CHAPTER 6 GST, PAYROLL AND LAND TAX

MAIN POINTS

- State and Territory governments have broad power to tax but raise only about 18 per cent of total tax revenue. This imbalance has existed since the federation. The payroll tax, stamp duties and property taxes raise most revenue for States and Territories.
- Nonetheless, Australia taxes the bases of consumption, payroll and land less than many comparable countries. There is scope to broaden each of these bases to improve the revenue of the States and Territories, making the tax system more efficient and resilient.
- The GST raises about 13 per cent of total tax revenue and is provided entirely to the States and Territories, equalized for tax and expenditure capacity. The GST is Australia's only broad-based tax on consumption. It applies at a flat 10 per cent rate on a wide range of goods and services but there are exemptions or input-taxed elements making up more than half of the GST base. The rate of GST is lower in Australia than in many comparable countries.
- Payroll tax is paid by businesses and if comprehensive, is equivalent to a tax on wages. Australia's State and Territory payroll taxes have various thresholds and exemptions which introduce distortions for business decisions and make them less efficient than otherwise.
- Property taxes raise under 3 per cent of GDP across all governments, lower than in many other countries.
- State and Territory property taxes are designed less efficiently than they could be. Land taxes and council rates are the most efficient taxes, according to economic models, but the base warrants reform. Stamp duties are easy to collect but their incidence is likely to deter individuals from moving when personal ircumstances change, while revenues are volatile. However, reform is challenging politically and may have an impact on housing markets; a long term transition may be required. The ACT reform provides an example.
- Insurance taxes are inefficient and create incentives to under-insure. These taxes would ideally be abolished and revenues raised through broad-based land taxes

6.1 State taxes

In spite of their broad constitutional power to tax, the States and Territories raise only about 18 per cent of total tax revenue in Australia. About 85 per cent of that proportion is raised by State and Territory governments and 15 per cent by local governments. Taxing capacity is uneven across States and Territories and as explained in Chapter 3, these governments raise only about half of their expenditures in taxation. The richest and most populous states of New South Wales (NSW) and Victoria raise by far the most tax revenues.

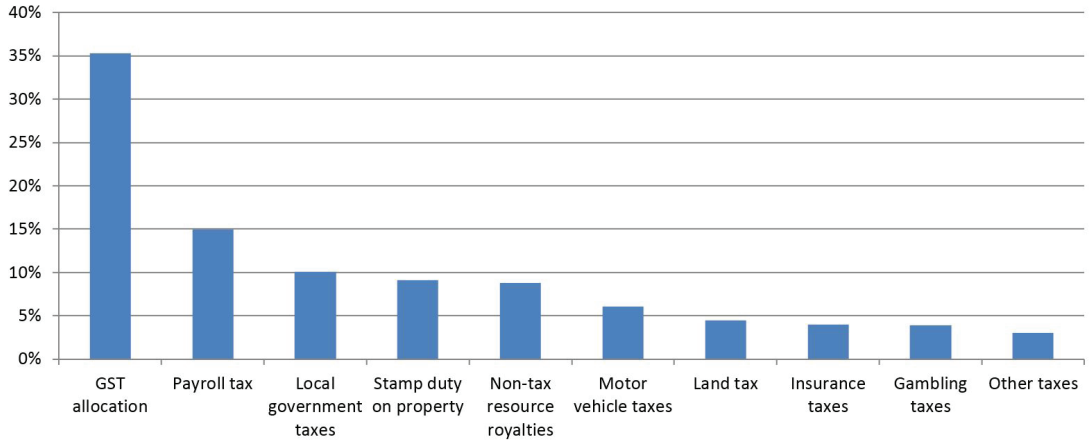
Chart 6.1 sets out State taxes in total and by State or Territory; royalty revenues; and GST revenue allocation, in 2012. The main tax bases are payroll tax; taxes on property transactions and land value; and motor vehicle taxes. States and territories also impose a range of other taxes including insurance levies, motor vehicle taxes and gambling taxes. Detailed information is provided in Table 6.1.

As explained in Chapter 3, the GST is collected by the Commonwealth Government with all GST revenues distributed to the States and Territories. In return for this arrangement established in 1999, the States and Territories undertook to abolish a range of minor taxes and duties. Accommodation tax, financial institutions duty, quoted marketable securities duty and debits taxes were all abolished by 2005.

State and Territory governments subsequently agreed to abolish in stages a further tranche of taxes including stamp duties on mortgages, leases, and credit and rental arrangements. No agreement was reached on the abolition of insurance taxes, payroll tax or stamp duties on the sale of residential properties (Treasury 2007). Progress in abolishing remaining taxes has been mixed, with some listed taxes yet to be abolished.

This chapter does a survey of key issues relating to the GST and the main State tax bases of payroll tax and property and insurance tax. The chapter does not discuss in detail the issue of vertical fiscal imbalance in Australia's federation, or the formula applied to determine horizontal fiscal equalization for distribution of GST revenues. However, these issues are fundamental to the Commonwealth Government White Paper processes for reform of the tax system and of the federation.

Chart 6.1: Types of tax as a percentage of total State and local tax revenue, 2012-13



Source: ABS (2014c); Commonwealth Grants Commission (2012) Interim Report, Table 4.2; Treasury (2013d), Table 3.2.
Note: Total State and local tax revenue for this comparison includes the GST and resource royalties.

Table 6.1: State tax revenues, with GST and royalties, 2012-13

	Total ($m)	Proportion of total State and local tax revenue including royalties and GST	NSW ($m)	VIC ($m)	QLD ($m)	SA ($m)	WA ($m)	TAS ($m)	NT ($m)	ACT ($m)
Payroll tax	20,752	15.0%	6.953	4,751	3,740	1,077	3,415	291	205	320
Stamp duty on real property transfers	12,610	9.1%	4,568	3,332	1,887	773	1,785	139	126	231
Motor vehicle taxes	8,399	6.1%	2,728	1,811	1,995	545	1,109	151	60	132
Gambling taxes	5,439	3.9%	1,873	1,745	1,034	421	218	93	55	54
Land tax	6,193	4.5%	2,333	1,589	990	562	559	89	0	71
Insurance taxes	5,526	4.0%	2,029	1,628	670	429	576	87	42	65
Other taxes (a)	4,173	3.0%	1,502	774	742	310	417	63	2	363
Total State tax revenue	**63,219**	**45.8%**	**21,986**	**15,630**	**11,058**	**4,117**	**8,079**	**913**	**490**	**1236**
Local government taxes (rates)	13,902	10.0%	3,624	3,890	3,023	1,238	1,695	335	97	
Total State and Local tax revenue	**77,411**	**55.9%**	**25,610**	**19,520**	**14,081**	**5,355**	**9,774**	**1,248**	**587**	**1,236**
Royalties (b)	12,171	8.8%	2,128	46	3,651	232	5,937	55	122	0
GST (equalized allocation) (c)	48,395	35.3%	14,666	10,947	9,478	4,463	2,907	1,694	2734	984
Total State and Local Revenue including royalties and GST	**138,517**	**100%**	**42,583**	**30,663**	**27,399**	**14,165**	**14,518**	**3,007**	**1,562**	**4,072**

Source: ABS (2014c).
Notes: (a) 'Other taxes' for the ACT includes rates (local government taxes) as it has no smaller local governmental bodies that levy rates.
(b) Royalties on natural resources for 2012-13, Commonwealth Grants Commission (2012), Interim Report, Table 4.2.
(c) GST allocations for 2012-13 from Treasury (2013d), Table 3.2.

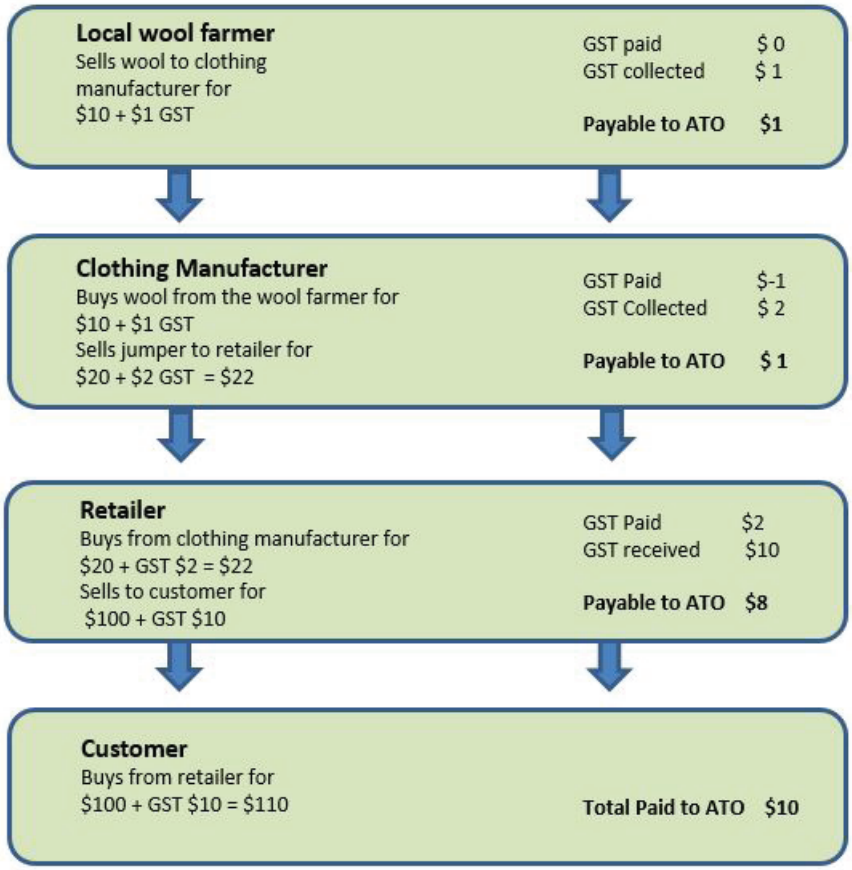
6.2 The GST: taxing consumption

The GST was introduced in 2000 and has changed little in the last fifteen years. Total GST collections amounted to around 13 per cent of total tax revenue in 2011-12.

The GST is levied at a flat rate of 10 per cent on most goods and services consumed in Australia. GST-registered businesses generally including the GST in the price of sales to their customers while claiming credits for GST included in the price of their business purchases. Businesses with annual turnover less than $75,000 do not need to register for the GST. Chart 6.2 shows how GST operates through the chain of production and sale.

The economic incidence of the GST generally falls on the individual consumer. The GST is passed onto consumers in higher prices so that consumers are able to purchase less from a given disposable income. Similarly, payroll tax is passed onto employees in lower wages, thereby reducing their disposable income available for purchases (Freebairn 2014, 13). A comprehensive GST has broad economic equivalence over the long run to a tax on wages such as a comprehensive payroll tax and, internationally, social security taxes (Kesselman 2010).

Chart 6.2: How does GST work?



Source: ATO (2014d).

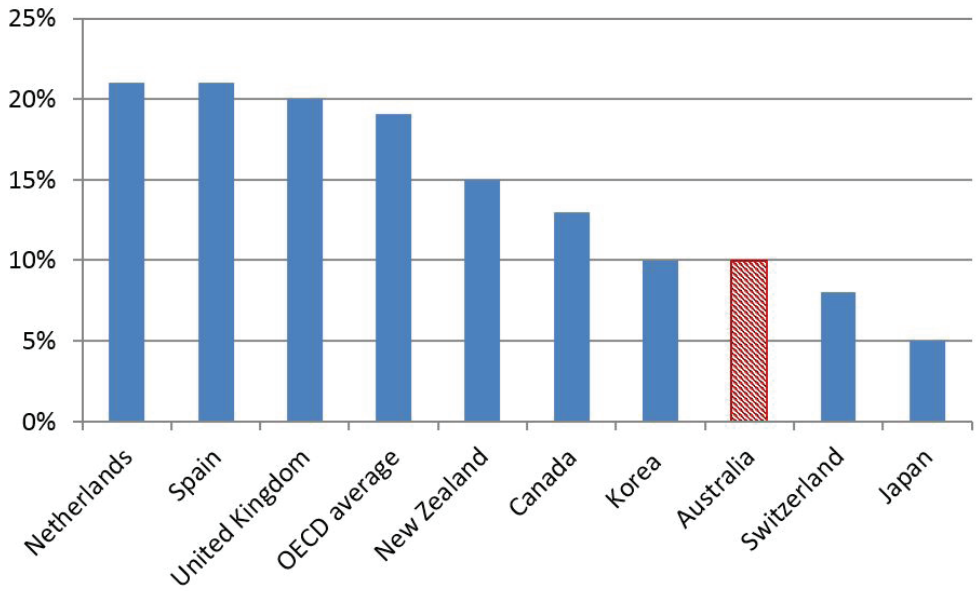
The GST rate and base

Australia's GST rate is lower that of other countries. Chart 6.3 shows the standard GST or equivalent value added tax (VAT) rate in selected countries. Most countries have a standard rate and some zero-rated or low-rated supplies.

The OECD's VAT revenue ratio provides a measure to compare the coverage of the GST with the coverage of value added taxes in other OECD countries. The VAT revenue ratio measures the proportion of national final consumption expenditure that is covered by value added tax.[28] The OECD's analysis indicates that the GST covers about 47 per cent of the consumption base, less than the OECD average of 55 per cent in 2012. Australia's GST coverage is similar to Canada but significantly lower than New Zealand's GST, which has almost total coverage of the consumption base. This is shown in Chart 6.4.

Apart from New Zealand, most value added taxes have significant exemptions in the base. However, Australia's GST base is narrower than that of many other countries. Major exclusions from the Australian GST base include basic food items, health care, childcare, education, water and sewerage services. These are shown as large tax expenditures in Table 3.1 above. In addition, there are a wide range of smaller exemptions including precious metals, cars purchased by people with disability and second-hand goods.

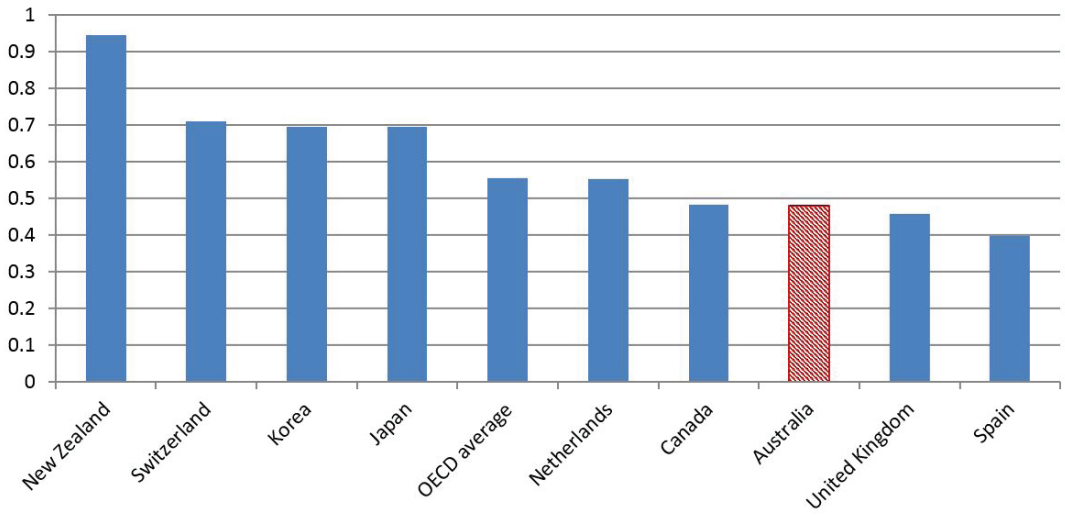
Chart 6.3: Statutory GST/VAT rates, selected countries, 2012



Source: OECD (2014f, 60).
Notes: Standard VAT/GST rates not reflecting exempt or concessional rates. Canadian rate of 13 per cent includes 5 per cent national GST plus 8 per cent Harmonised Sales Tax in provinces including Ontario; there are variations in other provinces. Switzerland bar shows the federal rate only; there are diverse additional rates levied by cantons.

28 The VAT revenue ratio is calculated according to the formula VRR= $\frac{VR}{(FCE - VR).r}$, where VRR is the VAT revenue ratio; VR = VAT revenue collected; VRdue = VAT revenue due; FCE = Final Consumption Expenditure: and r = Standard VAT rate. The denominator, Final consumption expenditure, in National Accounts data includes VAT revenue paid at the point of consumption and hence must be reduced by the amount of VAT paid. VAT revenue represents the amount of VAT revenue collected and, as such, takes into account actual VAT compliance. It does not represent the theoretical VAT base assuming perfect compliance. OECD (2014e).

Chart 6.4: The GST/VAT revenue ratio in selected countries, 2012



Source: OECD (2014e, 95).
Note: No value is available for the US as it does not have a national value added tax.

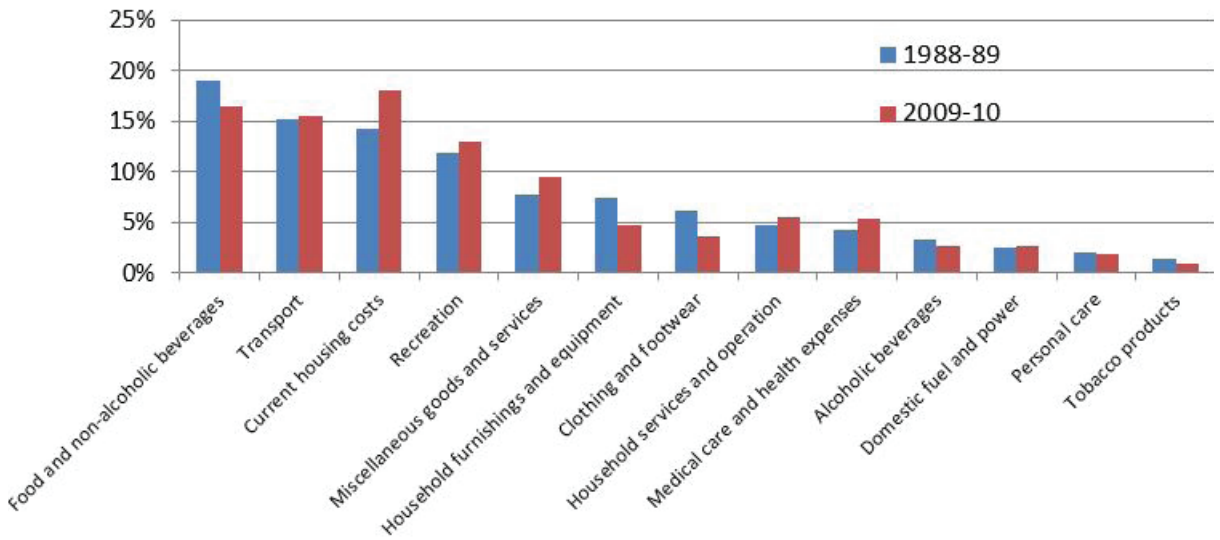
In keeping with the internationally accepted system for value added taxes, imports of goods are subject to GST. Exported goods and services, including international travel purchased in Australia, are exempt from the GST as they are not consumed in Australia. However, there is a threshold of $1000 for GST applicable to imported goods. The rapid growth of online retailing has meant that this threshold is associated with increasing base erosion for the GST. Imported intangibles or services may escape taxation entirely (e.g. digital products such as ebooks, films and apps). Apart from the revenue concerns there has also been concern about the competitive neutrality implications for retailers. The Government has committed to consider the continuing appropriateness of the low value threshold as part of the White Paper process.

Australian households are spending proportionately more on housing, health, education and financial services than two decades ago. As a consequence, more of the consumption of Australia's households is untaxed because these goods and services are exempt from GST. Chart 6.5 shows these changing household consumption patterns. Households have increasingly spent more on services and less on goods; have saved more overall; and have shifted consumption towards tax-exempt health and education services.

The rate and base of the GST have been discussed in a number of recent reviews including the GST Distribution Review (Commonwealth Grants Commission 2012) and the review of the low-value parcel processing threshold (Low Value Parcel Processing Taskforce 2012). While these reviews have examined aspects of the GST's operation, there has not been a comprehensive policy review of the effectiveness and distributional consequences of the GST, including the extent to which the GST concessions have affected the overall fairness of the GST.

Recently, New Zealand enacted a tax reform that increased the rate of its exceptionally broad-based GST to 15 per cent. Compensation was provided through indexing transfers and credits such as the Family Working Tax Credit. While there are many differences, it is worth examining the New Zealand experience to see what lessons may apply in Australia.

Chart 6.5: Changing household consumption patterns



Source: ABS (2014d).

Distributional impact of the GST

A broad-based comprehensive GST is proportional with respect to consumption but regressive with respect to income of individuals (see Chapter 1 for an explanation of these concepts). However, there are two caveats regarding the regressive nature of the GST.

First, it is important to weigh the consequences of the overall tax and transfer system when considering fairness. A regressive tax may fund a progressive transfer system and redistributive public goods across government as a whole. Many OECD countries with significant social security systems rely substantially on regressive taxes on consumption and wages to fund these systems. Moreover, the progressive income tax can offset regressivity of the GST, in particular if progression is maintained in marginal income tax rates and the base is broadened to tax savings more effectively.

Second, there are significant exemptions in the GST base. These are widely considered to make it more progressive especially the exemption of food. However, there is evidence in a recent OECD analysis of distributional features of other VATs (excluding Australia) that a number of GST exemptions may benefit high income earners more than low income earners (OECD 201f).

Administrative and compliance costs

The GST is a complex tax that has a relatively high administrative cost compared to most other Australian taxes including the income tax. The cost of collection by the ATO, which is paid by the States, is estimated at just under $700 million in 2014-15 (Treasury 2014a, Paper 3, Table 3.9). This is approximately 1.25 per cent of revenue collected. There is also a significant level of uncollected GST debt. The reasons for this are not fully understood. One factor may be that many collectors and remitters of GST are small businesses that may face cashflow difficulties.

Elements of the tax base, including low-value imports and financial services, are left untaxed or taxed at a lower rate than the standard rate, because the technical or administrative costs of taxing them are considered to be too great. Technical and practical difficulties arise in levying GST on the supply of some goods and services, in particular financial services, residential rental services, the sale of existing residential premises and certain charitable fund raising.

In consequence, under the current system, these supplies are 'input taxed'. The supplier cannot charge GST on the supply of the good or service and may not claim a credit for the GST paid on purchases (inputs) relating to those goods and services. There are also special rules regarding second-hand goods, gambling, land development, imports, insurance and cars. All these exceptions and special rules add complexity to the tax.

On some issues, such as the taxation of supplies of new housing (and the complex 'margin scheme' for real property developers), there has been significant litigation and uncertainty in application. Table 3.1 indicates that the TES estimate of input-taxation of financial services is estimated to have the highest revenue foregone of these various 'practical' tax concessions in the GST. Consequently, the issue of taxing financial services deserves greater research and policy attention.

Directions for GST reform

The Henry Review was precluded by its terms of reference from recommending changes to the rate or base of the GST. However, it provided commentary and related findings on three main issues that relate clearly to broad based consumption taxation.

First, the Henry Review found in favour of increasing emphasis on consumption taxation within the overall architecture of the tax system. This direction would be consistent with trends in other countries. There are some suggestions that value added taxes may be a substitute for company taxes and 'policy-makers can potentially shift from corporate taxation towards consumption taxation as a response to tax competition' (Loretz 2008, 651).

Second, the Henry Review considered financial services and canvassed a possible approach to the taxation of value added in the financial industry. This could enable the current input taxation of this sector to be replaced by full GST treatment. The approach measures value added as the sum of factor incomes in the sector rather than as the margin between sales and purchases (which does not work satisfactorily with finance), producing a more reliable measure of the same margin. The application of GST to financial services warrants research and policy development.

Third, the Henry Review discussed the technical and conceptual benefits of an alternative tax on consumption to the GST. This is a destination cash flow tax on business that would represent a substantial, broad-based reform of the GST and/or State payroll taxes. Apart from its potential for greater economic efficiency, this model of value added taxation would utilize the administrative and compliance advantages of 21st century, computer-based business systems. The Henry Review suggested that this form of taxation could be a more efficient tax base required to meet future needs for State governments. Improvements to payroll tax as an effective business tax at the State level would likely help improve revenue collection and efficiency.

The various concerns about administration, complexity and compliance in the GST system suggest that, if other tax base options become available and more easily administered in future, then these are worthy of further research and policy consideration. The tax policy goal is efficient, effective and fair taxation of consumption, a matter which is also being explored by other country governments.

6.3 Payroll tax

The most important State tax in terms of revenue collection is payroll tax (leaving aside the GST). This raises much more revenue in the most populous and industrialised states (NSW and Victoria) than in smaller, agricultural or resource-rich states. In Australia, payroll taxes do not directly fund social security obligations of government and consequently are not levied at the very high rates at which they are imposed in other countries.

Payroll tax has been harmonized in all states except Queensland. It is levied on the total payments for employee wages of employers, over specified thresholds (including wages, fringe benefits, bonuses and commissions). Nonetheless, the payroll tax is increasingly weakened through tax competition, producing increases in the threshold for taxation, variable rates and special exemptions. Most small businesses (and hence a large number of employees) are exempt from payroll tax because of the minimum threshold and it is in respect of the threshold that we see most payroll tax competition emerging.

As explained in section 6.2, the long-run economic incidence of a broad-based payroll tax is similar to that of a broad-based tax on consumption: it falls on labour income or wages. However, current Australian payroll taxes are not comprehensive. The concessions in the payroll tax base introduce distortions in the allocation of labour across the economy and render the incidence of the payroll tax more on businesses than on wages.

In spite of declining effectiveness, payroll tax remains an important State tax base. As technology improves, there is scope for further research to examine feasibility of broadening the payroll tax base, or levying it on a comprehensive national tax base, possibly through the Commonwealth PAYG wage withholding system, on behalf of the States.

Table 6.2: Payroll tax rates, base and thresholds across States

	Flat rate	Method of calculation	Exemptions
New South Wales	5.45%	Single marginal rate	First $750000 exempt
Victoria	4.90%	Single marginal rate	First $550000 exempt
Queensland	4.75%	Deduction system	First $1100000 exempt. For payrolls between $1100000 and $5500000, a deduction of $1100000 reducing by $1 for every $4 the payroll exceeds $1100000. No deductions for payrolls over $5500000
Western Australia	5.5%	Single marginal rate	First $750000 exempt
South Australia	4.95%	Single marginal rate	First $600000 exempt
Tasmania	6.1%	Single marginal rate	First $1250000 exempt
Northern Territory	5.5%	Deduction system	First $1500000 exempt. For payrolls between $1500000 and $7500000, a deduction of $1500000 reducing by $1 for every $4 the payroll exceeds $1500000. No deductions for payrolls over $7500000
Australian Capital Territory	6.85%	Single marginal rate	First $1750000 exempt

Source: NSW Treasury (2014, 13).

6.4 Taxes on land

Australia relies less on property taxes overall than some comparable countries. This is shown in Chart 6.6, which presents an overall picture of tax on property as a proportion of GDP.

State and Territory governments levy a stamp duty on transfers of land and all except the Northern Territory levy land tax on the aggregate holding of unimproved land value that is owned by a taxpayer in the jurisdiction.

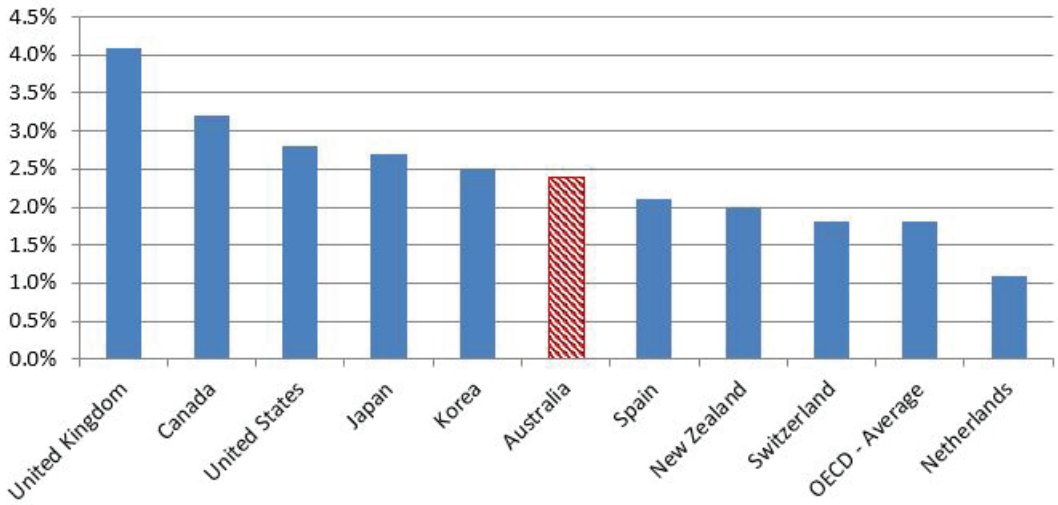
Duty is usually payable by the purchaser calculated on the sale price of the property (or market value if higher). Duty rates are progressive, for instance they range in NSW from 1.25 to 7 per cent (over $3 million in value) and in Victoria from 1.4 to 5.5 per cent (on total value, if over $960,000). The base includes the purchase of a home which is to be the main residence. There has been a significant increase in duty revenues for all states over the last decade as house prices have risen substantially in many locations. However, revenues are highly volatile. Some concessions apply for first home buyers although economists suggest that this likely benefits existing land owners through increased house prices.

The Henry Review recommended that stamp duties be replaced over time by more efficient annual land taxes, a policy approach that has been taken up by the ACT government (Recommendations 51-54).

Land tax is levied by all States and Territories except the Northern Territory. This is a less efficient base than the one developed and advocated by the Henry Review, essentially due to its substantial exemptions based on land use and its step-scale land-holding aggregation features. A more efficient tax would be one more akin to existing local government rates (Wood et al 2009).

States also levy a variety of mineral resource royalties. Royalties are intended as a price for access to a non-renewable resource. States apply a range of royalties including a fixed rate per unit (e.g., tonne) of production; ad valorem royalties as a percentage of value or price of resources or profit based royalties. Table 6.1 indicates the relative importance of royalties for revenue raising. Although not as large as most State tax bases, royalties are particularly important in the resource-rich states of Western Australia and Queensland.

Chart 6.6: Property tax as a proportion of GDP, selected countries



Source: OECD (2014f).

Local government taxes

Local governments are generally statutory bodies incorporated by under State Constitutions and Local Government Acts. They exercise delegated State legislative power to levy rates (property tax) on immovable property. Rates are charged on the value of residential and commercial immovable property in the jurisdiction. Councils apply a variety of different valuation methods including unimproved value, capital improved value and rental value and rates also vary by Council and use of property.

On average, local governments fund most of their expenditures from own-source revenue, although self-funding capacity is highly variable across councils and in particular, rural and remote councils are heavily reliant on grants. Overall, only 37 per cent of council expenditures funded by rates. Other own-source funding comprises fees and charges, developer charges, fines and investment revenue. The balance comes from government grants from State and Commonwealth governments.

Property tax reform in the Australian Capital Territory

The ACT levies conveyance duty and general rates on residential property, as well as land tax on commercial and rental property; it does not have a separate Council rates structure. Following recommendations of the ACT Taxation Review (2012) and commencing in its 2012-13 Budget, the ACT introduced an ambitious tax reform agenda to make property tax fairer, simpler and more efficient in future.

The ACT has begun a transition from duties on residential property to general rates and land tax. The ACT Taxation Review recommended that the benefits of this transition will overall result in a fairer system that has better allocation of housing stock and investment and enhanced ability of individuals to exercise housing choices (2012, 140).

Commencing 4 June 2014, the ACT reduced conveyance duty rates and introduced a flat rate of 5.25 per cent for high value properties. In 2014-15 it will increase general rates on residential and commercial properties by around 10 per cent, while making the rates structure progressive. Further rate changes will take place over coming years. To minimize the cost to revenue, fairness and economic impact, the reform transition may take up to 20 years. The ACT also proposes to abolish duty on insurance from 1 July 2016.