

AUSTRALIA'S FUTURE TAX SYSTEM REVIEW REPORT

2 MAY 2010

ALGA OVERVIEW BRIEFING

Overview

On Sunday 2 May 2010, the Australian Government released the Australia's Future Taxation System Review Report (the Report). It also released its response to the Report, titled *Stronger, Fairer, Simpler – a Tax Plan for our Future*.

The Report (over 700 pages long) serves as a comprehensive guide to the Australian taxation system as it encompasses the three levels of government and the three main sources of taxation in Australia: capital, consumption and labour. This is consistent with the Review having been established as a 'roots and branch' one, although the GST base and rate are not included (these were specifically excluded from the Terms of Reference establishing the Review).

Through both 'findings' and 'recommendations', the Report sets out directions for the future of Australia's tax and transfer system, covering all major types of taxation levied in Australia (other than the GST). These include: personal taxation (including person income tax); land tax; superannuation and retirement incomes; taxation of not-for-profits; user charging; housing affordability; road transport taxes; payroll tax; non-renewable resources tax; and local government.

The Report contains 138 recommendations based fundamentally on maximizing '4 efficient and robust tax bases' – personal income; business income; private consumption; economic rents (including land). In turn, the recommendations are aimed at advancing the 3P's (population, productivity and participation) especially the latter two.

Overall, the Report finds that there are fundamentally sound aspects of the current system but that "Australia has too many taxes and too many complicated ways of delivering multiple objectives through the tax system" (p.11 overview document).

Making the taxation and transfer system less complex, and enhancing the experience of taxpayers with the taxation and transfer system, are key themes throughout the Report.

Of note: the Report finds that the most inefficient taxes are levied predominantly by the states.

The report and local government (broad overview only: more detail below)

The Report includes a separate chapter on local government (section G3) but contains only two recommendations about local government – recommendations 120 and 121 regarding local government rates (see below) - but others of relevance include recommendations in the areas of road user charging, housing affordability, aged care, state taxes and income tax dealing with Fringe Benefits Taxation (FBT).

The Australian Government's response as released today is limited in that over the short-term it takes up only a small number of the 138 recommendations presented in the Report. This is contrary to a number of reports in the media leading up to the announcement today. However, the Australian Government has said that today's response constitutes the 'first steps' in its 'long term tax plan' which will be a '10 year agenda'. Given the Prime Minister has indicated that 'in the coming months, we will have more to say on a number of other areas considered by the review...' ALGA expects that a number of the recommendations will be announced/progressed as part of the Federal election campaign.

The Australian Government's response does not take up any of the recommendations relating directly to local government.

The Australian Government does rule out 27 of the more politically sensitive recommendations.

Background to Review Report and ALGA's involvement

The Review was announced just prior to the Federal Budget 2008-09 with the Australian Government establishing an 'independent' panel to conduct the review, which was to end at the end of 2009. The Review Panel comprised Dr Ken Henry (Treasury Secretary), Greg Smith, Professor Piggott, Heather Ridout, and Jeff Harmer.

ALGA lodged two submissions to the Review (October 2008 and June 2009) and met with the Review Panel in relation to each. The Panel received 1,500 submissions in total.

The Australian Government received the Report in December 2009.

All material relevant to the Report including the Australian Government's response, is at www.futuretax.gov.au

ADDITIONAL INFORMATION

The Australian Government response

The *Stronger, Fairer, Simpler – a Tax Plan for our Future* announces the first components of the implementation of the new 10 year agenda, covering resource, company and small business taxes, and superannuation, specifically:

- Introduction of a Resource Super Profits Tax (RSP tax) to be levied by the Australian Government.
 - According to the Australian Government, this is ‘to ensure Australians get a fair share from our valuable non-renewable resources’.
 - State royalties will be rebated and the States will be consulted on the implementation of the RSP tax. One-third of the revenue levied from this tax will be used to help the resource sector – through a Resource State Infrastructure Fund (starting at \$700m from 2012-13) and a Resource Exploration Rebate. ALGA would expect that the Fund would be administered through Infrastructure Australia although this is not stated explicitly in the materials released today.
- A further one-third of the revenue from the RSP will enable a phased cut in the company tax rate to 28 per cent with small business benefitting from the cut from 2012-13 (the Report recommends the company tax rate should be reduced to 25 per cent in the medium term but Treasurer Swan today has said 25 per cent is unaffordable at this time) and small business will benefit from a new instant write-off for assets worth up to \$5000. Depreciation for other assets will be simplified.
- Superannuation reforms will also be implemented through the allocation of the remaining one-third of the RSP taxation. The reforms will see the superannuation guarantee gradually increase to 12 per cent from 9 per cent (commencing with a 0.25 increase in 2013-14 and 2014-15 with full effect in 2019-20) and those over 50 with low super balances will be given more generous contributions caps.

The Australian Government has noted that the reforms are expected to increase Australian GDP by 0.7 per cent and real wages by 1.1 per cent ‘in the long run’.

Importantly, the Australian Government has made very clear that the package is dependant on the successful implementation of the RSP and has announced consultations will commence on the RSP from 24 May 2010.

In addition, the Australian Government has ruled out 27 of the remaining Report recommendations which are politically difficult. Of particular relevance to local government is

the decision to reject a recommendation for a broad-based land tax which would have been imposed on properties including the family home.

The Report and local government

Many of the points raised about local government take up directly the points noted by ALGA in its submissions to the Review. However, some of the implications of some conclusions are not readily apparent and would need to be further examined in detail.

Local government

Local government is the exclusive focus of Chapter G3 of the report which is where the two direct recommendations about local government are made. These are Recommendations 120 and 121, which state

Recommendation 120 States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality) and

Recommendation 121 Over time, state land tax and local government rates should be more integrated, which could involve (a) moving to a joint billing arrangement so that taxpayers receive a single assessment but can identify the separate state and local government component; and (b) using the same valuation method to calculate the base for local government rates and land tax, with the method being consistent across the State. The status of this recommendation – which related to a broader based land tax subsequently ruled out by the Government – is unclear.

so there are many positive findings presented in the Report in relation to local government. These include that:

- Local governments have come to play an important role in the delivery of government services in Australia (p.689) and that ‘given the expertise that local governments have in the delivery of some goods and services, [payments to local government for specific purposes] can represent value for money for higher levels of government’ (p.696);
- Council rates overall are relatively efficient, simple and fair, and serve as a stable source of revenue (pp 258-259) because rates are generally a tax on land (ie. a highly immobile tax base), they are a relatively efficient tax (p.693); (local government rates based on land value are an appropriate tax base for local governments to use to fund public goods and services; The immobility of land makes local government rates based on land value an appropriate tax base for local governments to use to fund public goods and services)
- The states should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality

- (Note that land tax on the family home has been ruled out). Land tax generally is efficient and should be used more effectively through a broad-based land value tax but it should not be used to support vertical equity objectives, which are better funded through income tax. However, the general efficiency and fairness of land tax is reduced by exemptions (exemptions from local government rates were raised by ALGA but are not discussed in the Report) and stamp duties are inefficient.
- When implemented correctly, user charging is an appropriate funding mechanism for local governments to deliver private goods and services.
- That governments in Australia should contemplate opportunities to expand user charging for the provision of private goods, which the Report says may offer the opportunity to lower rates and other charges (p.696).
- That there is legitimacy in heavy vehicle user pricing (see also below).
- Infrastructure charges are sound where limited to the benefits that those residing in the development will receive – including for local roads, storm water, drainage, utilities provision and open spaces.
- the Australian Government should have control of taxes with more mobile bases and taxes used for re-distribution and macroeconomic stabilisation (p.673).
- The Productivity Commission should be commissioned to examine concessions across all levels of government (p.624).
- The Productivity Commission should be commissioned to examine principles of public service delivery and the mechanisms available to governments to deliver them and their implications for financial arrangements in the federation (p.626).

The Report also raises some potentially more sensitive statements, or ones where more detail would be required before ALGA would be in position to accept them outright, such as:

- The efficiency of council rates is reduced in councils that use improved values, as this can discourage capital investment
- That over time, state land tax and local government rates should be more integrated (Recommendation 121) and use the same valuation method to calculate the base for local government rates and land tax
 - There are questions about who would do what and flexibility tailored to local needs
- The distribution of Financial Assistance Grants (FAGs) to local governments should be reviewed (in the context of the minimum grant principle) (p.696)
 - Contravenes ALGA board policy

- That as local governments are creatures of the States, general purpose grants might be more appropriately provided by the states, if they have a sustainable taxation revenue (p.696)
 - The Report does not make any observations on cost shifting from the States
- Better land valuation information, possible uniformity of the land tax and local government rates and single billing and collection of taxes based on recurrent property taxation to the taxpayer
 - It is not clear whether this would be a local government function or a state authority function and how funding would be allocated between them to support the administrative arrangements
 - There may also be public perceptions of double taxation in a single billing statement.
- User charges are legitimate where implemented correctly but note developer ones below; local government autonomy also transparency and accountability
- Housing affordability raises a number of complex tensions but COAG should review institutional arrangement to ensure zoning and planning do not unnecessarily inhibit housing supply and affordability. There is scope for reforms to planning and approvals processes to ensure a more responsive approach to infill and greenfields.
- There is less certainty about the validity of infrastructure charges imposed for community facilities such as schools and libraries and COAG should review such charges to ensure they appropriately price the infrastructure in question.
- That intergovernmental funding grants be transparent (p.675) and not work as a disincentive from own-source revenue raising.
- A number of reviews through COAG and the Productivity Commission are suggested. Local government should be involved closely to make sure they are appropriately reflective of community needs and administrative cost to local government

Road user charging

The Report notes the importance of reforms to the road sector and makes a number of recommendations in this area (see Recommendations 61 to 64). These include that

- Local government plays a significant role in relation to maintenance of the local road system. Reforms whereby heavy vehicle road-wear charges would flow to local government will enable local government to receive significant amounts of additional revenue and COAG should accelerate the development of mass-distance-location pricing for heavy vehicles so they pay for their specific marginal road wear costs.

- Substantial parts of the local road system would not be fully funded by the heavy vehicle charges and would continue to require funding assistance (p. 696).
- Road user charges for heavy vehicles do not accurately reflect the damage particular vehicles do to the roads (p.374) as they will involve action by all levels of government, and potentially high interaction with other reforms (such as housing assistance).
- Congestion costs in urban areas are almost entirely unpriced. Variable congestion pricing on existing tolled roads should be examined, whilst noting that the introduction of congestion pricing should be co-ordinated with and help finance, additional investment in public transport for affected communities.
- Where roads and rail compete, there should be additional charges on heavy vehicles to avoid distortions.
- A new national Transport Agreement should be developed and signed through COAG, to include an agreed model for the assignment of revenues from taxes and charges and a nationally consistent asset management arrangement and asset management plans as a pre-condition to receiving revenue.

Other points of note for local government

The Report presents other recommendations or ideas that would be of interest to local government, and have not yet been ruled out by the Australian Government, including:

- Car Fringe Benefits Tax (FBT) be valued at a single statutory rate of 20 per cent regardless of the kilometers travelled – there may be implications for local government as employer.
- There is a notion of certain payroll tax exemptions being removed.
- There is a suggestion that exploration of the States and Commonwealth sharing the income tax base be progressed.
- Inefficient state taxes like stamp duties should be abolished especially because they affect housing affordability.
- The implicit concept of a centralised taxation collection agency in some of the Report discussions would require consultation with local government if implemented.
- There is scope to improve aged care funding and the Productivity Commission should examine same (this was announced two weeks ago so is somewhat redundant).