THE REVENUE ASSESSMENTS

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THE REVENUE ASSESSMENT FRAMEWORK

1 This section outlines the revenue assessment framework and methods adopted in the 2004 Review, and followed in the 2008 Update.

2 The 2008 Update assessment results, and their effects on the assessed distribution of GST revenue and health care grants (HCGs), are set out in Volume 2 of these Working Papers.

3 In the 2004 Review, the Commission retained the tax by tax approach to revenue assessments. It considered that approach better achieved Horizontal Fiscal Equalisation (HFE) because it better reflects what States actually do. Its separate assessment of the revenue base for each activity being taxed better captures differences in the capacity of the States to raise revenue from the taxes available to them.

POLICY AND NON-POLICY INFLUENCES

4 Differences between States in per capita revenue collections may be explained by:

- differences in the range and scope of taxes and charges imposed;
- differences in the rates of taxes and charges;
- differences in the tax enforcement and compliance efforts; and
- differences in the capacity of States to raise revenue — their revenue bases (beyond the influences of the policies of an individual State).

5 The first three groups of differences reflect policy choices by the State governments. The last reflects non-policy or independent influences (they are usually called **disabilities)** and they are the only source of interstate differences that directly affect the assessments of State relativities.

CONCEPT OF ASSESSED REVENUES

6 The revenue assessments aim to measure the **'assessed revenue'**. It is measured by quantifying and comparing the revenue each State government would raise from its own sources if it made the same (average) revenue effort as the other State governments — that is, if they each imposed taxes and charges at the average Australian rates and collected taxes with the average level of effort and efficiency.

7 The task of estimating assessed revenues involves:

- selecting the range of taxes and charges and other revenues that should be included in the assessments, and the manner in which they should be grouped into assessment categories — the scope and structure of the adjusted budget;
- deciding whether differences in revenue capacity for a category or a group of categories are relevant to equalisation — whether the differences reflected disabilities (generally reflected

in interstate differences in the per capita size of revenue bases), or are caused by differences in State policies;

- identifying and measuring the revenue base for relevant revenues; and
- measuring the average revenue effort for each source of revenue.

8 Decisions on the scope and structure of the adjusted budget are discussed in Section 4 of this volume of working papers.

9 To aid decision making on revenue bases for individual revenue categories in the 2004 Review, a general framework based on the three pillars of equalisation (capacity equalisation, internal standards based on 'what States do' and policy neutrality) was applied to decide:

- whether an assessment which differed from equal per capita should be undertaken;
- if it should, how the revenue base should be measured; and
- what adjustments, if any, should be made to the base.

EQUAL PER CAPITA AND DIFFERENTIAL ASSESSMENTS

10 In the 2004 Review, the Commission concluded that differential assessments should be undertaken if:

- differences existed between the States in the size of their revenue base per capita and those differences were beyond the control of individual State governments; and
- data were available to measure those differences with confidence.

11 Equal per capita (EPC) assessments should be used:

- where interstate differences in per capita revenues were due mainly to differences in State policies; or
- where disabilities could not be measured and assessed with confidence; or
- for simplicity, when the revenues and likely disabilities were too small to have an impact on relativities and the extra effort and complication of an assessment was unlikely to have a material effect on equalisation.

12 In this update, differential assessments were made for most revenue categories.

13 EPC assessments were made for:

- the Contributions by Trading Enterprises category, because capacities to raise revenue from this source depended largely on the investment in Public Trading Enterprises (PTEs) by the State and because the amount of revenue raised was largely policy driven; and
- the Other Revenue category because interstate differences in these revenues were influenced by many differences in policy, and the differences in capacity could not be assessed with any confidence.

14 Some components in other categories were also assessed by EPC. For example, in the assessment of Stamp Duty on Conveyances, the Commission concluded that interstate differences in revenue from the sale of major State assets and revenue from corporate reconstructions reflected differences in State policies.

THE MEASUREMENT OF REVENUE BASES

15 Within the tax by tax approach, there were three approaches to measuring revenue bases.

- ***Tax bases.*** These reflected the legal incidence of the tax as indicated by the tax provisions of the States. They inherently captured differences in revenue raising disabilities. They were measured using data obtained directly from the State tax collection agencies or by estimating the taxable transactions using the actual collections and the tax rates. Comparisons based on tax bases may be affected by differences between States in their tax policies. Where necessary, the Commission adjusted the measured bases to remove the effects of differences in policy on the precise transactions taxed.
- ***Proxy tax bases.*** These were similar to tax bases in that they reflect the legal incidence of the tax, but they were generally measured using data from independent sources, such as the Australian Bureau of Statistics (ABS). The comparisons therefore should be less affected by differences in State policies. Proxy tax bases were generally close to but not necessarily the same as the legislated tax bases.
- ***Sub-global bases.*** These were broad economic indicators, such as Gross State Product, Household Disposable Income or State population. They reflected the capacity of a State to raise revenue in a broad way. They were used when the Commission was not confident that a tax base or proxy tax base could be measured in a policy neutral way. Their use reflected judgments about the effective incidence of taxes. Such measures were less affected by differences in State tax policies, but it may be necessary to adjust them in some way to better reflect what the States were taxing.

16 In general, the Commission preferred to use one of the tax base approaches because they better reflected interstate differences in what the States taxed than the sub-global approach.

17 The first step in measuring the revenue base for a category was to examine the taxation legislation of each State to identify which activities, transactions or assets were taxed, what concessions or exemptions were provided and how the liability for the tax was assessed. The extent to which data on the number and value of taxable transactions, as defined in the legislation, might be influenced by other State policies was also considered.

18 Tax bases were generally measured by reference to data on the number or value of activities, transactions or assets subject to a tax under conditions representative of those applied by the States in general — that is, they reflected the legal incidence of the tax. For example, the revenue base for Land Revenue was measured by reference to the value of commercial and

industrial, and non-principal residential land in the State, because that was what the majority of States taxed.

19 In one category, Stamp Duty on Shares and Marketable Securities for the FAG assessment, **assessed** revenues were assessed by reference to the actual per capita collections, adjusted to remove the effects of known differences between States in their stamp duty provisions. This method (the **modified actual per capita method**) was used only if the Commission considered that all the effects on revenues of any differences between the States in their revenue efforts could be measured and removed. For Stamp Duty on Shares and Marketable Securities, tax rates were generally uniform.

20 In the Mining Revenue category, the grant in lieu of royalty component was assessed by the actual per capita method. This was because the grants were decided by the Australian Government, and individual State governments had little influence on them.

ADJUSTMENTS TO BASES

21 It was often necessary to adjust tax bases or proxy tax bases for the effects on the data of observed policy differences, and to adjust sub-global bases for differences in needs not captured by those measures. For example, tax bases may be adjusted if the definition of the tax base for one or more States was wider (or narrower) than the States' average.

22 Sub-global bases need adjustment if there are practical limitations on the ability of some States to access part of the base. For example, the revenue base for financial transactions taxes (measured as total private consumption expenditure) was adjusted because the data for Western Australia was able to supply data on expenditure related to offshore mining facilities, transactions that the State could not tax.

23 Some of these adjustments involved judgment because reliable data were not available. Where sufficient evidence was available, the Commission made estimates of the size and direction of the adjustment required for each State, provided the adjustments had a material effect on the outcome and it had sufficient confidence in the accuracy of the adjustment.

24 ***Adjustments to reflect average policy.*** Measures of tax bases should be based on the average State policy on the definition and coverage of the tax (what is taxable). The average policy was derived from policies applying in the States where most of the revenue base was located.

25 Adjustments may be required to tax base measures to remove or add estimates of those parts of the base for each State that differed from the average. For example:

- a threshold adjustment was applied to the proxy tax base used in the payroll tax assessment to exclude wages and salaries all States exempted from the tax;
- principal residential properties were excluded from the land revenue bases because States in general did not tax them; and

- the data collected from Victoria on the value of conveyances was adjusted because Victoria did not impose stamp duty on goodwill or off-the-plan sales of unit title properties.

26 ***Adjustments for differences in disability influences.*** Differences in revenue capacity due to factors outside the control of a State government should be reflected in the revenue base chosen for a category. Most tax bases or proxy tax bases did this intrinsically.

27 They did not, however, always reflect the distribution of the tax base over different value ranges. Where it was average policy for States to apply progressive tax rates, value distribution adjustment factors were assessed because the distribution of the tax base over the value ranges affected the revenue States could raise. Value distribution adjustments were assessed in Land Revenue and Stamp Duty on Conveyances.

28 Sub-global bases rarely reflected all factors outside the control of States. The propensity for people to engage in taxable activity may be treated as a revenue raising disability if it were not influenced by State policy. Some States had natural advantages that attracted economic activity that may not be reflected in a sub-global base. Adjustments for these were made in several assessments. For example, in the Financial Transaction Taxes category, a capital market adjustment was made to the sub-global base of total private expenditure. This base did not reflect differences in capital market activity in each State and those activities were a source of material amounts of tax revenue.

29 ***Abolition of taxes***. Each State reached an agreement with the Australian Government on a timetable for phasing out by 2011-12 'business taxes'— most financial transaction taxes, stamp duties on non-quotable marketable securities and stamp duty on non-residential conveyances other than real property.

30 The Commission decided the implications of that agreement for revenue raising capacities should be reflected in its assessments. It did so by assuming the average tax policy expected to apply in the year the Update relativities will be used had applied in each assessment year.

31 Thus in the 2008 Update, the average tax policies expected to apply in 2008-09 were assumed to apply in each of the assessment years (2001-02 to 2006-07). Because State timetables for abolishing the business taxes were different, the average tax policy was considered to be to impose some of these taxes at lower rates for several years — the task became one of estimating the average effective tax rate that would prevail in 2008-09.

32 However, in the case of stamp duty on shares and marketable securities, the Commission noted that only three States (New South Wales, South Australia and the ACT) would be applying the duty in 2008-09. It concluded applying the tax was no longer the 'average' State policy and decided no assessment would be made for this tax in the 2008 Update.

AVERAGE REVENUE RAISING EFFORT

33 Once the revenue base was measured, the average revenue raising effort was calculated as the Australian average effective rate of tax — defined as total revenue collected by the States divided by the total of their revenue bases.

34 The use of the effective tax rate meant that any concessions or rebates States gave were automatically reflected in the average tax rate.

ESTIMATING ASSESSED REVENUES

35 Assessed revenues were calculated by multiplying each State's adjusted revenue base by the average effective rate of tax. This was equivalent to multiplying total actual revenue of all States by each State's share of the total revenue base.

36 Algebraically, the calculation of **assessed** revenue for each category is represented as follows:

$$\text{State i's assessed revenue per capita} = t_s \frac{Y_i}{P_i}$$

$$\text{where the average revenue raising effort, } t_s = \frac{R_s}{Y_s} = \frac{\Sigma R_i}{\Sigma Y_i}\text{; and}$$

Y_i	=	State i's revenue base;
Y_s	=	the total revenue base of the States (ΣY_i).
P_i	=	State i's population;
R_i	=	revenue raised in State i; and
R_s	=	total revenue raised by all States.

37 The calculation of assessed revenue can also be expressed in terms of revenue raising disability factors:

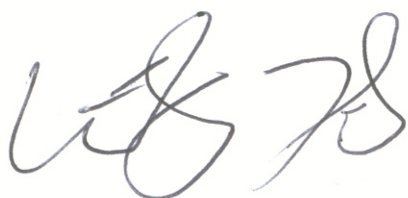
$$\text{State i's assessed revenue} = P_i \frac{R_s}{P_s} (\rho_i)$$

where ρ_i = State i's category revenue raising disability ratio or its assessed revenue raising capacity relative to the Australian average; that is

$$\rho_i = \frac{Y_i}{P_i} / \frac{Y_s}{P_s}$$

38 Assessed revenues were calculated for each of the years of the 2008 Update assessment period; that is, the years from 2002–03 to 2006–07. They used revenue bases, population and average revenue raising effort specific to each assessment year.

This chapter was prepared by the Revenue section of the Commonwealth Grants Commission. If you have any questions about its content please contact Lintong Feng on (02) 6229 8883 or lintong.feng@cgc.gov.au.



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