REAL ESTATE INSTITUTE OF AUSTRALIA

REIA SUBMISSION TO SENATE SELECT COMMITTEE ON STATE GOVERNMENT FINANCIAL MANAGEMENT

PROPOSAL

1. In order to address the significant vertical fiscal imbalance evident between the Commonwealth and State and Territory Governments, the Real Estate Institute of Australia (REIA) proposes that:

    a. a constitutional review of the roles and responsibilities of Australian Governments be undertaken, either separately, or as part of the proposal to move towards the establishment of an Australian Republic arising from the Australia 2020 Summit; and

    b. a broad, 'clean sheet' review of Australia's taxation system be undertaken as per the proposal arising from the Australia 2020 Summit. Alternatively, taxation reform could be pursued via the implementation of a new IGA on tax reform, focussing on using GST windfall gains to fund the abolition of remaining inefficient State and Territory taxes.

BACKGROUND

2. The REIA welcomes the opportunity to make a submission to the *Senate Select Committee on State Government Financial Management.*

3. The REIA is the peak national professional association for the real estate industry in Australia. The REIA has eight members, comprised of the State and Territory Real Estate Institutes, through which about 80% of real estate agencies are collectively represented.

4. The Australian property and business sector is taxed significantly by all levels of Australian Government. Property taxes are most prominent at the State and Territory level. State Government financial management is closely linked to the levels of taxation that are applied at the State and Territory level, and also the flow of monies between the different levels of Australian Government.

ISSUES

State and Territory Taxation

5. According to the 2005-06 Australian Bureau of Statistics (ABS) publication *Taxation Revenue*, the total amount of taxation levied across all levels of Australian Governments in 2005-06 was $297, 942m. Taxation revenues have grown by around 39% across all levels of Government between 2000-2001 and 2005-2006.

6. As illustrated in Table 1 (below), the proportion of total taxation collected by State and Territory Governments varies depending upon whether or not the GST is considered to be a Commonwealth or a State and Territory Tax. The total level of taxation raised directly by State and Territory Governments in 2005-06 was $44,235m. A further $38,884m was raised by the Commonwealth on behalf of the States and Territories via the GST.

2005-06	Taxation Proportions – GST Attributed to Commonwealth	Taxation Proportions – GST Attributed to States and Territories
Commonwealth	82%	69%
State and Territory	15%	28%
Local	3%	3%

Table 1: *Taxation Proportions for Australian Governments 2005-06. Source* ABS Taxation Revenue 2005-06.

7. State and Territory taxes on property amounted to at least $15,521m during 2005-06, or at least 35% of total State and Territory taxation (this figure does not include other taxes potentially attributable to the property sector such as stamp duties on mortgages, marketable securities, parking levies, metro improvement levies, fire/emergency levies or financial accommodation levies). This represents the largest proportion of taxation collected by, or on behalf of, State and Territory Governments aside from the GST.

8. **Stamp Duties.** Stamp duties on property conveyances represent approximately 71% of all property taxes applied by State and Territory Governments. Stamp duties on property conveyances represent a narrowly focussed turnover tax, which imposes a high deadweight economic cost on the community. According to a 2006 report published by Robert Carling of the Centre for Independent Studies, *State Taxation and Fiscal Federalism – A Blueprint for Further Reform* (The Carling Report), stamp duties have been subject to massive bracket creep over the past 20 years, resulting in an increase in the stamp duty applicable on a median Sydney house in 1986 of 2%, to around 3.6% in 2006 (an 80% increase in the tax burden).

9. The Carling Report states that stamp duties on property conveyances *"….distorts choices between buying and renting and between moving house and staying put or renovating. It tends to lock householders into sub-optimal housing and militates against resource mobility. Marginal deadweight costs have increased over the years as a rising proportion of transactions have become subject to the upper levels of the progressive scales."*

10. The imposition of stamp duties is a major factor affecting housing affordability. The REIA estimates that an additional $10,000 borrowed at the outset of a loan to cover stamp duties results in a real cost of around $46,000 over the duration of a 20 year loan.

11. **Land Taxes.** Land taxes are levied by State and Territory Governments on unimproved land value, with the principal place of residence being exempt. According to the ABS, the States and Territories together collected $3.6b in land taxes during 2005-06, representing around 23% of all property taxes collected at this level.

12. From the perspective of the potential property investor, land taxes represent a significant holding tax which is not applicable to other investments such as shares. Land taxes reduce the level of return for property investors, can lead to cash flow difficulties and effectively diminish the overall attractiveness of investing in new housing supply. For example, in the ACT, land tax can represent an annual average impost on the landlord of 15% – 20% of rent return after tax on a median residential property price in addition to mortgage repayments, normal rates, and maintenance etc. This additional impost can be considerably higher in some cases (e.g. inner suburbs can attract an impost of 40%). Effectively, investors without significant cash flow in addition to the rental return are denied the opportunity to invest in property.

State and Territory Spending and the Fiscal Imbalance

13. According to the Carling Report, State and Territory Governments are responsible for around 40% of all public spending. There is apparently a problem where Federal Government is making a surplus of $20b and State and Local Governments are barely funded.

14. Given that State and Territory Governments collect just 15% of total taxation revenue (or 28% including the GST), there is a clear fiscal imbalance between the revenue raising capacity of State and Territory Governments and the public expenditures for which they are responsible. The Commonwealth Government on the other hand collects around 80% of total taxation revenue yet is responsible only for around 54% (in terms of tax collected) of own purpose spending.

15. To make up this shortfall, the State and Territories are reliant on other monies in the form of payments for services, loans, tied grants from the Commonwealth and the general purpose GST grant.

Consequences of the Fiscal Imbalance

16. From the perspective of the REIA, there are three significant negative consequences arising from the Commonwealth-State fiscal imbalance.

17. **A Weaker Federation.** The States and Territories do not enjoy a substantial degree of financial autonomy from the central authority, as should be the case in a strong federation. States and Territories do not have the power to alter the level of GST which is collected on their behalf and are disempowered through the seeking of Commonwealth monies in the form of tied grants for the provision of services which are clearly the responsibility of the State and Territories. For this reason, States and Territories may resist funding new or enhanced community initiatives, leading to Governments blame shifting as a means of avoiding funding liabilities. In essence, the vertical fiscal imbalance breaks the nexus between expenditure responsibility and revenue raising responsibility, resulting in overlapping responsibilities. At the end of the day, inter-governmental relationships are undermined and Australian citizens are denied public services to which they should be entitled.

18. **Perpetuation of Inefficient State and Territory Taxes.** An ongoing lack of financial autonomy results in States and Territories clinging to taxation regimes which are known to be distortionary and inefficient. While significant progress was made as a result of the implementation of the intergovernmental agreement underpinning the introduction of the GST, a raft of relatively inefficient State and Territory taxes remain in place, with little prospect of removal in the absence of alternative revenue sources. These taxes include stamp duties on property conveyancing, land tax and payroll tax.

19. **Development Charges.** States and Territory Governments are increasingly seeking funding opportunities in areas where they have traditionally been net contributors. For instance, State and Territories have been steadily moving away from their traditional role in promoting urban development through providing required planning and infrastructure from consolidated funds, towards a model which constrains property development via onerous planning restrictions (acting to reduce the Government's trunk infrastructure costs) and significant charges imposed directly on those seeking to develop new land. This philosophy not only affects housing developments but also commonly permeates other community infrastructure projects such as the provision of new roads (i.e. toll roads) and utility provision (e.g. privatisation of gas, water and electricity providers). Essentially, State and Territory Governments now appear to view new housing developments as a revenue raising opportunity as opposed to an opportunity to invest consolidated community funds in increasing the overall economic base.

The Roles and Revenue Raising Capacity of Australian Governments

20. It is clear that there is an entrenched fiscal imbalance between the Commonwealth Government and the Australian States and Territories resulting in a lack of autonomy, the perpetuation of inefficient taxes and the imposition of steep development charges at the State and Territory level. The imbalance also leaves Governments apt to blame shifting and reluctant to address matters that require significant new funding.

21. In order to rectify this fundamental problem with the Australian Federation, a full review of the roles and responsibilities of Australian Governments will be required. In the context of the outcomes of such a review, it will be necessary to recast the Australian taxation system to ensure that all levels of Government enjoy an appropriate level of fiscal independence and that the taxes which support Governments are more efficient and independently controlled. Ideally, Australian taxation should move away from narrow-based, high rate, turnover taxes (such as stamp duties) towards more broadly based, low rate, growth taxes (such as the GST, income tax and company tax).

Opportunities

22. **Australia 2020 Summit.** There are several outcomes of the recently concluded Australia 2020 Summit that reflect the notions of recasting the roles and responsibilities of Australian Governments as well as the funding models that underpin them. For instance, the Summit has proposed:

a. the holding of a constitutional convention to define roles, responsibilities and structures of our Federal system; and
b. the establishment of a National Cooperation Commission to oversee and recommend on intergovernmental agreement.

23. The Summit also suggested that Australia must move towards a seamless national economy and single national markets in major areas of economic activity (including labour, energy, water, transport and communications). Supporting this idea was the proposal to establish an independent body to carry out a “clean sheet of paper” review of the roles and responsibilities of Federal, State and Territory, and Local Governments in areas of major economic activity.

24. On the taxation front, the Summit has proposed that the Federal Government undertake a comprehensive review of State and Federal taxes, within a 2 year timeframe, which would consider measures to simplify taxes, reduce inefficient taxes, harmonise tax regimes, ensure a progressive system, and address negative interaction with the welfare system.

A New Intergovernmental Agreement on Tax Reform

25. The 1999 *Intergovernmental Agreement on Tax Reform* (IGA) committed the Australian States and Territories to the abolition of a range of inefficient taxes in return for revenues arising from the implementation of the GST. While many taxes have now been, or are scheduled to be, eliminated, many inefficient State and Territory Taxes remain in place including stamp duties (including ‘tax on tax’ stamp duties payable on GST), land taxes and payroll tax.

26. According to figures published by Treasury as part of the 2007-08 Commonwealth Budget, all States and Territories are projected to receive GST payments exceeding the guaranteed minimum amount (GMA – represents the level of taxation expected to be received in the absence of GST related tax reform) in all years from 2006-07 to 2010-11. Table 2 below illustrates the projected net windfall gains of all States and Territories to 2010-11.

Jurisdiction ($million)	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	ALL
2006-07	162	450	681	327	203	109	61	119	2,112
2007-08	631	725	830	429	269	117	82	124	3,208
2008-09	970	1,017	966	530	342	131	97	127	4,181
2009-10	1,103	1,122	967	560	382	140	102	142	4,519
2010-11	1,117	1,189	893	517	402	152	112	173	4,554

Table 2: *Projected Net GST Windfall for Australian States and Territories 2006-07 to 2010-11.* Source: Commonwealth Treasury Budget 2007-08.

27. Given that GST payments are now exceeding the GMA in all States and Territories, there is a very strong case for State and Territory Governments to commit to the abolition of remaining inefficient taxes. The REIA asserts that, pending the outcomes of a broader governance and taxation review, that a new IGA should be established which aims to use GST windfall gains to fund the abolition or reduction of remaining inefficient State and Territory taxes.

SUMMARY

28. There is a fundamental fiscal imbalance between the Commonwealth Government and State and Territory Governments. The autonomy of State and Territory Governments has been undermined as they become increasingly reliant on the general purpose GST grant, Commonwealth tied grants, borrowing and service charges to raise sufficient revenue for the delivery of public services. The perpetuation of this imbalance weakens the Australian Federation, undermines efforts to remove inefficient State and Territory taxes and promotes the application of onerous development charges.

29. To address this fiscal imbalance, the REIA asserts that a review of the roles and responsibilities of Australian Governments is required, in conjunction with a review of the taxation models supporting the various Australian Governments.

30. Opportunities for a broad constitutional review and 'clean sheet' taxation reform have arisen as outcomes of the Australia 2020 Summit. Taxation reform could alternatively be pursued via the implementation of a new IGA on tax reform, focussing on using GST windfall gains to fund the abolition of remaining inefficient State and Territory taxes.

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