Queensland Government

COMMONWEALTH TAX FORUM

QUEENSLAND SUBMISSION

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OVERVIEW

The Queensland Government welcomes the opportunity to participate in the Commonwealth Government's Tax Forum.

Tax reform is an ongoing process for Government. The national and international economies are continually evolving, technologies are advancing, the population is growing and ageing, and climate change is presenting a new challenge for governments. The tax system – the main mechanism for governments to raise the revenue they require – must constantly adjust to both take advantage of the opportunities and respond to the challenges. The Commonwealth's Tax Forum will be part of that ongoing process of reform.

The Queensland Government believes that questions of tax efficiency, equity, simplicity and robustness are important ones for the Tax Forum to ask and seek answers to. The tax system creates incentives and disincentives, imposes compliance costs, and allocates amongst the community the burden of revenue raised by governments to spend on health, education, defence, welfare, transport and other community needs.

The Tax Forum should ask how this revenue raising can be done more effectively, efficiently and equitably, while supporting broader policy objectives such as stronger economic growth by promoting greater innovation, improved productivity, increased participation and greater skills development.

The Queensland Government believes good public policy requires a strong federation and that means ensuring states have a robust revenue capacity to deliver the services and infrastructure required by their communities. For the past century, Australia has been moving on a path that has centralised revenue capacity and, with it, policy making powers. The Tax Forum should consider whether it is time to take a different path, with a review of the respective revenue capacities of the Commonwealth and states as the first step.

Overall, the Queensland Government sees four main priorities for national tax reform:

- providing more robust revenue bases for governments, particularly state governments;
- providing support for economic growth and development;
- improving the efficiency of the tax system; and
- simplifying the tax system.

All governments should welcome the scrutiny their tax systems will face at the Tax Forum and take the opportunity to contribute and respond. It is hoped that all participants will take a positive and constructive attitude to the Forum, and that the discussion helps provide governments with guidance to the future tax reform path for this nation.

The Queensland Government lodged a submission to the Australia's Future Tax System (AFTS) Review in 2009, which discusses some of the issues in this submission in more detail. The submission can be found on the AFTS Review website at www.taxreview.treasury.gov.au.

A STRONG FEDERATION, STRONG REVENUE BASES

Australia was born as a nation as a federation, a choice that has served Australia well for over a century. The basis of our federation was the creation of a carefully circumscribed central government, with plenary power residing with the states.

At the same time, the states have willingly been flexible with its powers, ceding them to the Commonwealth when in the national interest, be it at federation, in times of national crisis or in times of review to support the continuation of prosperity.

By being adaptable to changing circumstances, Australia's federal system has been able to maximise the advantages of both centralised and devolved responsibility. Centralised responsibility can exploit economies of scale and a national perspective; devolved responsibility engenders a closer relationship to the community to interpret and act on the regional and national interest.

States have a proud record of policy innovation, from the enactment of legislation to support social reform, such as universal suffrage and anti-discrimination laws, to being amongst the first in the world to establish environmental protection agencies and introduce innovative approaches to service delivery such as health care call centres and casemix funding in public hospitals.[1]

Federation is not a relic from the last century. Of the countries with the eight largest economies in the world, four are federations and seven have at least three tiers of government. Almost every geographically large country in the world is a federation, with China the only country larger than Australia that is not.[2]

The virtue of federal systems is supported by the public policy and economics literature, which generally advances the principle of subsidiarity, that is, that matters ought to be handled by the smallest, lowest or least centralised competent authority. In economic terms, allocative efficiency is enhanced because the mix of goods and services provided by government is better calibrated to the demands of local communities. In political terms, subsidiarity ensures greater accountability of government to the people.[3]

Empirical evidence supports the existence of real benefits delivered by federalism. One study has found that federal nations have grown faster than unitary states over the last half century and that the advantage achieved by Australia through the federal structure equates to $4,507 per capita[4]. The study goes on to suggest that the federalism dividend could be larger still by moving to greater fiscal decentralisation.[5]

An important issue for tax reform, therefore, is how the tax system can support our federal system. Again, the public policy literature supports greater fiscal decentralisation, with states having their own robust revenue bases. A 2009 OECD paper argued that sub-central government "own taxes tend to make governments more responsive to citizens' tastes and preferences, thus improving resource allocation … tend to improve budget management efficiency … promote democratic accountability

[1] A. Twomey and G. Withers, *Australia's Federal Future: Delivering Growth and Prosperity*, http://caf.gov.au/Documents/AustraliasFederalFuture.pdf, page 15.
[2] A. Twomey and G. Withers, op. cit. pages 5, 19
[3] For a discussion of the principle of subsidiarity, see, for example, Prof J. Wanna, Prof J. Phillimore, Prof A Fenna with Dr J. Harwood, *Common Cause: Strengthening Australia's Cooperative Federalism*, http://www.caf.gov.au/documents/FP3%20-%20final.pdf.
[4] In 2006.
[5] A. Twomey and G. Withers, op. cit. page 41.

… provides [sub-central governments] with incentives for growth-oriented economic and fiscal policies, since they may fully reap their financial benefits".[6] This has been put even more succinctly: "[i]f big expenditure responsibilities are to be carried out responsibly, state governments generally need access to big revenues for which they are clearly politically responsible."[7]

In contrast, we have seen states' revenue bases eroded or prospectively constrained over the period since federation:

- income tax was lost to the states in 1942 when they agreed to transfer it temporarily to the Commonwealth to support the war effort, but the Commonwealth prevented its return after the War;
- the High Court's broad interpretation of provisions in the Australian Constitution effectively not only prevented states from introducing any tax based on the value of goods produced or sold, but directly resulted in the loss of franchise fees from state revenues in 1998;
- the *Intergovernmental Agreement on Federal Financial Relations* (IGA) prevents reinstatement of taxes, or similar taxes, that were abolished under the agreement associated with the introduction of the GST – including a number of stamp duties and financial taxes, such as debits tax. While this represents good policy, such tied arrangements don't constrain the Commonwealth. The IGA also specifically precludes the states from levying stamp duties on the transfer of emission trading permits, whereas this economic activity is likely to be subject to other taxation, including corporate and capital gains tax; and
- more recently, the planned introduction of the Mineral Resource Rent Tax and extension of the Petroleum Resource Rent Tax will not only have the Commonwealth accessing a revenue base traditionally belonging to the states, but have been associated with a view by the Commonwealth that states should not increase their mining royalties. While Queensland has a settled and progressive royalty regime, the policy principle of atrophying a revenue base is debatable.

History suggests that regardless of the political persuasion of governments, this erosion of state revenues is unlikely to end. GST revenue is failing to keep up with economic growth as saving rates increase and the taxable components of consumption contract as a proportion of total consumption.

The mining boom is likely to have a positive impact on state royalty revenue, but this will mostly be delayed until new LNG projects commence production. While payroll tax from mining employment will be boosted during the investment and production phases, the impact of the mining boom and high Australian dollar is likely to impact on other trade exposed and employment intensive sectors that are important to Queensland, such as tourism. This offsetting influence suggests that growth in sources of revenue such as payroll tax and transfer duty may be subdued.

At the same time, all states face significant spending pressures across most of their major expenditure responsibilities, reflecting rising community expectations of the level of services delivered. As the table below shows, growth of state expenditure in

[6] Hansjorg Blochliger and Oliver Petzold, *Taxes and Grants: On the Revenue Mix of Sub-Central Governments*, OECD (2009), page 8.
[7] R. Bird and M. Smart, *Assigning State Taxes in a Federal Country: the Case of Australia* in Melbourne Institute – Australia's Future Tax and Transfer Policy Conference, 2010, page 77.

these areas last decade more than matched growth in the economy and represented real per capita increases in investment in services. Moreover the pressure for ongoing improvements in state services will continue regardless of cyclical movements of the economy. State revenues, including Commonwealth grants, need to at least match these rising community expectations. Without that, the capacity for the states to deliver better quality health, education and other essential services to the community will be diminished.

Growing state government spending responsibilities

Expenses	Average growth 2000-2001 to 2009-10
Public order and safety	7.8%
Education	7.5%
Health	9.1%
Social security and welfare	8.9%
Housing and Community Amenities	11.5%
Transport and Communications	7.0%
In comparison to:	
Real per capita index[2]	*5.2%*
GDP (current prices)	*6.8%*

1. Total State General Government Expenses by Purpose.
2. Producer price index (final, domestic) used as inflation measure.
Source: ABS 5512.0, ABS 6427.0, ABS 3101.0, ABS 5220.0.

In his paper presented at the 2009 *Australia's Future Tax and Transfer Policy Conference*, Professor Richard Bird of the University of Toronto observed that "what is most striking about Australia in international perspective is that, unlike most federal countries, it seems to have moved surprisingly steadily in one single direction – towards greater centralisation of revenue powers – over the last century… [P]erhaps it is instead time to reconsider the advisability of continuing down the path towards total state dependency on federal finance."[8]

The Queensland Government agrees with Professor Bird – participants at the Tax Forum would do well to ask whether the century-long path we have been taking on centralising revenue powers is one that is in the long term interests of this nation.

QUEENSLAND'S RECORD ON TAX REFORM

Queensland has a strong record of tax reform over the past decade, with reform of its mix, design and administration of taxes.

In recent years, a large number of less efficient and so-called 'nuisance' taxes have been abolished, including marketable securities ('quoted' in 2001, and 'unquoted' in 2007); credit card duty (2004); debits tax (2005); lease duty (2006); credit business duty (2006); hire duty (2007); mortgage duty (2008); and duty on the transfer of core business assets (scheduled for 2013).

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[8] R. Bird and M. Smart, op. cit, page 78.

Over this period, insurance duty has also been cut, the payroll tax-free threshold raised, the land tax schedule reformed and transfer duty concessions for first home buyers significantly extended to make home ownership more affordable.

At the same time, a large range of administrative reforms have simplified the state tax system for taxpayers and made tax administration more efficient. These include:

- enactment of the *Taxation Administration Act* in 2001 with generic tax administration provisions designed to apply to any and all tax streams;
- replacement of the *Stamp Act 1894* by the *Duties Act 2001*, to provide a more robust legislative framework for continually evolving practices in self-assessment;
- introduction of legislation to more closely harmonise Queensland’s payroll tax system with those in other states; and
- involvement in the Standard Business Reporting program to reduce the compliance burden on business reporting to government agencies in Australia.

In 2008, the Queensland Government reviewed its mining royalty system and acted to introduce reforms that delivered to the Queensland community a fairer share of the financial benefits from high mineral prices. This included implementation of a progressive royalty rate in the coal sector, in contrast to generalised criticism of royalties as being uniformly regressive.

But tax reform is an ongoing task and more can be done. National tax reform presents the opportunity to advance the reform of the state tax system, including consideration of further reform of state tax administration, design and mix.

The challenges confronting state tax reform should not be underestimated. It is more than a simple accounting exercise. The recent history of attempts to broaden the land tax base, a reform consistent with the AFTS Review recommendations, offers an interesting case study.

- In 2003, Victoria’s Review of State Business Taxes recommended abolishing business stamp duties, funded by a reformed land tax with a flat rate and no tax-free threshold. A vehement community backlash greeted the proposal, which was not proceeded with.
- In 2005, NSW abolished the land tax threshold and introduced a three-tiered rate scale, ranging from 0.4% to 1.4%. Following substantial community criticism, a tax-free threshold of $330,000 was reintroduced in 2006, with a flat rate of 1.7% above the threshold.
- In September 2001, the Western Australian Government announced its intention to introduce a premium property tax which would apply to principal places of residence with an unimproved land value in excess of $1 million. A month later, following community opposition, the Western Australian Government abandoned its plan to introduce the tax.

Participants at the Tax Forum would do well to consider the reasons why these efforts failed to deliver long lasting reform and what measures could be implemented to address the community’s concerns about these and other state tax reforms.

PRIORITIES FOR NATIONAL TAX REFORM

The Queensland Government sees four main priorities for national tax reform:

- providing more robust revenue bases for Australian Governments;
- providing support for economic growth and development;
- improving the efficiency of the tax system; and
- simplifying the tax system.

Robust revenue bases for Australian Governments

As discussed earlier, states' revenue bases have been eroded over the last century, leaving states with narrow revenue bases heavily reliant on employer payrolls, land, motor vehicles, insurance and mining. States not only require reliable streams of revenue, but also capacity to adjust their levels of revenue to allow them to meet fiscal and economic challenges that arise.

The situation in Australia is in contrast to that in other federal systems such as the United States, Canada and Germany, where subnational governments either have direct access to broadly based income and consumption bases or have a significant say in the setting of rates of shared income and consumption taxes.

A number of reviews and commentaries on federal financial relations have suggested states having access to personal income tax as a means of equipping the states with a broader revenue base, arguing that it is a more preferable tax base for subnational governments, as tax uniformity is less crucial for individuals, who generally live and work in the one state. This makes personal income tax a potentially more desirable tax to use to align revenue capacity with spending responsibility, and thereby align the provision of services with the wishes of their state communities. Access to this revenue capacity could obviously facilitate the abolition of other less efficient taxes.

The Queensland Government accepts that states will continue to have a heavy reliance on Commonwealth grants and that it is possible that national tax reform may indeed increase that reliance. If so, and if we are to aspire to best practice for federal systems, it is important that Commonwealth grants reflect the following grant design principles:

- levels of grant payments should be correlated with states' expenditure requirements, not be at the sole discretion of the Commonwealth;
- grants should be untied to allow states to allocate them in the most appropriate way for their communities, subject to performance accountability; and
- reporting requirements should reflect the democratic compact that states should be accountable to their electors.

The *Intergovernmental Agreement on Federal Financial Relations* signed in 2008 broadly reflects these principles. However, the Queensland Government is concerned that the commitment to these principles may weaken over time, and would want any new grant arrangements associated with tax reform to fully reflect these principles in their design.

Support for economic growth and development

Australia faces a number of challenges in the current and future decades – the great potential of the mining boom and the pressures it will place on other sectors, the restructuring of the Australian economy as it responds to climate change, and demographic change as the population grows as the proportion represented by the elderly grows with it. And there will undoubtedly be other challenges that are not yet fully foreseen.

Our national capacity to respond to these social, economic and environmental challenges will in turn depend on whether the individual capacities of Australians are allowed to be utilised to the full. High quality education, health care and transport have important parts to play in developing and complementing the skills and abilities of the workforce, while providing a strong funding base to allow state governments to play a major role in delivering these services and infrastructure is critical, as discussed earlier.

But the tax system does more than provide funding – it creates incentives and disincentives in relation to the allocation of economic resources, be they labour, capital or land, and the productivity of these resources when they are combined.

Sustainable economic growth relies on productivity improvements. Innovation is a major contributor to productivity growth, with innovation (both the initial intangible capital investments and their spillover benefits) amounting to at least 62% of Australia's productivity growth in the long term[9]. The tax system needs to balance simplicity with the benefits that arise from effective incentives to encourage increased levels of investment in research and development and innovation to address market failures and increase spillover effects.

In this respect it will be important to monitor and evaluate the impacts of the recently introduced R&D tax incentive on business investment in research and development and, in particular, levels of activity by small to medium sized business.

A recent University of Queensland business survey has also demonstrated that availability and cost of finance is a significant barrier to business innovation. Australia has internationally low levels of seed finance, limiting business's capacity for innovation. The Tax Forum might usefully explore incentives such as relief for investors that could serve to stimulate additional investment in emerging companies and technologies.

Another important driver of productivity improvement is education and skills development and the full utilisation of these skills and abilities. The Tax Forum discussion paper highlights that the effective marginal tax rates resulting from the Commonwealth tax-transfer system remain very high, especially at lower-middle income levels, creating a disincentive for people to make their skills and abilities available in the workforce. This criticism is not new, and the deficiencies are arguably an inherent symptom of a progressive tax structure and a targeted transfer system, but the issues needs to be confronted by the Tax Forum as the demand for skills and the centrality of skill formation to our nation's future economic development increases.

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[9] Department of Innovation, Industry, Science and Research, *Australian Innovation System Report 2011*, page 1.

Another question for the Tax Forum is whether the tax system supports labour mobility, skills development and the movement of labour to those regions and sectors where employment is urgently required. For example, the AFTS Review recommends the review of zone tax offsets, including the regions they apply to which have been largely unchanged since 1956. The Tax Forum may also wish to consider what other tax-transfer mechanisms are warranted in the face of recent and expected future economic developments, high population growth and growing congestion in our capital cities to complement state government action.

Economic growth and development depends not only on the effective use of our labour force, but also of land and capital. The AFTS Review highlighted the inconsistent tax treatment of different forms of capital investment, which potentially results in a misallocation of resources. The Tax Forum may also wish to consider how the private sector can be supported when it works with government to create nation-building infrastructure for the long term benefit of our country.

A more efficient tax system

Improving the economic efficiency of the taxation system should clearly be one of the objectives of tax reform. Improved economic efficiency can result in better economic performance, resulting in more jobs and higher incomes.

That said, it should be remembered economic efficiency is not the only criterion for judging the desirability of a tax – equity, simplicity, stability and robustness should also be considered. There are a number of taxes whose efficiency rating, at least in a theoretical sense, is quite high, but whose assessment against these other criteria is much lower.

As the Commonwealth Government raises around 80% of total taxation and ninety-nine of the 125 or so taxes in Australia, it would be expected as a matter of logic that the bulk of potential efficiency gains would reside in the reform of Commonwealth taxation.

Nonetheless, state taxes attract a significant amount of attention from the AFTS Review, with stamp duties in particular being assessed as amongst the least efficient taxes in the national taxation system. Whether the debate on tax reform is proportionate to the actual policy task is seriously open to question.

The Queensland Government accepts that most recent reviews and commentaries on state tax systems agree that stamp duties are amongst the least efficient state taxes. One of the criticisms made is that state based exemptions further erode efficiency as the revenue effort is drawn from a smaller and smaller base. This line of argument also suggests that land taxes should be more efficient through removal of thresholds and exemptions. A flatter and more broadly based application would increase efficiency, and it is noteworthy that recent changes to the stamp duty regime in Queensland reflect this policy goal.

While such changes can improve the operation of stamp duty as a tax base in the current national tax mix, the larger question for this forum is whether the tax should ultimately be part of the national tax base at all. This question cannot be reserved for the states alone. Given the privilege appropriated by the Commonwealth in circumscribing state taxation, it has the responsibility to participate in facilitating reform.

The two stamp duties whose abolition would both deliver significant efficiency gains and be most manageable in a fiscal sense are insurance duty and motor vehicle registration duty, which are expected to raise around $5½ billion for state governments in 2011-12. The abolition of transfer/conveyance duty would represent a much larger reform effort, with revenue raised from this source expected to be $12½ billion across the nation.

Of course, the issue is how these abolitions would be financed. It is the Queensland Government's view that the Commonwealth Government has a major contribution to make in achieving this reform. The Commonwealth has access to the major efficient and broad-based revenue bases in Australia and collects the great majority of tax revenue. This also means that the Commonwealth, not the states, will receive the bulk of any reform dividend through improved efficiency delivering higher economic growth, leading to higher government revenues. Moreover, the Commonwealth would be expected to receive an income tax windfall from reduced deductions arising from the abolition of stamp duties.

Any funding from the Commonwealth to compensate states for loss of revenues is required to be robust, secure and untied. Compensatory funding that fails to meet these criteria can create a budgetary risk for states and would represent a diminution of states' fiscal management powers.

A simpler tax system

Confidence in the tax system is essential to ensure its long term sustainability and a high level of compliance by taxpayers. Transparency, simplicity and sound administration often underwrite this confidence.

Without a doubt, Commonwealth tax legislation, at least in parts, is almost impenetrable in its complexity. As the AFTS Review indicated, nearly 80% of taxfilers used a tax agent in 2005, amongst the highest rate in the world.[10] Earlier this year, the Chief Justice of the Federal Court was quoted as suggesting that "[o]pening the Tax Act is like entering the door to a parallel universe".[11]

States are not blameless in creating overly complex tax systems. While states have worked together to improve harmonisation in their tax systems, particularly in relation to payroll tax, the potential for even a greater degree of harmonisation needs to be investigated.

However, a balance must be struck in considering the degree of harmonisation and consolidation of tax regimes and administration. Difference can promote comparison and competition, while uniformity can reduce the incentive to reform. Arguably, a lack of competition is one reason why aspects of the Commonwealth tax system and administration are sometimes judged to be below international best practice.

[10] AFTS Review 2010, *Detailed Analysis*, page 6.
[11] The Australian Financial Review, 21 January, page 1.

CONCLUSION

The Tax Forum presents a great opportunity for Australians to discuss important national issues relating not only to improving the efficiency, equity and transparency of the tax system, but also the operation of the Australian federation and the development of the nation.

Federation is not an outmoded framework for national governance, but one that has been adopted by many large and rich nations as the system that can deliver the best economic, political and social outcomes. Australia has benefited from our system of federation, one that has allowed states to make their individual contributions to national success while being flexible enough to allow collaboration in the national interest.

Robust and secure revenues are required for all jurisdictions for our model of federation to work best. That means robust state revenue bases and an intergovernmental grants system that provide secure revenues from which state services and infrastructure can be adequately funded. This Tax Forum should consider the merit and means of reversing the continued erosion of the state revenue bases that has occurred over the last century. Taken to a conclusion, this trend ultimately undermines and imperils the federation.

The tax and transfer system can support the development of the nation through unlocking the skills and abilities in our people and giving the right incentives for individuals, businesses and other organisations to enhance our education and training capacity.

The tax systems of the Commonwealth and the states can also be reformed to reduce reliance on less efficient taxes and to be simpler and more transparent. But this will require a collaborative effort involving all governments and the community. The Queensland Government sees the Tax Forum as an important step in this process.