STANDING COMMITTEE ON UNIFORM LEGISLATION AND STATUTES REVIEW

TRANSCRIPT OF EVIDENCE TAKEN
AT PERTH
WEDNESDAY, 31 MAY 2006

Members

Hon Simon O'Brien (Chairman)
Hon Matthew Benson-Lidholm
Hon Sheila Mills
Hon Donna Faragher

Hearing commenced at 9.57 am

ALTUS, MR MARK
Director, Revenue and Intergovernmental Relations,
Department of Treasury and Finance,
12th Floor, Governor Stirling Tower, 197 St Georges Terrace,
Perth 6000, examined:

SCHERINI, MR ALEXANDER
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The CHAIRMAN: Gentlemen, on behalf of the committee, welcome to this meeting. You have both sighted a document entitled "Information for Witnesses". Have you read and understood that document?

The Witnesses: We have.

The CHAIRMAN: These proceedings are being reported by Hansard. A transcript of your evidence will be provided to you. To assist the committee and Hansard, could you give the full title of any document that you may refer to during the course of our proceedings. I remind you that your transcript will become a matter for the public record. If for some reason you wish to make a confidential statement during today's proceedings, you should request that the evidence be taken in closed session. If the committee grants that request, any public and media in attendance will be excluded from the hearing. Until such time as the transcript of your public evidence is finalised, it should not be made public. The premature alteration or disclosure of public evidence may constitute a contempt of Parliament and may mean that the material published or disclosed is not subject to parliamentary privilege. Mr Altus, would you like to make an opening statement to the committee?

Mr Altus: The Department of Treasury and Finance considers that this is an important inquiry and we are very pleased to provide whatever assistance we can. Some of the features of the intergovernmental agreement, or the GST agreement, are perhaps easily forgotten or may not have ever been all that well understood in the community. The commonwealth frequently makes claims of GST windfall gains for the states, which we think are exaggerated. We also think that there are highly misleading claims from time to time by other jurisdictions about who subsidises who within the Australian federation, particularly when we look beyond the narrow confines of the GST distribution arrangements to the broader scheme of commonwealth-state financial relations in this country. This inquiry is an opportunity to clear up some of these misunderstandings, to increase awareness in the community about some important issues within the Australian federal system and also to push Western Australia's case for a better deal than we currently get. The Department of Treasury and Finance is also doing its bit in this regard.

Something that we have produced recently - I have brought seven copies of this document along for the committee's future reference - is a fairly significant discussion paper. I will possibly refer to it during the proceedings. It is called "Discussion Paper on Commonwealth-State Relations: An

Economic and Financial Assessment of How Western Australia Fares". That is a useful piece of research for the committee's purposes as part of this inquiry. We also prepare and publish various pieces of information that might be of value to this inquiry on our web site and in the annual budget papers. In particular, there is a federal affairs chapter in budget paper No 3 that might be a useful reference source for this inquiry. Something else that the department is currently coordinating, which I expect would be fairly useful to the committee, although it is still in its fairly formative stages, is the state infrastructure strategy. I will leave those reference sources with you. That is all I wanted to say by way of opening comments.

The CHAIRMAN: The document that you are tabling - we thank you for providing us with several copies - is the "Discussion Paper on Commonwealth-State Relations: An Economic and Financial Assessment of how Western Australia Fares".

Mr Altus: Yes.

The CHAIRMAN: Is the last-mentioned document about infrastructure also available?

Mr Altus: At this stage there is no report available. There is information about this review of Western Australia's infrastructure needs on the Department of Treasury and Finance web site. A green paper will be published within the next month or two that will be like a discussion paper designed to prompt input from the community about specific infrastructure projects that might be emerging priorities in Western Australia and who should be helping to fund those infrastructure priorities, whether it be the state, the commonwealth or the private sector. We will have the green paper in the next month or two, and then a final report or a white paper about this time next year if the review goes according to the current timetable.

The CHAIRMAN: On behalf of the committee, in response to your opening remarks, what you are saying is in tune with what the committee wants to achieve. We are very pleased to hear that. Part of the purpose of our inquiry is to clarify matters that may have been subject to misinformation or parochial debate or simply misunderstanding by the public and also to catch up on where commonwealth-state financial relations are at. As time goes by, the picture evolves and changes. Thank you very much for the way that you are approaching this inquiry, which sounds very helpful. The specific document that provides our head of steam for this inquiry was the financial relations agreement reflected in the Financial Relations Agreement (Consequential Provisions) Act 1999. How far has the implementation of that agreement as reflected in that act progressed?

Mr Altus: I am not quite as familiar with the legislation as I am with the agreement but I assume that we are referring to the Intergovernmental Agreement on the Reform of the Commonwealth-State Financial Relations, which is what I referred to in shorthand form as the GST agreement. That is how we commonly refer to it within the department or within the discussions that we have with our colleagues in other jurisdictions.

The CHAIRMAN: We can adopt that nomenclature.

Mr Altus: In terms of its implementation, perhaps I firstly need to recount the key features of the agreement. The agreement provides for the GST revenue collected by the commonwealth government. We should bear in mind that the GST is a commonwealth tax constitutionally, legislatively and administratively. The GST agreement provides for the commonwealth to pass on the proceeds of the GST that it collects to the states. In terms of distributing that money to the states, the commonwealth government applies the principle of horizontal fiscal equalisation and it takes recommendations from the Commonwealth Grants Commission as to what share each state should receive of the national pool of GST revenues. That is one key feature of the GST agreement.

Other key features relate primarily to what the states have been required to do in return for receiving a share of this pool of GST revenue. The states have been required, for example, to abolish a number of their own state taxes - that is, taxes such as financial institutions duty, debits tax and stamp duty on share transactions. They have all been abolished in Western Australia and by the other states as required by the agreement.

The states were also required to put in place administrative mechanisms and to fund a first home owners grant scheme. That is in place. The first home owners grant scheme involves a $7 000 grant to all first home buyers. That has been in place since the GST was introduced on 1 July 2000. The states are also required to fund the Australian Taxation Office's administration costs in relation to the GST. The ATO provides a breakdown of the expenses that they incur in collecting and administering the GST and the states get the bill for that. In addition - I imagine this is partly what prompted this inquiry - there was a requirement for various other state taxes to be reviewed by 2005. It referred to taxes that the states were required to abolish, and that has occurred. There was the financial institutions duty, debits tax and stamp duty on share transactions etc. In addition, there was a requirement to review a range of other stamp duties. There were six classes of other stamp duties. The requirement was to review them in consultation with other states and the commonwealth, not to abolish them.

[10.10 am]

Nonetheless, Western Australia and the all the other states have announced and agreed with the commonwealth government a schedule for abolishing most of the stamp duties that were listed only for review by 2005. That review has taken place and we now have an outcome. All of those stamp duties, with the exception of one that I will mention in a moment, have been listed for abolition. They will not be abolished immediately, but will be abolished over the next few years according to a schedule that the federal Treasurer has signed off on at Ministerial Council of Treasurers meetings. The one stamp duty that is listed for review and which has not yet been scheduled for abolition by any state is the real property component of non-residential conveyance duty. That is a very substantial tax for all the states. That is the reason it has not been scheduled for abolition yet. It is a question of affordability. That has been accepted as far as the here and now is concerned by the commonwealth government also, although the federal Treasurer has made it clear that at some stage in the future he would like the states to also abolish this one remaining stamp duty.

I think I have probably covered the key features of the agreement. In so doing, I have probably indicated that its implementation is a fair way down the track. It is hard to identify anything that has not now been implemented other than the outstanding issue of stamp duty on non-residential property transactions, which will be reviewed at some time in the future.

The CHAIRMAN: Thank you. That is a good overview.

Mr Scherini: The agreement provided in the initial years that the commonwealth would provide top-up financial assistance to the states if the GST was inadequate. That was to ensure that the states were no worse off than under the pre-GST arrangements. At this stage it is forecast that from 2006-07 onwards, no top-up assistance is required for any jurisdiction.

The CHAIRMAN: I will quickly go through some of the provisions. Mr Altus has given a good overview of them, but I want to put them on the record. In the reform measures contained in section 5 of the intergovernmental agreement - the GST agreement - a number of taxes are to be done away with. It is a matter of history that the commonwealth government has introduced the GST. The commonwealth government also ceased to apply wholesale sales tax from 1 July 2000 and has not reintroduced any similar tax. The temporary arrangements for taxation for petrol, liquor and tobacco I think also ceased on 1 July 2 000.

Mr Altus: Correct.

The CHAIRMAN: The payment of financial assistance grants also ceased on 1 July 2000.

Mr Altus: That is right. The GST revenue grants from the commonwealth government to the state governments have replaced those old financial assistance grants.

The CHAIRMAN: Thank you. Moving to clause 5(vii), did Western Australia ever have bed taxes?

Mr Altus: No, it did not. As I recall, that tax was limited to New South Wales and possibly the Northern Territory. It was just those two jurisdictions.

The CHAIRMAN: We certainly do not have bed taxes now or from July 2000.

Mr Altus: No.

The CHAIRMAN: You have also confirmed that financial institutions duty has been abolished in this state from 1 July 2001. Were stamp duties on quoted market securities abolished also?

Mr Altus Correct, and on that date.

The CHAIRMAN: Debits tax was to be abolished by 1 July 2005.

Mr Altus: That occurred.

The CHAIRMAN: You have already discussed the matters covered in section 5(vii) relating to the ministerial council's 2005 review. We will turn now to those individual taxes and give the committee an update on what has actually happened. There are six categories of stamp duties listed under that clause 5(vii). I will ask you to deal with each category separately and to correct me if we have assessed them wrongly. I think there are six categories. The first is non-residential conveyances. What does that mean and what is its status as a tax?

Mr Altus: Non-residential conveyances refers to the sale of property other than residential property. Under the state Stamp Act, the sale of any property is subject to stamp duty at uniform rates, whether it is a residential or a business property. Non-residential properties are business properties that could include mining tenements, commercial property, shopping centres, office buildings and business property such as intangible business property like business goodwill, statutory licences, intellectual property and that kind of thing. That is what it is. The status of the stamp duty is that on 21 March this year the government announced that stamp duty on the sale of non-real, non-residential property would be abolished from 1 July 2010. That is quite a way down the track. I will clarify what I mean by "non-real property". It is essentially the intangible-type business property such as business goodwill, intellectual property, trademarks, copyrights and statutory licences such as taxi licences, egg producer licences and crayfishing licences, which can be quite valuable. It is that type of thing. As I have said, the one component of the taxes listed in clause 5(vii) whereby there is no undertaking to remove that tax is the real component of non-residential conveyances. That includes mining tenements, commercial land and buildings; that is, other than the intangible type components.

The CHAIRMAN: This next question may need to be taken on notice. The committee would like to know the amount of stamp duty that is collected on non-residential conveyances and what the projected collections are for the next few years in the budget projections. Can that be provided as supplementary information?

Mr Altus: I can certainly provide a general response now and perhaps follow it up with some specific numbers. We estimate that the broad category of non-residential conveyance duty accounts for up to 40 per cent of our total conveyance duty; that is, our total stamp duty from the sale of all kinds of copy. The residential components are the stamp duty on the sale of homes. We do not have specific information or get a specific breakdown on that from the Office of State Revenue, but the information it has available suggests that probably 60 per cent or more of our stamp duty on the sale of property comes from the sale of homes.

[10.20 am]

The balance is the non-residential component. There are two points that I would make about providing specific figures. Firstly, we will not be able to give anything precise because the information is not collected by the Office of State Revenue. Secondly, that proportion would be quite volatile from year to year, particularly because within this category of non-residential conveyance duty, we can have some very large one-off transactions. That tends to happen from time to time in the resources sector where some very valuable mining tenements can change hands.

The CHAIRMAN: Or a Dampier-Bunbury natural gas pipeline.

Mr Altus: That is an excellent example. That one transaction might pull in upwards of $100 million in one hit. That can obviously have a pretty big impact on both the proportion and the dollar amount of stamp duty that is at stake in this category of non-residential conveyances.

The CHAIRMAN: What proportion would the non-real value of those non-residential property conveyances represent?

Mr Altus: Again, it was hard to do anything other than estimate what the cost would be. We came up with an estimate that was very similar to other states of around seven per cent of our total conveyance duty base.

The CHAIRMAN: Is that seven per cent of the 100 per cent or seven per cent of the 40 per cent?

Mr Altus: That is seven per cent of the 100 per cent. For the non-residential component, we are talking about seven per cent plus up to 33 per cent.

The CHAIRMAN: You have indicated that from 1 July 2010 the states would like to get rid of stamp duty on that non-real value of non-residential conveyances. What about the real value of non-residential conveyances? Is there anything on the horizon to get rid of those stamp duties?

Mr Altus: The only thing that is on the horizon is a comment that is included in a letter from the federal Treasurer to his state counterparts indicating that he is not prepared to take the future abolition of this stamp duty off the agenda. Essentially, he indicated that it is something that the commonwealth government will want to have re-visited, having regard to the net benefits that the states are receiving under the GST agreement. We publish in our budget papers the estimates of the net financial gains to the states from the GST agreement. That is the net financial gain after we compare the post-GST arrangements with the pre-GST funding arrangements. Alex referred to this earlier. From 2006-07 onwards, all states are in front; that is, we are receiving a net fiscal benefit from the GST arrangements compared to estimates of what would be the case if the old arrangements still applied. The commonwealth has recognised that those benefits are likely to be too small for years to come to enable the states to abolish this one remaining stamp duty without going into the red. If the states were to go into the red - for example, if they were forced to abolish that stamp duty - there would be an onus on the commonwealth government to again provide the kinds of top-up grants that Alex referred to. Presumably, the commonwealth does not want to do that from its own budget management point of view.

The CHAIRMAN: Did the letter from the federal Treasurer that you just mentioned come after the March 2005 ministerial council review?

Mr Altus: There are a couple of letters. The one that I was primarily referring to was provided by the commonwealth Treasurer at this year’s Ministerial Council of Treasurers meeting - so, it was March 2006. From Western Australia’s point of view, that letter essentially agreed to the schedule of abolitions that the government had announced prior to that ministerial council meeting, but included a paragraph that the commonwealth government is not prepared to forget about the one remaining stamp duty.

The CHAIRMAN: If that communication reflects one of the more recent ministerial council considerations of this matter, we will seek to obtain a copy of that letter. Perhaps that could be provided from you by way of supplementary information or the committee can request it formally from the minister. We will follow that up.

Mr Altus: I am not quite sure what the protocols are. Perhaps it is worth mentioning that there has been some sensitivity in the past in relation to documentation concerning the Ministerial Council of Treasurers being made public. For example, as you would be aware, there was an earlier Western Australian parliamentary committee inquiry related to this agreement where our Treasurer was more than happy, for example, to table the review that was required under clause 5(vii). That was conducted on behalf of the ministerial council by heads of Treasury. Our Treasurer was prepared to make that public. He consulted with his interstate colleagues and they preferred not to make it public on the basis that it would potentially detract from free and open discussion within the ministerial council meetings themselves or within that forum. I am not necessarily saying that the same sensitivity will apply in relation to the letters that the Treasurer has written to each state Treasurer, but I note there is the potential for that sensitivity.

The CHAIRMAN: We had better move on to our next category, which we have identified as stamp duty on leases. What sort of leases are we talking about and what is their status?

Mr Altus: This stamp duty was abolished in 2004. I am not sure whether it was abolished on 1 January or 1 July 2004. The main category of leases we are referring to would have been the lease of property, whether residential or commercial leases. That was a relatively low rate of stamp duty compared to conveyances. It was abolished ahead of the requirement to review it in the intergovernmental agreement. That was an outcome of the business tax review that this government convened relatively early in its term. It reported in 2003. One of the outcomes was the early abolition of some of these stamp duties.

The CHAIRMAN: So stamp duty on leases is just an unhappy memory. The next category we have identified is stamp duty on mortgages, bonds, debentures and other loan securities. Could you describe the stamp duties that existed on those categories and the current status?

Mr Altus: This is stamp duty on loans or borrowings that are secured by property such as housing loans and business loans. The government announced on 21 March - this was also part of the recent state budget - that stamp duty on mortgages would be halved from 1 July this year and fully abolished in two years' time. This category of stamp duty still exists but is on its last legs. I do not have all the details here today but in terms of some of these other subcategories, apart from mortgages, I am pretty sure that one of the outcomes of the business tax review was the narrowing of this particular stamp duty base.

[10.30 am.]

I should mention also that the government announced the abolition of stamp duty on mortgage refinancing in last year's state budget, and that has since been implemented. Therefore, for someone who has already acquired a home by taking out a bank loan or a loan through another financial institution and who identifies that he can get a better deal from another financier by refinancing the loan, the government abolished the stamp duty on the refinancing to remove a barrier to competition in the finance sector. This is a duty that is well and truly on the way out and it has been narrowed quite significantly. The government will introduce legislation that will provide not just for the halving of this duty on 1 July 2006, but for its complete abolition in two years.

The CHAIRMAN: Can the status of the full category, which in addition to mortgages covers debentures, bonds and other loans and securities, be provided by supplementary information?

Mr Altus: Certainly that information can be provided on the more technical subcategories.

The CHAIRMAN: Any assistance that can be provide to draw the committee's attention to other material that might help it translate the meaning of these terms into plain English for the report of the interested members of the public will be appreciated also.

Mr Altus: Yes. Will we receive correspondence after this hearing that lists the supplementary information that is required?

The CHAIRMAN: Indeed. It will, of course, be reflected in the transcript. Our advisory research officer, Ms Kain - I apologise for not introducing her earlier - will be in touch for some follow-up information that has been noted during the course of the hearing that will be the subject of further action.

The next category we note is credit arrangements, instalment purchase arrangements and rental arrangements. Can you comment on those, please?

Mr Altus: Perhaps a simpler description of that category of stamp duty is hiring duty, or rental business duty. Again, it is a very low rate tax that is currently still in place. On 21 March, the state government announced that it would be abolished. In this case, the abolition will be legislated to occur on 1 January 2007. This is a category of duty that will be abolished in about seven months. I will give a couple of examples so that members get more of a feel for what is involved. This stamp duty applies to video and DVD rental stores. It applies also to larger hiring firms that might be leasing equipment to the construction industry, or even to households.

The CHAIRMAN: Does it include the party hire businesses?

Mr Altus: That is correct. That is what we are talking about.

The CHAIRMAN: Are the stamp duties on credit or rental arrangements only a stamp duty on the hire of goods, or are there other rentals also such as real property?

Mr Altus: The rental of property fell under the categories of leases, which we have already discussed. That is a good way to distinguish those two categories of stamp duty. Lease duty related to the rental of property, whereas the category we are talking about now refers to the rental of goods. Another way to describe it is it relates to rental arrangements and hire purchase arrangements.

The CHAIRMAN: Is that whole category subject to the will of Parliament on 1 January 2007?

Mr Altus: That is correct.

The CHAIRMAN: We will watch with interest to see which members do not want to vote for the abolition of these duties in due course. The next category identified was cheques, bills of exchange and promissory notes. Will you discuss those, please?

Mr Altus: That is a category of stamp duty that was abolished in 2004. Again, that was an outcome of the state government’s business tax review. That duty was abolished ahead of time, relative to the requirement for a review as described in the intergovernmental agreement. Again, it was a very small stamp duty. If I recall correctly, it was 10c per cheque or per bill of exchange. In many respects, a bill of exchange is just another term for what is more commonly known as cheque, as is a promissory note. It was a flat rate of duty paid irrespective of the amount of the cheque, promissory note or bill of exchange. It collected for the state government only about $10 million per annum. That has been abolished.

The CHAIRMAN: Did that include a duty on electronic debits?

Mr Altus: I do not believe so. If electronic debits related to a withdrawal of money from a cheque account, they would have been subject to the debits tax. As we noted, the debits tax was abolished from 1 July 2005.

The CHAIRMAN: Before we move on, has stamp duty on all of those transactions been abolished since 2004?

Mr Altus: That is correct.

The CHAIRMAN: The final category the committee identified was unquoted or non-quotable marketable securities. Can you describe what they are or were and what is their current status?

Mr Altus: There were two categories of stamp duty on marketable securities. The first was listed in the preceding clause; that is, quoted marketable securities. That was stamp duty on any purchase or sale of shares on the stock exchange. The other category related to the purchase or sale of shares privately rather than through the Australian Stock Exchange. In both cases, the stamp duty has been abolished. Stamp duty on unquoted market securities was abolished in 2004 as an outcome of the state government's business tax review. Again, it was abolished ahead of its time.

The CHAIRMAN: In all in, all in all, what is Treasury's view on Western Australia's compliance with clause 5(vii) of the GST agreement?

Mr Altus: Certainly Western Australia has fully complied with it. Western Australia has gone further than the requirement of clause 5(vii), which was a requirement only to review the stamp duties. The commonwealth government argued that the states were under a moral obligation that if the GST revenues had grown sufficiently, "to review" effectively meant to abolish those stamp duties. However, that is open to interpretation. From a Department of Treasury and Finance point of view, the state government has fully complied with and gone a bit further than the strict requirements of that clause. It is worth noting that the commonwealth government has now formally acknowledged in the letter to which I have referred that the state government has complied with the requirements of the agreement.

The CHAIRMAN: Did Treasury seek legal advice on Western Australia's compliance with that clause?

Mr Altus: Yes, it did about a year ago prior to the state government agreeing to the abolitions that it has now scheduled. Members might recall that at this time last year, the state government's position was that there was no obligation to abolish those stamp duties. A reading of the clause as it stands suggests the state was not under a strict obligation to abolish those stamp duties. The state government sought to confirm that. The Department of Treasury and Finance liaised with the State Solicitor's Office to seek legal advice to formally confirm that that was the situation.

[10.40 am]

The fact that the state government was not seeing eye to eye with the commonwealth this time last year and there was no obligation to do anything more than review - that is, to abolish the stamp duties - was one of the triggers to the state government initiating the state tax review, which is still under way. Stage one has just been completed. The government wanted to identify the community's priorities for further tax reform in Western Australia rather than just accept the position of the commonwealth government that "review" effectively meant "abolish".

The CHAIRMAN: The states' view was that the plain meaning of "review" meant "review", not "abolish" necessarily.

Mr Altus: There was no particular outcome implied from that review.

The CHAIRMAN: Was legal advice obtained which supported that view?

Mr Altus: Yes.

The CHAIRMAN: In any case, some of these taxes were abolished ahead of time or on time. There are intentions to abolish the rest, such as mortgages, hiring duties, credit duties and stamp duty on the non-real value of non-residential real estate in due course.

Mr Altus: Correct.

The CHAIRMAN: That leaves the real property component of non-residential real estate as the stamp duty on which there is no horizon at this stage.

Mr Altus: That is correct.

The CHAIRMAN: I have some more questions. Are there any other members who wish to ask clarifying questions at this point?

Hon MATT BENSON-LIDHOLM: In relation to your last point, you said there was no plan to change the 15 per cent reduction that has already occurred in mortgages. Could you just clarify that last point?

Mr Altus: The last point was referring to a different category of stamp duty whereas the one that you are referring to is another stamp duty that applies not to property but to borrowings that are secured by property. That is a much lower stamp duty rate than the non-residential conveyance duty. Legislation will be introduced to Parliament shortly to halve the stamp duty on mortgages or borrowings secured by property. It is a tiered rate. Those rates will be halved on 1 July this year. The same bill that will be introduced into Parliament will provide for the full abolition, so getting rid, of the other 50 per cent, on 1 July 2008.

Hon MATT BENSON-LIDHOLM: I wish to ask a question relating to comments that the Treasurer has made frequently over the last month or two with respect to a funding shortfall from the feds. He talks about the fact that contributions by way of general taxation revenue, including GST, amount to $28 billion. Am I correct in saying that? His information to Parliament is that we are then in turn in receipt of only $24 billion. Is that a correct statement? If that is correct, where does that funding shortfall stem from? What are we not receiving or where are we indirectly subsidising the rest of Australia to the tune of $4 billion? Can you explain that shortfall to us?

Mr Altus: This is what we commonly refer to as Western Australia's net fiscal subsidy to the commonwealth or to the rest of the federation. The $28 billion is an estimate of the component of commonwealth revenues that is sourced from activity in Western Australia. We have estimated the state of origin, if you like, of all of the commonwealth's revenue streams, particularly including company tax, personal income tax, petroleum resource rent tax etc. The commonwealth does not provide a state-of-origin breakdown of its revenues, but we can use various economic indicators to get that derivation. The $28 billion is what we have estimated to be a share of commonwealth revenues that come from Western Australia. The $24 billion is an estimate of the state of destination, if you like, of all the outlays on commonwealth programs such as social security, defence and telecommunications, and it includes grants to the states as well. All of those programs that are the responsibility of the commonwealth government are on the expenditure side of its budget. We have done the state of origin of the commonwealth's revenues and the state of destination of commonwealth outlays and we have come up with an estimate of a gap, in Western Australia's case, of about $4 billion.

To sum up, the commonwealth government is taking, we estimate, about $4 billion per annum more out of Western Australia than it is putting back in. That figure is in 2004-05 dollar terms. That is the most recent estimate we have been able to do because of data availability. It is a subsidy that has been growing significantly over the past two decades. It reflected the rate of economic development in Western Australia and the growth of the resource sector, particularly the North West Shelf project. We can see quite a close correlation between our subsidy to the federation and the ramping up of LNG production on the North West Shelf. We would expect that to continue to grow. In terms of the major contributors to that subsidy, apart from petroleum-related taxes, which is petroleum resource rent tax from petroleum developments off the Western Australian coast, there are also royalties. There is a royalty sharing in relation to the North West Shelf project. The commonwealth takes royalties from the North West Shelf project. That is part of this net fiscal subsidy calculation. That project is a little different from most of the other petroleum projects off the Western Australian coast in that WA at least gets a share of those royalties, albeit that share is subject to redistribution through the Commonwealth Grants Commission to the other states. Petroleum taxes to the commonwealth and company taxes from business activity in Western Australia are a major contributor to this net fiscal subsidy. If we look at what Western Australia is contributing to the commonwealth's company tax revenue relative to other states, Western Australia provides a much larger component than other states relative to its population share. That is on the revenue side. I might just mention the expenditure side.

Hon MATT BENSON-LIDHOLM: I wanted to tease out one comment you made about company taxes. We are informed through the financial pages of some of the major newspapers that a number of head offices are relocating to Western Australia. Are there any revenue implications for Western Australia from these sorts of moves? You are talking about significant increases in company taxes. In terms of Western Australia's development of funding for the whole federation, are there issues there with respect to the amounts of tax being paid? Is the tax take from Western Australia impacted upon by the decisions of some of these companies to relocate to Western Australia?

Mr Altus: The short answer is no. Our estimate of the state of origin of the commonwealth's company taxes is not based on where the head office of companies is; it is based on where the economic activity is occurring. We actually use ABS statistics, which include a state-by-state breakdown of gross operating surplus.

[10.50 am.]

That is our indicator for splitting company taxes on a state-by-state basis. The ABS estimates of gross operating surplus, which is part of its calculation of economic activity and gross state product in each state, are independent of where company's head offices are located.

The CHAIRMAN: Successive Western Australian governments over recent decades have always complained about vertical fiscal imbalance. Has that problem reduced since the GST arrangements displaced the previous grants?

Mr Altus: No; on the contrary. Vertical fiscal imbalance, as the chairman is probably aware, is a reference to the imbalance between the commonwealth government and the state government's respective revenue raising capacity and their expenditure responsibilities. In the Australian Federation, depending on how the GST is treated, the commonwealth government collects 80 per cent of total tax revenue but is responsible for only 55 per cent of total government outlays Australia-wide. On the other hand, the states and local governments collect only about 20 per cent of tax revenues but are responsible for the other 45 per cent of total government outlays. With the introduction of the GST, the states effectively gave up some of their existing taxes, as we have just discussed, including the financial institutions duty and the debits tax. In return, as replacement revenue, they have received GST revenue grants from the commonwealth government. As we have noted, the GST is very much a commonwealth tax. The states are constitutionally barred from imposing a similar tax. Effectively the payment the states receive from the commonwealth government in GST payments is a commonwealth grant. We have seen a deterioration -

Hon SIMON O'BRIEN: It has deteriorated from our point of view. I refer to the $4 billion disparity between the commonwealth government's tax take from Western Australia of $28 billion and the amount of $24 billion that it expends in Western Australia, which we have just discussed. What is that called, if it is not called vertical fiscal imbalance? What term does Treasury apply to it?

Mr Altus: We apply the term "net fiscal subsidy". It is the disparity between what the commonwealth government takes out of Western Australia through all of its various taxes and other revenue raising measures and what it puts back in through its grants, including GST revenue grants and specific purpose payment grants but also through its direct outlays on social security and defence etc.

The CHAIRMAN: I appreciate that it is an inexact science, but the general trend is probably right. If the cost to the commonwealth government of running an establishment of the defence department - it might be the 1st Armoured Regiment at Puckapunyal - was $1 billion, including the salaries of the soldiers and support staff and all the other expenses and materials such as tanks, petrol and everything else that is needed, and that department was transferred from Puckapunyal to Northam, would that be a net $1 billion addition to our $24 billion total of payments the state receives under the formula that is used?

Mr Altus: I will defer to Alex in relation to the particular methodology of splitting commonwealth government expenditure on a state or destination basis. It is a very approximate methodology.

Mr Scherini: Defence spending of that nature is included in a broader category within the Australian Bureau of Statistics' national accounts data, which is split by state. We just take the numbers that are produced by the ABS. That includes commonwealth employees according to which state they are located.

The CHAIRMAN: For example, the cost of the SAS headquarters at Swanbourne is included in our $24 billion as a net fiscal component from the commonwealth. If further operations of that kind were located in Western Australia, would that increase the $24 billion vis-a-vis the rest?

Mr Altus That is correct.

The CHAIRMAN: For example, when it was decided to relocate half the Navy to Garden Island, Perth, as opposed to Garden Island, Sydney, which must have caused a lot of internal postal problems, would that have been a major commonwealth subsidy to Western Australia in the sense of what we are talking about?

Mr Altus: Subject to when it was picked up in the ABS, it would have reduced the imbalance.

The CHAIRMAN: It would still exist to the tune of $28 billion and $24 billion.

Mr Altus: That is right. In relation to commonwealth outlays generally, Western Australia tends to get less than its fair share, or less than its population share, of programs such as personal benefit payments, whether that be pensions or unemployment benefits, for example. Again, that is a reflection of the current strength and the continuing growing strength of the Western Australian economy within the Australian Federation. Compared with other states, Western Australia has a higher labour force participation rate and low unemployment rates. Therefore, the commonwealth government pays Western Australia a relatively low amount in unemployment benefits. We have identified also that Medicare benefit payments in Western Australia are relatively low compared with other states and with Western Australia's population size. To some extent that might reflect Western Australia's population being slightly younger and healthier than the populations of other states. We think it is also a reflection of the relative shortage of general practitioners in Western Australia, particularly, although not only, in rural and remote areas. Rather than having access to a general practitioner whom then claims against the commonwealth government's Medicare scheme, people in rural and remote areas might go to a public hospital emergency department, which means that the state will wear the cost rather than the commonwealth through Medicare.

Hon MATT BENSON-LIDHOLM: This question may already have been answered. To what extent is the net fiscal subsidy out of Western Australia discretionary? Is it entirely discretionary? Does the federal government factor in the circumstances that you have just mentioned; that is, the uniqueness of Western Australia's economic growth and its population size and age component? What causes this imbalance?

Mr Altus: To a significant extent this imbalance is a reflection of the commonwealth government's uniform national taxation arrangements and its uniform national social welfare programs. A large component of the net fiscal subsidy is almost an automatic outcome of having central government taxes and central government welfare programs. It automatically comes about that a state that performs more strongly economically will contribute more to the commonwealth's company taxes and personal income taxes. If one state has a growing petroleum industry, naturally that state will contribute more to the commonwealth government through petroleum-related taxes. That is not to say that the state is being discriminated against relative to other states, because the commonwealth government would apply exactly the same revenue-raising regime to those activities wherever they occurred. However, we believe that an element of this net fiscal subsidy reflects Western Australia is not getting as good a deal as it is worthy of. This is where the more discretionary programs come into play. Based on feedback that we have collected from other state government agencies, which is reflected in the document that has been tabled with the committee today, we have identified that Western Australia warrants more support from the commonwealth government for the infrastructure that is needed to support resource developments.

[11.00 am]

Examples of that would be infrastructure to support gas processing projects on the Burrup Peninsula and infrastructure to support the development of the Ravensthorpe nickel mine. The state government is putting quite a bit of money in there, whether it is common-user infrastructure, such as water and electricity, which generally comes with a subsidy component - that is not just user-pays - or the soft infrastructure of schools and housing etc. There is a valid argument that because the commonwealth is getting the lion's share of the fiscal dividends in terms of company taxes and the other taxes that these developments are going to produce, maybe it could make a bit more of a contribution to the expenditures that are required to ensure that these projects actually go ahead. That is one example.

There are a number of other examples of commonwealth discretionary programs where we feel that perhaps WA misses out a little bit relative to other states. It is quite likely a reflection of the fact that Western Australia is remote from the central seat of power in Canberra. We do have some unique characteristics in terms of our geography, our resource-based economy and the make-up of our population, including a large indigenous population. These are particular needs in Western Australia that we feel are probably not fully recognised in Canberra in terms of the commonwealth's more discretionary programs. Apart from support for major resource developments, particularly infrastructure support, the commonwealth does have programs that we think are a bit underdone in Western Australia in terms of supporting indigenous communities and in terms of telecommunications expenditure. Telecommunications is primarily a commonwealth government responsibility, yet in Western Australia its investment in infrastructure is perhaps not quite up to speed compared to areas on the eastern seaboard.

In terms of general purpose commonwealth grants for the local government sector, we get only our population share, notwithstanding that it is more expensive for local governments to deliver services in rural and remote regions in particular. There is a theme emerging. We feel that the commonwealth government could be doing more in terms of its own purpose outlays or programs, particularly in relation to rural and remote areas of Western Australia.

Another example which is not in that category might be commonwealth government contributions to sporting infrastructure. There is a valid argument that the commonwealth should help fund facilities that states otherwise provide for national competitions or for international sporting events. That should not just be a state responsibility. The commonwealth seems to have been a lot more generous in providing funding in that area to other states compared to Western Australia. For example, we would not quibble with this but the commonwealth has provided a lot of funding over the past few years for the Sydney Olympics and the Melbourne Commonwealth Games. When we go back to the 1990s, albeit these were smaller events, WA hosted the world swimming events on a couple of occasions and received very little commonwealth support.

Hon MATT BENSON-LIDHOLM: I also wanted to follow up on the stated $700 million shortfall in GST revenue that we are told we are going to lose over the next year or two. Can you explain the nature of that? What is the reasoning behind that? Is that a discretionary decision from Canberra?

Mr Altus: No, I would not put that one in the discretionary expenditure category. That reduction in Western Australia's share of the GST revenue is an outcome of the Commonwealth Grants Commission process, the horizontal fiscal equalisation process. The commonwealth government takes recommendations from the grants commission, which is a semiautonomous body. The commonwealth government does not generally interfere with the calculations and recommendations that are produced by this semiautonomous body called the grants commission. The states do have some say in the methodology that is used by the grants commission in deciding what share of the GST each state will receive. That $700 million reduction is a figure that we have estimated for 2009-10. It is an estimate of the shortfall in Western Australia's GST revenue in that year compared to if we were receiving the same share of the national GST pool as we will be getting in 2006-07. The grants commission will be recommending and the commonwealth government will be accepting a big reduction in our share of GST by 2009-10 compared to our share in 2006-07. That will be an outcome of the fact that Western Australia's own source revenues - our revenues from mining royalties and property taxes, for example - are currently growing very rapidly compared to those of other states.

A key part of the Commonwealth Grants Commission's formula is that states that are able to collect more revenue than other states from their own taxes and royalties over a period of time will be penalised through a reduction in their share of GST. The grants commission process is essentially based on fairness or equity principles. It essentially says that if a state is more well-to-do in terms of revenues from its own sources, it should get a lower share of the GST.

Lags are built into this Commonwealth Grants Commission process. The impact of Western Australia's very strong revenue growth in the last two or three years, particularly in 2005-06, will only be gradually reflected in the grants commission's calculations. Effectively, it will be phased in other a period of up to seven years. By 2009-10, the Western Australian government will be pretty much feeling the full impact of strong economic and revenue growth that is occurring right now because of the lags that are built into the system. Because there are lags, that actually gives us more of a basis on which to project forward what the future impact will be. We have data right now which already provides part of the input into that GST share calculation for 2009-10. There is still a lot of uncertainty about that estimate. It is subject to considerable forecasting error. We have to have regard to not just what is happening in Western Australia in terms of economic and revenue growth, but what is happening in all other states. We have to try to estimate by how much Western Australia is outperforming the other states in order to come up with this projection. It is a pretty reasonable estimate.

The CHAIRMAN: That is a very useful discussion. We have exceeded the time we had allocated by 15 minutes but it was time well invested. On behalf of the committee, I would like to thank our witnesses very much for their assistance today and for the very useful information that they provided by way of discussion, documents and straightforward answers to questions. It is very much appreciated. We will have some further contact between the committee and yourselves on a few follow-up matters. I would like to say thanks again and wish you a good morning.

Mr Altus: Thank you and good luck with your inquiry.

Hearing concluded at 11.09 am