South Australian Government Submission

to

Australia's Future Tax System Review

25 May 2009

Government
of South Australia

1. Introduction

South Australia supports the establishment of the Australia's Future Tax System Review. The Government recognises the unique opportunity that this review provides to shape and design the tax and transfer system for many years to come.

The States and Territories play a major role in the Australian tax and transfer system, and as such, the South Australian Government is keen to work with the Review Panel as proposals to improve the operation of the Australian tax and transfer system are further developed.

The States are providers of key community services such as health care, education, transport, safety and environmental protection. A major concern of the South Australian Government is continuing revenue adequacy to meet service levels demanded by the South Australian community. This is of particular concern given the long-term demographic pressures facing South Australia and the States generally. Horizontal fiscal equalisation is designed to ensure that States such as South Australia, which may face early onset of pressures from ageing, will be in no worse relative position than other States, but this does not detract from the issue as a concern for each jurisdiction.

In line with work undertaken by the Productivity Commission on the fiscal impacts of demographic change, intergenerational modelling for South Australia indicates the significant fiscal challenges facing the Government in the years to come. To the extent that efficiencies and savings cannot meet these growing pressures, steps will need to be taken to ensure that adequate and sustainable funding is available in the future to meet community requirements for public services.

Current measures undertaken by South Australia

The SA Government has cut taxes by an estimated cumulative total of $3.3 billion between 2004-05 and 2012-13. This total includes taxes abolished and scheduled for abolition pursuant to the Inter-Governmental Agreement related to the GST, but also significant cuts to both land tax and payroll tax, and additional assistance to First Homebuyers, beyond the Commonwealth's original and revised assistance schemes.

This tax reform has occurred at the same time that the South Australian Government has significantly increased service delivery and reduced net debt. This has been possible due to both increases in revenues over the period, and prudent management of the State's finances. This should not be regarded as indicative of a strong ongoing capacity of States to raise revenue. It reflects the temporary capacity arising from boom-time GST and property revenues; and responding to the needs of industry, including interstate competitiveness.

In respect of non-IGA tax measures taken, the SA Government recognises that while payroll tax and land tax are economically efficient taxes, there remains a need to manage and maintain community acceptance of the level of taxation. The need for adjustments from time to time to "give back" the effects of price level induced bracket creep is well established (e.g. in respect of personal income tax). This is particularly so in the environment of differing taxation regimes across jurisdictions.

2. Background

The fiscal autonomy of the states in the Federation has been reduced over the last century, with major losses occurring with the transfer of income tax during the

Second World War, the increase in Special Purpose Payment (SPP) grants in the 1970s, and the loss of specific indirect tax bases including liquor, tobacco and petrol as a result of constitutional invalidity.

Further, within that narrowed range of taxes on which all States now have to rely, it needs to be acknowledged that interstate competition in respect of mobile tax bases (eg stamp duty on share transfers) perceived potentially mobile tax bases, (estate duty, payroll tax) and 'benchmark' competition even in respect of immobile tax bases (principal place of residence exemptions), has caused further erosion of the state tax base.

These developments have significantly reduced the capacity of the states to raise revenue. This has had the consequence of greatly reducing the capacity of states to make expenditure decisions that are required as the major service delivery level of government in the Federation. The states' power to manage their budgets has been weakened as a result.

For example, public hospitals in South Australia, run solely by the State, were funded approximately 50% by the Commonwealth and 50% by the South Australian Government in 1995-96. By 2005-06, this ratio had dropped to approximately 45% funded by the Commonwealth and 55% funded by the State. This clearly has implications for the State's capacity to run, budget for and develop a public hospital system. The most recent change to health care funding, under the National Healthcare Agreement, while reversing the trend of a declining proportion of Commonwealth funding, still leaves the State with more than 50 % of hospital funding. The new funding arrangements put in place at the 2008 COAG are an advance over previous arrangements but experience tells the States they cannot rely on the Commonwealth shouldering the increasing burden of health and other services funding. States must be guaranteed dependable and long-term own source revenue capacity or grant streams to fund the provision of services.

3. Discussion

Vertical fiscal imbalance

Vertical fiscal imbalance (VFI), the imbalance between revenue collection and expenditure responsibility within the Federation, is often raised as an issue relevant to tax reform. Disadvantages of VFI are thought to include a lack of accountability caused by these arrangements. However there is no question that States are responsible for their decisions to expand or reduce expenditure. VFI in large measure represents a comparative advantage that the Commonwealth has in revenue collection as compared with the States, particularly for a small population nation — albeit further entrenched by provisions of the Australian Constitution greatly restricting indirect taxation powers of the States. A possible downside to reduced VFI is greater scope for destructive tax competition between jurisdictions. The main concern is financial reliance on the Commonwealth Government which may not always be relied upon to administer a national tax collection with whole of nation spending requirements in mind.

In itself, VFI is not as great a concern to the South Australian Government as ensuring adequate revenue levels, whether from *assured* untied grants or own source revenues. Even if an adequate ongoing level of grants were somehow assured, a degree of fiscal autonomy is necessary, to allow individual States to deal with their own budgetary circumstances and pressures. It is also needed so that

States are able to redress the possible diversion by the Commonwealth of national tax collections, away from State provided services as has happened in the past.

Horizontal fiscal equalisation

Whatever the degree of VFI, the operation of the Federation is underpinned by horizontal fiscal equalisation (HFE), which seeks to allow States the capacity to provide similar levels of service, regardless of local revenue raising capacity. As pointed out in the Review's Discussion paper, HFE enables consideration of tax mix reform to occur on a whole of nation basis.

Tax reform and revenue adequacy

State level taxes include property taxes, payroll tax, motor vehicle taxes, gambling tax and a range of other smaller taxes such as insurance duty. State Government taxation of the finance sector is now relatively minor following Howard Government requirements in connection with the provision of GST to the States.

All taxes place a burden on the community. The Government recognises that some of the taxes at its disposal involve a larger burden and that there is an obligation to minimise that burden where possible.

The Government is open to the consideration of State taxation reform proposals which may come from the Review Panel on the proviso that the proposed reforms are revenue neutral and lead to an overall benefit for the South Australian community. It is essential, if State taxes are to be reformed, that there is adequate revenue replacement. Any reduction or abolition of taxes should be accompanied by provision of an offsetting revenue stream or streams.

The SA Government accepts that tax bases may be shared between the Commonwealth and the States. But it is important that any significant taxation changes are clearly explained to the taxpayer community. This is particularly so where new taxation arrangements are replacing existing State taxes. The justification for any change needs to address standard criteria of equity, administrative efficiency, economic efficiency and buoyancy.

Business taxation

Keenly debated by business and in academic circles are the effects of State taxes and Commonwealth company income tax on investment, business and employment, as well as new or varied taxation arrangements that would move away from the current mix of Commonwealth and State taxes. The Government will not attempt in this submission to elaborate on these discussions, nor put a view on the many and varied propositions being considered. However, South Australia does note that payroll tax is a revenue source, which to some degree aids States' fiscal autonomy.

Other specific matters

There are some particular issues that the SA Government has received representations on, which it wishes to present to the Review.

The Government strongly supports the maintenance of the Wine Equalisation Tax and the associated producer rebate. The wine industry is a critical and prominent industry in South Australia and small regional producers appropriately benefit from the producer rebate. In this area there is considerable merit in maintaining the status quo. It is doubtful that any alleged benefits of changed tax arrangements would warrant the subsequent industry disruption.

The Government also notes that if the tax benefit available to public hospital employees, whether or not it remains embedded in the Fringe Benefit tax system, were removed, that would likely be adverse to the cost of providing public health services. Further there is a case that the concession should be available to heath employees predominantly involved in the provision of public hospital services rather than exclusively. This would facilitate more flexible management of health units within the public health system.

3. Conclusion

The Government looks forward to considering the Review's further papers and possible proposals, and will evaluate them in the context of the benefits possible to South Australians in the long term. We note that there are a number of proposals in circulation that would require (further) cooperation among the States, and between the States and the Commonwealth to implement; for example, where property or places of other levels of Government are involved. We look forward to further engagement with the Australia's Future Tax System Review, and the Review's findings are keenly anticipated.