the acquisition threshold in companies/unit trusts with a minimum of 60 per cent of the assets being land (previously 80 per cent). Except in the case the company/trust is predominantly engaged in primary production the 80 per cent threshold has been retained, provided the company/trust remains predominantly engaged in primary production for at least 5 years from the date of acquisition. The land rich test does not apply to public unit trusts.
- ▼ **The value of land required** – the land rich test applies to companies/trusts that own \$2 million or more of land in New South Wales (previously \$1 million) to help genuine small businesses out of the scope of the land rich provisions.
- ▼ **Introduce a new category of wholesale unit trusts** – these are trusts in which other trusts and certain 'qualifying' investors invest. Provided a minimum of 80 per cent of units in these trusts are held by 'qualifying' investors, duty applies to acquisitions by a single investor of 50 per cent or more, rather than 20 per cent or more of the units in the trust (the new rule for private unit trusts).
- ▼ **New public unit trust definition** – there must be at least 300 investors in the fund, with no single investor or related group holding more than 20 per cent of the units. The new definition is designed to ensure trusts receiving the public unit trust tax concession are genuinely widely held. (The previous definition of a public trust was easily manipulated: it only required 50 or more investors in a trust, with more than 20 investors owning at least 75 per cent of the units to qualify for a tax concession.)

As part of the 6 April Mini-Budget changes in 2004, the Premium Property Tax that had applied to principal places of residence above a (land) tax free threshold was abolished to be replaced with the Premium Property Duty, with effect from 1 June 2004. Rather than attracting tax annually under the Premium Property Tax, high valued residences now attract a 7 per cent Premium Property Duty only when they are bought. This applies on that part of the purchase price above \$3 million.

The legislation was later amended to clarify where the sale price of a transaction involving more than one property exceeds \$3 million, transfer duty applies to the total price paid as if it were one transaction but Premium Property Duty only applies to that part of the total consideration applicable to each property that exceeds \$3 million.

In October 2004, the Government introduced an exemption from transfer duty on approved equity release scheme for aged homeowners. An equity release scheme provides elderly homeowners with cash in exchange for the scheme operator receiving a share of the proceeds when the house is sold in the future. Such an arrangement requires as collateral a contract (term of sale), which would normally attract transfer duty, even though the sale might not occur. In granting the

exemption, the Government removed an impediment to older homeowners wishing to obtain greater access to their wealth without having to sell and move house.

To close a loophole in the stamp duty provisions, which had allowed a waiver of purchaser transfer duty on transactions involving options, legislation was amended so that these transactions incur purchaser transfer duty, with effect from 1 July 2005.

History of Various First Home Buyer Assistance Schemes

The **First home Purchase (Stamp Duty Deferment) Scheme** was introduced on 1 December 1976 with couples being eligible if their home was valued below \$50,000. The scheme enabled eligible applicants to pay the duty in interest free instalments over 5 years.

The scheme was extended to single people on 1 November 1977. The eligibility limit was raised to \$75,000 on 1 September 1981. The limit was further increased for eligible first home purchasers from \$105,000 to \$125,000 on 2 June 1988.

To update the scheme and target assistance to those most in need, the 1990 Budget session made the following changes, from 1 October 1990:

- ▼ introduced income eligibility tests of \$48,000 for a purchaser with dependants and \$27,000 for a single person without dependants
- ▼ the property value threshold increased from \$125,000 to \$155,000 in Sydney and \$145,000 outside of Sydney
- ▼ extended the scheme to vacant land, with property value thresholds of \$80,000 in Sydney and \$70,000 outside of Sydney
- ▼ provided for a discount of 30 per cent in the duty for up-front payment by new applicants, in place of deferred payments over 5 years, and
- ▼ provided an option for existing participants in the scheme of paying out their remaining liability at a discount.

The single income limit for eligibility was increased to \$33,000 on 1 January 1992. For contracts exchanged after 2 June 1998, the up-front discount was increased to 50 per cent and the option to defer was removed from 1 August 1998. The income eligibility limits increased again to \$39,000 for a single person with no dependants and to \$57,000 for a single person with dependants and couples. The property thresholds were also increased to \$170,000 for the Sydney metropolitan area and to \$150,000 in the rest of the State.

To encourage first home buyers under the instalment program to fully discharge their outstanding liabilities, the discount offered increased from 10-25 per cent to a flat 50 per cent, from 23 June 1999.

The First Home Purchase Scheme was abolished from 30 June 2000 (along with the income test requirement) and was replaced with the **First Home Plus Scheme**. This scheme applied to contracts signed on or after 1 July 2000 and was designed to better target assistance to all first home buyers.

The definition of 'metropolitan area' under the scheme was also extended from 1 July 2000, to include the local government areas of Newcastle and Lake Macquarie to align with those applying to the metropolitan area of Sydney.

Under the scheme, all first home buyers received a total exemption from transfer and mortgage stamp duties for metropolitan property values up to \$200,000 and for properties valued elsewhere in New South Wales up to \$175,000. The stamp duties were phased out for metropolitan properties valued between \$200,000 and \$300,000 and between \$175,000 and \$250,000 for property values elsewhere in New South Wales. For vacant land, the exemption threshold value was \$95,000 in the metropolitan area, with the exemptions phased out between \$95,000 and \$140,000, and to \$80,000 elsewhere in New South Wales, with the exemptions phased out between \$80,000 and \$110,000.

The First Home Plus Scheme was further expanded, to take effect from midnight, 3 April 2004. It now provides first home buyers a full exemption from stamp duties for metropolitan and non-metropolitan properties valued up to \$500,000, phasing out between \$500,000 and \$600,000. For Vacant Land (metropolitan and non-metropolitan) the threshold for full exemption is \$300,000, phasing out between \$300,000 and \$450,000.

The First Home Plus thresholds were increased because the benefits of the original scheme were being eroded by the rapid growth of property prices since its introduction in 2000. Under the new thresholds, nearly 90 per cent of first home buyers in NSW pay no transfer and mortgage duties, and a further 5 per cent qualify for partial exemptions.

E.3.5 Benchmark against other States

Complex rate scales for conveyance duty make interstate comparisons difficult. One way of comparing is to calculate the tax liability for residential transfers in each state for transactions over a range of values. Using this measure, at the middle - to - higher value transactions more typical in Sydney, New South Wales is close to the bottom of the ranking in terms of conveyance duty liability as at 1 July 2007.

Table E.14 Contracts and Conveyances Duty Amounts, effective as at 1 July 2007

Value of Property (\$)	200,000	400,000	600,000	800,000	3,000,000
Stamp Duty Payable (\$)	6,830 SA	19,660 VIC	32,400 NT	43,200 NT	184,250 ACT
	6,810 VIC	18,800 NT	31,660 VIC	41,660 VIC	165,000 VIC
	6,800 NT	16,330 SA	26,830 SA	37,830 SA	162,000 NT
	6,200 WA	15,700 WA	26,250 ACT	37,750 ACT	158,830 SA
	5,675 TAS	15,000 ACT	26,100 WA	36,900 WA	155,700 WA
	5,600 QLD ^a	13,550 TAS	22,490 NSW	31,490 NSW	150,490 NSW
	5,500 ACT	13,490 NSW	21,550 TAS	29,550 TAS	127,475 QLD ^a
	5,490 NSW	12,475 QLD ^a	19,975 QLD ^a	28,475 QLD ^a	121,000 QLD ^b
	2,000 QLD ^b	6,000 QLD ^b	13,500 QLD ^b	22,000 QLD ^b	117,550 TAS

^a For properties other than principal places of residence.

^b For values up to \$320,000, Queensland has a concessional rate of 1 per cent for principal places of residence.

Source: NSW Treasury.

Simple Comparison of Top Marginal Rate

Table E.15 Comparison of Top Marginal Rate across States

NSW	VIC	QLD	WA	SA	TAS	ACT	NT
5.5% on non-residential or 7.0% on residential	5.5%	4.5%	5.4%	5.5%	4.0%	5.5% on non-residential 6.75% on residential	5.4%

Source: NSW Treasury.

E.4 Fire Services Funding

E.4.1 Definition, base, rate and thresholds

Fire services funding contributions are imposed under the *Fire Brigades Act 1989* and *Rural Fires Act 1997*.

Funding for the NSW Fire Brigades and Rural Fire Service is determined each year by the Minister for Emergency Services in consultation with the Treasurer for the following financial year. The total cost of NSW fire services is estimated at \$691 million in 2007-08, with statutory contributions as follows:

Table E.16 Sources of Funding for the Fire Services – 2007-08

	Fire Brigades		Rural Fire Service	
Insurance (FSL)	\$367 million	73.7%	\$146 million	73.7%
Local Government	\$61 million	12.3%	\$26 million	13.3%
State's Con Fund	\$65 million	14.0%	\$26 million	13.0%
Total	\$493 million	100%	\$198 million	100%

Note: Small differences in actual percentages due to rounding.

Source: NSW Treasury, Budget Papers 2007-08.

Some additional funding is also received from the Commonwealth. There are miscellaneous charges collected by the fire services for events such as false alarms and hazardous material calls. The current funding break-up has changed little since the 1950s.

The Insurance industry contribution is determined by the market shares of insurance companies issuing policies for fire, industrial specific risks, contractors, home and vehicle insurances.

The Fire Services Levy (FSL), as it is described on insurance policies, is not a New South Wales Government tax but a surcharge that general insurers impose on their customers to recoup the cost of their contribution to the fire services. As such, the FSL is a part of the insurance premium and is subject to both the GST and insurance duty.

E.4.2 Exemptions and cost

Nil.

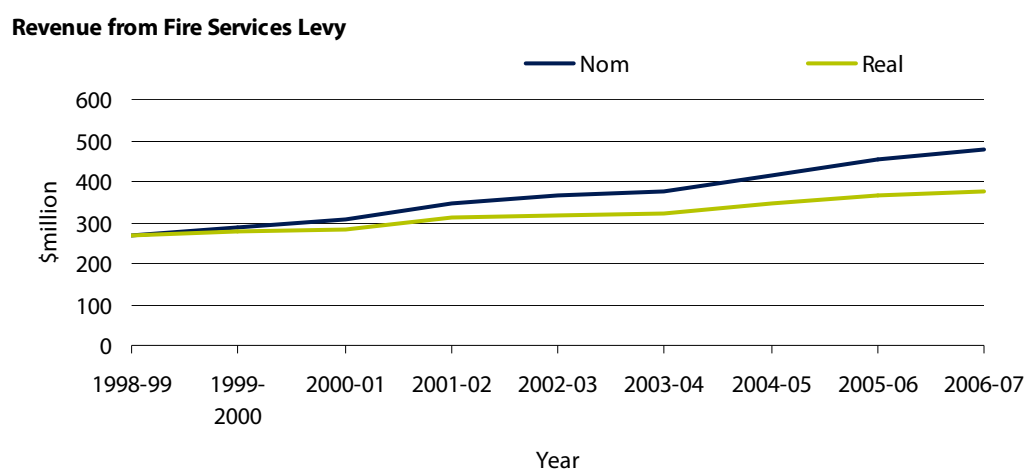
E.4.3 Revenue collected 1998/99

Table E.17 Revenue collected from Insurance Contributions to Fire Services Funding, 1998-99 to 2007-08

Year	\$m
1998-99	269
1999-00	286
2000-01	306
2001-02	347
2002-03	365
2003-04	378
2004-05	416
2005-06	454
2006-07	479
2007-08(est)	513

Source: NSW Treasury.

Figure E.4 Revenue from Fire Services Levy



E.4.4 History of rates and thresholds

The issue of replacing the fire services funding contributions with a property levy was considered by a public inquiry established by the Government. The inquiry was conducted by the Public Accounts Committee of Parliament (PAC) which included Government, Opposition and independent members of Parliament.

The inquiry reported in 2004, and found that while “...there is a clear benefit for replacing the current system with a levy on property in the residential sector”, the same could not be said about the commercial sector. The PAC was concerned that a large number of small and large businesses might be worse off under a property levy.

The PAC also reported at a time when the land tax reforms from the May 2004 Mini-Budget were proving very unpopular which made the prospect of moving to a property levy even more difficult.

In the end the PAC considered it was not prudent to introduce a new, administratively complex system for the residential sector alone and therefore recommended against a move to a property levy at that time. The Government accepted this finding of the inquiry.

The existing contribution from local government is in part funded through general property rates. As such, funding arrangements already have some elements of a property levy.

Tables E.18 and E.19 show the proportion of total contributions that insurance companies, local government and state government have made to the separate fire services over time.

Table E.18 History of contributions to NSW Fire Brigades

	Insurance companies	State Government	Local Government
1884 - 1926	33.3%	33.3%	33.3%
1927 – 1949	50.0%	25.0%	25.0%
1950 – 1989	75.0%	12.5%	12.5%
1989 - onwards	73.7%	14.0%	12.3%

Source: NSW Treasury.

Table E.19 History of contributions to Rural Fire Service

	Insurance companies	State Government	Local Government
1949 – 1994	50.0%	25.0%	25.0%
1994 – 2001-02	73.7%	14.0%	12.3%
1989 - onwards	73.7%	13.0%	13.3%

Source: NSW Treasury.

The one percentage point change in the funding balance between local government and the State Government for the Rural Fire Service in 2001-02 resulted from negotiations when staff employed by local councils transferred to the Rural Fire Service.

E.4.5 Benchmark against other states

Funding arrangements for fire services can be broken into three types:

- ▼ insurance-based levy
- ▼ property based levy
- ▼ funding from consolidated revenue.

Property based levy

Queensland and South Australia currently operate a property based levy.

Queensland's levy is based on four geographic classification levels, reflecting the standard of fire services provided in different urban localities. (Levies are not payable for areas serviced solely by the Rural Fire Brigade, although local governments may choose to levy special or separate rates and contribute amounts to Rural Fire Brigades operating in their areas). The levy is collected by local councils.

The levy is a fixed dollar amount – it does not relate to the value of the property – based on the area classification (area A is for a 24 hour fire station, Area B is for a 16 hour station, etc.), activity carried on or the use of the land and the size and nature of any improvements on the land.

In addition to the geographic localities, commercial properties have 16 risk categories. These categories reflect the risk of fire and the likely cost of providing assistance in the event of a fire.

A pensioner discount of 20 per cent is available for a pensioner's principal place of residence.

State Government land is not subject to the levy; however, the government contributes 1/7 of total fire service funding representing its notional share of the

State's property. This approach avoids the need to annually value all government land.

South Australia introduced the Emergency Services Levy (ESL) in 1999. The levy imposes a fixed \$50 charge and an amount based on the capital value of land adjusted for location (in the State) and land use (eg, residential, industrial). Unlike Queensland there is no risk weighting by industry – the only distinction is between industrial property and commercial property.

The levy varies from region to region based on the range and cost structures of services available to deal with emergencies. The levy on fixed property is collected by their State Revenue Office which issues an annual tax advice. A levy also applies to mobile property (motor vehicles, caravans etc) and is collected as part of motor vehicle registration.

The change-over to the new levy was not revenue neutral as the government sought to raise additional money to fund a new communications system for their emergency services.

The public reacted adversely to the new tax and the government responded by changing the exemptions or concessions and adding additional ones. The rates for mobile properties were reduced and abolished for some types. For example, cars were reduced by \$8, trailers and caravans were reduced by \$8 to no duty payable and boats were reduced by \$12 to no duty payable. Concessions were extended for pensioners and self-funded retirees and applied to a range of new welfare recipients.

Other changes included reducing the variable rate on properties classified as residential, commercial, rural, vacant and other, increasing the variable component on industrial properties and creating a new 'special community use' category (for hospitals, retirement villages etc.) which paid a reduced fixed charge. In addition, emergency service area boundaries were changed.

In 2001-02 the levy rates were reduced and the land use factor for industrial classified properties was increased.

Local Government properties are treated in a similar fashion to private properties. When the legislation was first introduced State Governments were required to contribute 11 per cent of the fixed property amount. This clause ceased from 1 July 2002 and government property is now treated as other private property. Their effective contribution amount has decreased, but they also make additional contributions to funding the fire services to meet the cost of the shortfall in service funding following the granting of the concessions.

Western Australia introduced a property based Emergency Services Levy (ESL) from 1 July 2003. Under the arrangements a levy is imposed on fixed properties, including commercial and industrial, based on the gross rental value (GRV) of property – which is a unique valuation system used in WA that tries to capture what the

amount of rent payable on that property would be. The levy is collected through local government rates. Councils are paid a fee for the collection of the levy.

The levy is based on service provision and gross rental value of property, with no variations for degree of risk. There are five emergency service levels. Areas 1 (Perth) to 4 (outer urban areas) will ring the metropolitan and outer urban areas, and all other areas classed as area 5.

The maximum amount payable for a residential property is \$205 and \$120,000 for commercial and industrial properties. Property in ESL Category 5 will receive a fixed ESL charge of \$38 per rateable property.

Pensioners and seniors who hold Concession Cards are entitled to the same concession rebate and deferment benefits on the levy that apply to their Local Governments Rates. Concessions also apply to Homeswest tenants (low-income tenants).

Under the arrangements the State Government pays an ESL in respect of the property that it owns. This is a lump sum payment each financial year based on the assessed value of this property by the Valuer-General and provides an ongoing subsidy to support the cost of volunteer services, particularly in rural and remote areas of the State. In addition, the ESL also applies to all property owned by Public Financial and Non-Financial Corporations (that are subject to competitive neutrality trading principles).

Local governments are no longer required to contribute their 12.5 per cent. Instead, each local government is required to contribute ESL based on its own property holdings. Local government property will therefore be assessed by the Valuer-General and a contribution will be made based on the local government's aggregate property GRV.

Consolidated revenue funding

ACT abolished its Emergency Service Levy from 1 July 2001. Emergency services are now funded from consolidated revenue.

Northern Territory does not impose a levy to fund fire services.

Insurance based levy

Victoria funds its fire services through a Fire Services Levy (which is allocated across insurance companies), and contributions from the State government and local government. Their respective contributions are:

- ▼ Melbourne Fire and Emergency Services Board: 75 per cent from insurance, 12.5 per cent from the State government, and 12.5 from local government, and

- ▼ Country Fire Authority: 77.5 per cent from insurance and 22.5 per cent from the State government (there is no contribution from local government).

Tasmania imposes a Fire Service Levy on:

- ▼ insurance companies: the rate varies from 2 per cent of the gross premium on marine and cargo insurance to 28 per cent of the gross premium on contractors risk, loss by fire insurance, etc,
- ▼ local councils: impose a minimum levy of \$31 based on an assessed annual value of properties, and
- ▼ motor vehicle registration: a flat fee of \$14 is levied on the registration of motor vehicles.

E.5 Motor vehicle taxes - Registration duty

E.5.1 Definition, base, rate and thresholds

Motor vehicle registration duty is imposed under the *Duties Act 1997*. Duty is payable upon:

- ▼ first registration of a new vehicle
- ▼ transfer of registration of a second hand vehicle.

Liability falls on the person or entity named on the registration certificate. The value for duty is the greater of the sale price or market value. The Roads and Traffic Authority collects the duty as agent for the Office of State Revenue.

The base is all transfers of registration (not necessarily ownership) of motor vehicles, including motor cycles and other vehicles that need to be registered for driving on public roads

The rates are:

- ▼ General rate: \$3 per \$100.
- ▼ Passenger vehicles over \$45,000: \$1,350 plus \$5 per \$100.

E.5.2 Exemptions and cost

Exemptions and their cost (estimated for 2007/08) are:

- ▼ Local councils \$12 million.
- ▼ Divorce or a breakdown of a de facto relationship \$2 million.
- ▼ Deceased registered owner \$7 million.
- ▼ New demonstrator motor vehicle \$44 million.
- ▼ Extreme Disablement Adjustment and other Disabled War Veterans \$2 million.

A number of smaller exemptions are listed in the Budget Papers.¹¹⁸

¹¹⁸ Refer to Budget Paper 2 – Budget Statement 2007-08, p E-14 for other minor exemptions.

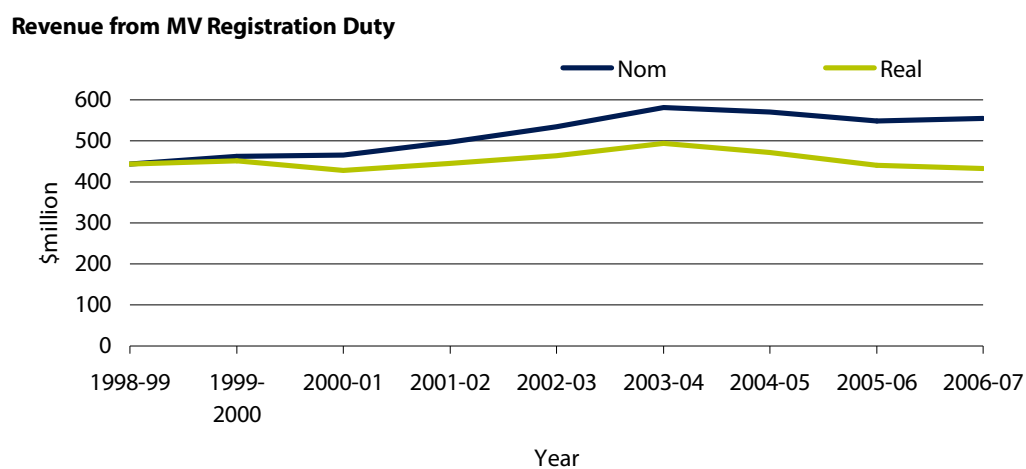
E.5.3 Revenue collected 1998-99

Table E.20 Revenue collected from Motor Vehicle registration duty from 1998-99 to 2006-07

	\$m
1998-99	444
1999-00	462
2000-01	465
2001-02	497
2002-03	534
2003-04	581
2004-05	570
2005-06	548
2006-07	554

Source: NSW Treasury.

Figure E.5 Revenue from MV Registration Duty



E.5.4 History of rates and thresholds

The last change was in the 1997-98 Budget when the marginal rate of 5 per cent was introduced for passenger vehicles exceeding \$45,000.

E.5.5 Benchmark against other states

Table E.21 Motor vehicle registration duty by State

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
MOTOR VEHICLE REGISTRATION DUTY (Based on the dutiable value of the vehicle being the greater of the consideration given or the market value of vehicle)	<p>\$3.00 per \$100, or part, except for</p> <p>Passenger Vehicles*</p> <p>\$1,350+\$5.00 per \$100, or part, of the dutiable value of the motor vehicle in excess of \$45,000.</p> <p>* a vehicle:</p> <p>a) with a dutiable value of not less than \$45,000, and</p> <p>b) that is constructed primarily for the carriage of not more than 9 occupants, including a sedan, station wagon, coupe, convertible,</p>	<p>Passenger Vehicles</p> <p>\$0-\$57,009:</p> <p>\$5.00 per \$200 or part.</p> <p>Over \$57,010:</p> <p>\$10.00 per \$200 or part.</p> <p>Other Vehicles (Including Non Passenger)</p> <p>\$5.00 per \$200 or part.</p> <p>Previously Registered Vehicles</p> <p>\$8.00 per \$200 or part.</p>	<p>From 1 January 2008</p> <p>1 to 4 cylinders or 2 rotors or steam vehicles: 3.0%</p> <p>5 or 6 cylinders or 3 rotors: 3.5%</p> <p>7 or more cylinders: 4.0%</p> <p>Hybrid/Electric: 2.0%</p> <p>Special vehicles (as defined)</p> <p>Flat rate of \$25</p>	<p>New and Used Heavy Vehicles</p> <p>3.0%</p> <p>Max duty \$12,000</p> <p>Other Vehicles</p> <p>\$0-\$20,000: 2.75%</p> <p>\$20,001-\$45,000: 2.75%-6.50%</p> <p>Over \$45,000: 6.50% flat.</p> <p>*There is a sliding rate scale between \$20,000 and 45,000.</p> <p>All (upper and lower) thresholds will increase by \$5,000 from 1 January 2009.</p>	<p>\$0-\$1,000: \$1 per \$100 (min \$5) or part \$100.</p> <p>\$1,001-\$2,000: \$10+\$2 per \$100 or part \$100 above \$1,000.</p> <p>\$2,001-\$3,000: \$30+\$3 per \$100 or part \$100 above \$2,000.</p> <p>Over \$3,000: \$60+\$4 per \$100 or part \$100 above \$3,000.</p> <p>Except for commercial vehicles where the rate is:</p> <p>0-\$1,000: \$1 per \$100 (min \$5) or part</p>	<p>Passenger vehicles</p> <p>Under \$600: \$20.00</p> <p>\$600-\$34,999: \$3.00 per \$100 or part.</p> <p>\$35,000-\$40,000: \$1,050+\$11 per \$100 or part in excess of \$35,000.</p> <p>Over \$40,000: \$4.00 for each \$100 or part of \$100 of the value of the vehicle.</p> <p>Vehicles subject to manufacturers fleet discount</p> <p>\$3.50 per \$100</p>	<p>\$3.00 per \$100 or part.</p>	<p>Passenger Vehicles</p> <p>Under \$45,000: \$3.00 per \$100 or part thereof.</p> <p>\$45,000 or over: \$1,350+\$5 for each \$100 or part thereof in excess of \$45,000.</p> <p>All Other Vehicles</p> <p>\$3.00 per \$100 or part thereof.</p>

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
	four wheel drive vehicle with seats and windows, two wheel drive panel van with seats and windows, three wheel car, forward control vehicle				\$100.	Heavy Vehicles		
	passenger vehicle, small bus (seating not more than 9 persons, including the driver), motor home, and snow vehicle, but not including:				\$1,001-\$2,000:	Under \$600: \$20.00		
	a motor cycle (with or without a side car), large bus (seating more than 9 persons, including a driver), hearse or invalid conveyance.				\$10+\$2 per \$100 or part \$100 above \$1,000.	Over \$600: 1 July – 30 September 2007 \$3.00 per \$100 or part.		
					Over \$2,000: \$30+ \$3 per \$100 or part \$100 above \$2,000.	1 October 2007 onward \$1.00 per \$100 or part.		
						(as stated in 2007-08 Budget Papers)		
						All Other Vehicles		
						Under \$600: \$20.00		
						Over \$600: \$3.00 per \$100 or part.		

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-2.

E.6 Motor vehicle – weight tax

E.6.1 Definition, base, rate and thresholds

The Motor Vehicle Weight tax is paid annually on all registered 'light' vehicles with different tare¹¹⁹ weight categories for business and private use. Motor vehicles of more than 4.5 tonnes gross vehicle mass (GVM) pay uniform rates under the National Heavy Vehicle Charging Regime according to GVM, number of axles, body type and trailer use. The Weight Tax is imposed under the *Motor Vehicle Taxation Act 1988* and *Road Transport (Heavy Vehicle Registration Charges) Act 1995*.

Weight tax is hypothecated to the RTA Roads program.

The base for the weight tax is the stock of vehicles registered in New South Wales for driving on public roads. The rates applied are shown in Table E.22 and are indexed each year by the CPI.

Table E.22 Weight tax categories for light vehicles under the *Motor Vehicle Taxation Act 1988*

Size of vehicle	Tare Weight	Private	Business
Cars, station wagons and trucks			
	up to 975kg	\$213	\$313
	976kg to 1154 kg	\$233	\$345
	1155kg to 1504kg	\$262	\$394
	1505kg to 2504kg	\$373	\$568
Trailers (including caravans)			
	up to 254kg	\$51	\$130
	255kg to 764kg	\$140	\$195
	765kg to 975kg	\$213	\$313
	976kg to 1154kg	\$233	\$345
	1155kg to 1504kg	\$262	\$394
	1505kg to 2499kg	\$373	\$568
Motor cycles	Fixed \$50		

Note: Rates apply from 1 January 2007.

Source: RTA.

¹¹⁹ Tare weight is used under the *Motor Vehicle Taxation Act 1988* which refers to unladen mass. GVM is the measure used under the national charging regime which is the unladen mass of the vehicle plus the capacity of the vehicle.

E.6.2 Exemptions and cost

Table E.23 Exemptions and the estimate of their cost (2007-08)

	\$m
Selected social security recipients	141
Primary producers	20
General purpose plant	18
Roadwork equipment – owned by local government	5
Federal government authorities	2
Concessions provided under Part 16 and 17 of the <i>Motor Vehicle Taxation Act 1988</i>	2
Apprentice Incentive – Small Business Work Vehicle Rebate	4

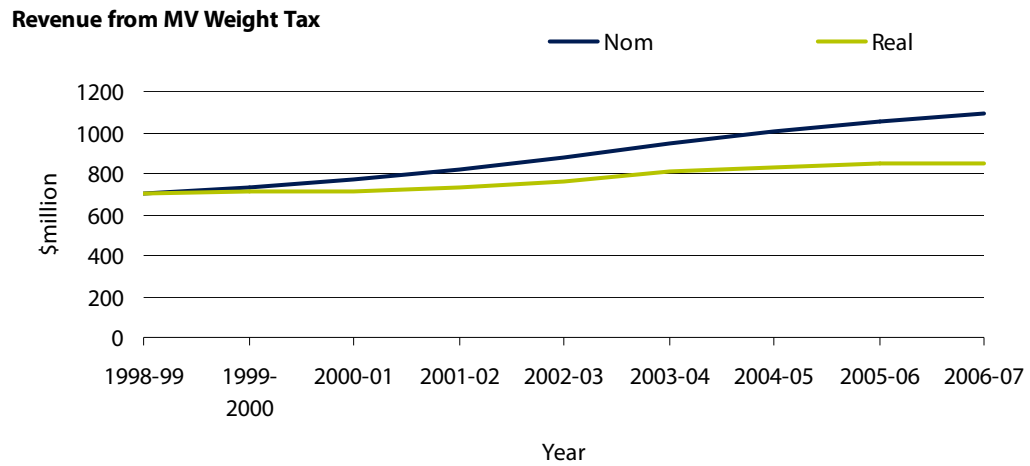
Source: NSW Treasury.

E.6.3 Revenue collected 1998/99 to 2006/07

Table E.24 Revenue collected from Motor Vehicle Weight Tax 1998-99 to 2007-08

	\$m
1998-99	698
1999-00	728
2000-01	769
2001-02	816
2002-03	881
2003-04	948
2004-05	1,003
2005-06	1,057
2006-07	1,090
2007-08(est)	1,176

Source: NSW Treasury.

Figure E.6 Revenue from MV Weight Tax

E.6.4 History of rates and thresholds

National Heavy Vehicle charging Regime introduced in 1996.

Indexation of light vehicle weight tax from 1 January 1997.

E.6.5 Benchmark against other states

Some states apply annual motor vehicle taxes on the basis of engine capacity or number of cylinders as shown in Table E.25.

Table E.25 Motor Vehicle Taxes

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Fee Implementation Date:	Effective from 1 July 2007.	Effective from 1 July 2007.	Effective from 1 July 2007.	Effective from 1 July 2007.	Effective from 1 July 2007.	Effective from 1 July 2007..		Effective from 1 July 2006.
MOTOR VEHICLE TAX (charged annually, unless stated otherwise, on the basis of vehicle weight, or engine capacity or number of cylinders and the number of axles for heavy vehicles)	Based on Vehicle Tare Weight with Gross Vehicle Mass (GVM).	Victorian registration fees are based on Mass Rating Charges and are not classified by the intended use of the vehicle (i.e. private or business use).	Based on the number of cylinders for passenger vehicles: 1 July 2007.	Based on vehicle type and tare (unladen) weight with Gross Vehicle Mass (GVM).	Registration fees are not levied by the intended use of the vehicle. Fees for Non Commercial vehicles (sedans etc.) with a GVM of 4,500kgs or less, is based on the number of cylinders. Fees for Commercial vehicles with an unladen mass of 1,000kgs or less are based on the number of cylinders. For vehicles with an unladen mass exceeding 1,000kg but with a GVM of 4,500kg or less, the fee is calculated	Based on the number of cylinders or vehicle weight. Effective 1 July 2007. Pensioners and farmers may be entitled to a 40% rebate on motor tax for Class A vehicles and other light vehicles.	Based on engine capacity.	Based on vehicle type and tare (unladen) weight. Road Rescue Fee for the grant or renewal of registration annual fee-payable for any motor vehicle other than a veteran, vintage or historical vehicle and vehicles registered to Jervis Bay residents. Annual Fee: \$16.00
(not Heavy Vehicles)		From 1 January 1996 Light Vehicles (motor vehicles with Mass Rating for Charges [MRC] not exceeding 4.5 tonne) and not otherwise entitled to be registered for a lesser fee (various exemptions): Flat Fee: \$172.80						

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
					according to the unladen mass.			
Motor Vehicles	0-975Kg:	Flat Fee:	No. of Cylinders	\$15.46 per	For passenger	As at 1 July 2007	Engine Size	For a passenger
Private:	\$162.00	\$168.60	1,2 & 3:	100kg.	carrying	3 cyl. or less:	Less than or	and goods
(not Heavy Vehicles)	976-1154Kg:		\$163.95	Discount for the	vehicles the fee	\$93.00	equal to 4	carrying vehicle
	\$182.00		4: \$208.55	registration of	is based on the	4 cyl.:	cylinders	with a GVM not
	1155-1504Kg:		5 & 6:	'Family' vehicles	number of	\$109.00	0-500:	exceeding 4.5
	\$211.00		\$320.50	\$58.00 for 12-	cylinders.	5 or 6 cyl.:	\$15.00	tonnes, where
	1505-2504Kg:		7 & 8:	month period or	to 4 cyl.:	\$136.00	501-1000:	the vehicle
	\$322.00		\$448.80	\$29.00 for a 6-	\$92.00	7 or 8 cyl.:	\$30.00	weighs
			9-12: \$526.40	month period.	5 to 6 cyl.:	\$187.00	1001-1500:	<i>For Business Use</i>
					\$186.00	Over 8 cyl.:	\$48.00	975kg or
					7 and over:	\$210.00	1501-2000:	less:\$298.00
			No. of Rotors		\$271.00	Rotary or	\$64.00	976-1154:
			2: \$208.55		Rotary or	electric:	2001-3000:	\$330.00
			3: \$320.50		electric:	\$109.00	\$70.00	1155-1504:
					\$92.00		Greater than 4	\$380.00
							cylinders	1505-4500:
							2001-2500:	\$556.00
							\$90.00	<i>For Private Use</i>
							2501-3000	975kg or
							\$108.00	less:\$197.00
							3001-3500:	976-1154:
							\$133.00	\$218.00
							3501-4000:	1155-1504:
							\$152.00	\$247.00
							4001-4500:	1505-2504:
							\$180.00	\$359.00
							4501-5000:	2505-2794:
							\$200.00	\$547.00
							5001-5500:	2795-4500:

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
							\$231.00	\$556.00
							5501-6000: \$252.00	Examination or Inspection of Vehicles
							6001-7000: \$294.00	Trailers not exceeding 4.5 tonnes GVM: \$28.60*
							7001-8000: \$301.60	Motor Cycles: \$38.40*
								Motor Vehicles not exceeding 4.5 tonnes GVM: \$38.40*
								Trailers exceeding 4.5 tonnes GVM: \$69.60*
								Motor Vehicles exceeding 4.5 tonnes GVM: \$114.00*
								Follow up inspections all vehicles: \$12.30
								* Includes GST.
Motor Vehicles Business:	0-975kg: \$262.00	Flat Fee: \$168.60	Registration fee as for private	Standard Vehicles	Light Commercial	Trailer with GVM of 4.5	Registration fee as for private	Registration of Vehicles.

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
(not Heavy Vehicles)	976-1154kg: \$294.00 1155-1504kg: \$343.00 1505-2504kg: \$517.00 The rate varies in many steps up to \$1,501 at 4,500kg.		motor vehicles.	Motor Car \$15.46 per 100kg tare weight. Motor Wagon \$15.46 per 100kg tare weight.	Vehicles (i.e. do not have a GVM or GCM greater than 4,500 kg). <i>Based on number of cylinders for vehicles with a Tare Mass not exceeding 1,000 kg</i> 1 to 4 cyl.: \$92.00 5 to 6 cyl.: \$186.00 7 and over: \$271.00 Rotary or electric: \$92.00 <i>Based on Tare Mass for vehicles over 1,000 kg</i> 1001-1500kg: \$202.00 >1500kg: \$344.00	tonnes or less: \$20 Tractors (non- agricultural): \$105 Tractors (agricultural): exempt <i>As at 1 October 2007</i> 3 cyl. or less: \$74.00 4 cyl.: \$86.00 5 or 6 cyl.: \$108.00 7 or 8 cyl.: \$148.00 Over 8 cyl.: \$166.00 Rotary or electric: \$86.00 Trailer with GVM of 4.5 tonnes or less: \$20 Tractors (non-agricultura l): \$83 Tractors (agricultural):	motor vehicles.	Fixed Load Trailer 250kg or less: \$55.10 251-764: \$140.00 765-975: \$214.00 976-1154: \$235.00 1155-1504: \$264.00 1505-2499: \$376.00 2500-2504: \$575.00 2505-2794: \$907.00 2795-3054: \$1,025.00 3054-3304: \$1,118.00 3305-3564: \$1,210.00 3565-3814: \$1,296.00 3815-4064: \$1,391.00 4065-4324: \$1,479.00

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
						exempt		4325-4500: \$1,572.00
						Other Light Vehicles		
						<i>As at 1 July 2007</i>		Motor Tractors 2000kg or less: \$109.00
						A truck with a GVM of 3.0 tonne or more:		2001-4000: \$182.00
								4000 & over: \$414.00
						4: \$210.00		
						5 to 6: \$244.00		Motor Implements
						7 to 8: \$279.00		975kg or less: \$81.10
						>8: \$315.00		976-1154: \$85.20
						A bus with 10 adult seats including the driver's seat: \$139.00		1155-1504: \$90.40
								1505-4500: \$111.00
Motor Vehicles Business: (continued)						A bus with more than 10 adult seats including the driver's seat: \$244.00		
(not Heavy Vehicles)						<i>From 1 October 2007</i>		

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
						<p>A truck with a GVM of 3.0 tonne or more:</p> <p>4: \$166.00</p> <p>5 to 6: \$193.00</p> <p>7 to 8: \$221.00</p> <p>>8: \$249.00</p> <p>A bus with 10 adult seats including the driver's seat: \$110.00</p> <p>A bus with more than 10 adult seats including the driver's seat: \$193.00</p>		
Heavy Vehicles:	<p>Motor Vehicles of more than 4.5 tonnes GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>The National Heavy Vehicle Charging Regime applies, where the various rates are</p>	<p>Motor vehicles of more than 4.5 tonne GVM:</p> <p>(Gross vehicle mass over 4.5 tonnes) are charged according to the <i>Road Transport</i></p>

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
	based on Gross Vehicle Mass, number of axles, body type and trailer use. An additional bridge levy of \$122.00 applies to Omnibus, Tourist vehicles and Coaches with a tare weight of 3,565kg upwards.	based on Gross Vehicle Mass, number of axles, body type and trailer use. where they are not otherwise entitled to be registered for a lesser fee, i.e. primary producers.)	based on Gross Vehicle Mass, number of axles, body type and trailer use.	based on Gross Vehicle Mass, number of axles, body type and trailer use.	based on Gross Vehicle Mass, number of axles, body type and trailer use.	based on Gross Vehicle Mass, number of axles, body type and trailer use.	based on Gross Vehicle Mass, number of axles, body type and trailer use.	<i>Charges (Australian Capital Territory) Act 1993.</i> These are nationally agreed charges.
Motor Cycles:	Flat Tax: \$48.00 (Weight Tax)	Flat Tax: \$34.60	Flat Tax: \$70.45	Up to 250cc: \$30.95 Over 250cc: \$46.42	Flat tax: \$31.00	As at 1 July 2007 Flat tax: \$15.00 <i>From 1 October 2007</i> Flat tax: \$12.00	Up to 600cc: \$10.00 Over 600cc: \$15.00	Up to 100cc: \$83.20 Over 100cc: \$83.20

Source: NSW Treasury, *Interstate Comparison of Taxes* 2007-08, TRP07-2.

E.7 Parking Space Levy

E.7.1 Definition, base, rate and thresholds

The Parking Space Levy is imposed under the *Parking Space Levy Act 1992* and the *Parking Space Levy Regulation 1997*.

The Parking Space Levy is applied to liable parking spaces in Sydney, North Sydney, Milsons Point, Bondi Junction, Chatswood, Parramatta, St Leonards.

The levy was introduced to discourage car use in business districts by imposing a levy on off-street commercial and office parking spaces in certain areas. The levy is used to develop public transport infrastructure.

The base is all parking spaces (excluding those that qualify for an exemption) in Sydney, North Sydney, Milsons Point, Bondi Junction, Chatswood, Parramatta, St Leonards. The levy is imposed at the following rates:

- ▼ \$460 for parking spaces in Bondi Junction, Chatswood, Parramatta and St Leonards
- ▼ \$930 for parking spaces in Sydney, North Sydney and Milsons Point.

E.7.2 Exemptions and cost

Exemptions apply to parking spaces set aside or used exclusively for one or more of the following:

- ▼ parking of a bicycle or motorcycle
- ▼ parking of a motor vehicle by a person resident on the same premises as those on which the space is located or on adjoining premises
- ▼ parking of a motor vehicle for the purpose of loading or unloading goods or passengers to or from the vehicle
- ▼ parking of a motor vehicle by a person who is providing services on a casual basis on the premises where the space is located
- ▼ parking of a motor vehicle while a disabled person's parking authority is displayed on the vehicle in the manner specified by the authority, the conditions specified in the authority are being observed and the authority is in force
- ▼ parking without charge of a motor vehicle on premises owned or occupied by the council of the local government area in which the premises are situated by a person other than an officer or employee of the council

- ▼ parking without charge of a motor vehicle on premises owned or occupied by a religious body or religious organisation, being a religious body or religious organisation in respect of which a proclamation is in force under section 26 of the *Marriage Act 1961* of the Commonwealth or religious body within a denomination in respect of which such a proclamation is in force
- ▼ parking without charge of a motor vehicle on premises owned or occupied by a public charity or public benevolent organisation
- ▼ parking without charge of an ambulance, fire brigade or police motor vehicle, if the space is the one used for garaging the vehicle overnight
- ▼ the parking without charge of a mobile crane, a forklift truck, a tractor or front-end loader
- ▼ parking without charge of a vehicle which is used only for carrying out deliveries or only for the provision of services, if the parking space is the one used for garaging the vehicle overnight on premises owned or occupied by the owner of that vehicle.

As well there are extra exemptions for parking spaces in Bondi Junction, Chatswood, Parramatta and St Leonards for parking spaces set aside for or used exclusively for, the parking of a motor vehicle:

- a) by customers of a retail shop or
- b) by guests or customers of a hotel or motel, or
- c) by members and guests of a registered club, or
- d) by customers of a restaurant, or
- e) by patients of a medical centre, or
- f) by customers of a car sales establishment, car servicing or repair centre, or car wash, or
- g) by clients and guests of a funeral parlour, or
- h) displayed or stored on the premises for the purpose of its being offered for sale or hire on the premises.

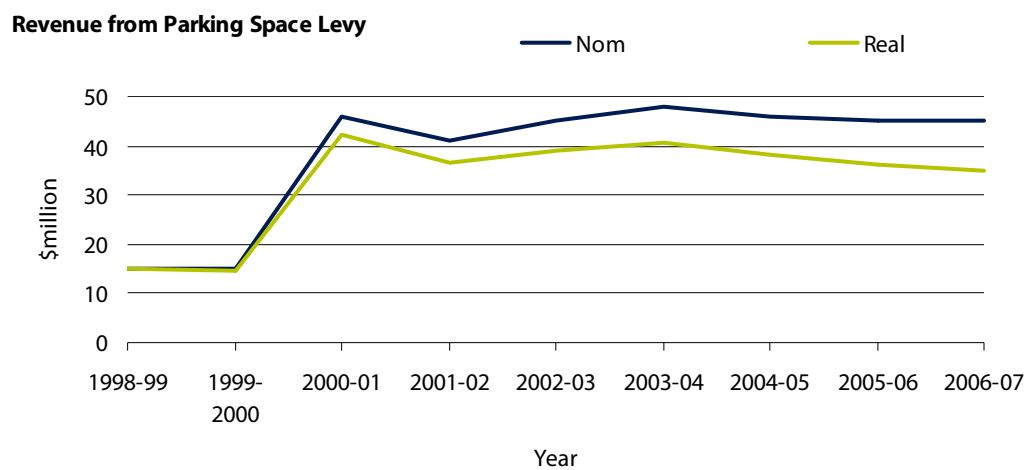
E.7.3 Revenue collected 1998-99

Table E.26 Revenue collected from Parking Space Levy 1998-99 to 2007-08

	\$m
1998-99	15
1999-00	15
2000-01	46
2001-02	41
2002-03	45
2003-04	48
2004-05	46
2005-06	45
2006-07	45
2007-08(est)	45

Source: NSW Treasury.

Figure E.7 Revenue from Parking Space Levy



E.7.4 History of rates and thresholds

The levy was introduced in 1992 to discourage car use in business districts by imposing a levy on off-street commercial and office parking spaces, including parking spaces in parking stations.

The revenue is directly used to finance, develop and maintain infrastructure that facilitates access to and encourages the use of public transport to and from the business districts where the levy applies. Funding for the infrastructure is administered by the Department of Transport through the Public Transport Fund.

The levy was originally set at \$200-per-space in the City of Sydney, Milsons Point, and North Sydney. From 1 July 1997, the levy was increased to \$400-per-space.

In the 2000-01 Budget, the Act was amended to increase the amount of the levy from \$400 to \$800-per-space for the City of Sydney, Milsons Point, and North Sydney. In addition, the area coverage was extended to include the central business areas of St Leonards, Chatswood, Parramatta and Bondi Junction. The levy for these 4 new areas was set at \$400-per-space.

From 2004-05, the levy has been indexed annually to movements in the Sydney CPI over the year to the previous March quarter.

E.7.5 Benchmark against other states

Table E.27 Comparison of Parking Space Levy by State

NSW	Victoria	Western Australia
\$460 for parking spaces in Bondi Junction, Chatswood, Parramatta and St Leonards	Parking Space Levy of \$800 in 2007 applied in CBD grid and adjacent areas including Southbank, Docklands and St Kilda Road precinct.	\$205 pa for long stay non-residential parking within the prescribed Perth city area.
\$930 for parking spaces in Sydney, North Sydney and Milsons Point.		\$169 per bay for short stay public parking.
		\$84.75 per bay for motor cycle parking.

Source: NSW Treasury.

E.8 Insurance taxes

E.8.1 Definition, base, rate and thresholds

Duty is imposed under the *Duties Act 1997* on the amount of GST-inclusive premium paid for general insurance policies, ie, the total consideration given to an insurer by or on behalf of the insured without deduction for commission or discount to an insurance intermediary. Duty is only payable on risks located in NSW.

Life insurance duty makes up a small component of insurance duty at about \$19.7 million for 2007-08.

Proportions of duty revenue from different categories other than FSL (see schedules for descriptions):

- ▼ Type A – 69 per cent.
- ▼ Type B (concessional) – 27 per cent.
- ▼ Type C (concessional) – 0.4 per cent.
- ▼ Life insurance – 3 per cent.

Base Any receipt (or payment in some circumstances) of monies for insurance covering risks in the state of NSW.

Rate

General insurance

- ▼ Type A: 9 per cent.
- ▼ Type B: concessional rate of 5 per cent.
- ▼ Type C: concessional rate of 2.5 per cent.

Life insurance

- ▼ **Policies of life insurance**, other than a temporary or term insurance policy or disability income insurance duty is calculated at:
 - a) \$1 on the first \$2,000, or part of \$2,000, of the sum insured; and
 - b) 20 cents for every \$200, or part of \$200, in excess of the first \$2,000.
- ▼ **Temporary or term insurance policies**, other than a group term policy Duty is calculated at 5 per cent of the first year's premium on the policy.
- ▼ **Group term insurance policies** Duty is calculated on
 - a) 5 per cent of the first years premium on the policy and
 - b) 5 per cent of the amount of the premium (if any) payable in any succeeding year in respect of each additional life covered by the insurance policy (that is, each life that was not covered during the previous year)

- ▼ **Life insurance riders** Duty is calculated at 5 per cent of the first year's premium on the life insurance rider.
- ▼ **Disability income insurance** Duty is calculated at 5 per cent of the premium paid to effect the insurance.

Threshold No threshold for duty applying to general insurance

E.8.2 Exemptions and cost

Exemptions and the estimate of their costs are:

- ▼ Motor vehicle, aviation, disability income, occupational indemnity (all at a concessional 5 per cent) and crop and livestock (at a concessional 2.5 per cent) \$142 million.
- ▼ Third party motor vehicle insurance \$150 million.
- ▼ Marine and cargo insurance \$20 million.
- ▼ WorkCover premiums \$198 million.

A number of smaller exemptions are listed in the Budget Papers.¹²⁰

The following types of insurance are exempt from insurance duty from 1 September 2005:

- ▼ compulsory third party for motor vehicles
- ▼ goods freight insurance by road, sea, air
- ▼ hospital & medical benefits insurance
- ▼ insurance take out by registered charities
- ▼ life insurance under annuities & superannuation plans
- ▼ mortgages or pools of mortgages
- ▼ workers compensation insurance.

¹²⁰ Refer to Budget Paper 2 – Budget Statement 2007-08, p E-8 for other minor exemptions.

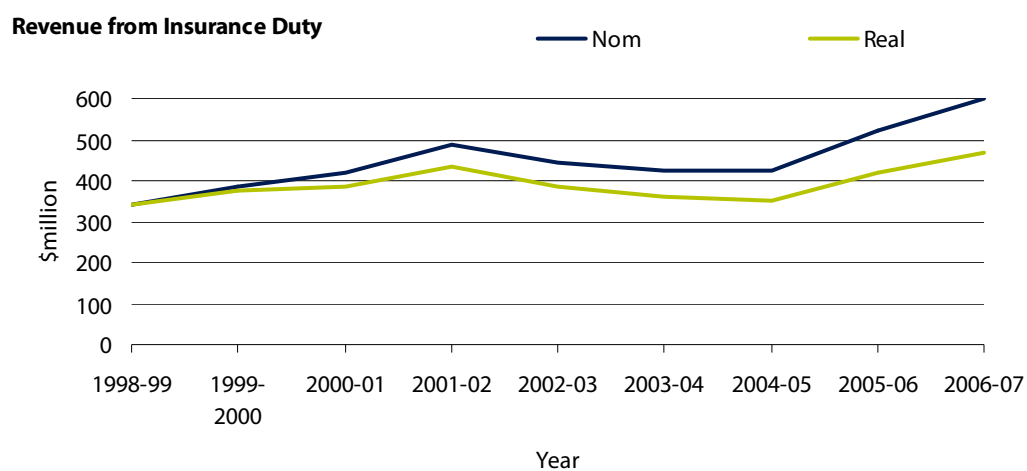
E.8.3 Revenue collected 1998-99

Table E.28 Revenue collected from Insurance Duty, 1998-99 to 2007-08

	\$m
1998-99	340
1999-00	383
2000-01	419
2001-02	487
2002-03	442
2003-04	423
2004-05	423
2005-06	523
2006-07	598
2007-08(est)	616

Source: NSW Treasury.

Figure E.8 Revenue from Insurance Duty



Data source: NSW Treasury.

E.8.4 History of rates and thresholds

Changes have generally been aimed at moving the Type A insurance duty rate, as follows:

- ▼ New contracts from 23 May 2000 – rate reduced from 11.5 per cent to 10 per cent.
- ▼ New and renewal of contracts from 1 August 2002 – rate reduced to 5 per cent.
- ▼ New and renewal of contracts from 1 September 2005 – rate increased to 9 per cent.

An attempt at harmonising life insurance duty across states with a change in the base to the sum insured occurred about 4 years ago but there hasn't been anything on this front since.

E.8.5 Benchmark against other states

Note that most states apart from Victoria and Tasmania have replaced the fire services contribution from the insurance industry with a property levy. As such the duty rate has a greater impact in New South Wales than if the same rate was applied in one of the jurisdictions without insurance contributions to the fire services. Of course this is dependent on the effect of market dynamics in each State and the extent that insurance companies absorb the cost of contributing to the fire services and do not pass this onto policyholders.

Table E.29 Insurance Duty Rates

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
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 compulsory 3rd party premiums).	8% of premiums. \$6 flat on 3rd party motor vehicle insurance..	10% of premiums (including indemnity insurance).	10% of gross premium.

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Exemptions: Annuities, workers compensation, compulsory 3rd party motor vehicle personal injury insurance, marine insurance, cargo insurance, insurance taken out by or on behalf of certain non-profit organisations, and medical benefit insurance.	Exemptions: No duty on workers compensation, insurance for hospital or medical benefits; goods and merchandise, or the freight thereof, carried by land, sea and air; hulls of floating commercial vessels; and damage by hail to cereal or fruit crops.	Exemptions: Insurance premiums for hull of commercial vessel, goods in transit, health insurance and reinsurance between insurers. Premiums paid for policies of public liability insurance by "not for profit organisations" (note that exemption is provided under an administrative arrangement	Exemptions: Policies covering transport of goods, commercial marine hulls, health insurance, workers' compensation insurance and life insurance.	Exemptions: No duty on workers compensation, commercial marine insurance, private guarantee fidelity insurance and policy of insurance by a registered medical benefits organisation	Exemptions: No duty on workers compensation. No duty on public liability insurance. Mortgage: 2% of the premium on the policy. \$20 is chargeable on an annuity issued by a life company, or purchased by a person from a life company	Exemptions: Policies covering workers compensation, transport of goods & commercial marine hulls exempt.	Exemptions: Amateur sporting and community not-for-profit bodies exempt from duty on public liability insurance and other prescribed general insurance required to hold a public event. No duty on workers compensation, compulsory 3rd party motor vehicle personal injury insurance, health insurance and international trade insurance

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-2.

E.9 Gambling taxes – Gaming machine tax (Clubs)

E.9.1 Definition, base, rate and thresholds

Club gaming machine tax is levied on the registered clubs under the *Gaming Machine Tax Act 2001* and *Tax Administration Act 1996* on revenue (player loss) from gaming machines. Clubs are liable to pay duty quarterly. Revenue is received in September, December, March and June.

Base Money wagered on gaming machines in registered clubs.

The threshold for payment of the Gaming Machine Duty has been machine revenue of \$200,000. From 2007-08 this threshold has been increased to \$1,000,000. For clubs earning gaming revenue above \$1,000,000 a year from 1 September 2007 the benefit of the tax-free threshold in the \$200,000 to \$1,000,000 revenue range will be withdrawn dollar for dollar as gaming revenue exceeds \$1,000,000, with complete withdrawal when revenue reaches \$1,800,000.¹²¹

Table E.30 Rates for Club Gaming Machine Duty from 1 September (%)

	Up to 200,000	200,001 to 1,000,000	1,000,001 to 5,000,000 ^a	5,000,001 to 10,000,000	10,000,001 to 20,000,000	Above 20,000,000
2004	0.0	10.8	18.3	19.7	20.4	20.4
2005	0.0	10.7	19.4	22.3	23.7	23.7
2006	0.0	10.0	21.0	25.5	27.7	27.7
2007	0.0	10.0	21.0	26.0	29.0	30.9
2008	0.0	10.0 ^b	21.0	26.0	29.0	30.9
2009	0.0	10.0	21.0	26.0	29.0	30.9
2010	0.0	10.0	21.0	26.0	29.0	30.9
2011	0.0	10.0	21.0	26.0	29.0	30.9

^a For gaming profits higher than \$1 million, rates shown are before the 1.5 percentage point Community Development and Support Expenditure (CDSE) Scheme tax rate reduction. Under the CDSE, the top marginal tax rate for clubs is reduced by 1.5 percentage points if clubs contribute 1.5 per cent of gaming revenues in excess of \$1 million to eligible community projects.

^b Clubs earning between \$200,000 and \$1 million will pay no tax from 2007-08. Clubs earning between \$1 million and \$1.8 million will have the benefit of the threshold phased-out.

Source: NSW Treasury.

¹²¹ NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-2, p 60.

E.9.2 Exemptions and cost

- ▼ The CDSE provides for a reduction in the top marginal duty rate of 1.5 percentage points if clubs contribute 1.5 per cent of their revenues in excess of \$1 million to eligible community projects. The scheme allows clubs to fund local community projects (including a proportion to fund club refurbishment) instead of paying a higher tax rate. The Scheme was introduced on 1 February 1998. This Scheme reduced the duty payable by \$39.8m in 2005-06. However, it is not reported in the budget as a tax expenditure.
- ▼ NSW club gaming rates are much less than those of NSW hotels. This in effect provides a tax concession to the club industry (relative to the hotel industry) – 2007-08 cost is \$484 million.

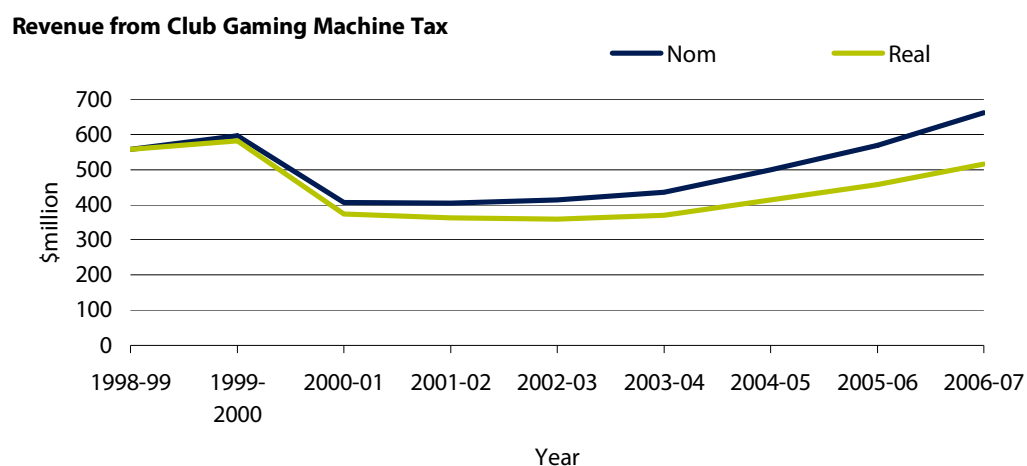
E.9.3 Revenue collected 1998/99 to 2007-08

Table E.31 Revenue collected from Club Gaming Device Duty, 1998-99 to 2007-08

	\$m
1998-99	557
1999-00	596
2000-01	406
2001-02	404
2002-03	414
2003-04	435
2004-05	500
2005-06	569
2006-07	660
2007-08(est)	623

Source: Various NSW Treasury Budget papers.

Figure E.9 Revenue from Club Gaming Machine Tax



E.9.4 History of rates and thresholds

- ▼ Until 1 December 1990, annual licence fees were payable by registered clubs on a per machine basis and a net revenue basis. The tax per machine varied according to the denomination of the machine and the number of machines operated by the club.
- ▼ From 1 December 1990, the tax was based on the profit from the machines.
- ▼ From 1 March 1997 a new marginal tax rate of 24.75 per cent on profits (player loss) above \$2.5 million was introduced. Previously, profits above this amount were taxed at 22.5 per cent. In addition, tax rates were reduced for smaller clubs, with the first \$100,000 of annual profits exempt from duty and the marginal rate of tax on profits between \$100,000 and \$200,000 reduced from 22.5 per cent to 1 per cent.
- ▼ In the 1997-98 Budget, the tax rates were proposed to change from 1 September 1997. Tax rates on profits greater than \$1 million were set to increase from 22.5 per cent to 30 per cent, whilst the tax rates on profits greater than \$2.5 million were set to increase from 24.75 per cent to 30 per cent.
- ▼ On 18 June 1997 the Government announced the deferral of the increase announced in the 1997/98 Budget from 1 September 1997 to 1 February 1998. On 20 February 1998 new tax rates were announced, replacing the tax rates announced in the 1997/98 Budget.
- ▼ As part of the introduction of the GST, NSW gambling tax arrangements needed to be adjusted to take account of the impact of the GST. As such, club gaming tax rates were reduced.
- ▼ However, it was not possible to effect a full GST offset by adjusting State duty rates, as the tax rate for the first \$200,000 of gaming revenue is zero. In recognition of this, the State Government paid \$68 million up-front to the clubs and was reimbursed by the Federal Government over four years. While the GST rebate was intended to be a one-off payment to assist clubs to adjust to the GST, the Government obtained the agreement of the Federal Treasurer to continue to fund GST rebates for clubs while NSW was under the Commonwealth guarantee. All clubs will continue to benefit from GST rebates on the first \$200,000 of gaming revenue from 2004-05 onwards.
- ▼ In the 2003-04 Budget, club gaming tax rates were increased from 2004-05, the beginning of new tax rates to be phased in over 7 years. These rates were maintained until the Government entered into a Memorandum of Understanding (MoU) in March 2006 covering the period to 2011 which reduced the club gaming tax rates to a lower level, but were still higher than the rates that applied before the 2003-04 Budget.

E.9.5 Benchmark against other states

Table E.32 Club Gaming Machine Tax by State

NSW	VIC	QLD	WA	SA	TAS	NT	ACT
From 1 September 2007	24.24% of gross profit (equates to player loss or gross margin of operator).	Based on monthly metered win (i.e. amount bet less payout to players). <u>Monthly Metered Win</u>	No gaming machines	Tax based on annual net gambling revenue in a financial year.	Tax based on annual net gambling revenue in a financial year.	Based on monthly gross profits:	Tax is levied on gross monthly gaming machine revenue (<u>player loss</u>) as follows:
Up to \$200,000: 0.0%		\$0-\$9,500: 0.0%		\$0-\$75,000: Nil		\$0-\$5,000: 12.91%	<\$15,000: 0.0%
\$200,001-\$1m: 0%/10.00%		\$9,501-\$75,000: 17.91%		\$75,001-\$399,000: 21% of excess.	<\$35m: 20.88%	\$5,001-\$50,000: 22.91%	\$15,000<\$25,000: 15%
(the tax free threshold is passed out where revenue is above \$1 million.		\$75,001-\$150,000:		\$399,001-\$945,000:	≥\$35m: 25.88%	\$50,001-\$150,000: 32.91%	\$25,000<\$50,000: 17%
\$1m-\$5m: 21.00%		20.91%		\$68,040+28.5% of excess.	In addition, a community support levy of 4% of gross profit is levied.	>\$150,000: 42.91%	>\$50,000: 21%
\$5m-\$10m: 26.00%		\$150,001-\$300,000:		\$945,001-\$1.5m: \$223,650+30.91% of excess.			Unlawful: 100%
\$10m - \$20m: 29.00%		23.91%		\$1.5m-\$2.5m: \$395,200.50+37.5% of excess.			
>\$20m: 30.90%		25.91%		\$2.5m-\$3.5m: \$770,200.50+47% of excess.			
(Under the Community Development and Support		Over \$1,400,000: 35.91%		Over \$3.5m: \$1,240,200.50+55			

Expenditure Scheme, the marginal tax rate on clubs’ earnings above \$1m is reduced by 1.5% if clubs contribute 1.5% of gaming revenue in excess of \$1m to eligible community projects).		(includes a levy of 8.5% for the Community Investment Fund).	% of excess.				
		Note: These tax rates are Post-GST.	These rates apply to all clubs and other not-for profit licensees.				
Club tax rates will remain frozen from 1 September 2007 until 31 August 2012.							
GST rebate payments will continue to be provided to all clubs on the first \$200,000 of gaming profits from 2004-05.							
Payments are quarterly, relating to the previous 3 months’ transactions.	Payment of taxation is required weekly within 7 days of the end of the week.	Payments are made monthly relating to previous month’s activity.	Payments are made monthly relating to previous month’s activity.	Payments relate to previous month's activity.	Payments are made monthly relating to previous month's activity.	Payments are made monthly and relate to transactions in the previous month.	

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-2.

E.10 Gambling Taxes – Gaming Machine Tax in Hotels

E.10.1 Definition, base, rate and thresholds

Hotel gaming machine tax is levied on the hotel under the *Gaming Machine Tax Act 2001* and the *Tax Administration Act 1996* on the gross revenue (player loss) from gaming machines. Hotels are liable to pay duty quarterly.

Base - All money wagered on gaming machines in hotels.

Table E.33 Rates for Hotel Gaming Machine Duty from 1 July (%)

	Up to 25,000	25,001 to 200,000	200,001 to 400,000	400,001 to 1,000,000	1,000,001 to 5,000,000	Above 5,000,000
Former marginal rates (%)	5.91	15.91	15.91	25.91	30.91	30.91
2004	5.8	15.8	17.2	26.5	31.5	33.6
2005	5.7	15.7	18.5	27.1	32.1	36.4
2006	5.5	15.5	19.8	27.7	32.7	39.1
2007	5.4	15.4	21.1	28.2	33.2	41.8
2008	5.3	15.3	22.4	28.8	33.8	44.5
2009	5.1	15.1	23.7	29.4	34.4	47.3
2010	5.0	15.0	25.0	30.0	35.0	50.0

Note: The *Gaming Machine Tax Act 2001* defines gaming profits as the excess of revenue from the gaming machines over outgoings in relation to the machine.

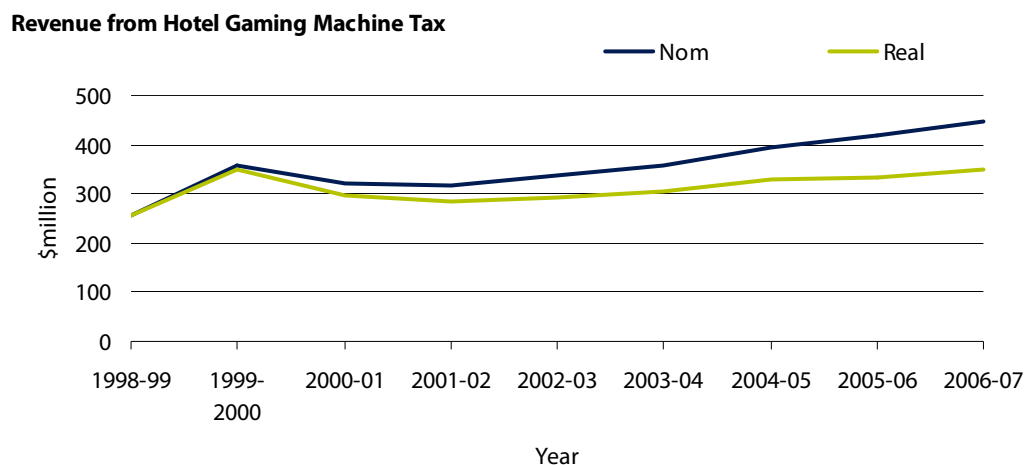
Source: NSW Treasury.

E.10.2 Revenue collected 1998-99 to 2007-08

Table E.34 Revenue collected from Hotel Gaming Device Duty, 1998-99 to 2007-08

	\$m
1998-99	255
1999-00	359
2000-01	323
2001-02	319
2002-03	338
2003-04	358
2004-05	395
2005-06	417
2006-07	446
2007-08(est)	438

Source: Various NSW Treasury budget papers.

Figure E.10 Revenue from Hotel Gaming Machine Tax

E.10.3 History of rates and thresholds

- ▼ Hotels gained access to Approved Amusement Devices (AADs) in 1984 and access to poker machines in 1997, subject to restrictions on machine numbers.
- ▼ Annual licence duty on AADs was paid by hoteliers on a per machine basis. The basic duty was \$4,000 per machine per annum with a reduction for the first machine purchased by a smaller hotel. Duty was levied this way from 1984 until 30 September 1989.
- ▼ From 1 October 1989 until 30 March 1997 the duty was based on turnover (total amount bet). The rate of duty was set at 3 per cent of the first \$2 million of turnover per hotel; 4 per cent on any turnover in excess of \$2 million.
- ▼ From 1 April 1997 duty has been based on player loss, consistent with the basis of taxation on gaming machines in the casino and clubs.
- ▼ Hotels gained access to poker machines in 1997, subject to restrictions on machine numbers.
- ▼ As part of the introduction of the GST, NSW gambling tax arrangements needed to be adjusted to take account of the impact of the GST. As such, hotel gaming tax rates were reduced.
- ▼ Hotel gaming rates (along with club gaming tax rates) were changed from 2004-05, the beginning of new tax rates to be phased in over 7 years. Higher taxation is one way above-normal profits from gaming can be shared with the broader community.

E.10.4 Benchmark against other states

Table E.35 Hotel Gaming Machine Tax by State

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Hotel:	<p>From 1 July 2007</p> <p>Levied on gross revenue (or player loss) derived from gaming machines.</p> <p>Up to \$25,000: 5.40%</p> <p>\$25,001-\$200,000: 15.40%</p> <p>\$200,001-\$400,000: 21.10%</p> <p>\$400,001-\$1m:28.20%</p> <p>\$1m-\$5m: 33.20%</p> <p>>\$5m: 41.80%</p> <p>Hotel tax rates changes are</p>	<p>32.57% of gross profit of which 8.33% is allocated to a Community Support Fund.</p> <p>In addition, Tattersalls is required to pay additional tax equal to 7% of its gross gaming revenue at clubs and hotels (in lieu of a licence fee payment).</p>	<p>35.91% of monthly metered win (i.e. amount bet less payout to players).</p> <p>(Includes 8.5% levy for the Community Investment Fund).</p> <p>In addition, hotels are required to contribute to the Health Services Fund.</p> <p>Based on monthly metered win (i.e. amount bet less payout to players).</p> <p>Monthly</p>	No gaming machines.	<p>Tax based on annual net gambling revenue in a financial year.</p> <p>\$0-\$75,000: Nil</p> <p>\$75,001-\$399,000: 27.5% of excess.</p> <p>\$399,001-\$945,000: \$89,100+37% of excess.</p> <p>\$945,001-\$1.5m: \$291,120+40.91% of excess.</p> <p>\$1.5m-\$2.5m: \$518,170.50+47.5% of excess.</p> <p>\$2.5m-\$3.5m: \$993,170.50+57</p>	<p>As for clubs.</p> <p>In addition, a community support levy of 4% will be levied.</p>	<p>42.91% of gross profit plus a Community Benefit Levy at 10% of gross profit.</p>	<p>25.9% of gross monthly gaming machine revenue.</p>

being phased in up until 1 July 2010		<u>Metered Win</u>		% of excess.			
		\$0-\$100,000:		Over \$3.5m:			
		0.0%		\$1,563,170.50+6			
		\$100,001-\$140,000:		5% of excess.			
		3.5%					
		\$140,001-\$180,000:					
		5.5%					
		\$180,001-\$220,000:					
		7.5%					
		\$220,001-\$260,000:					
		13.5%					
		over \$260,000:					
		20.0%					
		Note: These tax rates are Post-GST.					
Reference Period:	Payments are quarterly, relating to the previous 3 months' transactions.	Payment of taxation is required weekly within 7 days of the end of the week.	Payments are made monthly relating to previous month's activity.	Tax payments are made monthly relating to previous month's activity.	Payments relate to previous month's activity.	Payments are made monthly relating to previous month's activity.	Payments are monthly and relate to transactions in the previous month.

Source: NSW Treasury, *Interstate Comparison of Taxes 2007-08*, TRP07-2.

E.11 Gambling Taxes - Others

Keno, Casino, Lotteries and Lotto, Totalizator, Fixed Odds.

E.11.1 Definition, base, rate and thresholds

Keno

Relevant legislation: *Public Lotteries Act 1996*.

Description of tax- Keno duty is levied on the total amount wagered less return to player (ie, on player loss) at the following marginal tax rates:

Base - All bets from all categories of the keno game are liable for duty.

Duty is paid on a weekly basis. All prizes won in respect of the game are paid from the Keno Prize Fund. The return to players is set at 75 per cent of gross subscriptions in respect of regular keno and Keno racing and 80 per cent of gross subscriptions for Heads or Tail? And Let it Run.

Table E.36 Duty Rates for Keno

Clubs/Casino Rates		Hotels	
Player Loss	Tax rates	Player Loss	Tax rates
Up to \$86.5 million	8.91%	Up to \$37.7 million	8.91%
Above \$86.5 million	14.91%	Above \$37.7 million	14.91%

Source: NSW Treasury.

Casino

Relevant legislation - *Casino Control Act 1992*.

Description of tax - A tax paid on the commissions taken by the owner of Star City casino, Tabcorp.

Base - All bets placed on table and electronic gaming machines in Star City casino.

Rates for Casino Duty to 30 June 2008:

Electronic Gaming Machines: 13.41 per cent of gross gaming revenue.

Table Gaming: 10.91 per cent of gross table revenue plus a super tax on table revenue above \$291m at 1 per cent per each \$7.3m to a maximum of 35.91 per cent.

Responsible Gambling Levy: 2 per cent of gross gambling revenue to be paid into the Responsible Gambling Fund to be used for research and treatment related to problem gambling.

High rollers: A non-refundable payment of \$6m per year with an additional 10 per cent duty on gross gaming revenue in excess of \$60m (NSW Government must also pay the casino a rebate on the gross amount of GST paid on the program).

Rates for Casino Duty from 1 July 2008:

Combined table and electronic gaming machine revenue will be subject to a progressive tax rate structure from 2008-09 with the following minimum tax rates:

Table E.37 Casino Duty from 1 July 2008

Year	Rate
2008-09	13.04%
2009-10	13.41%
2010-11	14.41%
2011-12	15.41%
2012-13	16.41%
2013-14	16.41%

Source: NSW Treasury.

There will be no change to the rates for the Responsible Gambling Levy or the High Rollers Agreement (although the scope of gamblers eligible for the high rollers taxation rate will increase with the inclusion of inter-State gamblers).

Lotteries and Lotto

Relevant legislation - *Public Lotteries Act 1996*

Description of tax - The objects of this Act are:

- a) to make provision for the proper conduct of public lotteries in the public interest and to minimise any harm associated with public lotteries, and
- b) to ensure that revenue derived from the conduct of public lotteries is accounted for in a proper manner.

NSW Lotteries has seven licensed products:

- ▼ Lotto
- ▼ Lotto Strike
- ▼ Powerball
- ▼ OZ Lotto
- ▼ Instant Scratchies

- ▼ Lucky Lotteries
- ▼ 6 from 38 Pools.

The prize payouts for each product are:

- ▼ Lotto 60 per cent
- ▼ Lotto Strike 62 per cent
- ▼ Powerball 60 per cent
- ▼ OZ Lotto 60 per cent
- ▼ Instant Scratchies 63.4 per cent
- ▼ Lucky Lotteries 65.4 per cent
- ▼ 6 from 38 Pools 50 per cent.

All NSW Lotteries products are taxed at a uniform rate of 66.1 per cent of player loss. Player loss is defined, under the *Intergovernmental Agreement Implementation (GST) Act 2000*, as 'the difference between the subscriptions and the outgoings for the public lottery'.

Totalizator

Tax - On and off-course totalizator tax.

Relevant legislation - *Betting Tax Act 2001* and *Totalizator Act 1997*.

Description of tax - A tax paid on the commissions taken by the totalizator licensee, NSW TAB.

Base - All bets placed on a totalizator pool through the NSW TAB.

Duty is paid weekly.

Rate - 19.11 per cent of commission.

Threshold - Nil.

Fixed Odds

Tax - Fixed odds racing tax and fixed odds sports betting tax.

Relevant legislation - *Betting Tax Act 2001*.

Description of tax - A tax paid on the commissions from fixed odds books taken by the licensee, NSW TAB.

Base - All bets placed on fixed odds racing and sporting books through the NSW TAB.

Rate - 10.91 per cent of commission.

Threshold - Nil.

E.11.2 Exemptions and cost

Totalizator

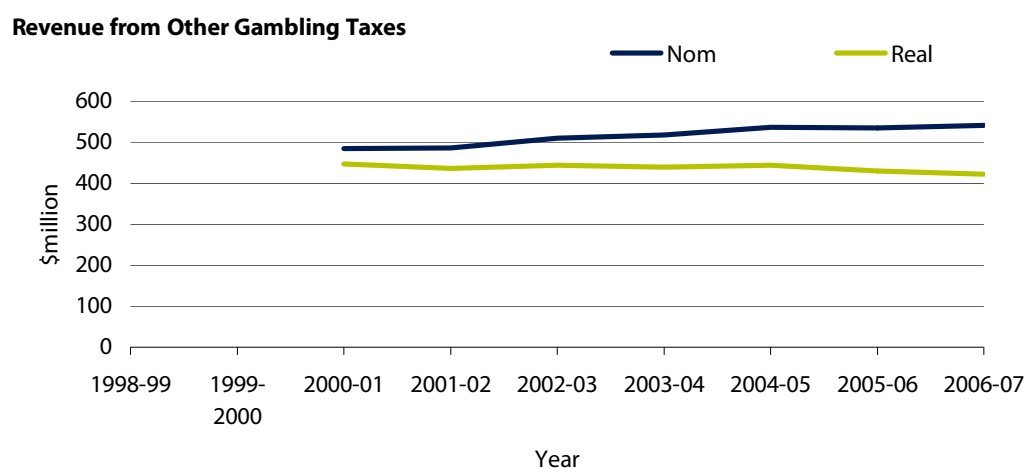
Subject to approval by the Treasurer, tax on 'domestic' non-TAB totalizator investments are fully rebated to clubs.

E.11.3 Revenue collected 1998-99 to 2007-08

Table E.38 Revenue collected from Other Gambling Taxes 2000-01 to 2007-08 (\$m)

	Casino	Lotteries and Lotto	Racing	Other (including Keno)	Total
2000-01	82	256	138	9	485
2001-02	80	256	142	8	486
2002-03	80	277	145	8	510
2003-04	81	278	150	8	517
2004-05	89	281	157	9	536
2005-06	93	283	150	8	534
2006-07	94	283	155	8	540
2007-08(e)	86	293	160	9	548

Source: Various NSW Treasury Budget Papers.

Figure E.11 Revenue from Other Gambling Taxes

E.11.4 History of rates and thresholds

Keno

- ▼ In 1991, the former NSW Government issued a joint licence to ClubKeno Holdings Pty Ltd (CKH) – a subsidiary of the Registered Clubs Association – and the keno operator Club Gaming Systems PTY Ltd (CGS) – a subsidiary of AWA Ltd. Club keno was developed to provide a different form of gaming for registered clubs in NSW. State Government policy was that the game be implemented “by clubs, for the clubs”.
- ▼ The keno licence was signed on 4 September 1991 and issued for the period 9 September 1991 to 8 September 1998. The licence holders paid a return to the Government based on the value of turnover (subscriptions). The 1991 keno licence required an annual review of the allocation of keno subscriptions to be undertaken and submitted to the Minister within 3 months of the anniversary of the first draw (ie, by 9 December each year).
- ▼ As part of the 1994 review, the tax rates for Keno were changed, to be introduced over a period of three years. New tax rates were introduced for the period 1 July 1995 to 30 June 1996, from 1 July 1996 to 30 June 1997 and from 1 July 1997.
- ▼ Star City Casino joined the keno network in November 1998.
- ▼ From 1 July 2000, the basis of taxation was changed from subscriptions to player loss and the tax rates were reduced to offset the GST.
- ▼ From 11 September 2007, the Keno licence was amended to allow Keno to be played in hotels in New South Wales. The extension of Keno into hotels in New South Wales is consistent with current practices in other jurisdictions, where Keno operates in both hotels, clubs, casinos, TABs and other venues.

Casino

Since the original casino duty and community benefit levy agreement was signed in 1994, there have been no significant changes to the electronic gaming machine and table gaming tax rates aside from amendments to the tax rates to take into account the introduction of the GST in 2000.

The only change aside from the GST adjustments has been the introduction of an international high roller program under the Casino Duty and Community Benefit Levy Supplemental and Amending Deed (the Deed).

The policy rationale for the international high roller program is to generate additional overseas income and tax streams - to the benefit of the State - through certain export incentives (ie, a lower tax rate). The international high roller tax rate allows Star City to offer commission rebates based on betting turnover to attract premium foreign gamblers to the Casino.

From 1 July 2008 there will be significant changes to the casino tax. There will no longer be separate rates of taxation for electronic gaming machines and table games. Instead there will be progressive tax structure applied to the combined gross gambling revenues from both forms of gambling. The minimum tax rates will increase each year until 2012-13 when the minimum rates will remain at 16.41 per cent.

There will be no change to the rates applied to the high rollers, although the number of persons eligible for the high rollers scheme will increase with the inclusion of interstate gamblers rather than just international gamblers.

Under the Casino Duty and Community Benefit Levy Agreement, the Treasurer can renew the existing tax agreement at any time but only with the consent of Star City. If no new agreement is reached with Star City by November 2019, the Treasurer can determine the tax arrangement to apply after this date.

Lotteries and Lotto

Product Development

In late 1930 the newly elected State Government, led by Jack Lang, decided the only course of action to solve the critical funding situation in the States Hospitals was to start a State Lottery. As such, the State Lottery Office was founded in 1931 during the height of the Great Depression.

Following vigorous debate and outrage by the Opposition and Churches (who believed that the Lotteries 'are evil and degrading' and 'would demoralise the youth of our State'), the State Lotteries Act was proclaimed on 22 June 1931. Mr W.H. Whiddon, the former Commissioner of Taxation in NSW, was appointed the first Director of State Lotteries.

The first Lottery was drawn by hand from a wooden barrel in Her Majesty's Theatre, Pitt Street, Sydney in August 1931. At that time, the Lottery consisted of 100,000 tickets at a ticket price of five shillings and three pence (52 cents) and had a first prize of £5,000 (\$10,000). (The first prize winner was Mrs Eileen Morton, a Manly housewife. With the winnings she and her husband built a house and took a cruise to Fiji.)

In February/March 1932 three lotteries were introduced to mark the opening of the Sydney Harbour Bridge.

In November 1957, tickets in Opera House Lottery No.1 went on sale at £5 (\$10) each with a first prize of £100,000 (\$200,000), in order to finance the building of the Sydney Opera House.

The first Monday night Lotto draw was held on 5 November 1979, televised live on Channel 9.

In November 1982 the first Instant Scratchies went on sale with a top prize of \$10,000.

Wednesday night Lotto draws commenced in November 1984.

In May 1989 the first national game, 6 from 38 Pools, began.

Australia's first national lotto game, OZ Lotto, was introduced.

Lotto Strike was launched in NSW in November 1995.

Powerball commenced nationally in May 1996.

Tax Changes

Early tax rates are not known.

1982/83 – the tax rate for soccer pools was 30 per cent plus 31 per cent for Lotto.

1985/86 – the tax rate for soccer pools was 32.5 per cent plus for Lotto 33 per cent up to \$100 million, 34 per cent between \$100 - \$200 million and 35 per cent over \$200 million.

1993 – the tax rates were 34 per cent pools licence (one third went to Consolidated revenue, with the remainder to the Sport and Recreation Fund) plus 31 per cent Lotto licence and a balance of duty from the other products to equate to 29.7 per cent overall (excluding Soccer Pools).

1996-97 – as part of the corporatisation process the existing tax structure was split into a two tier tax structure effective from 1 January 1997. One component was a general duty, set at 15 per cent of subscriptions. The second component was an annual fee based on 14.7 per cent of estimated subscriptions in 1996-97, with the

amount thereafter indexed to forecast changes in the Sydney CPI. The annual fee was also subject to a cap of 15 per cent of subscriptions.

1999-2000 – to allow for the introduction of the GST, the general duty rate was reduced from 15 per cent to 10.95 per cent. The licence fee was unchanged.

2000-01 – effective from 1 September 2001, the annual fee and the general duty of 10.95 per cent of subscriptions were removed, and replaced with a base general duty rate of 66.1 per cent of player loss for all products.

Totalizator

TAB Limited is licensed under the *Totalizator Act 1997* to conduct off-course and on-course totalizators in New South Wales on a comprehensive program of thoroughbreds, harness and greyhound racing events, and totalizator wagering on sporting events approved as sports betting events under the *Racing Administration Act 1998*.

Prior to the fixed tax rate, on-course totalizator tax consisted of the take from on-course investments and the distribution to the Consolidated Fund, Race Club, Racecourse Development Fund and Racecourse Assistance Fund and varied between the type of bets placed and location of the racecourse. In addition, all winning dividends were rounded down to 10 per cent multiples with the State receiving this amount.

However, on the privatisation of the TAB in 1998, instead of receiving revenue on each type of bet such as 6 per cent for quinella and 8 per cent for exacta, government revenue consisted of a fixed percentage of player loss. In 1999 this percentage was 28.2 per cent. State gambling tax arrangements were modified in July 2000 to take account of the impact of the GST on gambling operators. Where possible tax rates were reduced by the equivalent of the GST (ie, 1/11 of player loss or 9.09 per cent). Hence the current rate of 19.11 per cent.

Currently there is a 16 per cent average cap on the commissions from totalizator pools. This cap is likely to be removed with the passing of the *Totalizator Legislation Amendment Bill 2007* and caps for individual totalizator pools will instead be introduced. This change is likely to increase taxation for the NSW Government and some of the excess profits accruing to the licensee will be used to fund a Sports Fund administered by the Treasurer.

Fixed Odds

Fixed odds sports betting commenced on 27 July 1998 following approval by the Minister for Gaming and Racing for TAB Limited to conduct fixed odds sports betting on any declared event under the *Gaming and Betting Act 1912*.

Following consultation between the Minister and the Treasurer, TAB's fixed odds sports betting product was allowed from December 1998 to be offered in markets where the Queensland TAB had exclusive operating rights.

On 28 October 2000, the Minister for Gaming and Racing gave approval under section 13 of the *Totalizator Act 1997*, for TAB Limited to conduct fixed odds 'futures' betting on feature racing events (ie, Group 1 events across the three codes of racing – thoroughbred, harness and greyhound). This new betting form commenced on 16 February 2001.

The *Totalizator Act 1997* (s.70) specifies that the licensee (ie, TAB) must pay the Government a tax equal to 19.11 per cent (already taking into account the impact of the GST on operators) of net earnings on the total amount of bets placed. However, the Minister for Gaming and Racing approached the Treasurer with a recommendation that these products be subject to a tax rate of 10.91 per cent. The Treasurer supported this proposal and a Governor's Order to the effect was made on 31 January 2001.

E.11.5 Benchmark against other states

Keno

Table E.39 Interstate comparison of Keno Taxes

State	Keno Tax Rate ^a
SA	41% of player loss (Keno in SA is operated by SA Lotteries)
VIC	24.25% of player loss
QLD	26.25% of player loss, after deducting casino commissions ^b
NT	10.91% of player loss (after GST rebate)
NSW	8.91% of player loss if ≤ \$86.5m, 14.91% if > \$86.5m (clubs/casino) 8.91% of player loss if ≤ \$37.7m, 14.91% if > \$37.7m (hotels)
TAS	5.88% of player loss
ACT ^c	2.53% of turnover (which equates to a tax rate of 10.12% on player loss if maximum player loss is 25%)

^a From 1 July 2000 State gambling taxes were modified to take account of the impact of the GST on gambling operators. With GST levied at one-eleventh (or 9.09%) of the total mount wagered less total monetary prizes, State and Territory gambling taxes were changed by reducing tax rates to offset the GST or reimbursing the amount of GST paid where the tax rate adjustments were not possible.

^b A quarterly licence fee of \$165,800 is also payable. The licence fee increases on 1 October each year based on CPI. Brisbane & Gold Coast Casinos receive 25% commission on sales of Jupiters Keno and pay tax at 21% (including a 15% Community Benefit Levy (CBL) on commissions. Townsville and Cairns Casinos receive 25% commission on sales of Jupiters Keno and pay 11% tax (including a 1% CBL) on commissions.

^c Tax rate quoted is for ACTTAB Keno, which is operated by the SA Lotteries Commission. Tatts Keno also operates in ACT. Tattersalls is taxed on total subscriptions. The ACT Government has a revenue sharing agreement with the Victorian Treasurer to return to ACT 100% of ACT player loss after Tattersalls costs, including GST. ACT receives 79.4% of player loss.

Source: NSW Treasury.

Casino

From 1 July 2008, NSW will be the have the highest taxes on (non-high roller) casino gambling in Australia. However, the rates of taxation remain considerably lower than those faced by large clubs and hotels in NSW.

Table E.40 Comparison of casino tax rates in Australia

State	State Gaming Tax Rates
NSW	13.41% of gross revenue Responsible Gambling Levy: 2% of gross revenue (excluding international premium player revenue).
VIC	12.16% (after GST credit) of gross gaming revenue up to \$500m a year, plus marginal rates increasing by 1 percentage point for each \$20m revenue above \$500m up to a maximum 32.16% for revenue in excess of \$900m a year. (this tax applies to combined table and EGM revenues) Community Benefit Levy: 1% of gross revenue (for both regular and commission-based players). Health Benefit Levy of \$4,333 per machine per annum
QLD	10.91% (after GST credit) of gross revenue for Brisbane and Gold Coast casinos, 1.82% (after GST credit) for Townsville and Cairns. Casino licence fee of \$164,900 (indexed to CPI annually) per quarter. Community Benefit Fund: 1% of gross revenue.
WA	20% from December 2004 Casino licence fee of \$2.2 million in 2006-07 (indexed annually to CPI). Burswood Park Levy: 1.5% of gross revenue for upkeep of Burswood Park rising to 2% in January 2008.
SA	34.41% of net gambling revenue.
TAS	20.88% for revenues up to \$35 million 25.88% for excess revenues about \$35 million Casino licence fee of \$x per month in 2006-07 (indexed annually).
ACT	10.91% (after GST credit) of gross revenue. Annual licence fee \$658,372 for 2003-04 (indexed to CPI).
NT	Alice Springs: 11.91% (after GST credit). Darwin: 10.91% of gross profit (after GST credit).

Source: NSW Treasury.

Lotteries and Lotto

Most jurisdictions have their own State Lotteries, with the tax bases and rates varying significantly among them.

Tasmania, Northern Territory and the Australian Capital Territory receive a share of the duty paid to the Victorian Government from their respective subscriptions to the Victorian Tattersall's Lotteries.

Totalizator

- ▼ VIC: 19.11 per cent of commission.
- ▼ QLD: 20 per cent of commission (GST credit provided). Quarterly licence fee.
- ▼ WA: 11.91 per cent of commission (off-course totalizator only).
- ▼ SA: 6 per cent of net wagering revenue (off-course totalizator only).
- ▼ TAS: Nil.
- ▼ NT: 40 per cent of commission (less GST).
- ▼ ACT: Monthly licence fee of 10 per cent of capital value divided by 12 less GST. Dividend and tax equivalent payments.

Fixed Odds

- ▼ VIC: 10.91 per cent of commission.
- ▼ QLD: 10.91 per cent of commission.
- ▼ WA: 5 per cent of commission.
- ▼ SA: 6 per cent of commission.
- ▼ TAS: Nil.
- ▼ NT: Nil.
- ▼ ACT: Nil.

F | Constitutional Constraints to State Taxes

F.1 The impact of the Constitution and its interpretation by the High Court on the States' ability to raise taxes

As Chapter 3 discusses, section 90 of the Constitution provides the Commonwealth with the exclusive right to impose customs and excise duties, and section 92 prevents the States from imposing taxes that interfere with the freedom of interstate trade. However, the High Court's interpretation of these sections has increasingly limited the kinds of taxes the States are able to levy and, in the process, centralised taxation powers at the Commonwealth level and reduced the State's fiscal autonomy.

In addition, the Commonwealth's use of section 96 of the Constitution – which provides the Commonwealth with the power to grant financial assistance to the States on the terms and conditions it sees fit – has further centralised taxation and public finance in Australia.

This appendix provides a more detailed discussion of each of these sections and their impact on the States.

F.2 Section 90: Duties of Customs and excise

Section 90 of the Constitution provides that:

On the imposition of uniform duties of customs the power of the Parliament to impose duties of customs and of excise, and to grant bounties on the production or export of goods, shall become exclusive.¹²²

While this section prohibits the States from imposing customs duties and excise duties, it does not provide a clear definition of what constitutes an excise duty. The High Court's view of what constitutes an excise duty has expanded over the years.

The rationale for section 90 was to avoid the imposition of discriminatory tariffs between States and hence facilitate free interstate trade. This has led to the argument that the High Court's interpretation of section 90 is not only economically and financially unsound, it is in conflict with the intentions of the founders of the

¹²² *Commonwealth of Australia Constitution Act*, Section 90.

federation.¹²³ In his standard work on the Australian Constitution, Professor Colin Howard has said:

The definition of excise duty cannot be counted among the High Court's successes. No escape from the morass of judicial disagreement now seems possible by curial action alone. The main consequences have been lasting uncertainty, and consequential litigation, in a significant area of liability to taxation and now a severe and unnecessary restriction on the taxation revenue of the States ... The case law on s.90 suggest[s] that the High Court is by and large unsympathetic to State revenue and expenditure problems in general.¹²⁴

Whatever the view, there is no question that section 90 has a profound impact on the design of State tax systems. Despite States developing tax legislation carefully so as not to offend the High Court's previous interpretations of section 90, they almost invariably found new legislation struck down by the High Court under a new, narrower interpretation of section 90.

For example, in the 1970s the States imposed new taxes which came to be known as 'business franchise fees' on petroleum products, tobacco and alcohol. In time, these fees grew into a significant source of State tax revenue. Although levied at increasingly high rates the fees were considered to have satisfied the criteria expounded by the High Court in previous cases until the High Court struck them down on 5 August 1997 in *Ha v NSW* (1997).¹²⁵

F.3 Section 92 - freedom of interstate trade

Section 92 provides that:

On the imposition of uniform duties of customs, trade, commerce and intercourse among the States ... shall be absolutely free.

Section 92 has been relied on in several cases to strike down State taxes. The 1988 NSW Tax Task Force recognised that a body of law had developed on the relation between the guarantee enshrined in section 92 and the power of the States to tax. For instance, it showed that taxes and charges which had received consideration by the High Court in this regard included a tax on the poultry industry,¹²⁶ a primary products marketing levy,¹²⁷ a road tax on interstate hauliers,¹²⁸ and a stamp duty on motor vehicles.¹²⁹

¹²³ Lambert, M. Secretary to the NSW Treasury, *Whither the Federation*, Address to the Reform Club, 12 July 1996.

¹²⁴ See Howard C, 1985, *Australian Constitutional Law* (3rd Ed.), Penguin Books, p 437. Another commentator has put it even more strongly: "The interpretation of section 90 – through diverse opinions, partial adherence to precedent, shifting majorities and changes to the composition of the Bench – is a complete mess": M. Coper, *Sydney Morning Herald*, 22 August 1983.

¹²⁵ *Ngo Ngo Ha v New South Wales* (1997) 146 ALR 355.

¹²⁶ *See Damjanovic & Sons Pty Ltd v Commonwealth* (1968) 117 CLR 390.

¹²⁷ *Harper v Victoria* (1966) 114 CLR 361.

¹²⁸ *Hughes & Vale Pty Ltd v New South Wales* [No.1] (1955) AC 251, *Hughes & Vale Pty Ltd v New South Wales* [No.2] (1955) 93 CLR 127.

¹²⁹ *Finemores Transport Pty Ltd v New South Wales* (1978) 139 CLR 338.

Rather than enunciating discrete rules on the relationship between State taxation and the guarantee contained in section 92, these cases were concerned with principles of more general application, albeit with consequences for State tax powers.

F.4 Section 96: financial assistance to the States – section 96

The Commonwealth has power under section 96 of Australia's Constitution to:

... grant financial assistance to any State on such terms and conditions as the Parliament thinks fit...¹³⁰

The 1988 NSW Tax Task Force recognised that, while this provision does not on its face appear to interfere in any way with State taxing powers, its potential to do so had been demonstrated by the history of the use of the provision.¹³¹ The provision has also been described by one eminent writer as “a devious source of Commonwealth hegemony”.¹³²

From the end of World War I until 1942 both the Commonwealth and the States levied their own income taxes. In 1942 the Commonwealth compulsorily took over all income tax collection, initially as a temporary wartime measure. It did this by:

- ▼ raising its own tax rates to a level equivalent to that of the previous State and Commonwealth taxes combined
- ▼ legislating to give priority to the collection of Commonwealth income tax
- ▼ legislating to provide for the payment of annual grants to each State, pursuant to s.96, on condition that the State did not impose its own income tax.

The overall effect of the scheme was to deny the States the ability to raise their own income taxes. In 1946 the Commonwealth Government advised the States that it would retain its income tax powers indefinitely.

All three levels of the scheme implemented by the Commonwealth were upheld as valid by the High Court when it was challenged by South Australia in the First Uniform Tax Case (*South Australia v The Commonwealth*).

The validity of the third element of the scheme was again challenged in 1957 in the Second Uniform Tax Case (*Victoria v The Commonwealth*). In that case, the High Court reaffirmed its decision in *South Australia v The Commonwealth* to the effect that the Commonwealth's power under section 96 was very wide and that the terms and conditions of the challenged grants were a valid exercise of the power.

After 1959, the Commonwealth, in making general grants, ceased to stipulate that the States refrain from imposing an income tax, though an informal stipulation to that effect was made until 1976.

¹³⁰ *Commonwealth of Australia Constitution Act*, Section 96.

¹³¹ Saunders, C. 'Towards a Theory for Section 96', 16 *Melbourne University Law Review* 1.

¹³² Lane, P. 1979, *The Australian Federal System* (2nd Ed), Law Book Co, p 850.

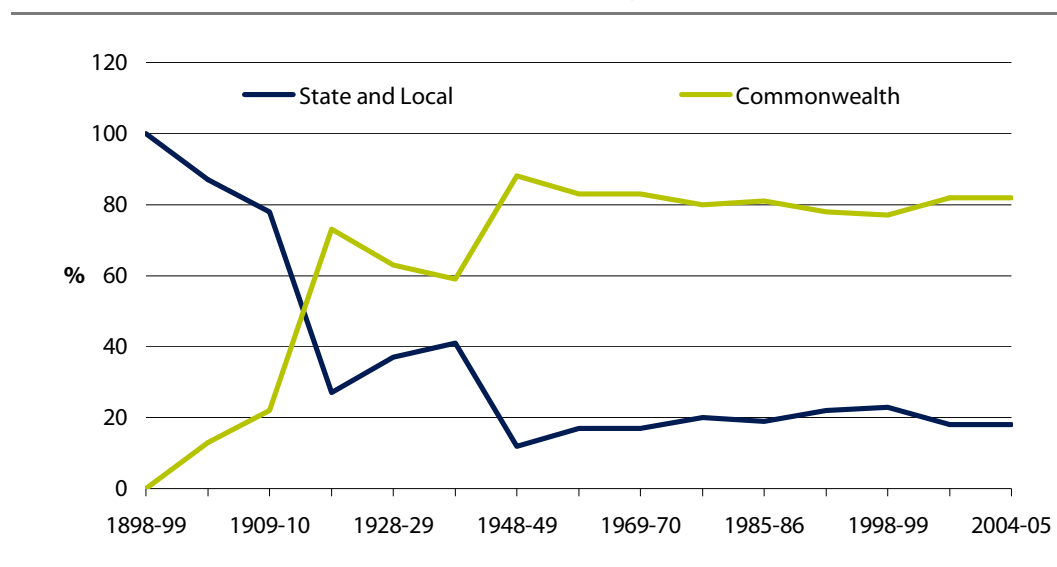
F.5 Centralisation of taxation powers at the Commonwealth level

Table F.1 below sets out a range of selected events – for example, Commonwealth policy decisions on income tax and approaches to revenue sharing, and High Court rulings on section 90 of the Constitution – and indicates how they have contributed to the centralisation of taxation powers at the Commonwealth level, by expanding the Commonwealth's powers and increasing the States' dependence on the Commonwealth.

Figure F.1 illustrates the impact of these and other events on the total taxation revenue share between the Commonwealth and the States. Fiscal centralisation and decentralisation are normally measured in respect of the shares of subnational governments in national taxation revenues and public expenditures.

As Figure F.1 shows, there has been a steep decline of fiscal decentralisation in Australia (and a corresponding steep increase in fiscal centralisation), particularly after World War II. The data show that the share of total tax revenues collected by the State (and local) governments has fallen from 87 per cent following federation to 18 per cent in 2004-05. This shows the States experiencing a declining share of total taxation revenues since federation in contrast to the Commonwealth's increasing share.

Figure F.1 VFI: Share of total taxation revenues by level of government in Australia



Note: the two sharp increases in Commonwealth taxation correspond with WWI and WWII.

Data source: Mathews, R. and W. Jay, 1997 (reprint of the 1972 edition), 'Federal Finance: Australian Fiscal Federalism from Federation to McMahon', Centre for Strategic Economic Studies, Victoria University, Melbourne, pp 54, 58, 83, 100, 152, 194, 230, 282; and Mathews, R. and Grewal, B. (1997), 'The Public Sector in Jeopardy: Australian Fiscal Federalism from Whitlam to Keating', Centre for Strategic Economic Studies, Victoria University, Melbourne, and ABS, various years, *Government Finance Statistics, Australia*, Cat No 5512.0.

Table F.1 Major Changes in the constitutional division of powers, selected landmarks

Year	Selected events	Impact
1908	The States lost their Constitutional right to at least 75% of the Commonwealth surplus revenue under Section 94	Greater dependence of States on Commonwealth
1920	New legal doctrine established by the High Court in the Engineers' case, favouring Commonwealth government	Expansion of Commonwealth powers
1923	The power of Section 96 begins to unravel when road grants are introduced	Expansion of Commonwealth powers
1927	The Financial Agreement sets up Australian Loan Council, which would diminish States' borrowing powers	Expansion of Commonwealth powers
1942	Commonwealth gains exclusive power over income taxation	Greater dependence of States on Commonwealth
1951	States cannot raise sufficient borrowings and become dependent on Commonwealth Special Loans	Greater dependence of States on Commonwealth
1969	State receipts duty declared invalid by the High Court	Loss of States' independent revenue sources
1970	The High Court rules that the States cannot levy a tax on any stage of sales of a product	Loss of States' independent revenue sources
1971	Transfer of Commonwealth Payroll tax to the States, with corresponding reduction in tax sharing grants	States gain independent source of revenue
1973	Commonwealth specific purpose grants mushroom under Whitlam administration	Expansion of Commonwealth powers
1974	Commonwealth takes over financing of tertiary education from the States	Expansion of Commonwealth powers
1976	Commonwealth stops sand mining on Fraser Island using external affairs power	Expansion of Commonwealth powers
1978a	Commonwealth legislates to allow each State to vary the personal income taxes levied on its residents	
1983b	Commonwealth stops, under international treaty obligations, the proposed dams in Tasmania	Expansion of Commonwealth powers
1985	Transfer of Bank Account Debits Tax to the States, with corresponding reduction in tax sharing grants	States gain independent source of revenue
1988	Commonwealth threatens to reduce Queensland's financial assistance grants for not cooperating in the Loan Council	Unconditional grants no longer without conditions
1989c	Commonwealth repeals legislation empowering the States to impose surcharges or grant rebates on income tax	
1990	Corporations power is coordinated at the Commonwealth level, although problems remain	Expansion of Commonwealth powers
1997	The High Court declares invalid State business franchise fee on tobacco, alcohol and petrol	Greater dependence of States on Commonwealth
1998	Commonwealth introduces 'safety net' arrangements to save States' finances	Greater dependence of States on Commonwealth
1999	Intergovernmental Agreement on Commonwealth-State Financial Relations	Greater dependence of States on Commonwealth
2000	States receive GST revenue instead of revenue grants from the Commonwealth	Greater dependence of States on Commonwealth
2006	High Court upholds validity of Commonwealth's 'WorkChoices' legislation	Expansion of Commonwealth powers

Source: Sheehan, P and Grewal, B, 2003, 'The Evolution of Constitutional Federalism in Australia: An Incomplete Contracts Approach', Centre for Strategic Economic Studies (CSES) Working Paper No.22, Victorian University of Technology (Melbourne). Note additional information from Tasmanian Parks, Matthews and Grewal (1995) and <http://www.parliament.vic.gov.au/fsrc/report2/body/chapter3.htm>.

G Vertical Fiscal Imbalance and Commonwealth Funding Arrangements

Four basic strategies have been adopted to address the vertical fiscal imbalance in the Australian federation:

- ▼ general revenue (untied) grants
- ▼ re-assignment of taxing powers
- ▼ specific purpose (tied) payments from the Commonwealth to the States
- ▼ revenue sharing arrangements.

G.1 General Revenue Grants

The Commonwealth has made general revenue grants to the States since its earliest days. Since assuming income tax from the States in 1942 these grants have increased in importance, but have taken a number of different forms along the way.

A major change occurred in 1976-77, when the Commonwealth introduced a two stage system of personal income tax sharing. Stage 1 involved a system of income tax revenue sharing grants, under which States would receive a percentage of personal income tax. (Stage 2 involved a State income tax and is discussed further below). States' grants were later changed to a percentage of total Commonwealth tax receipts.

This revenue sharing approach was abandoned in 1985 when the Commonwealth sought to bring greater stability to its State grants. It introduced Financial Assistance Grants (FAGs) which were indexed in line with inflation. This 'real maintenance' subsequently became 'real per capita maintenance' to help States cope with the pressures of population growth.

The most recent change was in 2000 when FAGs were replaced with GST revenue grants – a return to a revenue sharing approach. FAGs continued to be calculated, as they served as a floor under the new system to ensure that States were not disadvantaged by the change.

A particular and enduring feature of the various systems of untied grants has been the Commonwealth Grants Commission. The Commission advises the Commonwealth Treasurer how to distribute the pool of general revenue grants amongst the States. In doing so it adopts the principle of Horizontal Fiscal

Equalisation (HFE). It aims to provide each State with the capacity to deliver the average level of services, providing that it makes the average effort to raise taxes and operates at the average level of efficiency.

It is important to note that the Commission is concerned only with capacity, not performance. There is nothing to prevent a State from delivering an above average level of service, but it must do so with above average efficiency or else fund it through higher taxes, at least in the long term.

G.2 Tax re-assignment

The Commonwealth has made some effort to address VFI through changes in tax assignment. Three instances stand out:

1. In 1971 payroll tax¹³³ was transferred from the Commonwealth to the States following agreement at a Premiers' Conference for the States to have a more flexible source of revenue. At the same time, general revenue grants to the States were reduced by their estimated collections from payroll tax. States subsequently significantly increased the rate and base of this tax.
2. In 1978, the Commonwealth passed the *Income Tax (Arrangements with the States) Act 1978* (Stage 2 of its personal income tax sharing system), which facilitated the introduction of a State income tax.

In essence, the Act permitted each State to impose an income tax surcharge or to grant a rebate which would be collected or administered by the Commonwealth. However the Commonwealth did not reduce its own income tax rates to make accommodate a State income tax, and no State took up the offer. The Commonwealth enabling legislation was eventually repealed in 1989.

3. The third instance occurred in 1997 when the High Court determined that the NSW tobacco franchise fee – and by implication all State business franchise fees – contravened s90 of the Constitution which bars States from imposing an excise. This decision had been widely anticipated and alternative arrangements were immediately introduced to protect State finances.

At the States' request, the Commonwealth increased the rates of customs and excise duties on tobacco and petroleum products and the rates of wholesale sales tax on alcoholic beverages. It then agreed to return all revenue thus collected (net of administrative costs) to the States in the form of revenue replacement payments (RRPs). This arrangement was discontinued from 1 July 2000.

A further, though relatively smaller, instance was the transfer of the Bank Account Debits Tax (BAD Tax) from the Commonwealth to the States. The tax was introduced by the Commonwealth in 1982 but the power to levy the tax was

¹³³ The Commonwealth Government introduced payroll tax in 1941 to partly fund child endowment payments. In 1952 the link with child endowment was abandoned and payroll tax was included in consolidated revenue.

transferred to the States in 1990. The tax was abolished by the States on dates between 1 July 2002 and 1 July 2005 as part of the package of reforms for the introduction of the GST.

G.3 Specific Purpose Payments

SPPs represent the flip side of tax reassignment. The Commonwealth uses SPPs to assume some expenditure responsibility for areas of State expenditure from which it would otherwise be barred under the Constitution. By contributing to the funding of programs, the Commonwealth has been able to exert policy influence by requiring the States to meet various conditions to qualify for the funding. These conditions have typically only related to inputs and resources consumed, rather than policy outcomes achieved.

Through these input controls, the Commonwealth has been able to leverage its own contributions to control State outlays as well, for example by requiring States to match its own contributions. The NSW Treasury has estimated that whilst SPPs provide around 15 per cent of NSW total Budget revenues, the conditions attached to these grants control around 30 per cent of NSW budget outlays.¹³⁴

G.4 Revenue sharing arrangements

Concurrent with the introduction of the GST from 1 July 2000, there were major reforms of Commonwealth-State financial arrangements. These reforms were the result of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA) which was signed by Heads of Government in 1999.¹³⁵ Major provisions of the IGA are:

- ▼ distribution of GST revenue to the States through untied grants based on fiscal equalisation principles (horizontal fiscal equalisation)
- ▼ abolition of Financial Assistance Grants (FAGs) and Revenue Replacement Payments to the States
- ▼ GST revenue to be used to fund abolition of the Commonwealth's wholesale sales tax (WST) and the abolition or reduction of various State taxes, including financial institutions duty, stamp duty on quoted marketable securities, debits tax and bed tax
- ▼ review by 2005 of certain other State taxes with a view to their possible abolition.

Significantly, the IGA also provided that the States are not to reintroduce the taxes that were agreed to be abolished or reviewed nor to introduce similar taxes.¹³⁶ The

¹³⁴ NSW Government, Budget 2006-07, *Budget Paper No 2*, p 8-14.

¹³⁵ Commonwealth Government, 1999-00, Commonwealth Budget, *Budget Paper No. 3*, Appendix B.

¹³⁶ IGA, paragraph 5 (vi).

IGA therefore further limits the kind of taxes available to the States – although on this occasion with the States’ full agreement.

The NSW 2007-08 Budget Papers¹³⁷ show that NSW has met all its commitments under the IGA to abolish or reduce relevant taxes under the IGA, and also provide the revenue impacts.

Taxes abolished under the IGA are:

- ▼ 1 July 2000 – Bed Taxes (cumulative revenue impact of \$592 million to 2006-07)
- ▼ 1 July 2001 – Financial Institutions Duty (cumulative revenue impact of \$4.3 billion to 2006-07)
- ▼ 1 July 2001 – Marketable Securities Duty on listed securities (cumulative revenue impact of \$3.8 billion to 2006-07), and
- ▼ 1 January 2002 – Debits Tax (3½ years ahead of the schedule in the IGA, cumulative revenue impact of \$1.9 billion to 2006-07).

In terms of the taxes to be reviewed under the IGA, the Budget Papers show:

New South Wales took part in the 2005 Ministerial Council Review of the taxes listed in the IGA, namely, stamp duty on non-residential conveyances; unquoted marketable securities; leases; mortgages; debentures, bonds and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; and cheques, bills of exchange and promissory notes.

The conclusion reached by the Ministerial Council was that sustainable taxation reform can only be achieved where such measures are consistent with sound fiscal policy.

New South Wales announced a schedule for the phasing out of the remaining stamp duties that were listed for review under the IGA in last year’s Budget.

In addition, the NSW Government has decided to bring forward the abolition of mortgage duty earlier than previously announced.

The revised timetable for the abolition of mortgage duty is:

- 1 September 2007 – for individuals taking out mortgages of owner-occupied residences;
- 1 July 2008 – for individuals taking out mortgages of non-owner-occupied residences; and
- 1 July 2009 – complete abolition.¹³⁸

The Government abolished hire of goods duty from 1 July 2007 and lease duty from 1 January 2008. The Government has also announced that stamp duty on non-quotable marketable securities will be abolished from 1 January 2009 and that stamp duty on business conveyances (other than real property) will be abolished from 1 July 2012.

Table G.1 sets out the schedule for the abolition/reduction of certain State taxes under the IGA.

¹³⁷ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, pp 8-19 and 8-20.

¹³⁸ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, pp 8-19 and 8-20.

Table G.1 Scheduled abolition/reduction of certain State taxes under the IGA

Tax	Action
Gambling taxes	Reduced from 1 July 2000
Bed taxes	Abolished from 1 July 2000
Financial Institutions Duty	Abolished from 1 July 2001
Stamp duty on listed marketable securities	Abolished from 1 July 2001
Debits tax	Abolished from 1 January 2002 ^a
Hire of goods duty	Abolished from 1 July 2007
Mortgage duty	To be phased out from 1 September 2007 with complete abolition from 1 July 2009 ^b
Lease duty	Abolished from 1 January 2008
Stamp duty on non-quotable marketable securities	To be abolished from 1 January 2009
Stamp duty on business conveyances (other than real property)	To be abolished from 1 July 2012

^a The debits tax abolished 3 ½ years ahead of the schedule in the IGA.

^b The revised timetable for the abolition of mortgage duty is: 1 September 2007 – for individuals taking out mortgages of owner-occupied residences; 1 July 2008 – for individuals taking out mortgages of non-owner-occupied residences; and 1 July 2009 – complete abolition.

The effect of the IGA was also to increase the State's dependence on Commonwealth grants. In 2007-08 Commonwealth grants to NSW are estimated to be \$19.1 billion, which represents 48.5 per cent of the State's total revenue.¹³⁹ This comprises \$11.9 billion in general purpose payments (ie, GST revenue grants) and \$7.2 billion in specific purpose payments.

The Warren Report shows:

State taxes in Australia account for just over 30 per cent of total State revenue, and represent approximately 16 per cent of total General Government tax revenue in Australia. This means that State governments in Australia have discretion over only a relatively small proportion of their total revenue, are heavily reliant on other sources of revenue – primarily grants from the Commonwealth over which they have little or no discretion – to finance their expenditures, and that tax revenue in Australia is highly centralised.¹⁴⁰

The Warren Report also found that:

The GST and associated reforms introduced in July 2000, including the abolition of some State taxes, have further diminished the assignment of taxes to the States. This has resulted in the exceptionally high degree of VFI in Australia illustrated in Figure 4. This is because those reforms increased States' reliance on Commonwealth grants (GST revenue grants) while at the same time reducing States' reliance on own-source taxes.

¹³⁹ NSW Treasury, Budget 2007-08, *Budget Paper No 2*, p 3-2.

¹⁴⁰ Warren, N. *Benchmarking Australia's Intergovernmental Fiscal Arrangements – Final Report*, May 2006, p 71.

This compounded the trend since federation to greater concentration of taxing powers in the hands of the Commonwealth (Figure 5) causing Australia to have one of the most centralised tax systems of any federation.¹⁴¹

The IGA and the associated GST revenue sharing arrangements have increased NSW's reliance on revenue grants from the Commonwealth, resulting in less autonomy over State tax policy, thereby reducing tax reform options.

G.5 Limitations of current CGC HFE process and their implications for the States' grant allocations

As noted in Chapter 3, the objective of the Commonwealth Grants Commission is to ensure that each State government has the financial capacity to provide the same level of service to its residents. In relation to taxes, the objective is to measure the circumstances beyond a State's control that would result in it raising more (or less) revenue per capita than other States, if it applied Australian average tax rates to its tax.

The Commission calculates States' available tax capacities, which are reflected in standardised revenue estimates for each State for each tax. A State's standardised revenue for a tax is a per capita amount measured as the average tax per capita in Australia multiplied by the State's relative size of the tax base. This relative size is measured as the ratio of what a State would raise per capita if it applied Australian average tax rate to its base, relative to the national average per capita for that tax.

Through standardised revenue estimates for each tax, the CGC attempts to measure fiscal disparities and does this by estimating differences in States' fiscal outcomes that would result from a given fiscal effort.¹⁴² Summing all standardised revenue per capita for a State across some 37 different taxes yields an estimate of assessed revenue for each State. Any State whose actual revenue is below the Commission's estimate of their standardised revenue per capita is treated as if they had collected that revenue when grants distribution is being estimated.

Key to understanding the limitations of the Commission's methods in relation to tax revenue is understanding that the approach assumes that while a State can control its tax rate schedule, it has no control over the base. The problem is that contrary to this Commission assumption, States can indeed exert policy influence over their revenue bases. The example described in Box 3.1 illustrates this point. The impact of tax capitalisation provides another example. In the case of land tax, the CGC assumes land tax does not affect property prices and therefore assumes no capitalisation of this tax. No literature supports this position and as Dahlby and Warren (2003) highlight, this can lead to distortions in grant allocation and State actions to take advantage of this assumption.

¹⁴¹ Warren, N. *Benchmarking Australia's Intergovernmental Fiscal Arrangements – Final Report*, May 2006, p 51.

¹⁴² Commonwealth Grants Commission, 2007, *Report on State Revenue Sharing Relativities*, 2007 Update, Canberra, p 27.

A contributor to this problem is that the Commission bases its assessments on what it calls 'internal standards'. This means that its calculations are generally driven by what the States actually do. Within the Commission's revenue assessments, it weights the individual taxes according to how much revenue is actually collected from each of them, in aggregate across all States. Accordingly, if a State alters its regime so that it collects more from, say, land tax and less from say, property transfer duty, the relative weights of these two taxes within the Commission's calculations will automatically adjust to reflect their changed importance. This is particularly relevant for a large State such as NSW, which typically comprises around a third of total collections and hence has a greater proportional influence on aggregate collections than the smaller States.

The relative weighting placed on a tax is important because the distribution of individual tax bases varies across States. If a State is relatively poorly endowed with a tax base that other States find quite lucrative and hence is weighted relatively heavily, that State will receive greater compensation through the HFE process than if that tax base did not yield much revenue. Conversely, a State blessed with a large share of a tax base that generates a lot of aggregate revenue across the States will find that the HFE process takes away the benefits of that large share and redistributes it to the other States.

The important implication of this overall process is that if a large State such as NSW reforms its taxes in such a way as to tax more heavily those tax bases with which it is relatively well endowed, the increased weighting placed on those taxes in the HFE process would see its share of the GST revenue reduced. On the other hand, if NSW reduced the revenue from those tax bases, their reduced weighting would see NSW's share of the GST increase.

Box G.1 below provides a number of examples of the interaction between the revenue collected from various current State sources and the Commission's HFE processes. For States considering various tax reform options, it is therefore crucial that the impact of the limitations of the Commission's HFE processes on their grant allocation is directly factored into any discussion about the merits of or incentives from undertaking tax reform. The key limitations which need to be considered can be summarised as follows:

1. *The CGC fiscal equalisation methodology is not independent of State tax policies.* This non-neutrality arises because the CGC estimates of a State's Standardised Revenue from each tax type are based on 'average' State policies derived from actual State practices imposed on bases they are assumed to be unable to control. In practice, a State's tax policies do impact directly on the 'average' and can change the tax base. The result is that reform to a State's taxes does affect the magnitude of that State's grant through its effects on the distribution of total Standardised Revenue between all States.

2. *Each tax adopted by any State is examined independently from all other taxes:* No account is taken of whether a particular State should or should not introduce a tax for economic efficiency reasons. This could be important if the economic incidence of the tax is likely to be different in each State.
3. *No direct account is taken of inter-state or inter-national tax exporting:* This could be important if one State has a greater ability to export its taxes (say on natural resource exports or visiting tourists) compared to another jurisdiction. While this can be captured in part through tax capacity measures, such measures do not indicate the jurisdiction where the tax burden might ultimately reside. This is likely to be important with gambling and tourist based taxes and could be with taxes on exported manufactured goods such as a payroll tax.
4. *No account is taken of the implication of tax capitalisation:* Tax capitalisation is a commonly observed consequence of taxing an asset or the stream of earnings from that asset. This means that the tax rate schedule is not independent of the tax base so that in the case of land taxes, the different land tax regimes adopted by different Australian States can potentially result in differential impacts on asset prices in these States.
5. *Assessed GST relativities* are based on a 5 year moving average which can lead to a disjuncture between the immediate situation confronting a State and their grant allocation, even when . For example, the 2008 Assessed NSW GST Relativity is 0.91060. This is the relativity that applies in 2008-09. It is based on a five year average which encompasses a 2002-03 single year GST relativity of 0.83886 and a 2006-07 single year GST relativity of 0.96321. This means that over the 5 year period to 2006-07, NSW GST relativity for individual years rose by 14.8 per cent. For the natural resource endowed States of Queensland and WA, over the same period their GST relativities for individual years fell 14.6 per cent and 27.3 per cent respectively. This is at a time when their Assessed GST Relativities averaged over five years of data between 2003 and 2008 fell by -2.2, 5.3 and 8.9 per cent respectively. Clearly, the immediate fiscal experience of a State is removed from consideration in determining their grant allocation. While averaging has the benefit of offsetting any short term trends in relativities, it does offer some tax reform revenue planning opportunities for States.

Box G.1 Interaction between NSW taxes and share of the GST Pool

Examples where the CGC processes take money from States in relation to taxes that don't collect much money for that State in the first place:

- ▼ Gambling tax: In 2005-06 the ACT collected \$50.85m through this tax, but lost \$19.7m to other States through the CGC assessment process. That is, gambling in the ACT provided only \$30m or \$94pc, compared with the average of \$222pc. That is, the ACT's net revenue from gambling in 2005-06 was just enough to cover the costs of providing crisis accommodation and related services. (ACT Budget 2006-07, BP4 p 190.)
- ▼ Insurance taxes: In 2005-06 NSW collected \$523m through this tax, but lost \$99m to other States through the CGC assessment process. That is, insurance taxes in NSW provided only \$424m or \$62pc, compared with the average of \$110pc.
- ▼ Mining revenue: In 2005-06 the NT collected \$55m through this tax, but lost \$45m to other States through the CGC assessment process. That is, mining revenue in the NT provided only \$10m or \$48pc, compared with the average of \$197pc.
- ▼ Housing User Charges: In 2005-06 the NT collected \$30.5m through this tax, but lost \$17.5m to other States through the CGC assessment process. That is, housing user charges in the NT provided only \$13m or \$63pc, compared with the average of \$91pc.

Examples where the CGC processes give extra money to States in relation to revenue sources that the State already finds quite lucrative:

- ▼ Land Tax: In 2005-06, SA was able to collect \$291m from its own sources, which in per capita terms was already slightly above the average (\$188pc compared with the average of \$184pc). SA then collected more than half as much again (\$151m or \$98pc) from NSW because NSW had a larger proportion of the tax base.
 - ▼ Hospital Patient Fees: In 2005-06, the ACT was able to collect \$19.2m from its own sources, which in per capita terms was already well above the average (\$59pc compared with the average of \$41pc). It then collected an extra \$2.7m, or \$8pc, through the Commission.
 - ▼ Hospital Patient Fees: In 2005-06, the NT was able to collect \$8.6m from its own sources, which in per capita terms was already slightly above the average (\$42pc compared with the average of \$41pc). It then collected an extra \$2.1m, or \$10pc, through the Commission.
 - ▼ Property Titles Registration Fees: In 2005-06, SA was able to collect \$89m from its own sources, which in per capita terms was already double the average (\$58pc compared with the average of \$29pc). It then collected an extra \$5.6m, or \$4pc, through the Commission.
 - ▼ Public Safety User Charges: In 2005-06, Tasmania was able to collect \$44m from its own sources, which in per capita terms was already well above the average (\$90pc compared with the average of \$66pc). It then collected an extra \$8.1m, or \$17pc, through the Commission.
 - ▼ Housing User Charges: In 2005-06, the ACT was able to collect \$63.1m from its own sources, which in per capita terms was already more than double the average (\$193pc compared with the average of \$91pc). It then collected an extra \$5.0m, or \$15pc, through the Commission.
 - ▼ General Public Service User Charges: In 2005-06, SA was able to collect \$465m from its own sources, which in per capita terms was already almost triple the average (\$300pc compared with the average of \$112pc). It then collected an extra \$8.6m, or \$5.5pc, through the Commission.
-

Table G.2 shows the calculation of the per capita GST relativities for 2006-07.

Table G.2 Per capita GST relativities 2006-07

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Average State Budget Result	-202.85	-202.85	-202.85	-202.85	-202.85	-202.85	-202.85	-202.85
Plus: Assessed expenses	5657.16	5226.92	5734.56	6212.44	5634.26	6109.48	5595.92	14534.65
	5454.31	5024.06	5531.71	6009.58	5431.40	5906.63	5393.07	14331.80
Less: Assessed revenue	2753.89	2385.40	2961.62	3852.11	2119.43	1847.73	2327.14	2450.49
Total requirement for financial assistance	2700.42	2638.66	2570.09	2157.47	3311.98	4058.91	3065.92	11887.31
Less: SPPs treated by inclusion	472.54	425.59	481.05	494.77	484.40	498.67	370.80	978.99
GST and HCGs requirement	2227.96	2213.07	2089.04	1662.70	2827.58	3560.23	2695.13	10902.32
Per Capita relativity ^a	.96321	.95677	.90315	.71883	1.22244	1.53918	1.16517	4.71336

^a Per capita relativities are equal to each State's GST and HCG requirements divided by the average GST and HCGs.

Source: CGC, *Report on State Revenue Sharing Relativities 2008 Update*, Table B-10.

H Framework for intergovernmental consultation

The Council of Australian Governments (COAG) is the peak intergovernmental forum in Australia. It is chaired by the Prime Minister and includes each State's Premier and a representative from local government. The role of COAG is to initiate, develop and monitor the implementation of policy reforms that are of national significance and which require cooperative action by Australian governments.

Supporting COAG are over 40 Commonwealth-State Ministerial Councils relating to particular areas of portfolio responsibility. Both Ministerial Councils and COAG can initiate, develop and monitor the implementation of policy reforms of national significance requiring cooperative action. When formal agreement is needed, this is embodied in an Intergovernmental Agreement.

One such instance was the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA). The IGA established the Ministerial Council for Commonwealth-State Financial Relations, which comprises the Commonwealth and State Treasurers. It was established on 1 July 1999 to, inter alia, oversee the operation of the GST and discuss the recommendations of the Commonwealth Grants Commission (CGC) on the interstate sharing of the GST, prior to the Commonwealth Treasurer determining those shares.

The Ministerial Council's functions include:

- i) the oversight of the operation of the GST
- ii) the oversight and coordination of the implementation of the IGA
- iii) the review of matters of operational significance raised through the GST Administration Subcommittee
- iv) discussion of Commonwealth Grants Commission recommendations regarding relativities prior to the Commonwealth Treasurer making a determination
- v) monitoring compliance with the conditions governing the provision of assistance to first home owners set out in Appendix D to the IGA
- vi) monitoring compliance with the Commonwealth's undertaking with respect to SPPs
- vii) considering reports of the GST Administration Subcommittee on the performance of the ATO in GST administration
- viii) reviewing the operation of the IGA over time and considering any amendments which may be proposed as a consequence of such review

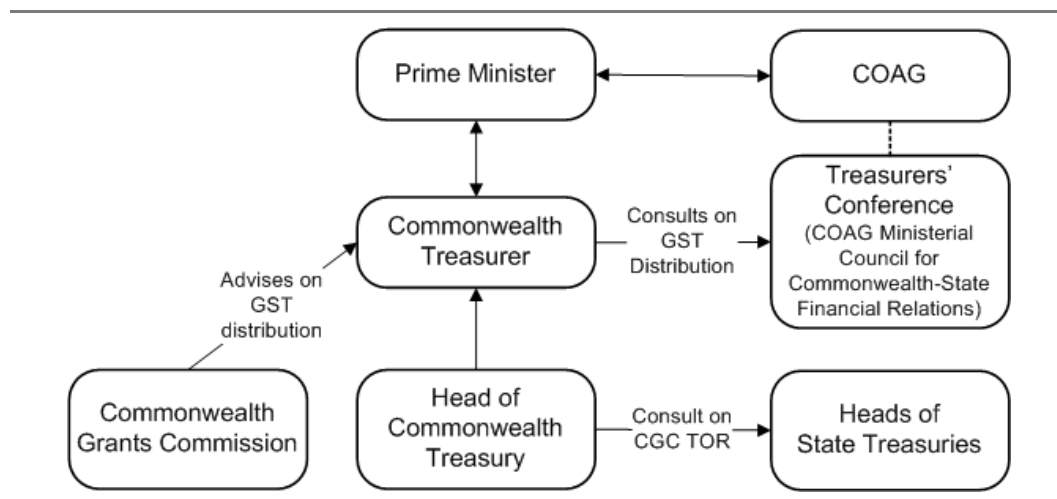
- ix) making recommendations to the Commonwealth Treasurer on the Guaranteed Minimum Amount applying to each State and Territory under the Transitional Arrangements
- x) approving changes to the GST base which require the support of a majority of Commonwealth, State and Territory Governments
- xi) considering on-going reform of Commonwealth-State financial relations
- xii) considering other matters covered in the IGA.

Under the IGA the Commonwealth Treasurer, as Chair, convenes the Ministerial Council in consultation with the other members of the Council not less than once each financial year. If the Commonwealth Treasurer receives a request from a member of the Council, the Commonwealth Treasurer consults with the other members concerning convening a meeting.

Under the former Howard Government, the Commonwealth Treasurer, as chair of the Ministerial Council for Commonwealth-State Financial Relations, insisted that any departure from the CGC's recommendations had to be supported by all States. Since the recommendations relate to a fixed pool, such unanimous agreement was never going to occur, regardless of the merits of the argument.

Supporting the Ministerial Council for Commonwealth-State Financial Relations are regular meetings of the Heads of the Commonwealth and State Treasuries. The Heads of Treasuries (HOTS) meetings provide the forum for negotiating the Terms of Reference for the CGC's annual updates, although as chair, the Head of the Commonwealth Treasury retains the final say.

Figure H.1 Intergovernmental Consultative Framework



I Assignment of taxes to national and subnational governments

The table below considers a range taxes, and their suitability for assignment at the subnational, or State level.

Table I.1 Suitability of taxes for assignment to subnational government

Tax	Suitability for assignment to subnational government
Taxes on income, profits and capital gains of individuals (OECD tax classification 1000)	The literature on fiscal federalism suggests that subnational governments should minimise the use of highly mobile tax bases, redistributive taxes, and taxes subject to sharp cyclical fluctuations ^a . It thus excludes corporate income taxes and personal income taxes which are both imposed at the subnational level and subject to large interstate differentials. It also excludes redistributive personal income taxes at the State level but does not exclude a subnational surcharge on a national tax.
Corporate taxes on income, profits and capital gains (OECD tax classification 1200)	See comments above for personal taxes. Also, the volatility of corporate income tax revenues compared with other tax revenues makes this revenue source problematic for subnational governments. This is because the financing needs for State governments' core expenditure responsibilities are often largely unresponsive to the economic cycle (eg, education) or tend to increase during down turns (eg, social assistance). The need to split corporate income tax revenues when a company operates in several jurisdictions can also be problematic in terms of administration and compliance.
Taxes on payroll and workforce (OECD tax classification 3000)	Payroll tax revenue is more predictable than many taxes as it tends to grow steadily in line with wages and employment growth, making it suitable for subnational government. While a broad based payroll tax is theoretically efficient, in practice its economic efficiency can be reduced by its selective application which narrows the potential tax base considerably (eg, through high tax free thresholds), although harmonisation of bases ^c by subnational governments could address some inefficiencies.

^a See Joumard, I. and Kongsrud, P.M. (2003b).

^b The Australian Government's International Comparison of Australia's Taxes, 3 April 2006, recognises that while it is difficult to substantiate the actual incidence of payroll taxes, it is widespread practice to assume that taxes levied in respect of remuneration are ultimately borne by the employee (p 60).

^c Harmonisation of tax bases includes common definitions, allowances and exemptions, and uniform approaches to administration. A more extended definition could include common tax rates and thresholds.

^d Imposta Regionale sulle Attività Produttive (IRAP) is a subtraction method VAT, that is, (tax rate)*(outputs-inputs), with revenue accruing to the region where value is added.

Table I.1 (ctd) Suitability of taxes for assignment to subnational government

Tax	Suitability for assignment to subnational government
Taxes on property (OECD tax classification 4000)	<p>Interstate tax competition on the tax rate can also potentially reduce the effectiveness of payroll tax as a revenue source for State government.</p> <p>Property taxes have key advantages as subnational taxes. Most notably, the base is highly immobile, the tax is difficult to evade and efforts to improve local infrastructure are likely to be reflected in property values, thus increasing the yield for subnational governments. Property tax revenue is also relatively predictable. Property taxes avoid some of the pitfalls of consumption taxes making them generally attractive for subnational government use. However, they raise equity issues and their yield is often low (revenue from property taxes amounted to less than 2 per cent of tax revenue in the OECD in 2000) (Joumard and Kongsrud 2003). In the case of taxes on financial and capital transactions, while inefficient they are nonetheless suitable as State taxes because they are imposed on a relatively immobile base.</p>
Taxes on goods and services (OECD tax classification 5000, and 5110 representing VAT, sales tax and other general taxes on goods and services)	<p>Giving subnational governments discretionary powers with respect to general consumption taxes, either sales taxes or value-added taxes, may involve high compliance and administrative costs to contain tax fraud and evasion and may create distortions in interjurisdiction trade. These difficulties reduce the attractiveness of general consumption taxes for subnational governments. However, a subnational supplement to the national tax is not uncommon. In Canada, an 8 percentage point addition to the 7 per cent national GST is added by some provinces; in Italy an addition to the national VAT is added by regions in the form of an IRAP.^d In Germany and Austria State governments share VAT revenues with the central government.</p>
User Fees and Charges	<p>Reliance on user fees and charges by subnational governments faces two main constraints. First, increasing subnational government reliance on user charges may raise equity concerns, especially where applied to core goods and services (namely education, health care and social assistance). Second, user charging is an attractive option only if the implementation costs are lower than the expected efficiency gains. Implementation costs are also likely to reflect scale economies and thus be high in the smaller jurisdictions.</p>

J | Sensitivity Analysis for Weights

To undertake its assessment of NSW taxes against the standard tax principles (efficiency, equity, simplicity and transparency) and robustness, IPART rated each criterion out of 5 (where 5 means the tax meets the criteria very well, and 0 means it barely meets it at all). So that it could compare the taxes with each other, IPART also applied a weighting system to the ratings for each criterion, based on their relative importance for the purpose of this analysis. For the analysis in this report IPART used the following weights:

- ▼ efficiency has a weighting of 40 per cent
- ▼ robustness and equity each have a weighting of 20 per cent
- ▼ simplicity and transparency each have a weighting of 10 per cent.

Using these weights IPART calculated a weighted score for each tax and ranked the taxes according to this score.

The above weights reflect IPART's views that efficiency is more important than the other criteria followed by robustness and equity. For this assessment, transparency and simplicity have the least importance.

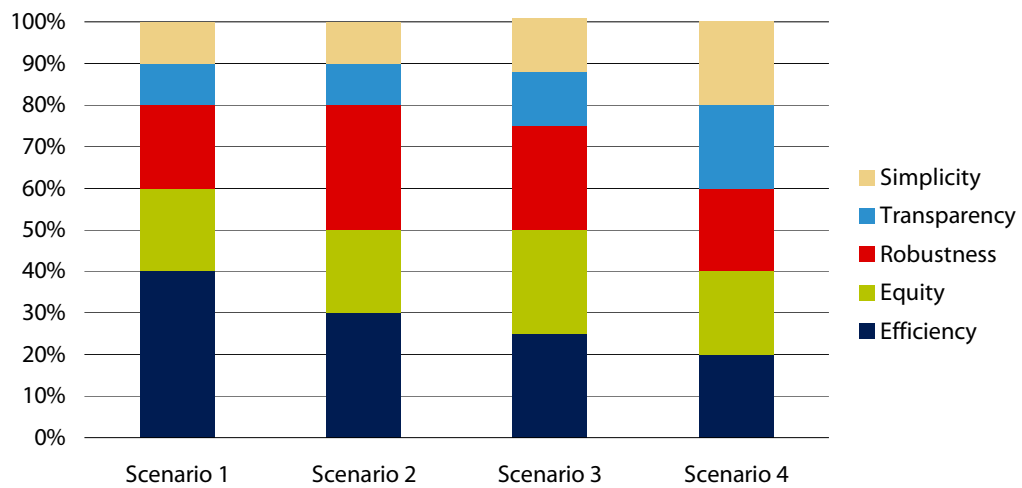
To test the sensitivity to changing weights, IPART used a number of alternative weightings, as shown in Table J.1 and Figure J.1. The resultant rankings are shown in Table J.2 and Figure J.2 (the detailed ratings, weighted scores and rankings for each of the taxes on the four Scenarios are shown in Table J.3).

Figures J.2 and J.3 show that, for the first three weighting Scenarios, the rankings are reasonably robust to changes in the weights. However, the rankings are not robust for changes in weights when equal weights are applied. Equal weighting for each criterion would increase the weighting for transparency and simplicity. The weighting for efficiency would reduce compared to the preferred scenario, while for equity and robustness the weighting would be the same in relation to the preferred scenario but would be less than in Scenarios 2 and 3.

The taxes whose rankings would be most affected by using equal weights would be Land Tax (+5 positions), Purchaser Transfer Duty (-3) and Fire Services Levy (-2). For the other taxes the movements in rankings are small.

Table J.1 Alternative weight Scenarios used in determination of ranking of taxes

	Efficiency	Equity	Robustness	Transparency	Simplicity
Scenario 1	40%	20%	20%	10%	10%
Scenario 2	30%	20%	30%	10%	10%
Scenario 3	25%	25%	25%	12.5%	12.5%
Scenario 4	20%	20%	20%	20%	20%

Figure J.1 Comparison of weights attributed to each criterion

- a** Efficiency 40%, Equity 20%, Robustness 20%, Transparency 10%, Simplicity 10%.
b Efficiency 30%, Equity 20%, Robustness 30%, Transparency 10%, Simplicity 10%.
c Efficiency 25%, Equity 25%, Robustness 25%, Transparency 12.5%, Simplicity 12.5%.
d Efficiency 20%, Equity 20%, Robustness 20%, Transparency 20%, Simplicity 20%.

Table J.2 Rankings using alternative weight Scenarios

	Scenario 1 ^a	Scenario 2 ^b	Scenario 3 ^c	Scenario 4 ^d	Range	Difference
Payroll tax	1	1	1	1	[1, 1]	0
Land tax	3	3	6	8	[3, 8]	5
Purchaser transfer duty	8	8	6	5	[5, 8]	3
Insurance duty	6	7	3	3	[3, 7]	4
Motor vehicle registration duty	3	3	3	4	[3, 4]	1
Weight tax	1	1	1	1	[1, 1]	0
Fire services funding contributions	7	3	5	5	[3, 7]	4
Gambling taxes	3	3	6	7	[3, 7]	4

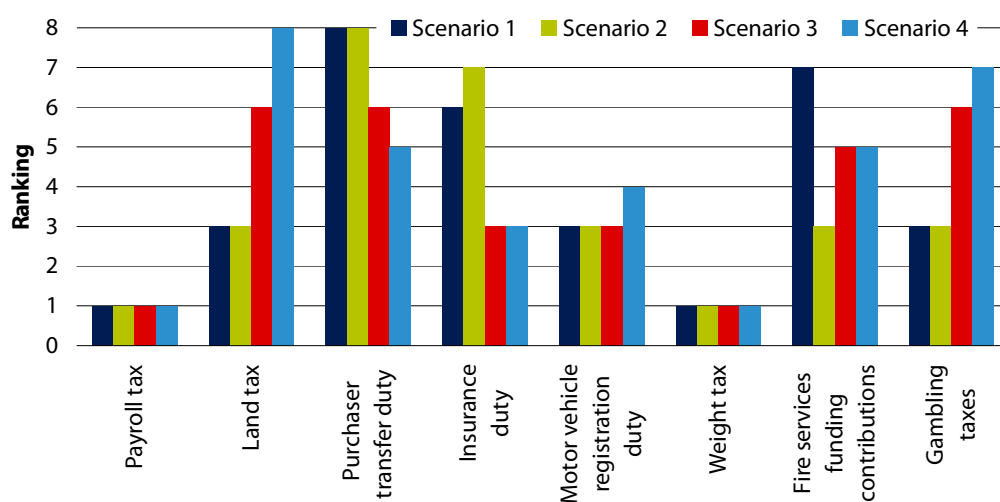
a Efficiency 40%, Equity 20%, Robustness 20%, Transparency 10%, Simplicity 10%.

b Efficiency 30%, Equity 20%, Robustness 30%, Transparency 10%, Simplicity 10%.

c Efficiency 25%, Equity 25%, Robustness 25%, Transparency 12.5%, Simplicity 12.5%.

d Efficiency 20%, Equity 20%, Robustness 20%, Transparency 20%, Simplicity 20%.

Source: IPART Analysis.

Figure J.2 Rankings using alternative weight Scenarios

Note: A ranking of 1 means that the tax was rated best against the criteria, while a ranking of 8 indicates that the tax was rated the worst against the criteria.

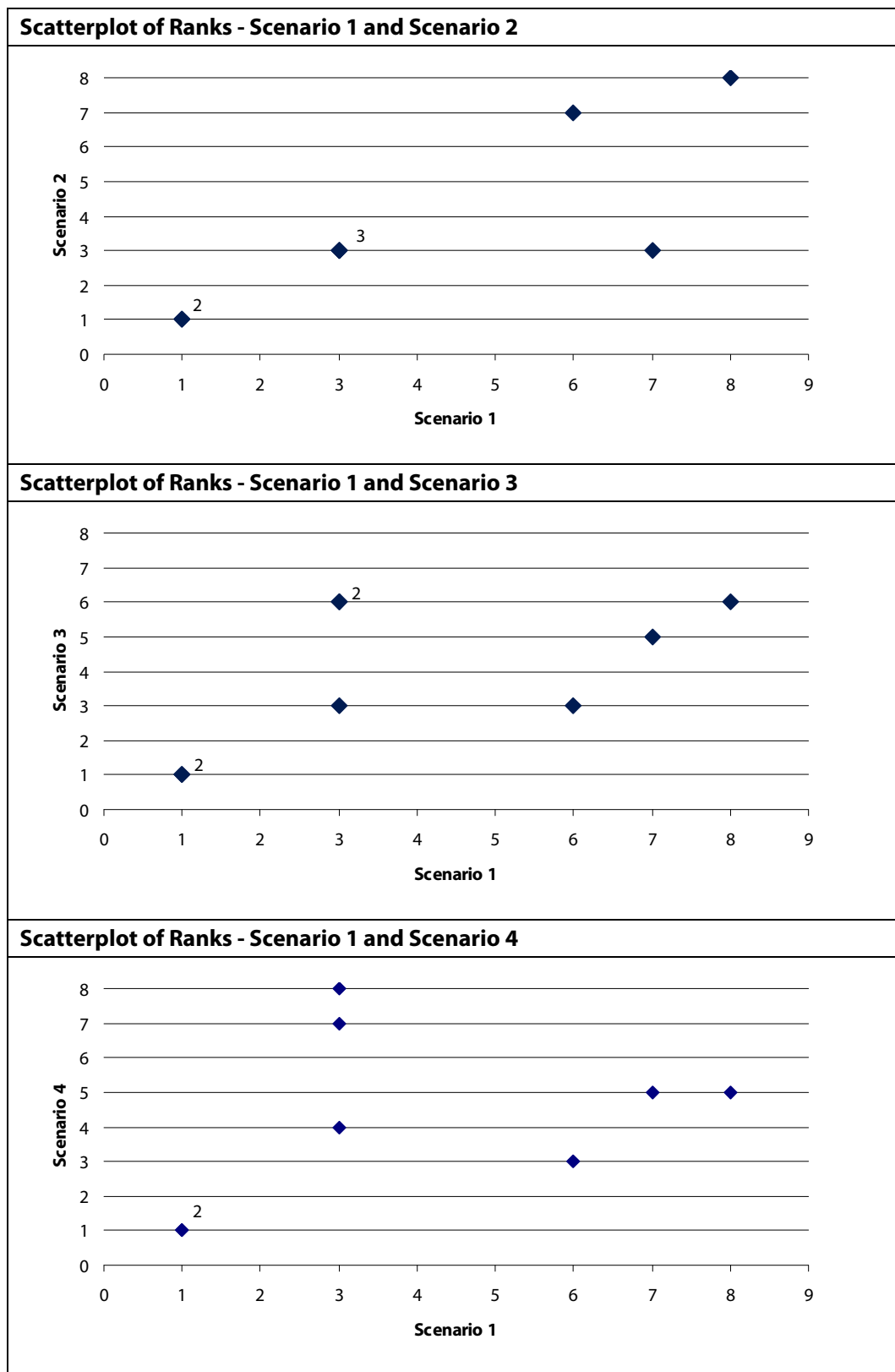
Data source: IPART Analysis.

Table J.3 Calculation of weighted scores and rankings under 4 Scenarios

Tax	Efficiency	Equity	Robustness	Transparency	Simplicity	Weighted Score	Rank
Scenario 1	40%	20%	20%	10%	10%		
Payroll tax	3	2	4	4	4	3.2	1
Land tax	3	2	3	2	1	2.5	3
Purchaser transfer duty	2	2	1	4	3	2.1	8
Insurance duty	1	3	2	4	5	2.3	6
Motor vehicle registration duty	2	3	2	3	4	2.5	3
Weight tax	3	2	4	4	4	3.2	1
Fire services funding contributions	1	2	4	3	3	2.2	7
Gambling taxes	3	1	3	1	4	2.5	3
Scenario 2	30%	20%	30%	10%	10%		
Payroll tax	3	2	4	4	4	3.3	1
Land tax	3	2	3	2	1	2.5	3
Purchaser transfer duty	2	2	2	4	3	2.3	8
Insurance duty	1	3	2	4	5	2.4	7
Motor vehicle registration duty	2	3	2	3	4	2.5	3
Weight tax	3	2	4	4	4	3.3	1
Fire services funding contributions	1	2	4	3	3	2.5	3
Gambling taxes	3	1	3	1	4	2.5	3
Scenario 3	25%	25%	25%	13%	13%		
Payroll tax	3	2	4	4	4	3.3	1
Land tax	3	2	3	2	1	2.4	6
Purchaser transfer duty	2	2	2	4	3	2.4	6
Insurance duty	1	3	2	4	5	2.6	3
Motor vehicle registration duty	2	3	2	3	4	2.6	3
Weight tax	3	2	4	4	4	3.3	1
Fire services funding contributions	1	2	4	3	3	2.5	5
Gambling taxes	3	1	3	1	4	2.4	6

Tax	Efficiency	Equity	Robust- ness	Transpar- ency	Simplicity	Weighted Score	Rank
Scenario 4	20%	20%	20%	20%	20%		
Payroll tax	3	2	4	4	4	3.4	1
Land tax	3	2	3	2	1	2.2	8
Purchaser transfer duty	2	2	2	4	3	2.6	5
Insurance duty	1	3	2	4	5	3.0	3
Motor vehicle registration duty	2	3	2	3	4	2.8	4
Weight tax	3	2	4	4	4	3.4	1
Fire services funding contributions	1	2	4	3	3	2.6	5
Gambling taxes	3	1	3	1	4	2.4	7

Source: IPART Assessment.

Figure J.3 Scatterplot of rankings for pairs of scenarios

Glossary

ABS	Australian Bureau of Statistics
ATO	Australian Taxation Office
AWB	Analytical Work Bench
CGC	Commonwealth Grants Commission
COAG	Council of Australian Governments
CPI	Consumer Price Index
CRC	COAG Reform Council
CTP	Compulsory Third Party
ESL	Emergency Services Levy
FAG	Financial Assistance Grant
GSP	Gross State Product
GST	Goods and Services Tax
GVM	Gross Vehicle Mass
HCG	Health Care Grants
HFE	Horizontal Fiscal Equalisation
HOTS	Heads of Treasuries
IGA	Intergovernmental Agreement on the Reform of Commonwealth-State Financial relations
IPART	Independent Pricing and Regulatory Tribunal
MOU	Memorandum of Understanding
NCC	National Competition Council

NCP	National Competition Policy
NECS	National Electronic Conveyancing System
OECD	Organisation for Economic Cooperation and Development
OFM	Office of Financial Management (NSW Treasury)
OSR	Office of State Revenue (NSW Treasury)
PTD	Purchaser Transfer Duty
PTE	Public Trading Entity
RRP	Revenue Replacement Payment
SBR	Standard Business Reporting
SPP	Specific Purpose Payment
SRO	State Revenue Office
TAB	Totaliser Agency Board
TRP	Treasury Research Paper
VFI	Vertical Fiscal Imbalance
WST	Wholesale Sales Tax

