AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Comments on the December 2008 Consultation Paper on Australia's Future Tax System Submission

The Victorian Farmers Federation (VFF) would like to thank the Henry review for the opportunity to comment on the consultation paper released in December 2008 in response to the original call for submissions. We would like to take this opportunity to raise some issues that we did not think were address adequately in the consultation paper. This paper is meant to supplement the submission made in October and we will do our best to not reiterate taxation issues raised in that submission.

Issues of considerable concern to Victorian farmers that were raised and discussed in the original VFF submission include:

- Removal of the taxation of insurance
- Removal of the Taxation of the transfer of business assets
- Removal of the CPI indexation of State Government charges and taxes
- Maintain the Fuel Tax Credit

Please refer to our original submission for comment on those issues. The views of the VFF on Fire Services levy and Municipal rates are below. While there was acknowledgment of the concerns with the Fire Services Levy we wanted to re-iterate our concerns in light of recent fire events in Victoria. Also, the VFF would like changes to the municipal rating system explored and considered as a part of this review.

Fire Services Levy

The fires services levy (FSL) provides 77.5 per cent ($215 million in 2008) of the funding to the Country Fire Authority with the State Government contributing 22.5 per cent. The State Government contribution could be viewed, at least in part, as a payment for the fire services provided to state assets.

It is the Victorian Governments position that the only State tax on insurance is the ten per cent stamp duty, and it is the insurance companies that choose to apply the fire services levy, which is then passed onto policy holders. The State Government argues the main beneficiaries of the fire services are the insurance companies themselves as it reduces claims, but creates a issue with the free-riders.

The Government solution to the free rider problem, ie. the non insured, is that the CFA can submit a bill to uninsured landholders; this will not happen in practise, as the recent decision by the State Government admits.[1]

The VFF has been pointing out the inequities and the unsustainable nature of the FSL. The VFF is not the only organisation holding this view. A review conducted (2000) by the State Tax Review Committee, the Centre for International Economics (August 2005), Access Economics (2000) and the NSW Treasury have all reported on the inefficiency of taxes on insurance premiums.

This problem was identified in the Victorian Review of State Business Taxes review (2001) which found that the FSL provided a disincentive to insure thereby reducing the pool from which the levy is collected causing an increase in the levy providing a greater disincentive and so on.

An alternative to the current CFA funding system would be to move to a broader collection base that captures all the beneficiaries of the fire services. This would include users of motor vehicles. A large portion of the CFA resources is used for call-outs for road incidents.

Municipal Funding

Municipal funding is a concern to agricultural enterprises and should be addressed as a part of this review. Municipal rates should be considered under this review as the amount of rates revenue received by local governments directly impacts the amount of revenue required from other sources including the grant system. This submission will be proposing an alternative to the current system that will have a direct impact on transfers through the grants commission.

The VFF maintain that the municipal funding system is a regressive tax as the capital base rating systems does not capture accurately capacity to pay nor benefit received. Land, labour and capital are the factors of production. Land is the farmer's major income producing asset. Land, however, in the non-farm sector is where the enterprise and income producing assets are located. The income producing assets of the non-farm sector are not subjected to an annual *ad valorem* tax; whereas, the major income producing asset of the farm sector (land) is so subjected to this tax. This imposes a distorting burden on agriculture.

The farm rate differential was introduced in 1949 (in Victoria) to reflect the lower rate of return on monies invested in the farm sector vis-a-vis the non-farm sector.

Even with the farm rate differential, the Productivity Commission report assessing the revenue raising capacity of local government points out that property values are not an accurate method to assess ability to pay.

[1] Media release, NO CHARGE FOR DEFENDING HOMES FROM RECENT BUSHFIRES, Office of Premier and Cabinet, March 12, 2009

> *Although there is likely to be a link between property values and incomes, property values are an imperfect and incomplete indicator of the incomes of residents and hence of their ability to pay rates.*[2]

The Productivity Commission report also states that total income within a shire is a more appropriate way measure local government's fiscal capacity and individual income is a more appropriate measure of individuals' capacity to pay.

> *All things considered, the Commission considers that the appropriate indicator of fiscal capacity for each council in the context of this study is the aggregate income of its local community. Ultimately, it is the incomes of individuals in local communities that constrain the choices they face between consuming public or private sector goods and services.*
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> *The most appropriate indicator is based on a comprehensive measure of income. This includes income from all sources, such as wages, salaries, interest, dividends, imputed income from housing ownership, and capital gains on assets (whether realised or not). It also includes all business income (such as retained earnings) that has not been paid to residents in the form of dividends (Barro 2002; Musgrave and Musgrave 1989).*
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> *People and businesses in local government areas pay taxes and charges to other spheres of government and receive income from outside the local area (including welfare and other transfer payments from the Australian and State Governments). In principle, the indicator of a community's ability to pay for local government services should be based on disposable income, net of other taxes and charges.*
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> *However, a complete quantification of a broad measure of income disaggregated down to the level of local government areas is not available in existing data collections. In practice, it is necessary to use incomplete measures of disposable income, as explained in chapter 5.*[3]

Alternative to the Current Municipal rating System

The current inequitable municipal rating system needs to be re-thought. Funding Local Government through consolidated revenue would achieve the suggestion of the Productivity Commission that income is a better indicator of capacity to pay. Below is an additional alternative that should be considered.

[2] Productivity Commission 2008, *Assessing Local government Revenue Raising Capacity*, Research Report, Canberra Page 54

[3] Productivity Commission 2008, *Assessing Local government Revenue Raising Capacity*, Research Report, Canberra Page 55

Rates + Municipal Levy

The VFF suggest that the rates portion of local government revenue should be split between two separate streams of income. The first stream would be similar to the existing rates collection as currently exists, however rates are only collected on the value of home and curtilage at current assessment rates. Rates on farm land should be abolished as in the UK because farmland is a means to production, and its value bears little relationship to the farmers' wealth or his capacity to pay.

Admittedly, this change to rates collection will affect the total rates income of some local governments especially those with a large portion of agricultural land within its borders. For example, a regional shire could expect as much as 30% of their rates income to come from farm land.

To make up for the shortfall in direct rates income we suggest the creation of a Municipal Levy assessed on income earners in Australia, similar to the existing Medicare Levy. Much of the activities undertaken by local governments benefit not only its residents but also any person passing though that shire. We feel a more equitable way to share the burden is though a levy on income earners.

The revenue from the levy could be added to the existing grants system to facilitate the administration and distribution of funds, naturally with a strong priority placed on local governments whose rate income has dropped through the change in assessment.

Using figures provided in the Productive Commission report we estimate that local government earning from property rates is approximately $8.8b/yr. Some industry estimations put rates derived from farm land at approximately 30% of the total, leaving a reduction in the total pool of revenue of $2.64b/yr.

In the 2005/06 taxation year, there were 7,833,149 contributors to the Medicare levy and a total collection of 6.121b[4]. If a Municipal Levy was assessed on the same group of tax payers a levy of 0.65% would be required make up the short fall. It is also reasonable to apply the Municipal Levy to business income as well. If the municipal levy was added to business income tax assessment the amount of levy would obviously drop considerably.

> **The Federal Government, as a part of the Henry Review, should investigate the feasibility of removing Municipal Rates from Farm Land and the establishment of a Municipal Levy on income.**

While the VFF has a preference for the above alternative to the rating system, we will be happy to continue dialogue with the government and this taxation review to

[4] Personal Taxation Statistics 2005-06, http://www.ato.gov.au/content/downloads/00117625_2006CH2PER.pdf

develop any other system that will deliver equity into the system, which may include rates based on the rental value of property.

Thank you for the opportunity to make comment and we look forward to continuing to working with tax system review to develop the more progressive and equitable tax system possible.

Kind regards,

Russell Amery
VFF Economics Committee Chair