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Dr Ken Henry
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Dear Dr Henry

The Northern Territory Government welcomes the opportunity to contribute to the *Australia's Future Tax System (AFTS)* review. The Territory supports the objectives that were outlined in the review panel's terms of reference: to create a tax system that is simple, efficient and equitable (horizontal, vertical and intergenerational).

In this context, the Territory recognises the need for further and broad reforms to the states' and territories' tax bases to ensure they are able to meet growing expenditure needs as a result of Australia's changing demographics. As well as the ageing of the population, expenditure growth in the Territory for current and future generations will be driven by services aimed at closing the gap between Indigenous and non-Indigenous outcomes.

I understand that the AFTS Secretariat has advised my Treasury officials that the review panel will accept a submission from the Territory before 15 May 2009. A copy of the Territory's submission is attached.

The Territory looks forward to working with the review panel and the AFTS Secretariat to progress this review.

Yours sincerely

DELIA LAWRIE

15.5.09



AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

NORTHERN TERRITORY SUBMISSION

INTRODUCTION

The Northern Territory welcomes the comprehensive review being undertaken by the Commonwealth on Australia's tax and transfer system. The review represents an opportunity for cooperation and collaboration between the Commonwealth and the states and territories (the states) to further reform Commonwealth-state financial relations to address the known inefficiency and inequity issues related to Australia's tax and transfer system without reducing the states' overall revenues or budget flexibility.

KEY POINTS

Reform of the tax system

- A certain level of vertical fiscal imbalance (VFI) is necessary in Australia to ensure a national approach to monetary and taxation policy while maintaining the long held achievement of horizontal fiscal equalisation (HFE) with states having sufficient autonomy to tailor services to meet the needs of their constituents.
- Changes to intergovernmental arrangements including those that affect state taxes should be based on the following tenets:
 - no state will be worse off as a result of reforms to the tax and transfer payment system;
 - states should have the ability to apply different rates in order to respond to their expenditure needs or economic circumstances within their jurisdiction;
 - any replacement taxation/revenue streams or expenditure obligations that result from the reform of the tax and transfer system should be included in the existing equalisation processes as implemented by the Commonwealth Grants Commission (the Commission); and
 - if a tax revenue sharing arrangement is adopted, additional revenue received by the states should be provided on an untied basis.
- The Territory's preference is for the remaining inefficient state taxes to be abolished and replaced with the states gaining access to a broad tax base, subject to any incidence shift being properly considered.
- The Commonwealth should share with the states revenue streams that are derived from activities where there is significant flow-on expenditure for the states.
- States, and where appropriate the Australian Taxation Office (ATO), should be encouraged to harmonise terminology and valuation principles they apply to mineral royalties. This would be preferable to the imposition of an alternate Commonwealth taxation arrangement based on profit or resource rent principles which would have significant transitional difficulties.

- The administrative costs and benefits to states, businesses and the community of reform to state tax administration should be properly considered.

Indigenous workforce participation

- Targeted tax incentives should be considered to increase private sector investment in initiatives/projects being undertaken on land where title has been conferred by the *Aboriginal Land Rights (Northern Territory) Act (ALRA)*.
- Welfare to work reforms including those affecting the Community Development Employment Projects (CDEP) should continue so as to remove the disincentives for Indigenous people to join the workforce; this is likely to require ongoing commitment to training and employment initiatives.

Reform of the transfer system

- The zone rebate should be maintained and increased to ensure that it remains contemporary.
- The current arrangements for Commonwealth Rent Assistance (CRA) should be simplified and reformed to take into consideration sustained and material variations in rents in different locations in order to deliver more equitable outcomes.

REFORM OF TAX SYSTEM

Key principles

The Territory supports further reforms to the assignment of revenue raising powers between the Commonwealth and the states to improve the simplicity, accountability, transparency and efficiency of the nation's taxation arrangements.

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- states should have the ability to apply different rates in order to respond to their expenditure needs or economic circumstances within their jurisdiction;
- any replacement taxation/revenue streams or expenditure obligations that result from the reform of the tax and transfer system should be included in the existing equalisation processes as implemented by the Commonwealth Grants Commission (the Commission); and
- if a tax revenue sharing arrangement is adopted, additional revenue received by states should be provided on an untied basis.

Vertical fiscal imbalance

VFI is a key feature of Australian federalism. In Australia, states have significant service delivery responsibilities but limited capacity to raise revenue, while the Commonwealth's revenue-raising capacity exceeds its limited responsibility for providing services. It is the extent to which VFI exists in Australia that is the subject of much debate.

The Territory's view is that that a certain level of VFI is both necessary and desirable. VFI allows the Commonwealth to achieve national objectives particularly in respect of monetary and tax policy, as well as ensuring continuation of equity as the basis of revenue sharing, such that all Australians have access to comparable levels of government service irrespective of the jurisdiction in which they reside. The current system allows states to maintain their autonomy by having the fiscal instruments to determine the size and structure of their revenue and expenditure to address local needs.

The long term challenge for the states will be to meet their growing expenditure responsibilities as a result of Australia's changing demographics. As well as the aging of the population, expenditure growth in the Territory for current and future generations will be driven by services aimed at closing the gap between Indigenous and non-Indigenous outcomes. The aim of the reform of state taxes should be to ensure that states have a guaranteed revenue stream that is sufficiently broad and where the growth in the tax base is comparable to the growth in states' expenditure needs.

Horizontal Fiscal Equalisation

Arguably, Australia has the most comprehensive system of equalisation of all federations. Many countries have sought advice from Australian experts on the way in which the Australian system could be applied in their circumstances. The two differences that set the Australian system apart from those in other federations are the comprehensive approach to equalisation and the emphasis on equity in determining the distribution of revenues.

The Commission's assessment of the distribution of GST revenue encompasses all state general government expenditure and revenue sources. The assessment takes into account efficiency and capacity as well as differential needs and costs. If the reform of the tax and transfer system results in a new revenue base for the states or a centrally collected tax, these new arrangements should be included within the scope of the equalisation process. This ensures that the different revenue raising capacities between states are recognised, and subsequently states with low capacity to raise revenue from the new tax bases are compensated through the equalisation process. If this is not done, then one of the stated aims of the review to not disturb HFE processes would not be met.

Assignment of revenue raising powers

In the absence of wide-ranging reforms to the roles and responsibilities between the Commonwealth and the states and/or the assignment of revenue raising powers, states will continue to rely heavily on fiscal transfers from the Commonwealth to fund their expenditure needs. The Territory notes that the allocation of spending responsibilities between the tiers of governments is outside the scope of this review; it will therefore not be discussed in this submission.

One or a combination of the following options has been proposed to reform state taxes.

- Revenue sharing between the Commonwealth and the states.
- Allow states access to a broad growth tax base.
- Expand the existing state tax base.

Given the restricted nature of the states' existing tax bases, reforms that focus only on these bases will not result in any meaningful outcomes. Rather, broader reform of state taxes is required, specifically those that will result in a closer alignment of revenue and expenditure responsibilities of government in the long term.

Revenue sharing

States could be compensated for abolishing inefficient taxes through a revenue sharing arrangement. Under revenue sharing, the Commonwealth takes responsibility for raising the revenue either through existing tax base or from a new tax, and for distributing some or all of the proceeds to the states.

The introduction of the GST, including the replacement of a range of inefficient state taxes and distribution between states on a HFE basis, provides a template for future revenue sharing arrangements. The GST revenue sharing arrangements have alleviated some of the budgetary pressures on the states by providing states with the proceeds from a broad based tax that grows in-line with the economy.

If a revenue sharing option is adopted to substitute for the abolition of any state taxes, the Territory strongly supports the revenue being provided to the states on an untied basis and distributed in accordance with the principle of HFE.

There is the potential for sharing of Commonwealth revenue streams derived from activities that carry significant state expenditure responsibilities. Candidates for revenue sharing reform are:

- providing the states with a portion of the proceeds of revenue collected from alcohol and tobacco products because of the strong link between consumption and the requirement for services which are predominantly provided by states through health and law and order; and
- providing the states with a portion of the proceeds of company tax receipts arising from mining companies to meet the state responsibilities for mine related infrastructure, and regulatory and environment related costs. This could be coupled with reform to the company tax regime to allow it to address super profits received by mining companies.

Base sharing

Under the base sharing arrangement, both the Commonwealth and the states would have the capacity to levy a tax on the same tax base. This approach would allow the states to take political responsibility for raising their own taxes from these broad tax bases, and hence have greater control of their revenues. In addition, it would lead to greater accountability of state governments to their constituents. The ideal base sharing option is to allow states to gain access to personal income tax base because there are no Constitutional constraints.

The base sharing option would require full cooperation between the Commonwealth and the states. There are significant issues that would need to be addressed and agreed upon before a base sharing option could be adopted, including the administration arrangements, the tax base that could be shared and the aspects of the tax base that the states would be permitted to vary.

Similar to the revenue sharing option, if the base sharing arrangement is adopted the Territory strongly supports the revenue raised by each state to be assessed as part of the Commission's equalisation process, as is the case with all other state owned source revenue streams.

Base sharing is the Territory's preferred option for reform of state taxes.

State taxation reform

States rely on a small number of narrow tax bases: payroll; land; transfer of property; and gambling. The states limited ability to raise own-source revenue is the result of the Australian Constitution and changes to Commonwealth-state financial relations. States have also contributed to the narrowing of their tax base through the application of thresholds and by providing exemptions.

The Territory has significantly reformed its taxation base since 2001. In accordance with the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA), the Territory has abolished:

- tourism marketing duty from 1 July 2000;
- stamp duty on quoted marketable securities and financial institutions duty from 1 July 2001;
- debits tax and electronic debit transactions duty from 1 July 2005;
- stamp duty on the transfer of marketable securities and stamp duty on the rent paid for the grant and renewal of non-residential leases and franchise arrangements from 1 July 2006; and
- stamp duty on rent paid for the hire of goods, including consumer and producer goods and instalment purchase arrangements, from 1 July 2007.

The Territory has also announced that it will abolish stamp duty on conveyances of business property (excluding land) from 1 July 2012. This timetable meets the Territory's commitment under the Intergovernmental Agreement on Federal Financial Relations.

The Territory has also provided significant non-IGA related taxation reductions in recent times, including a program of payroll tax rate reductions; increased the payroll tax general exemption threshold; reduced the stamp duty rate; and increased home ownership stamp duty concessions.

Abolish state taxes

Taxes are a significant source of revenue for the states. In 2007-08, revenue generated from state taxes totalled \$53.1 billion¹. This is greater than the amount of revenue raised from GST and is approximately equal to 42 per cent of total income tax revenue. In addition to being a significant source of revenue for the states, taxation revenue provides states with fiscal autonomy and flexibility to tailor services to meet the needs of their constituents.

The Territory would be amenable to considering further abolition of some state taxes, particularly those that are identified as inefficient, if it formed a part of a package of broader reform options and there was a guarantee that states would not be worse-off. Moreover, the incidence shift that arises from the replacement of these revenues would also need to be carefully considered.

Of the state taxes, the Territory has a preference for reform to stamp duties and favours the retention of the remaining taxes and royalties.

Expand the existing tax base

One option that is raised in the review panel's consultation paper is to broaden states' existing tax base. The payroll and land tax bases have been targeted for consideration. Expanding the payroll and land tax bases would increase the efficiency and reduce the costs of administering these taxes. This option would also lead to an increase in state revenue. However, despite the potential benefits, the states' tax bases have eroded. There needs to be a balance between broadening states' revenue base and the political pressure from constituents to minimise the tax burden and keep down the ongoing costs of running a business.

One practical option may be to reform the payroll tax base to be equivalent to the group wage amount disclosed by employers in meeting their Pay-As-You-Go (PAYG) returns. This approach would allow payroll tax to be calculated and administered as part of the PAYG collection mechanism. Under this approach, states would set different rates for their jurisdiction and abolish the threshold. Consideration would need to be given to possible distortions on the PAYG scheme arising from salary structuring as the existing payroll tax rules include fringe benefits and superannuation contributions provided by the employer on behalf of the employee. In addition, consideration would need to be given to a methodology for the imposition of this tax on persons currently in the payroll tax base that are not included in the PAYG scheme. For example, payroll tax is levied on contractors providing predominantly labour services that may not be employees of the business paying for the services, and hence not included in that business' PAYG returns.

¹ ABS, Government Finance Statistics, Australia, Cat No. 5512.0

Mining royalties

The Territory's mining royalty revenues are largely based on a profits-based regime provided within its *Mineral Royalty Act*. The profits-based regime is unique to the Territory as ad valorem regimes predominate in other jurisdictions. Profits-based or resource rent royalty schemes are generally accepted as being less likely to alter investment decisions than other royalty schemes.

The Territory considers that the ad valorem schemes that predominate in the other states are inefficient and do not provide an adequate return to governments in times when a mine may experience super profit conditions. While it would appear desirable to transition all state royalty schemes to a profit or resource rent approach, the Territory notes that transitioning would be highly problematic due to incidence shifts for governments and existing miners that would arise from moving from an ad valorem to profit based scheme. An additional difficulty is the legal implications of altering individually negotiated combined lease and royalty agreements that exist between some significant mines and state governments. Although it is possible to phase in new arrangements as existing agreements expire, this would give rise to complexity and equity issues as different royalty regimes will be applied for existing and new mines.

Nonetheless, the Territory considers that compliance cost savings could be realised for miners with projects in more than one state through a program of harmonising key aspects of existing state royalty schemes, including the terminology and valuation rules that apply to commodities. Similar issues apply in respect of certain matters administered by the ATO that are relevant for mineral royalty schemes. One example is the way transfer pricing arrangements, as assessed by the ATO, have implications for profit-based and ad valorem mineral royalty collections.

Given the transitioning difficulties, an alternative could be for the Commonwealth to reform its company tax scheme to address the issue of ensuring adequate government returns are realised from super profit conditions. The Territory contends that a proportion of the proceeds of any such reform be distributed to the states under the existing equalisation process. This recognises that states bear the incidence of large expenditure items arising from mines located in their jurisdiction such as infrastructure, environment and the regulatory role.

Administrative arrangements

A common criticism of state taxes is the complexity that is created by the different legislation adopted in each jurisdiction. For similar taxes, there can be differences between states in rates, thresholds, concessions, exemptions, definitions of the tax base, reporting requirements and method of collection.

The states have commenced a process of harmonising payroll tax administrative arrangements that relate to payroll tax including the adoption of common rulings and collection and compliance processes. This is expected to reduce the complexity and provide compliance cost savings for businesses that operate in more than one jurisdiction.

There is potential to expand the work undertaken to harmonise payroll tax to other state taxes. The review panel, in conjunction with the states, could undertake work to identify other key

areas that could be harmonised which would reduce the administration and compliance costs on businesses.

Central collection agency

There have been some industry responses to the review indicating the higher compliance costs arising from the existing state based administration of payroll tax. There is evidence to suggest that these compliance costs are minimal in the context of taxation related compliance costs that affect businesses. In February 2009, the Allen Consulting Group released the report, *A harmonised payroll tax system for NSW and Victoria*, which used a cost model to measure the change in the administrative costs arising from the harmonisation of Victoria's payroll tax definitions with New South Wales legislation. The report estimates that the harmonisation saves Victorian businesses about \$1.5 million annually in administration costs². When applied to the approximately 8900 taxpayers in this category, this equates to an average saving of \$170 per business per annum. In contrast, the PriceWaterhouseCoopers report, *Tax Nation: Business taxes and the federal state divide*, commissioned by the Business Council of Australia, estimated that the annual median compliance costs for all taxes for large businesses surveyed was on average \$925 000 each³. Given the relatively low compliance savings from payroll tax harmonisation, it is conceivable that the cost incurred by governments of moving to a centralised payroll tax administration arrangement could exceed the compliance cost savings by businesses.

There is a concern that a central collection agency responsible for administering and raising all taxes could lead to confusion as to which taxes are raised for the Commonwealth and those that are for the states leading to a reduction in transparency and accountability. However, the ATO already collects a large amount of information as part of the reporting requirements for various Commonwealth taxes such as income tax, company tax and GST. There is merit in considering whether this information could be used to determine a state tax liability such as collecting a payroll tax equivalent through the PAYG return scheme.

INDIGENOUS WORKFORCE PARTICIPATION

Private investment in land under the Aboriginal Land Rights (Northern Territory) Act

As part of the Northern Territory Government's *Closing the Gap* initiative, the Territory is committed to working with the Australian Government to foster investment in economic development activities in Indigenous communities. This commitment is also enshrined under the National Partnership Agreement on Indigenous Economic Participation, where the Commonwealth and the Territory have agreed to create real sustainable employment opportunities in Indigenous communities across the Territory.

The review of Australia's tax and transfer system should consider reform options that encourage economic development in the Territory's remote Indigenous communities. The Territory believes there is merit in providing targeted tax incentives to increase private sector

² Ahearn, T, Stewart, G 2009, *A harmonised payroll tax system for NSW and Victoria*, The Allen Consulting Group

³ PriceWaterhouseCoopers, 2007, *Tax Nation; Business taxes and the federal-state divide*

investment in initiatives/projects being undertaken on land where title has been conferred by ALRA. This could be achieved as a consequence of leasing arrangements being put in place on ALRA land throughout the Territory.

Community Development Employment Projects

The review panel is currently examining the disincentives created by the transfer system for individuals to join the workforce or acquire new skills. The focus has mainly been on pension and disability payments. This issue is also relevant for CDEP. Removing the disincentives from CDEP, combined with encouraging private sector investment in Indigenous communities, will lead to greater economic activity in areas where CDEP was widely used and where further employment opportunities are necessary.

REFORM OF THE TRANSFER SYSTEM

Zone rebate

The zone rebate was introduced in 1945 to provide income tax concessions for individuals in remote areas that face disadvantages because of uncongenial climatic conditions, isolation and high cost of living. The high costs of living associated with these factors are evident across the Territory and are recognised by the Commission as impacting on costs of Government. The additional costs faced by the Territory Government reflect those faced by businesses and individuals alike. The Territory contends that the zone rebate should be reviewed and set at more appropriate levels to ensure that it reflects contemporary factors. At a minimum the zone rebate should be restored in real terms to the level of 1993-94 and indexed by inflation annually in the future.

Commonwealth Rent Assistance

The CRA aims to address housing affordability in Australia. The current CRA arrangement does not account for sustained differential in rents that are caused by higher building costs in certain locations. The uniform nature of CRA payments gives rise to equity issues where the level of assistance provided by CRA is a lesser offset to housing costs in the Territory than in other jurisdictions.

CONCLUSION

The review is an opportunity to undertake further reform of state taxes to provide states with a tax base that is efficient, equitable, simple and meets their growing expenditure needs. However, there are key aspects of that current tax system that are working well and should be maintained, such as HFE which ensures all Australians have access to comparable levels of government service irrespective of the jurisdiction in which they reside.

Closing the gap between Indigenous and non-Indigenous outcomes is a high priority for all governments. To this end, the review should consider ways in which the tax and transfer system can promote economic development and workforce participation in Indigenous communities.