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CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia
GPO Box 2820
Melbourne VIC 3001
Australia
**Phone** 1300 737 373
**Outside Aust** +613 9606 9677
**Website** cpaaustralia.com.au

Department of Treasury and Finance
State Tax Review
GPO Box 1045
ADELAIDE, SA 5001

**By email:** statetaxreview@sa.gov.au

Dear Sir/ Madam

**SUBJECT: State Tax Review Discussion Paper**

CPA Australia represents the diverse interests of more than 150,000 members in 120 countries, including more than 25,000 members working in senior leadership positions. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background, we welcome the opportunity to provide this submission in response to the South Australian Government's State Tax Review ("the Review").

CPA Australia commends the South Australian Government on initiating this review. If South Australia - and indeed Australia as a whole - is to grow and compete globally, we need world-class tax systems that provide the incentives necessary for businesses to grow, to encourage innovation and attract investment. They must also enable the delivery of the services the Australia community expects of a sophisticated economy and increases its overall standards of living.

We note the Commonwealth Government has flagged two related reviews: *the White Paper on the Reform of Australia's Tax System* and the *Federation White Paper*. It is expected that these reviews will have implications for all States and Territories, either through the level of services to be funded by the States or the mix of funding provided by the Commonwealth to fund those services.

Given that the timelines for the completion of these interrelated reviews stretch to at least the end of 2016, any resulting reform initiatives are unlikely to have any impact on government budgets until some years later.

South Australia's leadership in pursuing its own review in the meantime is most commendable. States have their own tax bases and the power to reform them, even though the opportunity in a competitive landscape means that reform is somewhat limited. There is no 'silver bullet' solution here and certainly all the answers to tax reform will not come from the Commonwealth's reform agenda.

State Government participation in the Commonwealth's reviews is critical to achieving sustainable outcomes. Therefore not only is the South Australian Government's current review potentially beneficial to bringing about earlier much-needed tax reform at the State level, it will also be beneficial to framing its response and participation in the national reviews and the potential for a better outcome for business and the nation as a whole.

It is important to keep in mind one of the key observations made in the Australia's Future Tax System (AFTS) report in 2011 which was that Australia has around 125 taxes and charges of which just ten collect 90 per cent of the revenue. Businesses and households rightly want fewer taxes which are more efficient. We also need a more resilient tax system, one that is less exposed to shocks such as property price bubbles or another global financial crisis and commodity price drops.

The Review should also bear in mind the lessons that can be learned from tax reform initiatives in other jurisdictions around the world, including the so-called Kansas experiment in the United States. In 2013, the State of Kansas introduced reforms cutting state income taxes in an effort to attract businesses and create jobs, and subsequently to increase tax revenues.

The changes remain controversial and the expected benefits are yet to be realised, though it is noteworthy that Governor Sam Brownback was re-elected last year so his reforms are likely to continue.

CPA Australia's submission to this Review is in two parts as follows:

- Part A considers the key questions raised in the State Tax Review Discussion Paper.
- Part B draws on CPA Australia's recent tax reform report[1] that modelled the economic benefits of retiring inefficient state taxes – in particular taxes on motor vehicles, insurance and conveyancing duty on real property.

  This scenario modelling also allowed for income tax cuts and increased welfare payments, funded by either raising the rate of the goods and services tax (GST), broadening its base, or both. A copy of our research is provided as part of this submission.

If you have any questions regarding this submission, please do not hesitate to contact me.

Yours faithfully

Paul Drum FCPA
Head of Policy

T: +61 3 9606 9701
E: paul.drum@cpaaustralia.com.au

[1] http://www.cpaaustralia.com.au/documents/tax-reform-in-australia.pdf

# PART A – Discussion paper key questions

**1. Should the Government target tax revenues at a certain level of the economy (GSP) to ensure there is sufficient revenue to maintain the services necessary to make South Australia a great place to live?**

As a matter of prudent fiscal management, tax levels as a percentage of GSP is a useful comparator for governments for monitoring economic activity and the level and competitiveness of taxes. However CPA Australia is of the view that a strict use of such a comparator as a trigger for tax changes would not be appropriate. Such an approach would be too inflexible, and unable to adjust to ever-evolving markets and market conditions.

**2. What are the key State taxes that constrain business expansion and investment? What tax reforms could address this?**

Most taxes impact business and/ or consumer decisions to some degree. In the context of South Australia's taxes, and as identified in the reform paper, the most distorting – or economically inefficient tax - is conveyancing duty on real property.

Transaction taxes like conveyancing duty are a disincentive to a more free-flowing property market. Investors tend to hold property longer, and new entrants to the property market – both commercial and residential – are discouraged from investing because of the high transaction costs imposed.

We note that the removal of stamp duty on marketable securities such as shares - as part of the Australia's New Tax System (ANTS) in 2000 - was beneficial to encouraging investment in the Australian share market. The challenge is how conveyancing duties on real property could be reduced or removed in an equitable manner, and also how such a move could be funded.

The Australia's Future Tax System (AFTS)[2] proposed as one of its framing principles that taxes should be low on mobile capital, and higher on immobile capital. CPA Australia is supportive of this principle. It follows then that the Review should consider greater land taxes in lieu of less conveyancing duty on real property.

The Review should model scenarios of increasing land taxes and abolishing conveyancing duty on real property. The modelling should include transitional rules such as a slow withdrawal of conveyancing duty and the introduction of the replacement land tax over a number of years. This is discussed further under the Review's question 3 below.

However we also note that it may not be possible to fund such a shift, either completely or quickly, from the existing State tax mix without at least some Commonwealth assistance. In this regard see Part B of CPA Australia's submission to this Review. Part B of our contribution to this Review considers how conveyancing duty could be eliminated in all States without any change to land tax regimes. The scenario modelling outcomes should not be viewed as being mutually exclusive to the South Australian Government's own tax reform agenda. They should be viewed as options that could be explored as part of the white paper process that ultimately may enable states to fast-track some of the tax reform options they may be considering.

Regarding South Australia's Review, CPA Australia has also considered other possible options to help fund a reduction in conveyancing duties, for example:

[2] http://taxreview.treasury.gov.au/content/content.aspx?doc=html/pubs_reports.htm

- Gambling taxes – we do not see increasing gambling taxes as a real option for reform mainly due to the fact that in the digital age betting services can be and are streamed in from other tax jurisdictions. As such the ability to tax – and/ or collect tax revenue from these transactions is, at best, difficult.
- Payroll tax – increasing payroll tax to fund such a change is a less viable option than seeking to broaden/ increase land taxes from a tax incidence perspective but also as payroll tax is viewed by-and-large as a significant disincentive for small businesses to employ more staff and grow, and as such is a handbrake on economic activity.

We note the concerns raised over the impact on lower income households of increasing land tax. We suggest that in modelling the scenarios around reducing conveyancing duty and increasing land tax that the Government also model the impact of such a change on households from differing income groups. This will give the government more data with which to consider appropriate policy responses to reduce or address any identified inequity.

We also recommend that any potential compensation mechanism that may be considered be separate from the tax system. Using the tax system to deliver welfare outcomes through for example, exemptions adds complexity to the tax system, and is considered by many to not be the best approach to addressing any identified inequity. The AFTS supports this view, stating that "Some exemptions from land tax may be motivated by equity concerns. In general, land tax is not a good tool for achieving vertical equity objectives. As land holdings are just one asset in a wealth portfolio, they are not a comprehensive mechanism for assessing means. Exemptions based on use are also unlikely to target equity well, as they will reduce tax for people regardless of their means. The income tax transfer system is a more effective and targeted means of achieving vertical equity between Australian residents than exemptions from land tax."[3]

**3. The ACT Government is progressively phasing out conveyance duty and replacing it with an annual property tax - would an annual property based tax be preferable to conveyance duty? If so, what transition arrangements could be implemented to minimise the impact on property owners and the Government's finances?**

It is well understood that revenue from conveyancing duty is a highly volatile tax as it is driven by both fluctuations in property prices and the number of property transactions. A more stable revenue base such as annual property tax would give the South Australian Government greater fiscal certainty, allowing it undertake more comprehensive long-term planning and implementing more far-reaching reform.

The AFTS found "Land has the potential to be an efficient tax base for the States capable of delivering significant and sustainable revenues. Land is an efficient tax base because it is immobile; unlike labour or capital, it cannot move to escape tax. This means that economic growth would be higher if governments raised more revenue from land and less revenue from other tax bases. However, this efficiency is harmed if there are significant exemptions from land tax that encourage people to change how they use land.

"Stamp duties on the transfer of commercial and residential land and buildings are a significant, though volatile, source of State tax revenue. Stamp duties are poor taxes. As a tax on transferring land, they discourage land from changing hands to its most valuable use. Stamp duties are also an inequitable way of taxing land and improvements, as the tax falls on those who need to move.

"Existing land taxes are narrow, which make them less efficient and fair than they could be. Levying higher taxes on larger holdings discourages investment in land by institutional investors in rental housing. Since owner-occupied housing is exempt, land tax on residential investment properties is probably passed through to renters as higher rents.

"Stamp duties on conveyances are inconsistent with the needs of a modern tax system. Land tax needs to be reformed. Broadening the base of land tax would provide a reliable and stable source of

[3] .http://taxreview.treasury.gov.au/content/downloads/final_report_part_2/AFTS_Final_Report_Part_2_Vol_1_Consolidated.pdf at p.250

revenue to State governments. Land tax rates should be based on the value of a given property, so that the tax does not discriminate between different owners or uses of land."[4]

Conveyancing duty adds to the cost of buying and selling land, which in turn can encourage land banking and the sub-optimal use of land. In other words, conveyancing duty is discouraging some land holders from making the most productive use of the land they hold.

A tax system should also not discourage people from moving. Conveyancing duty adds to the cost of moving, which is seen as a significant barrier to labour mobility.

AFTS also makes the important point that …."Land is a highly visible and immobile base and the tax is difficult to evade. Indeed, land tax is one of the only taxes that if levied on foreigners, is not shifted to domestic factors of production."[5]

Against this background, the exploration of how to effectively retire conveyancing duty on real property transactions and move to a broader land tax regime is supported.

**4. What effect would changes to conveyance duty or land tax have on property prices and how would any changes to property prices, in combination with the effects of changes to conveyance duty or land tax, affect housing affordability and business investment?**

The answers to the issues raised here depend on the actual design of the tax reform measures and as such any response would be at best speculative.

However we make the following observations. Under Australia's income tax laws, conveyancing duty expenses incurred by investors and businesses form part of the cost base of a capital asset, and as such are not immediately deductible. It is effectively carried as a loss or outgoing for which there is no tax relief until such time as the property is ultimately disposed of. Conversely, an annual land tax charge would generally be deductible for both investors and businesses in the year in which it was incurred.

In the absence of any other changes, the elimination of conveyancing duty on property purchases would of itself reduce the overall costs incurred on the purchase of a property. Further, the annual income tax deductibility for land taxes incurred would mean the actual economic loss or outgoing for investors would be less under a reformed land tax model in lieu of conveyancing duty.

**5. Does the community believe that landholders with a higher value of aggregate land holdings should pay proportionately more land tax than landholders with more modest land holdings?**

Based on member feedback the consensus is that land taxes could be on a progressive scale based on the aggregate value - and not aggregate quantity - of land holdings.

The review should also consider the current land tax exemptions. For example, it should consider to what extent there should be any exemptions. In considering whether to include exemptions, we draw your attention to our response to Question 2 above.

Low land tax rates, or no land tax helps facilitate so-called land banking. In some instances this facilitates the ongoing under-utilisation of scarce resources.

**6. If so, what is the best way to structure the land tax system to achieve this objective?**

We are not is a position to provide a comment.

[4] Ibid, p247
[5] Ibid, p. 251

**7. Does either the payroll tax threshold or payroll tax rate have a greater impact on employment and business expansion decisions?**

Based on member feedback, currently the major disincentive for small businesses is the threshold as it may discourage small business from growing beyond a certain size – that size being limited by the threshold at which payroll tax first kicks in. This being the case, the rate is of moderately less importance as some businesses seem to go out of their way not to fall within the ambit of the threshold.

However it is not possible to empirically determine which of the above has the greater impact on employment and business expansion decisions. This would vary depending on the actual threshold level and the rate(s) of payroll tax actually levied. For example, if the payroll tax rate was lower, the threshold may not be seen as such a 'showstopper' for small business.

We also note that there is significant overlap between states in the administration of payroll taxes and that this can be an impediment to business, especially those that operate across state borders.

While payroll tax laws are largely harmonised (except for the rates and thresholds), how a business's payroll tax liability is calculated varies between jurisdictions. This adds complexity as it requires staff to be familiar with different methods of calculating their payroll tax liability.

As one member stated "while the differences may appear marginal to a bureaucrat, the administrative costs are significant and inefficient, and have existed for far too long."

Moving to single national agency to administer, interpret and enforce the various state payroll tax laws and have one method of calculating liability would significantly reduce overlap and burden. Such a national agency need not be a Commonwealth agency – it could be jointly owned by each of the State and Territory governments.

Such a national approach could also allow for a single national payroll tax return and one payment. It would be the responsibility of the national agency to distribute the revenue collected to the appropriate government. In this regard we suggest that the South Australian Government enter dialogue with the other state governments on the best ways to harmonise the administration of payroll tax, such as creating a national agency and a single national payroll tax return.

Ultimately payroll taxes, which are efficient if designed properly, should be reduced. However due to fiscal restraints we do not see a lot of opportunity for this to be done in the context of the current Review. However this is fertile ground for discussion as part of the Commonwealth Government's Tax White Paper process.

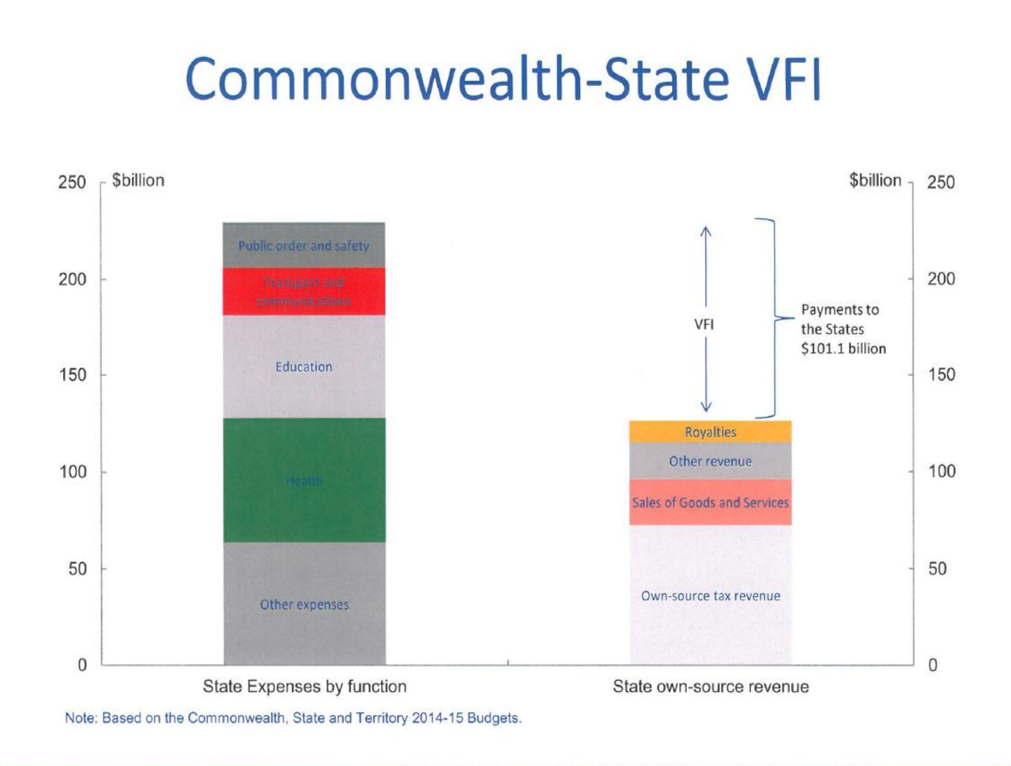
**8. Should an annual property tax replace insurance duty? Are there other options for offsetting the revenue loss associated with a removal of insurance duty?**

As the Commonwealth Government's 'Re:think' Tax Discussion Paper of March 2015 states, insurance taxes are among the most inefficient taxes levied in Australia, and they may contribute towards under-insurance or to people not holding insurance. This leaves such people more financially vulnerable in the event of loss, which may in turn see the state offering assistance to such people, which may in turn lead to higher taxes.

An annual property tax would have some benefits. However the challenge is that property owners already face other property taxes – for example many will pay land tax, and everyone with the exception of certain exempt entities also pay municipal rates. As such we expect community acceptance of such a new charge may be low, depending on how it was done. The success of the Review process and its outcome will depend on the overall package and whether it can be sold to the people of South Australia, taking into account any shift in tax incidence.

# PART B What could be achieved with a ‘whole-of-governments’ approach

While it is appropriate for States to manage their tax policy settings, it is clear that the States are unable to do everything without assistance from the Commonwealth. This is made quite evident in the following chart that considers the issue of the Commonwealth-State vertical fiscal imbalance.




Commonwealth-State VFI[6]

The chart amplifies the challenges South Australia and the other States have in setting tax policy and at the same time remaining competitive. It suggests that South Australia - like the other states - will need to work with the Commonwealth to ensure an optimal outcome.

To this end and around the time that South Australia released the State Tax Reform Discussion Paper, CPA Australia released the landmark study ‘Tax Reform In Australia – The Facts’[7]. The CPA Australia-commissioned study considers the impacts of GST reform and the elimination of inefficient State taxes. The research found that reforming the GST can deliver tax cuts, improve household incomes and boost Australia’s economic growth.

The CPA Australia-commissioned research looks in detail at four different scenarios of changes to the base and rate of the GST, accompanied by the abolition of a range of inefficient taxes, income tax

6 http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2014/Martin-Parkinson-20140911

7 Ibid

cuts and compensatory welfare payments and presents a comprehensive picture of how changes to the GST will impact households and the broader economy.

It shows the results from four different scenarios modelled at 10 and 15 per cent, with each scenario generating additional GST revenue, ranging from $12.1 billion to $42.9 billion in the first year of introduction.

The modelling results also show that additional GST revenue could be used to abolish a number of inefficient state taxes, provide for personal income tax cuts and compensation for low income households, while also boosting economic growth.

It further demonstrates the importance of packaging different tax reform priorities to achieve positive economic and social outcomes.

We also draw the Review's attention to the strong correlation between the modelling of the elimination of these inefficient taxes, and the economic efficiency ranking of these taxes as set out in the State Tax Review Overview document.

A complete copy of 'Tax Reform In Australia – The Facts' is provided to the Review as part of this submission.

**Summary of the modelling outcomes**

| Scenarios | Additional GST revenue generated in the first year of reform | This revenue can be used to remove inefficient taxes | Australian households overall will be better off | By 2029/30 Australia's GDP will be increased |
|---|---|---|---|---|
| 10% GST on a broader base including fresh food, education and health | $12.1 billion | • Insurance taxes<br>• Motor vehicle stamp duty<br>• Conveyancing duty (9%) | $33.20 per year | $16.1 billion |
| 15% GST with current exemptions | $26.0 billion | • Insurance taxes<br>• Motor vehicle stamp duty<br>• Conveyancing duty (80%) | $98.20 per year | $3.1 billion |
| 15% GST applied to health and education but exempting fresh food | $36.8 billion | • Insurance taxes<br>• Motor vehicle stamp duty<br>• Conveyancing duty | $499.40 per year | $23.6 billion |
| 15% GST and applied to health, education and all food | $42.9 billion | • Insurance taxes<br>• Motor vehicle stamp duty<br>• Conveyancing duty | $749.40 per year | $27.5 billion |

Source: Tax Reform In Australia – The Facts[8]

We therefore encourage the South Australian Government along with the other States, and as part of the Commonwealth Government's Tax White Paper process, to consider the possibility of a change to the rate and/ or base of the GST, with part of the additional revenue from any change to be used to eliminate South Australia's most inefficient taxes including insurance taxes and stamp duty on motor vehicles, and help fund the transition from conveyancing stamp duty to land tax.

8 http://www.cpaaustralia.com.au/documents/tax-reform-in-australia.pdf