

Victorian response to CGC Staff Draft Assessment Papers on Revenue

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1. Introduction

Victoria acknowledges the efforts of the staff of the Commonwealth Grants Commission (Commission) in reviewing the methods used to assess states' own-source revenue and that they have seriously examined changes to methodology that some of the states have suggested.

Victoria has examined the current methodology used by the Commission. In some cases, we have proposed alternative approaches as outlined below. Responses have also been given to the proposals made by Commission staff in each of the revenue draft assessment papers.

Each of the draft assessment papers are separately discussed in the sections that follow.

2. Payroll tax

2.1 Assessment

The Commission assess a state's capacity to raise payroll tax using ABS national account data on Compensation of Employees (CoE). The data are adjusted to remove CoE not normally taxed, namely CoE below an average deduction threshold, which is calculated by weighting each state's threshold by its share of total CoE. General Government CoE is removed because it raises no net revenue for a state.

The Commission recommends retaining the above approach from the 2015 Review, because it reflects what states do, is based on reliable data and produces a material result.

Victoria supports using the approach from the 2015 Review as it reflects the payroll structures in most states, including the two largest.

2.2 Payroll concession for regional businesses

The assessment paper notes that most states allow various exemptions and concessions regarding payroll tax.

From 1 July 2018, the Victorian Government reduced the payroll tax rate applicable to regional businesses from 3.65 per cent to 2.425 per cent. Regional based businesses are eligible for the lower payroll tax rate on their entire payroll, provided they pay at least 85 per cent of their payroll to regional employees and have an ABN registered in regional Victoria. In 2018-19, the estimated revenue forgone due to this measure was \$77 million¹.

Further information on payroll tax and regional employees can be found at: <https://www.sro.vic.gov.au/ptxregional>

¹ Victorian 2018-19 Budget Paper 5, Statement of Finances, page 166

2.3 Treatment of diminishing thresholds

Like most states, Victoria imposes a single marginal rate of tax on payrolls above a threshold. Three states, however, have diminishing deduction thresholds. The Commission proposes to continue to reflect the policy to exempt small payrolls above a single average threshold as data to capture the diminishing reduction threshold are not available. Victoria supports the Commission's approach and its endeavours to find alternative sources of data to account for diminishing reduction threshold.

2.4 Elasticity adjustment

Victoria notes that the Commission has engaged a consultant to provide advice on whether it should consider reinstating elasticity adjustments. Victoria supports this approach and will assist the consultant as required.

3. Land revenue

3.1 Revenues to be included in land revenue category

The draft assessment paper proposes to include all land based taxes in the land revenue category, except those deemed to be user charges (such as Victoria's Growth Area Infrastructure Contribution). The Commission propose to include property based fire taxes, such as the Fire Services Property Levy in the land revenue category.

3.1.1 Fire Services Property Levy

From 1 July 2013, the Victorian Government replaced the insurance based fire services levy, as recommended by the Victorian Bushfires Royal Commission.

Rather than contributing through insurance premiums, the Fire Services Property Levy (FSPL) is collected with council rates. Previously, the insurance-based levy was imposed by insurance companies who then determined how it was passed on to policy holders.

The FSPL collects 87.5 per cent of the Metropolitan Fire Brigade (MFB) budget and 77.5 per cent of the Country Fire Authority (CFA) budget. The remainder of their budgets is funded from general revenue.

The FSPL consists of a fixed charge and a variable charge based on the property's capital improved value.

The fixed charge is indexed annually in accordance with movements in the consumer price index as required by legislation. The variable charge is determined based on the funding requirements of the MFB and CFA and the administration cost of collection agencies.

Importantly, the factors used for determining the levy rates are not directly influenced by property prices or the value of land. Although individuals may experience variations in the amount they pay under the levy, the overall amount collected by the state does not

fluctuate with property prices. The amount charged to each property household is calculated based on the funding requirements of the state's fire services, not on property values.

The full amount raised by the FSPL funds the fire services and as such is more like a user charge than a tax. The assessment paper notes that hypothecation of revenue from fire services levies does not satisfy the definition of a user charge since those paying the levy do not receive something in return. However, while this may be the case for individual levy payers, collectively they benefit from the availability of the fire services.

Victoria believes that the FSPL should be assessed equal per capita and not treated as a land tax.

3.2 Drivers of revenue capacity

Victoria supports the recommendation to continue to use land values as the basis of the land revenue capacity measure.

While state policies can affect land values this may not have any impact on revenue raising capacity.

3.3 Data sources

Victoria considers that State Revenue Office (SRO) data is the most appropriate source of land value data as it generally reflects the way Victoria levies land tax. Principal place of residence is excluded and land holdings are aggregated.

A move to Valuer-General data would imply that principal place of residence and aggregation should not be part of the assessment. This would be inconsistent with the "what states do" principle.

Victoria notes the disadvantages of moving to ABS National Accounts as a source, as discussed at the Officer Working Party presentation. These include:

- the data do not reflect how states levy land tax;
- non-taxable properties would need to be removed;
- the data do not capture states' aggregation policies; and
- data cannot be provided by value ranges.

These findings affirm Victoria's position that data from each state's revenue office is the appropriate source for land value data

3.4 Other issues

From 1 July 2019, valuations in Victoria will be conducted annually by the Valuer-General, replacing the previous valuation conducted by local councils every two years.

The change will resolve the inconsistency of the current arrangement, in which some valuations are undertaken by in-house valuers, some by the Valuer-General, and some by contract valuers across municipal boundaries.

By undertaking annual valuations, land and property values will be more accurate and up-to-date, ensuring taxpayers' land tax bills will more accurately reflect the value of their landholdings.

To ensure consistency among states, the Commission should consider if an adjustment to Victoria's annual valuations is required so they are on a common basis with other states that have less frequent valuations.

The 2015 Review recommended a 25 per cent discount of the income producing property component due to concerns around the reliability of adjustments required to account for policy differences among states. If reliable adjustment methods were found, then the discount would not be required.

Victoria supports the Commission's recommendation to defer consideration of a discount until the assessment method is settled. If all adjustments to SRO data can be made accurately, then a discount is not needed.

Victoria supports the Commission engaging a consultant to investigate whether to reinstate an elasticity adjustment.

4. Stamp duty on conveyances

4.1 Revenues to be included in this category

Victoria notes the equal per capita treatment of the sale of major assets. Some states, such as Victoria, have sold many major assets many years ago. The ability to generate revenue from asset sales is mainly determined by individual state circumstances. Therefore, Victoria's preference is to treat the sale of major assets on an actual per capita basis.

Victoria supports including transfers of motor vehicles in this category since it is a type of non-real property.

4.2 Drivers of revenue capacity

Victoria supports the recommendation to include revenue from duties on the transfer of real and non-real property, including the foreign owner surcharge and to include an amount equal to the concessional duty provided to first home owners.

The draft assessment paper proposes that non-real property transfers (other than motor vehicles) be treated on an equal per capita basis. Victoria prefers the treatment to be actual per capita basis. Victoria believes that states still charging this duty have not met their obligations under the IGA agreement. An EPC assessment implies that states that have met their IGA commitment are assessed as receiving revenue from these duties.

Victoria supports the Commission's recommendation to discontinue the off-the-plan adjustment on materiality grounds. Victoria also note that the budget data quoted in paragraph 44 are from the 2017-18 Budget (Statement of Finances). The same volume of the 2018-19 Budget has more recent figures (refer Table 5.2).

Victoria supports the recommendation to assess stamp duty on conveyances using the value of property transferred with adjustments:

- to remove values relating to non-real property, corporate reconstructions and sales of major state assets;
- for the wider scope of unit trusts and commercial property in selected states; and
- for the progressivity of transfer duty.

4.3 Other issues

Victoria notes that the Commission has engaged consultants to provide advice on whether it should consider reinstating elasticity adjustments in this category. The proposal to allow the consultancy to address this issue is supported.

5. Insurance tax

Victoria supports the Commission's recommendation to retain the 2015 Review insurance tax assessment, but to include workers compensation duty in the category and assess it using the general insurance base.

Victoria notes that the Commission has engaged consultants to provide advice on whether it should consider reinstating elasticity adjustments in insurance tax. The proposal to allow the consultancy to address this issue is supported.

Victoria notes that two states levy insurance based fire services charges. The proposal to include insurance based charges in the insurance category is supported.

6. Gambling taxes

Victoria does not consider that there is a conceptual and material method for assessing gambling revenue. Victoria agrees that the level of gambling activity is too policy influenced to be a reliable measure for a gambling revenue assessment and that there is insufficient evidence to construct a reliable assessment of gambling revenue using alternative measures.

Victoria supports the Commission continuing to investigate disaggregated gambling assessment based on Household, Income and Labour Dynamics Survey (HILDA) data and an aggregated assessment based on broad measures of gambling capacity. Victoria notes that:

- if it is determined that a disaggregated gambling assessment is to be employed, a discount would need to be applied to the assessment reflecting the limitations of the HILDA data set;

- it is likely that substitutability between gambling products varies between products, for example, casino table games and electronic gaming machines may be relatively substitutable, while lotteries and wagering are likely to be less substitutable products;
- improvements in technology and the digital economy have facilitated gambling activity, which has also reduced the nexus between gambling activity and where taxes are collected; and
- it is unclear how the impact of state policies could be effectively removed as part of the methodology, particularly given that these policies are wide ranging across jurisdictions. This would be further complicated considering that many states, including Victoria, are introducing point of consumption taxes for wagering and betting activity.

Pending the outcome of the Commission's investigations using HILDA data and the use of broad measures, Victoria supports continuing to assess gambling taxes as equal per capita.

6.1 Point of consumption tax

Victoria agrees with the Commission's finding that there are significant differences between states in their approach to raising revenue from gambling activity. The assessment paper notes that South Australia recently introduced a point of consumption tax (POCT) on the net wagering revenue of betting companies offering services to South Australia. The Commission identified these as mostly online betting companies based in the Northern Territory which have a low tax rate for online betting revenue.

From 1 January 2019 Victoria is proposing to replace the current wagering and betting tax structures with a point of consumption tax. The new POCT will apply at a rate of 8 per cent of the net wagering revenue derived from all wagering and betting activity by customers located in Victoria. A review of this tax will be conducted no later than June 2020.

Victorians spend approximately \$1.2 billion annually betting on thoroughbred and greyhound racing, sports and other events. Increasingly, wagering and betting is being conducted with online corporate bookmakers licensed outside of Victoria, who are not captured by the current Victorian wagering and betting taxation framework. This has led to declining wagering tax revenues.

A betting operator will be liable for the POCT if the customer is located in Victoria at the time of placing a wager or bet. POCT will apply to the revenue derived by operators from all wagering and betting types.

The Victorian POCT will better align Victoria's wagering and betting tax system with the increasingly digital betting environment. It will level the playing field between all providers of wagering and betting services, who provide these services to people in Victoria.

This reform will ensure that all wagering and betting by customers in Victoria, whether online or in person, will be captured by the Victorian taxation framework. The Government will continue to work with other states and territories on extending a common POCT model to other jurisdictions to achieve national harmonisation, where possible.

7. Motor taxes

7.1 Tax capacity measures and presentation of stamp duty on vehicle transfer assessment

Victoria notes that there are no major issues identified in the assessment paper. We support the recommendation to retain the 2015 Review motor taxes capacity measures.

As noted above, Victoria considers that the assessment of motor vehicle transfers should be presented as part of stamp duty on conveyances, to maintain consistency across review periods.

7.2 Other issues

To facilitate the Commission's potential adjustment to reflect differences between states in the value distribution of vehicle sales, Victoria is in the process of sourcing data on motor vehicle value ranges, as requested by the Commission. It is likely that these data will be provided to the Commission following submission of this response.

In terms of the Commission's split of vehicle registration revenue between heavy and light vehicles, Victoria notes that the Commission's current split is consistent with Victoria's estimates.

Victoria supports the Commission's plans to investigate motor tax concessions and to engage a consultant to provide advice on whether the elasticity adjustment should be reinstated.

8. Mining revenue

8.1 Revenues to be included in mining

The mining revenue category includes mining royalties levied on mining production. Royalties represent a payment to owners of a resource for the right to sell or use a resource.

Victoria supports the recommendation that this category to continue to comprise royalty revenue and grants in lieu of royalties.

8.2 Drivers of revenue

Victoria notes that most royalties are not imposed on a profit basis but on the value of mine production or an amount per tonne of production.

Victoria supports the recommendation to assess mining capacity using value of production and to collect production data from states on a free on board basis.

8.3 Balance between what states do and policy neutrality

Victoria notes that the unevenness of the mineral base across states makes determining a policy neutral assessment more difficult. However, grouping mineral categories is likely to produce an assessment that does not capture the underlying differences in states' revenue capacities.

Victoria supports the recommendation to assess mining revenue capacity using a mineral by mineral approach.

In the Principles of HFE position paper, the Commission states it will ensure that future discretionary revenue policy changes do not excessively change the GST distribution. It proposes doing this by limiting the extent to which any discretionary change in royalty rates by a state (which has a dominant role in the production of a mineral) flows through to the assessed revenue capacity of that treatment of mining revenue.

Victoria understands that for the mining revenue assessment an increase in revenue from a state increasing its royalty rate may result in a much higher proportion of the additional revenue being lost in GST share than would be the case for other revenue sources.

However, while such an outcome may not be regarded as desirable on policy neutrality grounds, there are other considerations that may be relevant.

Increasing revenue through increasing royalty rates is not an option that is available to all states. It is not an option at all for the ACT. The "penalty" for a state that can increase revenue from increasing a royalty rate rather than a tax rate on a revenue source common across the states could be regarded as an equity outcome that provides an incentive for states to increase revenue from increasing tax rates on revenue sources that are available to all states.

Further, if mineral resources are regarded as belonging to all Australians rather than the citizens of the states in which they are located then the current assessment results in all Australians benefiting from increased royalty revenue, not just the citizens of the state that has increased its royalty rate.

Mining is a significant source of state revenue and a material driver of differing fiscal capacity. It should therefore continue to be fully assessed when determining state fiscal capacity.

Victoria does not support the recommendation to assess a portion of the revenue increase on an EPC basis where a dominant state makes a discretionary change to its royalty rate.

Victoria notes the Commission's discussion on the influence of state development policies on its mineral reserves. States with a lower than average revenue raising capacity may not have weaker state development policies.

Victoria supports the recommendation to not adjust for differences in state development policies or compliance efforts.

8.4 Coal seam gas

The *Resources Legislation Amendment (Fracking Ban) Act 2017* commenced on 16 March 2017. The Act banned onshore hydraulic fracturing and unconventional gas activities and extended the moratorium on onshore conventional gas through to 30 June 2020. The

Victorian Government imposed the permanent ban on fracking and onshore coal seam gas, to protect farmers and the state's world-class food and fibre sector.

The moratorium on onshore conventional gas allows time for the due diligence to be done on an onshore conventional gas industry. The Act will not have any immediate impact on gas supply as there are no proved and probable onshore conventional or unconventional gas reserves in Victoria. If any gas were to be found, it would take approximately seven to fifteen years for projects to develop and begin producing gas.

The Victorian gas program is investigating onshore gas potential. The Victorian Gas Program, which will run from 2017 to 2020, is delivering a comprehensive program of geoscience and environmental research and related activities - including community engagement, resource planning and regulatory improvements - for onshore conventional gas, offshore gas and underground gas storage.

The program is looking closely at Victoria's gas prospectivity and the issues associated with onshore conventional gas to inform future decisions by the Victorian Government. The geoscience investigations for onshore conventional gas are designed to provide an evidence-based resource estimate.

In May 2018, the Victorian Government invited applications for five petroleum acreage release areas in the offshore Otway Basin to help build long-term supply of gas for Victoria. An airborne gravity survey of the Otway Basin will also be conducted later in 2018, covering up to 30,000 square kilometres, with data made available to explorers to assist them discover offshore gas.

In the Principles of HFE position paper, the Commission states that it will aim to strengthen application of the policy neutrality principle by ensuring that assessments do not unduly penalise or reward states which, in similar circumstances, adopt very different policies towards potential mineral and energy developments (for example, coal seam gas production).

The Commission has observed that differences in states' royalty revenue are primarily driven by states circumstances. i.e. their natural endowments. Mining revenue raising capacity is overwhelmingly dictated by resources located within state boundaries. The Commission notes that imputing a relevant base for minerals in states where the extraction is banned is not possible.

Victoria supports the current treatment of an assessment of zero capacity for states that ban a mineral. There have been no material changes in coal seam gas or uranium royalties since the 2015 Review.

Victoria does not support the recommendation to assess revenue from banned minerals such as coal seam gas as equal per capita.

8.5 Other issues

Victoria notes that the Commission has engaged consultants to provide advice on whether elasticity adjustments should be reinstated. We support this approach.

Victoria believes that suggestions to discount the mining revenue assessment have not been justified. As Western Australia itself has previously observed:

“Discounting assessments should be avoided, and only used if an improvement in equalisation can be demonstrated.”

And: “Discounting reduces transparency, as the basis for the discount can rarely be explained using objective data”².

A discount or ‘carve out’ to the mining revenue assessment would reduce transparency, equity and efficiency, and undermine the conceptual consistency and credibility of the system. It represents a second-best solution.

9. Other revenue

As stated in the assessment paper, there are no major issues in this assessment.

Victoria supports assessing revenues such as fees and fines, user charges (except those differentially assessed in the expense categories), contributions by trading enterprises and interest and dividend income as equal per capita.

2 Western Australia, *February 2009 submission*, CGC2008/04, p.1 and p.3.

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