

Tasmania's state taxation system: a case for reform

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Wide-ranging reform of Australia's federal tax system has proven to be a 'bridge too far' for the past two decades of federal politicians.

There has been a plethora of official enquiries, academic research and pre-budget submissions from a wide range of interest groups – some of them motivated by self-interest, to be sure, but more of them prompted by a sincere belief in what they see as the national interest – urging successive Australian Governments to 'seize the moment' to draw up, and then implement, reforms which they argue would make our taxation system fairer, more efficient, simpler or even just more 'sustainable' in the face of demographic, economic, social or structural change.

Despite that, and notwithstanding numerous changes at the edges of specific federal taxes, and occasional changes to some of the rates of those taxes, there hasn't really been any comprehensive reform of federal taxes since the Howard Government's 'New Tax System' of 2000.

But if taxation reform at the federal level has spent much of the past two decades in the 'too hard' basket, reform at the state level has (in general) proven even more elusive. With the exception of the reforms at the state level which accompanied the introduction of the GST, systems of state taxation haven't really changed all that much since the 1970s, which began with the transfer of payroll tax from the Commonwealth to the States, and ended with the abolition of death duties.

For their part, state governments have spent most of the past four decades narrowing the bases of the few taxes over which they do have control, in order either to curry favour with numerically large groups of voters such as small businesses and home owners, or to compete with each other in order to induce footloose businesses to move from one jurisdiction to another.

The two largest states have become increasingly reliant on a tax which both official enquiries and academic research have almost uniformly condemned as a 'bad tax' – stamp duty on the transfer of land – while the next two largest have ridden booms in royalties from mineral and gas production which have, for the most part, allowed them to avoid the need for even thinking about reform of their own taxes.

Only in the ACT has there been a genuine (and so far successful) effort to undertake a reform which enjoys almost unanimous support among economists, the replacement of stamp duties on land transfers with a broadly-based land tax: which, because the ACT Government is also in effect the Canberra City Council, it has been able to accomplish by raising municipal rates rather than breaking the 'taboo' of imposing land tax on the 'family home'.

The Tasmanian Government raises less from its own resources (taxes, royalties, user charges and GBE dividends) than any other jurisdiction except the Northern Territory. That's largely because, as identified by the [Commonwealth Grants Commission](#) in its annual reviews of GST revenue-sharing relativities, Tasmania's revenue-raising capacity is less than that of any other state or territory, although it also partly reflects policy choices by successive Tasmanian Governments of both political persuasions to raise less revenue from their own resources than they could.

Perhaps because it has been able to rely on its share of GST revenues, and other grants from the Commonwealth, for a greater share of what its governments have wanted to spend on public services than any other jurisdiction except the NT, there has been no serious conversation about Tasmania's state tax system since a tri-partisan parliamentary enquiry was abruptly terminated almost nine years ago. Since then, Tasmanian political parties have been more anxious to indicate to voters what they *wouldn't* do, than to seek to persuade them to endorse any kind of reform agenda.'

That complacency is likely to be challenged by the abrupt decline in revenue from the GST as a result of the current recession, as well as by the longer-term decline in GST revenue as a share of GDP for reasons recently identified by the [Parliamentary Budget Office](#) – which will hurt Tasmania's budget more than that of any other state or territory (except, again, the NT).

[The Report](#) which I've written for The Australia Institute, published today notes that Tasmania raises a higher proportion of its total state tax take from 'bad taxes' – stamp duty on land transfers, and taxes on insurance premiums – than any state or territory except Victoria; and raises a smaller proportion of its total tax take from what it argues should be seen as 'good taxes' – payroll tax and land tax – than any state or territory except Queensland.

I propose three reforms which can (with a mandate from voters at the next state election due in March 2022) be implemented by a Tasmanian Government without falling foul of the words of the Australian Constitution (as they've been interpreted by the High Court); without requiring financial assistance from the Commonwealth (although that would be helpful, especially with transitional arrangements, and if the Commonwealth is as serious as the [Federal Treasurer](#) says he is about encouraging productivity-enhancing reform at the state level, then it should be prepared to provide some); and without requiring a lead from the larger states.

The first of these reforms is replacing existing 'conveyancing duties', as stamp duties on the transfer of land are officially called in Tasmania, with a land tax whose base should be broadened to include owner-occupied homes and 'shacks', which are currently exempt or zero-rated, and which should be levied on individual land holdings (rather than the aggregate of them) at progressive rates on the per-square-metre value of each holding.

There would need to be a transitional provision – such as a 'credit' for stamp duty paid on recently-acquired property, to be set against the land tax that would become

payable, to avoid 'double taxation' of recent purchasers. And there would need to be a deferral provision for 'asset rich but income poor' home-owners, such as pensioners. But both of those are 'doable'.

I calculate that the most the average residential landowner would have to pay by way of land tax would be the equivalent of 90% of what the average land-owner currently pays in municipal rates – and that only if the state government seeks to recover *all* of the revenue from stamp duties, including that on transfers of commercial property, from residential land-owners (which needn't necessarily be the case).

And the average residential land-owner would not have paid more in land tax under this proposal than he or she would have by way of stamp duty on the purchase of the property until he or she had lived in it for more than nine years – by which time, as the recent [Thodey Report](#) to the NSW Government argues, any reasonable interpretation of 'fairness' demands that they *should* be paying more than they currently do.

My second proposed reform is the reduction in the threshold for payroll tax to the equivalent of the average annual earnings of five Tasmanian employees (from the current level which is equivalent to the average annual earnings of 36 employees): and using the resulting revenue gain to lower the rate of payroll tax from what is currently the second-highest in Australia to what would likely be the second-lowest, and to exempt *new* businesses from payroll tax altogether for the first 'x' years of their existence, where 'x' could be, for example, three or five.

This will of course produce howls of outrage from small businesses, a larger proportion of which are exempt from payroll tax in Tasmania than in any other state, and from others who also believe that small business is the 'engine room' of the economy in Tasmania, as in (so it is widely believed or asserted) other states and across Australia as whole.

I show that, what appears to be a widespread and bi-partisan conviction notwithstanding, small business is *not* the 'engine room' of Tasmania's economy (or of any other state's for that matter); and that exempting small business from payroll tax has *not* done anything to enhance job creation, innovation or any of the other blessings commonly attributed to preferencing small businesses, simply because they are small.

On the contrary, [ABS figures](#) show that over the four years to 2018-19, during which time Tasmania's economy in many respects out-performed that of Australia as a whole, small business created only 13% of the net increase in private sector employment in Tasmania, while 34% of private sector jobs growth was at large businesses (who have to pay the second-highest payroll tax in Australia), and 52% was at medium-sized businesses, many of whom are also liable to payroll tax. Indeed, over the 12 years to 2018-19 employment at Tasmanian small businesses in Tasmania has actually declined by 11.6%, more than double the national average – despite Tasmania having the most generous payroll tax concessions for small businesses of any state.

Of course, as economists (but it would seem few others) recognize, the fact that payroll tax is payable in the first instance by employers *doesn't mean* that it is a 'tax on jobs', as is so often claimed, any more than is the GST (which like payroll tax is in essence a tax on the difference between 'sales revenue' and 'cost of goods sold').

Preferencing *new* businesses would do far more to spur entrepreneurship, and to stimulate job creation and innovation, than preferencing small ones, simply because they're small.

It would also cost less, by way of revenue foregone: which means that the preferences could be more generous, if desired. And since a 'new' business can't prevent itself from becoming an 'old' one, other than by going out of business, there would be no perverse incentives such as those which often result in small businesses ceasing to grow at just below the point at which they become ineligible for preferential treatment.

My third, and probably the most controversial, proposed reform is the re-introduction of death duties: specifically, duties on estates valued at over \$1 million (which would exclude 91% of the estates granted probate by Tasmania's Supreme Court over the past three financial years), at rates ranging from 5% on amounts between \$1mn and \$5mn, 10% on the next \$5mn, and 20% on anything over \$10mn (which in Tasmania would have affected just 10 estates, 0.1% of the total, over the past three years.

However, I also propose that people whose estates would be liable to such a tax could obtain a credit against the tax that would be payable out of their estates, for donations to Tasmanian-based Deductible Gift Recipients – up to the point where, if they wished, their liability was completely extinguished. Such an arrangement would provide a powerful incentive for philanthropy in Tasmania – as it has in the United States. And such an incentive would still exist, even if it was structured as a deduction from the taxable value of estates rather than a credit against the tax payable.

There will of course be predictable cries of outrage against such a proposal, not so much, perhaps, from those whose estates could be subject to such a tax, as from those who hope to benefit from inheritances without any requirement to share some of their windfall with their fellow citizens – something which a surprising number of Americans whose estates will be subject to such a requirement don't seem to find at all objectionable. No doubt opponents of such a proposal will also find it convenient to ignore the stipulation that fewer than 10% of estates would be liable to the proposed tax, or the suggestion that estates passing to a surviving spouse (though not to other beneficiaries) should be completely exempt.

All or any of these proposals could be used to raise more revenue than the current Tasmanian tax system does, if a party seeking government at the next election wished to offer voters more by way of publicly-provided goods and services. Alternatively, they could be used to raise less revenue, by a party which wanted to argue that reducing the overall state tax burden would improve Tasmania's competitiveness, or help to create jobs. I don't advocate either option – but they are both there for the taking.

What my proposals would help promote is a system of state taxation which would be *fairer* in the demands it makes on different households and businesses to help fund the cost of providing public goods and services by the Tasmanian Government; and a system which would be *more efficient*, in the sense of doing less to distort the choices which businesses and households make as to how they allocate their capital, where they live and how often they move home, and in other ways.

And, I argue, it would make Tasmania's financial position less vulnerable to forces entirely beyond any Tasmanian State Government's direct control or indirect influence.

That is, it would represent *real reform*: something that has been sorely lacking, no less in Tasmania than anywhere else, over the last two decades.