# Business Council of Australia
# Corporate Tax Association
# and
# PricewaterhouseCoopers

## Submission to the Independent Pricing and Regulatory Review Tribunal

## Review of State Taxation

**November 2007**

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## Introduction

Taxation plays a fundamental role in providing the optimum environment for Australian business to run effectively, improve productivity, and take advantage of the increasingly global and competitive world economy. This means the taxation system has the potential to have a significant impact – be it positive or negative – on the immediate and long-term prosperity of Australia.

In a federation like Australia, where taxes are imposed by several layers of government, the overall competitiveness of the business tax environment hinges on an effective interrelationship between the tax systems of often competing jurisdictions.

Unfortunately, the complexity caused by the fiscal arrangements that have developed over the course of the last century create an additional weight Australian businesses must carry as they seek to compete with the world's best.

The Business Council of Australia (BCA), the Corporate Tax Association (CTA), and PricewaterhouseCoopers (PwC) therefore welcome this Review of State Taxation by the Independent Pricing and Regulatory tribunal of New South Wales (IPART).

**As Australia's largest state economy, the BCA, CTA and PwC believe NSW should be prepared to play a leading role in the reform of state taxation, and work collaboratively with other states and territories, as well as the federal government, to ensure progress in reforms across the board.**

Business recognises the important role state governments play in funding essential services that help provide the standard of living Australians expect and deserve. Business also recognises the important and legitimate role of taxation to achieving those funding goals.

As significant contributors to both state and federal revenues, large Australian businesses are in a unique position to comment on the complexity, inefficiency, and administrative burden caused by our multiple taxation systems.

While taxing business can be a relatively easy political option in the short term, maintaining a competitive business taxation system is vital to the economic health of Australia. In an age of internationally mobile capital, the business taxation system of a country is an important determinant in attracting and retaining investment. This is as true for state tax systems as it is for the federal system – as recent research by the BCA, CTA and PwC shows, state tax regimes can weigh just as heavily on business as the federal tax system.

The BCA, CTA and PwC also support the guiding principles for tax reform outlined in Chapter 4 of the IPART Issues Paper, and believe these should be guiding principles of tax reform at all levels of government.

This submission presents a business perspective on the need for greater state taxation reform, following on from recent research for the BCA and CTA conducted by PwC. This research, published in April 2007, revealed the significant burden placed on business by the duplication and overlap of multiple business tax regimes. A full copy of this report, *Tax Nation: Business Taxes and the Federal State Divide*, is attached at Appendix 1.

## Business taxes and the federal-state divide

The *Tax Nation* report, which examined the actual tax paid and collected by 92 of Australia's largest corporations, raised serious questions about the structure of business taxation in Australia.

In particular, it highlighted a number of issues in regard to:

- Complexity, especially as a result of unnecessary differences between state jurisdictions;
- Inefficiency, raising particular questions about the very large number of taxes that raise very small amounts of revenue; and
- The administrative burden, both in terms of the additional work companies must do in order to comply with their role as tax collectors on behalf of governments, and the extra administration that results from the complexity and inefficiency mentioned above.

The report identified 33 separate state and territory taxes, in addition to 21 business taxes levied at the federal level.

Importantly, of the 33 taxes identified at the state level, taxes that apply in multiple states and territories (such as payroll tax and conveyance duties) were counted only once, even where they operate under different rules in every state.

As is now well known, the fact that rules and regulations governing the same types of taxes differ across states means that the effective number of taxes potentially faced by business is even greater. It means, for example, that companies potentially face eight different payroll taxes and eight different sets of conveyance duty. As a result, an Australian business that operates across several states and territories can be subject to a large number of potential taxes. The total number of potential taxing points identified in the survey was 182.

Clearly, not all businesses are subject to all potential taxing points. However, the businesses involved in the *Tax Nation* survey had operations in an average of six states and territories (and were also subject to federal taxes). The potential for inefficiencies caused by such complexity, duplication and overlap is clear.

## Why the business perspective is important

The report also demonstrated that Australia's largest businesses are contributing a substantial share of state taxes. For example, the 92 survey participants contributed more than $2.3 billion in state payroll tax, that is, almost 20 per cent of payroll tax collections, which in turn is the largest stream of tax revenue for the states and territories.

In an economy of more than 1.5 million companies and around 11 million individual taxpayers, this highlights the dependence of state governments on a very small number of businesses to provide a significant portion of taxation receipts.

The business taxation system also influences the business structure, production costs and investment decisions of companies and thus their direct competitiveness. The need to remain cost-competitive is important in an increasingly global economy, and particularly for Australia, which will always face strategic disadvantages including relative remoteness from major global markets and relatively small and geographically dispersed domestic markets.

The BCA, CTA and PwC believe that the economic credibility of Australia's governments now rests firmly on their ability to deliver a world-class business environment, and an internationally competitive business taxation system is a key part of that. Without it, our ability to achieve broader economic outcomes, low unemployment and low inflation are undermined.

**Against this background, the time is right for a thorough consideration of the structure and frameworks for tax arrangements in Australia, with business tax being a priority element. Such reforms would enhance the efficiency of tax arrangements and support competitiveness, investment, higher rates of participation and economic growth.**

**While individual states can do much to streamline their business tax systems, the BCA, CTA and PwC believe that long-lasting and effective reforms depend on a comprehensive reform program involving all states and territories, in conjunction with reforms at the federal level.**

## **State taxes and efficiency** (issues paper questions 1, 6 & 8)

The BCA, CTA and PwC recognise the right of, and the need for, state governments to raise revenue in order to help fund their administrative responsibilities.

However, further consideration is needed of the way those revenues are raised.

The *Tax Nation* report supports recent contentions that state taxation plays a large part in Australia's taxation inefficiencies. In particular, it supports concerns about the number of taxes being used to raise relatively small amounts of revenue, yet creating large administrative burdens.

For example, survey participants paid $27.5 billion in taxes across all levels of government in 2006.

Just 17 per cent, or $4.7 billion, of this amount was paid to state, territory and local governments, compared with 83 per cent, or $18.1 billion, to the federal government.

**The 17 per cent of total business taxes that were paid to state, territory and local governments were collected via 35 separate taxes, more than double the**

**number used to collect the 83 per cent of business taxes paid to the federal government.**

**Further, there were 28 state and local taxes that, combined, raised a mere $0.7 billion, or just 2.7 per cent of the taxes paid by the survey participants.**

**Given the small amount of revenue raised by many taxes, questions should be asked as to whether some taxes can and should be rationalised.**

Further, the sheer number of taxes highlights that closer co-operation and harmonisation of tax systems between states is just as critical to sound taxation reform as changes to the types of taxes imposed by individual governments.

**Business welcomes recent moves by states to embark on payroll tax harmonisation, and in particular the recent lead taken by NSW and Victoria in this regard. While this is an important step forward, to be truly effective such projects should engage all states, and many more taxes.**

**The BCA, CTA and PwC believe it imperative that as many state taxes as possible are harmonised.**

**NSW could play a valuable role in encouraging greater interstate co-operation of this kind.**

For example, the *Tax Nation* report identifies approximately ten taxes that are applied in every state and territory. A further eight taxes apply in five states or more.

There is considerable scope for harmonisation between states that would result in significant compliance savings for business, considerable reductions in tax complexity and potentially significant administrative cost savings for State Revenue authorities if they are prepared to consider harmonising some aspects of revenue collection. Such moves could also contribute to significant improvements in the operational efficiency of tax collection.

## **Results specific to NSW** (issues paper questions 2 & 3)

**The *Tax Nation* survey identified 25 different business taxes levied in NSW during 2006, more than any other individual government in Australia.**

While we acknowledge there have been some changes to the NSW tax system since the 2005 and 2006 tax years when this data was compiled, this result emphasises that NSW can not afford to be complacent in taxation reform.

The BCA, CTA and PwC acknowledge the challenges for state tax reform, as outlined in Chapter 3 of the IPART Issues paper. To a large extent, these issues are common across all states.

However, notwithstanding the restrictions on revenue raising that may be imposed due to history and circumstance, state governments, including the NSW government, should think carefully before the introduction of any new taxes.

In particular, taxes that seek to take advantage of changing market conditions and national reform priorities are strenuously discouraged. For example, any attempt to tax a national emissions trading scheme would have a significant and detrimental effect on the success of such a scheme, and would be vigorously opposed by business.

Before any changes to taxes are introduced, as well as considering the guiding principles for tax reform as outlined in Chapter 4 of the discussion paper, the government should always give consideration to:

- The administrative and compliance burden on business; and
- The cost and administrative burden on government;

in addition to the wider economic and revenue consequences of particular tax types. Further, these implications should be considered in a national context, not just the context of NSW.

The BCA, CTA and PwC note the taxes already abolished by the NSW state government under the Intergovernmental Agreement (IGA) following the introduction of the Goods and Services Tax.

However, the NSW government is strongly encouraged to continue the removal of additional 'nuisance' taxes, over and above their IGA commitments.

When considering taxes that should be rationalised or abolished, priority should be given to these 'nuisance' taxes that raise very small revenue amounts, but often require a disproportionately high level of compliance.

## **Improvements to Commonwealth-State tax sharing arrangements** (issues paper questions 9 & 10)

As stated above, the BCA, CTA and PwC strongly support greater harmonisation of state taxes, and encourage NSW to play a leading role in such a movement.

In addition, the BCA, CTA and PwC also support a broader review of intergovernmental fiscal arrangements.

As is detailed in Chapter 2.3 of the attached *Tax Nation* report, the breakdown of tax collections outlined in the survey raises broader issues in regard to federal–state fiscal relations.

As the report outlines, a number of recent studies have investigated these issues further, and raised questions about the economic efficiency costs of state taxes, even after the GST-related reform schedule is fully implemented. In general, these studies find that many state taxes are very inefficient, with narrow bases, high rates, and progressive structures that serve political rather than principled policy ends.

Even those state taxes that are considered to be relatively efficient in principle have often been rendered inefficient through the unnecessarily confusing differences in the tax bases of different state regimes, and attempts by state governments to 'pick winners' through the use of special concessions and exemptions.

As was highlighted in the BCA's 2006 paper, *Reshaping Australia's Federation: A New Contract for Federal-State Relations*, reforms are needed to better define the roles and responsibilities of the Commonwealth and states in key areas such as education, health, infrastructure and transport. Already we are seeing significant signs of strains across all of these areas.

In order to achieve a sustained improvement in federal–state relations and greater clarity in roles and responsibilities, there will need to be discussion of the spending and revenue raising and sharing implications. Consideration of the interaction of state and federal taxation systems, with a view to sustaining revenue security at all levels of government, will also be a necessary part of any effective review and change. This will ultimately need to include discussion of the issues associated with vertical fiscal imbalance (the gap between revenue-raising capability and expenditure requirements) and horizontal fiscal equalisation (financial support for less well-off states).

It is now well known that, while the states raise approximately 16 per cent of revenue, they are at present responsible for around 40 per cent of all government expenditure. In the absence of structural change, this situation is expected to be exacerbated by population ageing.

As recent research on federal–state financial relations highlights, changes are needed to the relative fiscal responsibilities of the Commonwealth and states to reduce the size or impact of this revenue–expenditure gap. This does not necessarily mean that all responsibility for revenue raising and spending should be transferred to the federal government, or that having only one kind of tax would be the most effective way to raise revenue. However, it does mean that a review of business taxes should examine these issues carefully.

Against this background, the BCA, CTA and PwC believe the time is right for a more fundamental consideration of the structure and frameworks for tax arrangements in Australia, with business tax being a priority element. Such issues will not be resolved quickly, but it is clear that they need to be resolved. Such reforms would enhance the efficiency of tax arrangements and support competitiveness, investment, higher rates of participation and economic growth.

The BCA, CTA and PwC believe business taxation should be seen as a fundamental part of the broader debate on federal-state relations reform and business deregulation.