Re:think
Better Tax System, Better Australia

SUBMISSION ON THE DISCUSSION PAPER

Local Government Association of Queensland Ltd

1 June 2015

SUBMISSION TO TAX WHITE PAPER TASK FORCE

1 June 2015

1. Background

This submission has been prepared by the Local Government Association of Queensland (LGAQ) in response to the Tax Discussion Paper released in March 2015.

The LGAQ is the peak body for local government in Queensland. It is a not-for-profit association set up solely to serve councils and their individual needs.

The LGAQ has been advising, supporting and representing local councils since 1896, allowing them to improve their operations and strengthen relationships with their communities. The LGAQ does this by connecting councils to people and places that count; supporting their drive to innovate and improve service delivery through smart services and sustainable solutions; and delivering them the means to achieve community, professional and political excellence.

The LGAQ welcomes the release of the Discussion Paper which sets out how the tax system operates now and the opportunities and challenges it faces. This submission by the LGAQ does not discuss all the issues raised by the Discussion Paper but rather focuses on matters relevant to the financial sustainability of the local government sector and its capacity to raise revenue. In preparing this submission, the LGAQ invited comments from Queensland councils and has considered comments received from councils including Burdekin Shire Council, Cassowary Coast Regional Council, Gold Coast City Council, Mackay Regional Council, Moreton Bay Regional Council and Townsville City Council.

The LGAQ considers that local government in Queensland is currently raising as much revenue from its own sources as it can in terms of the capacity of the community to pay. It is essential that this Tax Review does not erode local government's own source revenue raising capacity or result in reduced financial support from Federal sources such as through Financial Assistance Grants (FAGs), Roads to Recovery and other programs. The Discussion Paper discusses the issues of vertical fiscal imbalance. This impacts on local government through the narrowness of its tax base which relies solely on property taxation. No other form of taxation revenue is available to local government.

Grants from other spheres of government are important in addressing this vertical fiscal imbalance and the narrowness of the local government tax base. The LGAQ notes that these Federal grants have been falling over a lengthy period as a proportion of tax revenue as well as suffering from recent decisions to suspend indexation for both cost of living and population increases.

As community expectations increase, funding for local government has decreased. It is estimated that the shortfall in Queensland is somewhere in the vicinity of $1 billion. This is comprised of the following:

- $350 million reduction in state grants and subsidies between 2008-09 and 2013-14
- $170 million reduction in revenue from capped infrastructure charges
- $180 million reduction in FAGs due to freezing indexation
- $300 million reduction in revenue from capping water businesses' dividends

As a consequence of this reduced funding, local government debt in Queensland reached $6.7 billion in 2014-15 and is expected to be $8.2 billion by 2016-17. Queensland council rates and charges have increased by 32.3 per cent between 2006-07 and 2011-12, which is 16.4 per cent above inflation which only highlights the widening gap between the revenue base and required expenditure.

The LGAQ Policy Statement 2014 contains a number of statements of relevance to the Tax Review. Specific policy statements include:

> ***3.1.1 Federal Funding***
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> *3.1.1.1 Untied Federal funding for local governments should continue.*
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> *3.1.1.2 The amount allocated by the Federal Government should be based on a fixed share of Commonwealth taxation.*
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> *3.1.1.7 Financial assistance for roads (the Identified Road Grant) should remain a specific allocation for this purpose and not become absorbed in any other avenue of financial assistance for local government.*
>
> *3.1.1.8 The Roads to Recovery program should become permanent with annual indexing of funding to reflect increases in road and bridge construction costs.*
>
> *3.1.1.9 A permanent Bridges to Renewal program should be introduced, including annual indexing of funding in light of the need to support greater heavy vehicle access to the local government controlled road network.*
>
> ***3.2.2 Taxation Benefits***
>
> *3.2.2.1 All local government rates and charges on a person's domestic residence should be fully tax deductible.*
>
> *3.2.2.2 All gifts and endowments to local governments should be fully tax deductible.*

2. Property Taxation

Queensland local government currently (2013/14) raises around $3 billion annually from property tax (rates). In contrast, the Queensland State Government raises around $1 billion through State land tax. However, State land tax is not paid by the majority of ratepayers because of exemptions for the principal place of residence and the threshold of $600,000 where land tax cuts in. So at present, while State land tax is eroding the tax base of local government, it does so to an extent that has only a small impact on the revenue raising capacity of local government.

However, the Discussion Paper appears to be suggesting that State Governments should make far greater use of property taxation noting (p.129) that *"… Some studies have suggested there are significant economic gains associated with state tax reform, particularly reducing stamp duties and making greater use of potentially efficient payroll and land taxes."*

The LGAQ does not support the further encroachment on the land tax base of local government by other spheres of government.

A proposal in the Henry Tax Review also raises concerns for local government. That Review proposed that *"…Over time, State land tax and local government rates should be more integrated. This could involve:*

> *(a) moving to a joint billing arrangement so that taxpayers receive a single assessment, but are able to identify the separate State and local component; and*
> *(b) using the same valuation method to calculate the base for local government rates and land tax (with this method being consistent across the State)."*

While the exact nature of such a proposal has not been spelt out, there could be significant implications for councils across the State in terms of the impact on ratepayers.

At present, the State uses fixed percentages of land valuation to determine the tax liability. If a uniform fixed rate was applied state-wide as the council rate component, there would be a substantial shift in the incidence of rates across the state partly as a result of higher relative valuations in the metropolitan area and in key growth areas.

In south east Queensland (SEQ), for example, such an approach would result in rate levies increasing by more than 15% while rate levies elsewhere in the state would reduce. For small rural and remote councils, a uniform state-wide rate in the dollar would result in rate levies reducing by more than 50%. Clearly, a uniform state-wide tax rate for local government rates is not an appropriate approach and would impinge on the autonomy of individual councils in determining the revenue required to provide the range and level of services having regard to the wishes of each community and their capacity to pay.

Under current rating, with differential rates, councils are able to adjust the impact of high or low valuations to achieve an appropriate balance of rate revenue by sector to provide the services and facilities appropriate to each community. Differential rating powers in Queensland are very flexible and allow councils considerable scope to maximise rate revenue while taking into account ratepayers' use of, and benefits derived from, council services and facilities, as well as their capacity to pay.

3. Indirect Taxes

The Discussion Paper outlines a number of indirect taxes of which fuel taxes are the most significant raising around $18.3 billion in 2013/14. In comparison, Commonwealth expenditure on roads in 2013/14 was only around $3.4 billion. The LGAQ considers that any review of taxation should consider the need for hypothecation of revenue obtained from road revenue to road expenditure. Fuel taxes should not be seen as general revenue, particularly bearing in mind the overall deficiency in road infrastructure across the nation as evidenced by the Engineers Australia Infrastructure Report Card rating of "C" for roads across Australia.

The Discussion Paper also raises the issue of other user charges for roads noting that cost-reflective road pricing has been supported as a means to promote efficient investment in road transport, improve congestion and reduce vehicle costs. For local government, greater use of user charges for roads may be appropriate provided revenue obtained is hypothecated to road infrastructure investment.

The Henry Review also made proposals in relation to road transport. The Review suggested that *"congestion charges should apply to all registered vehicles using congested roads. The use of revenues should be transparent to the community and subject to further institutional reform."*

In addition it was proposed that there should be "*… development of mass-distance-location pricing for heavy vehicles, to ensure that heavy vehicles pay for their specific marginal road-wear costs. Revenue* *from road-wear charges should be allocated to the owner of the affected road, which should be maintained in accordance with an asset management plan."* A Heavy Vehicle Charging and Investment (HVCI) Reform project was established in 2007. The project reports included hypothecation of user charges to affected roads, but the closure of the project office in June 2014 suggested that the Federal Government did not see moving to such an approach as a priority. This Tax Review needs to consider the HVCI proposals.

The LGAQ supports hypothecation of road user charges to investment on affected roads.

4. Revenue Sharing

If international approaches to funding local government were adopted, particularly those in parts of Europe, local government would be assigned an agreed proportion of taxation revenue, providing a much broader revenue base. Alternatively, local government could have the capacity to set some local tax rates as in the USA. The narrowness of the rate base as the major source of local government revenue has always been a concern.

Whereas in Australia, around 38% of local government revenue is from property taxes, in Denmark and Germany only around 8% of local government revenue is from property tax. The major component of local government revenue in many European countries is from a share of income tax and other central government taxation.

In Denmark for example, around 70% of municipal revenue is from a share of income tax. In Germany, local government receives 15% of national personal income tax and 2.2% of VAT plus a share of business taxes.

In the USA, in addition to property tax (i.e. similar to local rates), sales tax and / or real estate transfer tax (i.e. similar to stamp duty) are commonly used mechanisms of local government fund raising, often with specific increases earmarked for particular local matters. For example, real estate transfer taxes can be used for specific purposes such as affordable housing and open space development.

As the LGAQ Policy Statement notes, **funding for local government from the Commonwealth should be based on a fixed share of taxation revenue**. This has been a long term objective of local government, providing access to a potential revenue growth stream. While the mix of taxation revenue may change (e.g. more GST, less personal and business taxation), this could readily be incorporated into any tax sharing arrangement.

As Table 4.1 shows, Financial Assistance Grants (FAGs) as a proportion of Commonwealth taxation revenue has dropped over a 10 year period from around 0.78% to approximately 0.68%. Further reductions will occur as a result of removing previous indexation provisions estimated to cost Queensland councils alone more than $180 million over the three year period.

Table 4.1: FAGs as Share Taxation Revenue 2001/02 to 2012/13

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
GST Revenue $ billion	27.4	31.3	34.1	35.7	39.1	41.2	44.4	42.6	46.6	48.1	48.8	50.3
Other C'wealth Taxation revenue $ billion	150.4	163.6	175.5	193.6	206.2	220.9	241.6	235.7	221.1	241.0	268.7	288.1
Total FAGS $ billion	1.39	1.46	1.50	1.56	1.62	1.69	1.78	1.87	1.93	2.06	2.16	2.30
FAGS as % total Taxation Revenue including GST	0.78 %	0.75 %	0.72 %	0.68 %	0.66 %	0.64 %	0.62 %	0.67 %	0.72 %	0.71 %	0.68 %	0.68 %

Note: Estimated annual FAG entitlement excluding bring forward payments

The Tax Review must consider how the revenue sources of local government can be expanded to increase overall financial sustainability. Tax sharing with local government must be considered.

The Discussion Paper notes that the GST rate at 10% is one of the lowest among developed countries and is roughly half of the average rate among OECD countries. The implication of the discussion of tax would appear to be that GST revenue should increase (by an increased rate and/or by reducing GST exemptions). However, the Paper also notes that any change to the GST would require agreement of all the States.

For local government, reduced Federal taxation revenue but with increased State revenue through increases in GST could result in responsibility for funding support to local government through programs such as FAG and Roads to Recovery becoming a matter for State Government to determine. The LGAQ considers that it is important that the Commonwealth maintain a direct funding relationship with local government to address both vertical and horizontal fiscal imbalances.

Surveys conducted by the LGAQ show strong community support for access to a share of Federal taxation for local government. There also appears to be a reasonable level of support for a small increase in the GST rate if the additional funds were allocated to local government. However, this is only one option for providing local government with a fixed share of Commonwealth taxation revenue.

Respondents to the LGAQ survey were asked *"Should local government have access to a set share of Federal taxation revenue to help it fund local services or should local government continue to rely primarily on property rates and charges?"*

Overall, 75% of respondents supported local government having access to a set share of Federal taxation rather than relying primarily on rates and charges.

The next question asked - *"Would you support an increase in the GST (goods and services tax) from say 10% to 10.5% if the additional revenue obtained was distributed to local government?"*

While this increase might appear to be relatively small, it would provide additional revenue equivalent to what is currently provided to local government by FAG and Roads to Recovery grants.

While 53% did not support such an increase in GST, overall a relatively high 41% did support it.

Those that did not support the increase were then asked - *"Would you support such a GST increase if personal income taxes were reduced to offset the extra GST revenue?"*
Some 13.2% of those that did not support the first proposition would then support it subject to the reduction in personal income tax. With this qualification on reduction in personal income tax, some

48% of the sample would support a small increase in GST to fund local government while 46% would not support it. The balance were undecided.

5. Member Consultation

Taxation reform, including access by local government to a set revenue stream from a growth tax along with decisions over which level of government delivers which service to the community and how those services should be paid for are key issues for Queensland local government. A comprehensive reform of roles and responsibilities in the Federation and how the taxation system supports these is vital for the future financial sustainability of local government. One area of particular concern to local government is the complexity of the tax system. The LGAQ contends that simplification is required across the taxation system including fringe benefits tax (FBT), payroll tax and GST as compliance costs for local government increases due to complexity in the administrative arrangements. The LGAQ will seek to undertake further research in this regard and provide feedback to the Task Force.

The LGAQ intends to play a leadership role in obtaining local government input into the two White Papers (Tax Reform & Federation Reform). A Discussion Paper has been prepared by the LGAQ to gain feedback from member councils. The issues have also been discussed at the annual LGAQ Finance Summit in April 2015.

As further input on issues is obtained from members, this will be shared with each Task Force.