3.1 ACT TAXATION REVIEW

Introduction

The ACT Taxation Review was commissioned following the release of the Australia's Future Tax System (AFTS) report.

The Review Panel comprised former ACT Treasurer Ted Quinlan (Chair), Professor Alan Duncan from the National Centre for Social and Economic Modelling at the University of Canberra and the ACT Under Treasurer, Megan Smithies.

The Terms of Reference for the review required an analysis of:

- whether the mix of taxes currently levied is appropriate;
- whether the current ACT tax base is equitably and effectively distributed;
- options to ensure revenue certainty and sustainability of the tax base;
- whether reforms are required to improve efficiency and equity of the tax base; and
- completing a social impact assessment of any proposed reforms.

The Review Panel examined and provided recommendations on whether ACT taxes are appropriate, equitable and effectively distributed, and provide the stability and certainty required for the Government to continue delivering important community services to Canberrans.

The Review Panel also assessed the scope for reform, both individually and as part of a national approach to state tax reform. It provided feasible reform options and flexible pathways for Government's consideration.

Main Findings and Conclusion of the Review

The ACT Taxation Review found that the ACT's taxation mix is not out of the norm, taking into account its circumstances and that the Territory's higher than average taxation effort funds above average expenditure on services. Overall, the ACT's taxation has relatively higher economic efficiency compared to other jurisdictions.

However, the Review also found that there are risks to the long term sustainability of the Territory's services – the Goods and Services Tax (GST) base is eroding, the cost of health services is rising faster than the economic growth rate and significant taxation lines, such as duty on conveyances, are volatile, unfair and unsustainable.

The main findings and conclusions of the ACT Taxation Review are summarised in the following section.

The ACT Taxation Review Report is available on the Treasury website:
http://www.treasury.act.gov.au/TaxReview/Index.shtml

The Current Taxation System

The Panel's main conclusions on the current taxation system are summarised as follows:

- ACT's taxation effort is higher than its assessed capacity. Expenditure on services has been higher than the national average, funded by higher taxation. These assessments are gauged against the national average capacity to raise taxes and deliver services. The ACT collects the lowest tax per capita as a proportion of its mean disposable income compared with the national average. Taxation per employed person is also below the national average.
- The Territory's taxation mix is not out of norm when compared to other jurisdictions and taking into account individual circumstances. Land based revenue is the predominant tax base in the ACT.
- There are risks to the long term sustainability of the Territory's revenues. The GST base has been eroding. Major own source taxes are volatile, unfair and inefficient, and therefore unsustainable in the long term.

Wider Social, Economic and Regional Contexts

In undertaking the review, the Panel had a detailed consideration of the wider social, economic and regional contexts for the Territory's taxation system. It noted that:

- the Territory's position in the Capital region, its economic capacity and socio-demographic structure present both opportunities and challenges;
- the relatively large public sector provides stability in the labour market and the overall economy. The reliance on a single large employer (Commonwealth Government) also poses risks for the economy;
- Canberra is a significant employment hub for the surrounding area of NSW. The economies of the ACT and the surrounding region are closely linked. Overall, the cross border activity results in net fiscal costs for the Territory;
- this is expected to rise as the population growth in the region outstrips growth within the Territory. To the extent possible, there should be no disincentives for households and businesses to locate within the Territory borders as opposed to the surrounding region;
- the ACT's economy and its budget have considerable dependence on land supply and construction industry. Supply of affordable land should continue to be a key policy objective;
- it is difficult to accurately project the expenditure needs for the long term due to changes in expectations, technology and policy responses. There are general trends of an ageing population and health services growing faster than the rate of economic growth. Tax and tax settings that equitably and efficiently draw on, and support, economic growth to meet these service needs will be necessary; and
- considerable investments in infrastructure for services such as transport, water and sewerage will be required. Land value capture should be factored into revenue generation to finance infrastructure, and to provide a stable source of revenue growth to deliver services.

Scope for Reform

The Panel explored scope for reform in considerable detail, and noted that tax reform is difficult. Behaviours of markets and individuals adjust, even to what may be inefficient taxes. Yet it is generally well accepted that changes to Australia's tax system will be necessary and will occur.

The Panel argued that The ACT is in a unique position to undertake reform due to:

- its combined local and state level government and ready access to a broad base for land tax; and
- relatively higher average incomes compared to other jurisdictions, which should provide capacity to absorb and cushion the impacts of reform.

The Panel considered that national consensus on pursuing structural reform will take time. In the ACT, specific measures and steps can still be considered for the short term. Individually and combined, they will provide a basis for transition as it inevitably occurs.

The Panel suggested that engaging the Commonwealth Government and seeking its support is essential in pursing taxation reform in order to ensure that the benefits of the reform are retained by the Territory, and that it is not unduly penalised through the Commonwealth Grants Commission's distribution methods.

Key Recommendations of the Review

The ACT Taxation Review made 27 recommendations for taxation reform in the Territory. Two further alternative and additional recommendations were made by the Panel Chair.

Overall, the Review made recommendations in relation to overarching structural reform to the Government, to remove a number of inefficient taxes and ensure that appropriate support and assistance is provided to offset the cost of tax reform to lower income households.

The key recommendations from the Panel were to:

- abolish Conveyance Duty over a 10-20 year period;
- abolish duty on general insurance and life insurance;
- adopt a broad based land tax as a base for revenue replacement;
- pursue measures that make progress towards long term structural reform;
- engage the Commonwealth Government in any taxation reform; and
- ensure that low income households are cushioned from any undue effects of taxation reform.

The recommendations and findings of a number of key taxes are outlined in the following.

Conveyance Duty

The Review Panel concluded that Conveyance Duty is an inefficient tax that distorts consumer behaviour and exercise of housing preferences, leading to a misallocation of resources in the economy.

It is inequitable, as the tax burden is carried by a small number of people transacting in the housing market and it only applies to those who purchase real property. The duty is a very volatile and unpredictable source of revenue for the Territory.

The Review Panel recommended that Conveyance Duty be abolished over a 10-20 year period.

General Rates

The Panel concluded that General Rates are an efficient and adequate tax. However, there is considerable scope to improve the rating system and to establish it as a base for a stable, efficient and fair source of taxation. Improvements could also make the system more coherent to Government's policy objectives.

Effective tax rates are flat, as is the feature of a municipal services cost recovery system. Some progressivity exists because of the land values in the rating formulae.

The Review recommended that General Rates be levied through a two-part charge incorporating an element to meet the cost of providing basic city services, and a progressive general taxation component contributing to general revenue.

Land Tax

For the residential sector, land tax is currently applied to a narrow base (rental properties). A broad-based land tax is considered to be efficient. The Review Panel noted that the ACT is in a unique position among States and Territories to have access to a broad-based land tax base in General Rates

It was recommended that the Territory adopt a broad-based land tax as a base for revenue replacement in order to remove a number of small inefficient taxes.

The Panel recommended that the commercial land tax be combined with the commercial rates.

Payroll Tax

The Review Panel noted that views on the efficacy of payroll tax differ. There is evidence that it reduces employment, creates a welfare loss and provides an inefficient method of raising tax. On the other hand, noting States' circumstances, it could be considered an efficient tax.

Its efficiency and equity would depend on the circumstances for States. Overall it performs relatively well.

The Panel recommended that the ACT retain a form of tax on payroll to maintain a diversified tax system and work towards national harmonisation of the system.

Insurance Taxes

The Panel concluded that insurance taxes are highly inefficient. They are essentially transaction taxes, although they are levied on aggregate premiums and are less likely to be visible to the consumer.

The duty increases with the level of insurance cover and may create adverse consequences of under insurance and less than optimal production of insurance products. Under insurance caused by insurance taxes can impose a direct cost on governments where there is an expectation of direct assistance should a major catastrophe occur.

The Panel concluded that these taxes are unsustainable in the long run due to the pressure on governments to provide compensation after the event.

The Panel recommended that duty on general insurance and life insurance be abolished.

Other Recommendations

The Review made a number of other recommendations around increasing Gaming Machine taxes. The Chair made a qualifying recommendation in this regard. The Chair has also suggested consideration of supporting poker machines in Casino Canberra.

The Panel recommended utilising the current concessions system to cushion the distributional impacts of reform through the transition period, and on an ongoing basis.

Government Response to Review

The Government released its response to the ACT Taxation Review on 7 May 2012. Overall, the Government Response was supportive of the recommendations made by the Panel. The Government Response:

- agreed to 15 recommendations;
- agreed in-principle to 14 recommendations;
- noted 1 recommendation; and
- did not agree with 1 recommendation.

The Government response noted that taxation reform is important for economic and fiscal sustainability, and to support broader social and environmental policy objectives.

The Government Response stressed that revenue replacement is of particular importance - if reliance on inefficient taxes is to be reduced or abandoned the benefits of improved economic efficiency should not be at the expense of social costs that may arise from reductions in services.