FEDERATION TAX REFORM

Adequate tax revenue enables the public sector to provide essential services and will lead to a more equitable society for all Australians.

Background

The States have a long-term revenue problem, with a growing fiscal gap that some estimates put at up to $45 billion on a net lending basis by 2030.

This is primarily due to growth in health expenditure far exceeding growth in any existing revenue source - a problem that was significantly exacerbated by recent Commonwealth cuts to health and education funding.

The Commonwealth Government has concerns about the effect of taxes on economic activity. In particular they have raised concerns about the impact of high marginal income tax rates reducing incentives to work and the company tax rate being high compared to our trading partners.

The Commonwealth has stated an intention to reduce personal income and company tax rates, but they do not want to increase the overall tax take as part of tax reform.

Increasing the GST rate from 10 to 15 per cent is one of the most widely discussed options for addressing both the States' fiscal problem and the Commonwealth's desire to undertake a tax mix switch.

An increase in the GST rate alone cannot adequately address both problems.

The States have a growing fiscal gap. A one-off increase in the GST rate could provide the States with too much revenue in the short term and too little revenue in the long term to meet growing service delivery costs.

This is due to the inadequacy of the GST as a growth tax, largely reflecting the exemptions from the base.

South Australia's Tax Reform Proposal

There is an alternative option worth consideration that addresses both the structural weakness of the States' revenue base in comparison to expenditure responsibilities and the Commonwealth's desire to provide a tax mix switch in the short term.

The States could receive a fixed share of the Commonwealth personal income tax revenue base in place of non-GST Commonwealth grants (excluding infrastructure and on-passed grants) whilst providing the Commonwealth with the full benefit of a rise in the GST rate from 10 to 15 per cent.

The share of the GST revenue received by the Commonwealth, after adequate compensation for low income earners, would allow them to implement their own tax reform agenda.

In return the States would gain access to a growing revenue base to better meet future fiscal needs and increase their fiscal autonomy. In the context of Federation reform, this is a significant genuine reform.

The sharing arrangements of both the GST and personal income tax would be legislated.

It is important to note that this proposal is not the only solution to the States long term fiscal pressures.

Health expenditure is expected to grow more strongly than any revenue source keeping pressure on the States to contain future expenditure and introduce service delivery efficiencies.

It will also not fully reverse the impact of the 2014-15 Commonwealth Budget cuts to health and education funding arrangements. However, it will improve the current fiscal position of the States and provide greater fiscal autonomy

Key features of the reform proposal

SA is proposing the following changes to the GST system and federal-state funding arrangements.

1. The GST rate would be increased to 15% with the Commonwealth retaining all revenue proceeds and taking responsibility for compensating low income earners. Any remaining revenue would be available for the Commonwealth to implement its own tax reform agenda.
   - GST revenue would effectively be split between the States and Commonwealth on a two thirds, one third basis.
2. In return for the sharing the GST base the States would be given access to a fixed share of personal income tax revenue in place of non-GST Commonwealth grants.
   - There would be no overall increase in personal income tax rates and the Commonwealth would retain control of the personal income tax levers.
   - Based on the existing personal income base and historical payment levels the States would receive around a fifth of the personal income tax base, but the actual share received would be dependent on a range of factors, including any changes introduced through the national tax reform and federation processes.
3. All other non-GST Commonwealth payments to the State, excluding infrastructure payments and on-passed grants, would be abolished. This would include Specific Purpose Payments and National Partnership payments.
   - Legitimate national policies would still be formally agreed.

Benefits of this proposal

- Mutual benefits for both Commonwealth and State Governments.
- States gain access to a tax base that is expected to grow stronger than the current GST base and more in line with underlying expenditure responsibilities, particularly in the area of health.
- The switch to untied general purpose payments provides States with greater autonomy over key expenditure areas to pursue productivity growth through policy innovation.
- Commonwealth gains the revenue capacity to implement its own tax reform agenda.
- Access to both the income tax and consumption (GST) base provides greater revenue stability, diversifying exposure to economic parameters.
- Removes duplication between the State and Commonwealth and also reduces red tape associated with the administration of and reporting on Specific Purpose Payments and National Partnership Agreements.
- Proposal is compatible with other reform options that are being considered.