

Treasurer

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AFTS RECEIVED

25 MAY 2009



Tasmania

20 MAY 2009

Dr Ken Henry
Chair
Review of Australia's Future Tax System
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Henry

The Review of *Australia's Future Tax System* provides a welcome opportunity for discussion on the future direction of tax reform in Australia, in particular on tax reform that cannot be achieved by states and territories acting alone. Such reform is vital not only to achieve continued economic growth and improvements in productivity at a state level but is essential to continuing to drive improvements at a national level.

Tasmania has been at the forefront of tax reform in recent years and has been one of the first states to meet all of its tax cut obligations under the *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations*. In addition, Tasmania has been proactive in implementing further cuts to state taxation levels. These tax cuts have taken Tasmania from being the second highest taxing state as determined by the Commonwealth Grants Commission to being the second lowest taxing state. This change has been an important factor in increasing the competitiveness of the Tasmanian economy.

It should be noted, however, that in the current economic and financial environment being proactive in implementing tax reform has created specific issues for Tasmania. Unlike other states that were yet to meet their tax reduction obligations, Tasmania does not have the opportunity to improve its Budget position by cancelling or further postponing promised tax cuts. For a small jurisdiction such as Tasmania, which is already highly dependent on Commonwealth funding including GST receipts, this is a major constraint on an already very limited own source revenue position.

The Tasmanian Government is committed to an ongoing review of its state taxation regime. To this end, the State Government has announced the establishment of the Business Taxation and Regulation Reference Group. The Government has requested this Group to provide feedback to the State Government on a range of issues including the impact on the business community of proposals for budget neutral taxation reform. Attached for your information is a copy of the terms of reference for the Business Taxation and Regulation Reference Group. At the present time the Reference Group is continuing its deliberations. While it is understood that the Reference Group has provided a submission to the Review, the Government believes that it would be inappropriate to provide any detailed comments on individual tax reforms before the Reference Group provide information to the State Government.

Notwithstanding this position, the following general comments are provided.

Importance of taxation reform

All jurisdictions need to understand the significance of improving the position of Australia in a global economic setting. In order to maintain our standard of living, there will need to be a variety of changes that facilitate productivity and the efficiency of our regulatory and other institutional arrangements that impact the viability of industries. In this, the taxation system plays a key role.

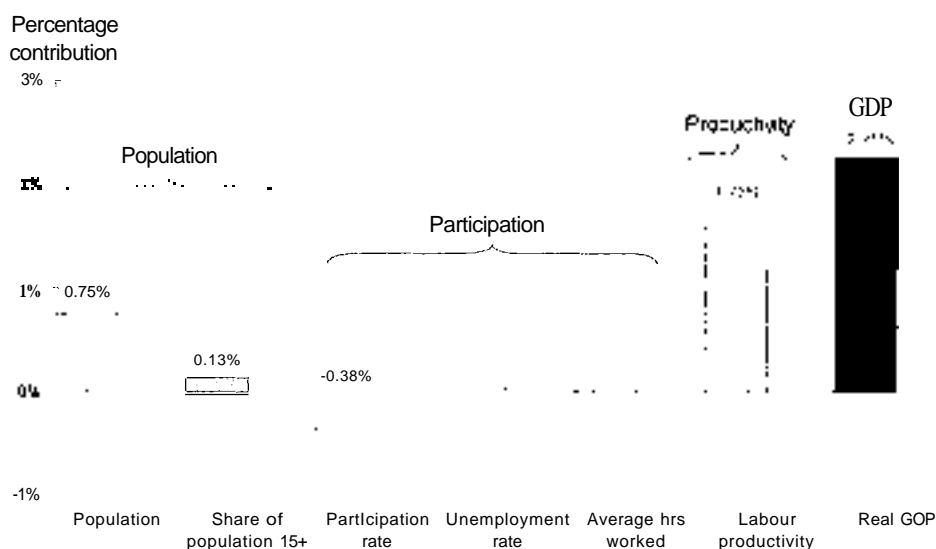
However, there will be broad, often competing, considerations about how fairly our taxation arrangements treat like and unlike community sectors. As the primary means of achieving redistribution and welfare support, our taxation regimes are therefore also central to these considerations. At the policy level, managing a reform that takes these issues into appropriate measure will require careful judgment.

The states are aware that their taxation regimes do not operate independently of broader national considerations, but at the same time, it needs to be recognised that the states will not be in a position to make more than marginal contributions to a national reform effort without the close co-operation and support of the Commonwealth.

States necessarily rely on some inefficient and narrow tax bases. The number of these taxes has fallen significantly in recent years as a consequence of IGA related tax reforms. It is only through collective action of all the states that significant reform will be achievable with a greater emphasis on improving the efficiency of the tax system in its application and administration. This is where the Review of Australia's Future Tax System can promote a positive outcome nationally.

The Review of Australia's Future Tax System provides a valuable opportunity for bold long term planning. A core challenge for state governments in particular, is the ageing population. This will lead to reduced workforce participation and a potential reduction in per capita income growth. Furthermore, health and aged care expenditures will continue to rise and put further pressure on maintaining strong state fiscal management. As such, reforms need to contribute as far as possible to increased productivity and workforce participation. This is highlighted by your own forecasts of the drivers of Australian GDP growth in the chart below.

Components of long term average annual GOP growth



Source: Australian Treasury 2002, *The Demographic Challenge to our Economic Potential*

The Productivity Commission has noted that microeconomic reforms have boosted productivity in Australia to date, but future economic performance will depend more on innovation and service quality, which are in turn dependent on the development of human capital. As such, taxation reforms that encourage training and development should be priorities to be progressed.

In implementing the necessary state taxation reforms, the preference should be for no worsening of Vertical Fiscal Imbalance. Keeping VFI in check has the strong public finance benefit of maintaining a nexus (however strong) between expenditure and revenue raising decisions. As indicated above, the implementation of tax reform in recent years has accentuated the already significant impact of VFI on a small jurisdiction such as Tasmania. In the difficult financial and economic times which we currently face, the capacity of the State Government to be able to manage the revenue side of the Budget is severely limited. Furthermore, it should also be noted that whilst Horizontal Fiscal Equalisation is beyond the terms of reference for the Review, the Tasmanian Government considers that its preservation as a feature of the Australian Federation is essential.

State tax harmonisation

The Tasmanian Government is a strong supporter of state taxation harmonisation.

An opportunity exists for state tax harmonisation to be rapidly progressed as part of any redesign of the tax system in order to provide simplicity for taxpayers, adequate revenue for states and maintenance of overall tax efficiency. State tax competition has an important role to play in driving best-practice and efficiency, but it must be constructive.

Productivity Commission analysis shows that interstate tax competition is generally in the form of special exemptions and concessions, which narrow tax bases, rather than lower rates. Constructive tax competition should facilitate increased economic output rather than simply shifting output from one state to another, or providing select groups in the community with income or other support through tax exemptions.

Nation-wide harmonisation opportunities should be encouraged for state taxes with specific priorities being:

1. legislative harmonisation;
2. administrative harmonisation (harmonise tax rulings); and
3. harmonisation of tax bases (thresholds, exemptions and concessions).

This would leave just tax rates as the basis for interstate competition, maintaining the integrity of tax bases and simplifying the tax system.

It should be recognised, however, that it may not be possible to harmonise all exemptions and concessions given different policy needs in individual jurisdictions.

There would be significant benefits to taxpayers and some cost savings from administrative harmonisation of land and particularly payroll tax, even if rates differ across jurisdictions. However, in the long run a common approach across all jurisdictions to the treatment of the bases of these key taxes would aid in further integrating the national economy and reducing compliance costs.

A careful assessment of the appropriate tax bases nation-wide would be required in the event of moves to greater harmonisation. Competing efficiency and equity considerations and particular policy goals must all be considered. Any change to the tax regime will impact taxpayers, but the key criteria should be whether the overall incidence of state taxes can be reduced as a consequence of such changes.

Income tax sharing

The issue of a state income tax surcharge is often raised by some sectors as an effective option to replace state taxes. While such an approach would certainly be a radical departure from current state revenue arrangements it is an option which should be investigated further by a review such as that currently being undertaken. In doing so it is acknowledged that it would be difficult for any single state to introduce such a surcharge alone, or even for the states to do it collectively without the co-operation of the Commonwealth.

Sharing in a Commonwealth tax base would be administratively simple as it utilises existing collection systems. Furthermore, a state income tax surcharge could be one of the more efficient ways for states to raise the revenue required to abolish other taxes. Any such surcharge could only be introduced on a cost neutral basis to the community.

It is noted that it may suit some jurisdictions to have a revenue sharing arrangement, which could involve collective policy decisions on the rate to be applied. However, this would not be proposed as a means of furthering the policy objective of income redistribution or vertical equity.

Summary

The Tasmanian Government welcomes the Review of Australia's Future Tax System. It strongly supports further tax reform at both a state and national level. In Tasmania, the last ten years have seen significant changes to the Tasmanian tax system which has delivered significant benefits to the Tasmanian community. The Government is seeking to continue this reform process through the establishment of a Business Tax and Regulation Reference Group. The Tasmanian Government believes that the work being undertaken by this Group will compliment the work being undertaken as part of your review. The Tasmanian Government looks forward to the outcomes of the Review and to healthy debate and discussion of those outcomes.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michael Aird', with a stylized flourish at the end.

Michael Aird
Treasurer

APPENDIX A: Business Taxation and Regulation Reference Group

The Business Taxation and Regulation Reference Group was established by the Tasmanian Treasurer in 2008 in order to provide two-way liaison with Government on business regulation and taxation reform issues. The Group includes several of Tasmania's most senior business executives and peak body representatives. This Government-sponsored forum is a principal point of contact with the business community for consultation on business taxation reform measures.

Under the Terms of Reference, the Business Taxation and Regulation Reference Group is to:

- operate as a forum within which the diverse views of the business community on business regulation and tax reform issues can be considered and then exchanged with the State Government;
- consider and provide feedback on business regulation and taxation reform proposals developed by the Commonwealth and State Government; and
- facilitate the dissemination of information and educate the business community on significant business regulation and taxation reform matters at the state and national level as they arise over the next two years.