



Submission to Independent Pricing and Regulatory Tribunal

Review of state taxation

We provide comments on the draft report, 'Review of state taxation' (June 2008).

Shelter NSW is a nongovernment, nonprofit, social change agency – our comments on the draft report are based on two concerns of a public interest nature. The first is that the NSW government, a subnational sphere of government within the Australian federal system of government, should have taxation capacity and taxation revenues commensurate with its responsibilities to provide for the welfare of the people of New South Wales. The second is that since the state government has primary constitutional responsibility for housing assistance, the state's taxation system should promote efficiency of housing markets and promote equity in housing outcomes, in a way that is joined up with the government's redistributive programs.

We submitted comments to the Review in response to the issues paper, on 22 November 2007 [see Attachment, page 5]. This letter deals with 3 matters:

- o the state's taxation capacity and taxation mix
- o land tax
- o taxation expenditures

Tax capacity and tax mix

The draft report emphasizes the importance of the state government having adequate revenues to deliver the services appropriate to a state government and to meet the expectations of NSW citizens. It points out the need for more appropriate arrangements with the Commonwealth government. It also notes that the NSW state government draws on a higher proportion of own-source revenue than other states and territories, at 37%. Given the vagaries of Commonwealth policies and the way that Commonwealth governments use income tax revenue to influence states' spending, as well as various anomalies in distribution of Commonwealth grants to New South Wales, we believe that is a 'happy' situation for the resilience and coherence of the NSW tax system and government service provision.

However, the draft report notes that NSW own-source tax revenue is growing at a slower rate than the Commonwealth's tax revenue.

While New South Wales will, for constitutional and political reasons, be constrained in the range and type of taxes it can raise, it is in a position to do better with what it has got. We therefore support the broad package of changes recommended by the draft report, which is, in its totality, a quite modest suite of reforms, yet one which seeks to coax the government out of complacency, conservatism, and concessions to vested interests.

Shelter NSW

Suite 2, Level 4, 377-383 Sussex Street, Sydney NSW 2000

ABN 95 942 688 134

Phone (02) 9267 5733 Fax (02) 9267 5001 Web www.sheltersnsw.org.au

While we understand the reason for the draft report's reassurances about the long-term aim of its reforms being revenue-neutral, we hope that the Government does *not* implement a reform process on the basis of such a foundation. To do so would be an acceptance of the 37% figure as something other than as constructed and contingent. Rather than using a figure that has arrived at a particular point in the state's history as a permanent threshold for own-source tax revenue, we hope the Government would seek to maximize the contribution of own-source revenue to the state's finances according to need and to NSW taxpayer's capacity and willingness to pay.

In general, we support an approach that retains and makes more effective efficient taxes, and phases out inefficient taxes. It is clear that land tax and payroll tax are important taxes for the state to retain, and whose efficiency should be enhanced by expanding the tax base. While we support the phasing out (and eventual removal) of purchaser transfer duty, the timing of this should be dependent on prior increases in land tax.

We note the draft report's support for greater use of environmental taxes, and while this seems to be worthy from a public interest perspective, we are not sure that there are many options in the short term. Many of the suggestions proposed by the Total Environment Centre (submission S07-16134) appear to be about licensing fees and utility pricing, or matters outside of the state's jurisdiction, rather than state government taxes. In relation to state taxes, the Centre proposed an increase in the waste levy, a tax which contributes 1.2% of taxation revenue (2007-08 revised estimate) and which the Government is increasing (with a 131% increase estimated for 2011-12 from 2006-07). The Centre also proposed a congestion charge for the Sydney, Newcastle and Wollongong CBDs. Just looking at the Sydney CBD and its nodal place in the metropolitan area because of the Harbour crossing, it is not clear that congestion there is related to traffic to the city centre rather than traffic through the city centre, and it might be that congestion could be relieved more efficiently (than by a congestion tax) by an increase in the Sydney Harbour Bridge toll. There might also be some scope for increasing the parking space levy to discourage traffic to city centres: though, the Government is already currently estimating a 14% increase in revenue from this levy by 2011-12 from 2006-07. In short, we believe that *how* greater use might be made of environmental taxes needs further consideration.

Land tax

Expansion of the base of land tax appears to be the obvious candidate for improving the robustness of the state taxation system. While land tax clearly has its detractors, the rent-seeking nature of such criticism is so transparent few bother to name it. The efficiency of this tax has been identified in a number of dispassionate reports; these include the draft report of this Inquiry, and also reports of the Productivity Commission (*Directions for state tax reform*, 1998, and *First home ownership*, 2004) and N Warren for NSW Treasury (*Benchmarking Australia's intergovernmental fiscal arrangements*, 2006). The report of the Australian Senate Select Committee on Housing Affordability (*A good house is hard to find*, 2008) discussed the impact of land taxes – in relation to housing unaffordability only – but did not go beyond noting the views of lobbyists.

Not only is land tax an efficient tax, it has some operational advantages. One, it is assessed on a sound methodology. The draft report quotes from a NSW Ombudsman inquiry report of 2005 on land tax assessment methodology: 'The methodology employed to produce land valuations in New South Wales, the component system of mass valuation, was generally sound.' (p.176) The draft

report also concludes that New South Wales has the simplest land tax arrangements compared with other states (p.177).

We therefore support the draft report's recommendation no.11, which suggests the Government develop a strategy for increasing property taxes (land tax and municipal rates). However, the recommendation uses the phrase 'in the long term'; given the obstacles that exist to such reforms, we suggest the Government develop such a strategy as soon as possible.

Betterment

In our submission of 22 November 2007, we commented on the worth of infrastructure levies for reasons of 'beneficiary pays' and of capture of 'betterment'. To an extent, there is a component of betterment embedded in the land tax valuation methodology, based as it is on the unimproved value of land.

The Government has established a mechanism for recouping some of the costs (based on the 'beneficiary pays' principle) of government services to new urban release areas, through development contributions for public infrastructure in 'state contributions areas' (Environmental Planning and Assessment Amendment Act 2008, section 116O). However, the decisionmaking and implementation arrangements it has constructed around all types of development contributions, under that Act, are a dog's breakfast.

The state government interest – in terms of revenue-raising – in development contributions for public infrastructure is in the 'state contributions areas'. The sphere of government with even more interest in development contributions – for community infrastructure and affordable housing – is local government. Such contributions are outside the scope of this inquiry, but we hope they will be considered by the Tribunal in its review of the revenue framework for local government.

Tax expenditures

The draft report identifies the disadvantages of tax expenditures compared with direct grants, arguments which it shares with a number of recent reports for the Commonwealth and NSW governments (R Warburton and P Hendy, 'International comparison of Australia's taxes', Commonwealth of Australia, April 2006; M Vertigan and N Stokes, 'New South Wales audit of expenditure and assets report', Sydney, February 2006).

We do not disagree – in principle – with the intent of recommendation 16, which suggests the Budget include and indicate an explicit appropriation for a matter that is (currently) a tax expenditure, and that the allocation be indicated in the relevant agency's budget. However, we have *reservations* about whether:

- (a) this should apply to 'all' tax expenditures without a case-by-case assessment of the more optimal delivery of the benefit to the recipient – we note that the draft says: '*Often* there are alternative direct expenditure and transfer policies that can achieve the same objectives, perhaps more efficiently.' (p.10; our emphasis); this wording leaves open, and perhaps rightly so, the scenario that a tax expenditure might be more effective than a grant;
- (b) this is a matter for 'the short term' (as recommended), rather than the medium term after careful review.

We have in mind, particularly, those exemptions from or concessions on land tax that promote affordable housing or housing affordability, to:

- o providers of low-rent private rental accommodation in inner Sydney (exemption)
- o landowners who use their land for boarding houses for low-income persons (exemption)
- o cooperatives (which legal form includes some community housing providers) (exemption)
- o retirement villages (exemption)
- o residential parks predominantly occupied by retired persons (exemption)
- o Aboriginal land councils (who are owners of some 3,000 units of social housing) (exemption)
- o owners of rent-controlled land (i.e. where the land has a dwelling rented as a 'protected tenancy') (concession)

And also, in relation to purchaser transfer duty, those exemptions that promote housing affordability to:

- o first homepurchasers (exemption)
- o group self-help build schemes (exemption)
- o tenants of Housing NSW, the Aboriginal Housing Office, and the community housing program administered by Housing NSW, who are purchasing at least 25% interest in a dwelling in New South Wales (whether it is a public housing dwelling or a dwelling on the private market) for their principle place of residence (exemption)
- o certain purchasers of manufactured relocatable homes (exemption)

Only three of the above exemptions are significant, in terms of revenue foregone (using a threshold of \$10 million as 'significant', and many of the categories of beneficiary are way under that amount), namely:

- o first homepurchasers – exemption from transfer duty
- o retirement villages – exemption from land tax
- o residential parks predominantly occupied by retired persons – exemption from land tax

It might be the case that the welfare/redistributive benefits from the exemptions and concessions listed above are, indeed, more efficiently *delivered* as tax expenditures, rather than as grants. The biggest of the above schemes is First HomePlus, the exemption from transfer duty for first homepurchasers, with an estimated cost of \$396 million in 2008-09. While the scheme is large in terms of total revenue, the amount received by an individual beneficiary is not. If administering this benefit as a tax exemption has less transaction costs than administering it as a small-grants scheme, the Government might prefer to keep the current arrangement.

- Date of submission: 3 July 2008
- Enquiries:
Mary Perkins (02) 92675733 ext.14
Craig Johnston (02) 92675733 ext.11

Attachment: Shelter NSW comments on the IPART issues paper, 'Review of state taxation', submitted 22 November 2007

Review of state taxation

We provide these comments on the issues paper, 'Review of state taxation' (October 2007).

Revenue adequacy

We believe that the fundamental issue for the state's taxation system is that it does not raise enough revenue for state government to spend on the key areas of responsibility that a state government has in the Australian constitutional system. While there is no public interest in state governments spending for the sake of spending, there are needs of NSW consumers, citizens and communities that could be better met if the state government was not so constrained.

The NSW state government is in a better position than other states and territories in that a bigger proportion of its general government revenue comes from state taxes.

There is no doubt, however, that the provision of state government services in New South Wales is dependent on subsidies from the Commonwealth government – as pointed out by the issues paper for this inquiry, and by reports by Neil Warren for the state government on intergovernmental fiscal arrangements in 2006. The problem of vertical fiscal imbalance is underpinned by inconsistent and ad hoc allocation of responsibilities between the Commonwealth and the states and territories. Federal fiscal arrangements in Australia do not reflect the principle of subsidiarity.

The Commonwealth's introduction of a goods and services tax, even with the dedication of revenues from this tax to the states and territories, has not resolved either vertical fiscal imbalance or the financial challenges the states have.

Nor does the Commonwealth's payment of specific purpose payments fill the gap. The critique of these, as a mechanism (rather than for the specific purpose towards which the money is directed) is well-known. It has been documented in the reports by Neil Warren referred to above, in a report by the Allen Consulting Group for the Victorian government ('Governments working together? Assessing specific purpose payment arrangements', 2006), and in a report by Anne Twomey and Glenn Withers for the Council for the Australian Federation ('Australia's federal future: delivering growth and prosperity', 2007).

There are three fundamental problems with specific purpose payments. One is that they skew states' decisions on what to spend. Two is that they influence and constrain how spending is done. In the case of the Commonwealth–State Housing Agreement, for example, a tight targeting of social housing assistance has been driven by Commonwealth policy preferences. The current Commonwealth–State Housing Agreement provides: '... subsidies should be designed to provide greatest assistance to those with the greatest need ...' (section 4(25)(a)). This provision influences policy on allocation of new tenancies in public housing, and allocation policy influences the degree to which the tenant population might include tenants who can afford to pay market rents (and thus not be eligible for rental subsidies). Three is that they are not always or necessarily based on a partnership model of equal partners.

In those respects, specific-purpose payments are less efficient and effective for states' social and fiscal policy than a situation where the states got untied, general purpose payments from a dedicated proportion of income tax revenue, distributed according to the fiscal equalization principle in the same way as they get GST revenue. The report by the Allen Consulting group suggested the arrangements be reformed.

We agree, and believe they need to be addressed through the Council of Australian Governments processes as part of a fundamental review of Commonwealth–state responsibilities and fiscal arrangements, with a view to reform. By reform, we suggest that Australia's federal fiscal arrangements be reconfigured to perform well against the benchmarks suggested by Warren ('Benchmarking Australia's intergovernmental fiscal arrangements', 2006).

While we believe key issues for the state's finances rest in the national sphere, there is a responsibility for the state government to maintain a state-based taxation system that is efficient, effective, and contributes adequately to overall government revenue. In looking at state taxes, we do think the state government should necessarily have to be bound by the notion of 'revenue neutrality (which the Tribunal's issues paper, at page 27, says is a requirement of the overall package of reform, notwithstanding the inquiry's terms of reference making no reference to that notion).

Efficiency

We are not supportive of less state taxation, per se, or of unilateral abolition of taxes that provide a significant proportion of the state's own-source revenue. In particular, we support the retention of payroll tax and of land tax, which are known to be economically efficient, and more economically efficient than other state taxes such as transfer duty.

We are aware that land tax has its critics because of concerns about housing affordability. However, we think that the state tax that has a more detrimental distorting impact on housing markets is purchaser transfer duty. Because this tax raises such a large proportion (20%) of own-source revenue, it is not a tax that could be abolished lightly. *A phasing out of purchaser transfer duty would be desirable, so long as there is a commensurate extension and increase in land tax.* Economists have argued that an enhanced land tax is more efficient and effective than purchaser transfer duty, because it has no disincentive effect on mobility, it does not discriminate against movers, it is not lumpy, and it does not impact at times of particular financial stress (such as when moving house) (Owen Gabbitas and Damien Eldridge, *Directions for state tax reform*, Productivity Commission, 1998; Frank Stilwell and Jennifer English, 'Housing affordability, stamp duty and land tax', University of Sydney, 2004).

Such an enhancement to land tax should involve broadening its base, including extension to principal places of residence.

While we support extension of the base of land tax, we do think that selective use of taxation expenditures are useful for welfare purposes. *In particular, we suggest that investment in rental housing for leasing at the lower-priced end of the private rental market could be encouraged through further, targeted exemptions from land tax.* These could be done by:

(i) providing an extension of the current exemption from land tax for land used and occupied primarily for low-cost accommodation to a greater geographic area (from inner Sydney, to the inner and middle ring suburbs) – this extension could be confined to property owners owning three or more properties, since the 'mum

and dad' investor-owners of only one residential investment property benefit from a tax threshold of \$352,000 on that property; and/or
(ii) exemption from land tax for investors who provide lower-cost private rental housing to registered community housing providers.

Finally, we comment on the special development levies being deployed in the growth centres in greater Sydney. There are two public interest arguments for using special levies in the circumstances of the two growth centres. The first is planning gain, i.e. the land and property developers benefit from land releases and rezonings by government for this urban development that enable them to get a windfall benefit. Passing on some of the cost of putting in the physical infrastructure to the developers recoups some of that windfall for the government. The second is that approval of new housing developments will generate new demand on state government services by incoming residents, the cost of which is an externality not priced into the cost of the development. We note that the state government has modified its original approach to the implementation of these charges. Our concern here is to affirm that, in principle, they are worthy of support from a public interest perspective.