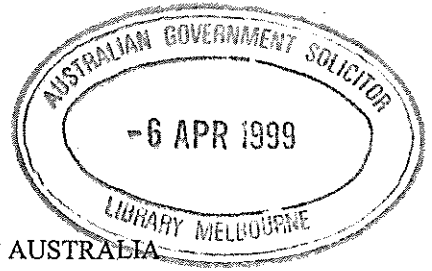


1999



THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

**A NEW TAX SYSTEM (COMMONWEALTH-STATE FINANCIAL ARRANGEMENTS)
BILL 1999**

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon Peter Costello, MP)

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General outline and financial impact

Providing GST revenue to States and Territories

All Goods and Services Tax (GST) revenues will be paid to the States and Territories and, subject to transitional arrangements, distributed in accordance with the principles of horizontal fiscal equalisation.

Date of effect: States and Territories will be entitled to receive GST revenue grants from 1 July 2000.

Proposal announced: Announced by the Government on 13 August 1998, as part of its tax reform package in *Tax Reform: not a new tax, a new tax system: The Howard Government's Plan for a New Tax System*.

Financial impact: The States and Territories are expected to receive GST revenue grants of the order of \$27 billion in 2000-01, \$32 billion in 2001-02 and \$33 billion in 2002-03 on the basis of current estimates.

Compliance Cost impact: No impacts are expected as the amount appropriated to the State and Territory Governments will be freely available for use for any purpose. No Regulation Impact Statement is required.

Changing the GST rate and base

The Bill provides for the GST rate and, in most cases, the GST base not to be altered without the unanimous agreement of the Commonwealth, State and Territory Governments.

Date of effect: This measure will apply after the *A New Tax System (Goods and Services Tax) Act 1999*; the GST imposition Acts; and the *A New Tax System (Goods and Services Tax Administration) Act 1999* have commenced.

Proposal announced: Announced by the Government on 13 August 1998, as part of its tax reform package in *Tax Reform: not a new tax, a new tax system: The Howard Government's Plan for a New Tax System*.

Financial impact: None.

Compliance Cost impact: None. No Regulation Impact Statement required.

Transitional arrangements

The Commonwealth will provide transitional assistance to ensure that State or Territory budgets are no worse off. Transitional arrangements will apply for at least three years and any other years that may be prescribed by regulation.

Date of effect: States and Territories will be entitled to receive transitional assistance from 1 July 2000.

Proposal announced: Announced by the Government on 13 August 1998, as part of its tax reform package in *Tax Reform: not a new tax, a new tax system: The Howard Government's Plan for a New Tax System*.

Financial impact: The amount of transitional assistance which the States and Territories will receive will depend on actual collections of the GST revenue in the transitional years and estimates of a number of aspects of the proposal put to the States and Territories as part of the tax package including estimates of the revenues to be forgone by the States and Territories when a range of inefficient taxes are abolished. These estimates are the subject of negotiations with the States and Territories. (In the Mid Year Economic and Fiscal Outlook it was estimated that the States and Territories would receive transitional assistance of the order of \$0.9 billion in loans in 2000-01 and of the order of \$0.7 billion in grants in the following year.)

Compliance Cost impact: No impacts are expected as the amount appropriated to the State and Territory Governments will be freely available for use for any purpose. No Regulation Impact Statement is required.

Other payments

The States and Territories will continue to receive competition payments and any franchise fees windfall tax reimbursement payments.

Date of effect: States and Territories will be entitled to franchise fees windfall tax reimbursement payments and competition payments under this legislation from 1 July 2000.

Proposal announced: Announced by Government on 13 August 1998, as part of its tax reform package in *Tax Reform: not a new tax, a new tax system: The Howard Government's Plan for a New Tax system*.

Financial impact: Franchise fees windfall tax revenues are difficult to estimate. However, no payments to the States and Territories are expected over the forward estimates period.

Competition payments to the States and Territories are expected to total \$454 million in 2000-01, \$699 million in 2001-02 and \$716 million in 2002-03.

Compliance Cost impact: No impacts are expected as the amount appropriated to the State and Territory Governments will be freely available for use for any purpose. No Regulation Impact Statement is required.

Providing GST revenues to States and Territories

Overview

1.1 All Goods and Services Tax (GST) revenues will be paid to the States and Territories and, subject to transitional arrangements, distributed in accordance with the principles of horizontal fiscal equalisation.

Summary of the legislation

Purpose of the legislation

1.2 To fulfil the Government's commitment to provide all GST revenue to the States and Territories and maintain the principles of horizontal fiscal equalisation.

Date of effect

1.3 States and Territories will be entitled to receive GST revenue grants from 1 July 2000.

Background to the legislation

1.4 The key element of the reform of Commonwealth-State financial arrangements is the replacement of the current system of Financial Assistance Grants from the Commonwealth to the States and Territories with the provision of GST revenues to the States and Territories. Horizontal fiscal equalisation is a longstanding feature of financial relations between the Commonwealth and the States and Territories.

Explanation of the legislation

1.5 *Clause 5* requires the Commissioner of Taxation to make a written determination of the total amount of GST revenue that is collected in each year, inclusive of diesel fuel excise credits and voluntary GST payments by Governments. The Commissioner's determination will comprise actual GST collections to 31 May, estimated collections for the month of June and an adjustment for any difference between estimated and actual collections in a previous year's determination.

1.6 Subject to the transitional arrangements contained in *Schedule 1* of the Bill, *clause 12* provides each State and Territory with an entitlement to GST revenue grants according to the principles of horizontal fiscal equalisation. These principles are currently used to allocate Financial

Assistance Grants between the States and Territories. A State or Territory's *adjusted population* incorporates a relativities factor which reflects its relative fiscal needs as assessed by the Commonwealth Grants Commission. The population of a State or Territory will be determined by the Statistician under *clause 7*. The relativities factor will be determined by the Treasurer under *clause 9* in consultation with the State or Territory. The application of horizontal fiscal equalisation to a combined pool of GST revenue grants and hospital grants (as defined in *clause 6*) is consistent with the terms of the Australian Health Care Agreements between the Commonwealth and the States and Territories.

1.7 *Clauses 16 and 17* provide the Treasurer with the authority to determine the frequency and amount of the payments of GST revenue grants during a year. This will enable the Treasurer to make payments according to a schedule which is agreed between the Commonwealth and the States and Territories.

1.8 *Clause 15(1)* requires the Treasurer to deduct any overpayments from payments to a State or Territory in the following year. *Clause 15(2)* requires the Treasurer to add the amount of any underpayments to payments to a State or Territory in the following year.

Regulation Impact Statement

1.9 No impacts are expected as the amount appropriated to the State and Territory Governments will be freely available for use for any purpose. No Regulation Impact Statement is required.

2

Changing the GST rate and base

Overview

2.1 *Part 2* specifies that the GST rate and base cannot generally be altered unless each State and Territory agrees to the changes. Provisions are made to allow the Commonwealth to make some unilateral changes to the GST base during the first year of operations and to allow changes in the base of an administrative nature to be approved by a majority of the Commonwealth and the States.

Summary of the legislation

Purpose of the legislation

2.2 Consistent with the approach set out in the Government's tax reform package and endorsed in the Agreement on Principles for the Reform of Commonwealth-State Financial Relations negotiated at the 13 November 1998 Special Premiers' Conference, the Bill provides that the rate of the GST and, in most cases, the GST base are not to be changed unless all States, Territories and the Commonwealth agree to the change.

Date of effect

2.3 *Clause 2* of the Bill provides that this Act commences when it has received Royal Assent or after the *A New Tax System (Goods and Services Tax) Act 1999*; the GST imposition Acts; and the *A New Tax System (Goods and Services Tax Administration) Act 1999* have commenced, whichever is later.

Background to the legislation

2.4 These arrangements are designed to 'lock-in' the GST rate and base thereby addressing community concerns that the Commonwealth could increase the GST revenues in the future by unilaterally increasing the GST rate or expanding the tax base. These provisions specify the Commonwealth's intention not to alter the GST rate or, in most cases, the GST base without the unanimous support of all State and Territory Governments.

Explanation of the legislation

2.5 *Sub-clause 10(1)* requires that each State and Territory supports a modification to the GST rate or GST base. It provides that any changes to the base should be consistent with:

- (a) maintaining of the integrity of the GST base; and
- (b) simplicity of administration; and
- (c) minimising compliance costs for taxpayers.

2.6 There are two exceptions to this general principle which are designed to facilitate the efficient administration of the GST:

(a) *sub-clause 10(2)* provides that, prior to 1 July 2001 (the first year of operation of the GST), the Commonwealth can make unilateral changes to the GST base where these changes are of an administrative nature, are necessary to facilitate minor adjustments to the GST and have regard to the need to protect the revenue of the States; and

(b) *sub-clause 10(3)* provides that, after 1 July 2001, changes of an administrative nature to the GST base only need to be approved by a majority of the Commonwealth and the States.

2.7 These arrangements for changing the GST rate and base will also be included in the proposed Intergovernmental Agreement to be signed by the Commonwealth and all State and Territory Governments.

Regulation Impact Statement

2.8 No Regulation Impact Statement is required.

3

Transitional arrangements

Overview

3.1 The transitional arrangements will ensure that no State or Territory budget is worse off as a result of the reforms to Commonwealth-State financial arrangements.

Summary of the legislation

Purpose of the legislation

3.2 To provide a State or Territory with transitional assistance to ensure that its budget is no worse off.

Date of effect

3.3 States and Territories will be entitled to receive transitional assistance from 1 July 2000.

Background to the legislation

3.4 The reform of Commonwealth-State financial arrangements will involve the States and Territories forgoing some existing revenues (such as financial assistance grants and a range of inefficient State taxes) and assuming additional expenditure responsibilities (such as local government, GST administration costs and first home owners schemes). The budget of each State and Territory will also be affected by other measures such as reduced gambling tax revenues and the abolition of wholesale sales tax.

3.5 GST revenues are not expected to fully offset the net budgetary cost of these measures for each State and Territory in the early years. To meet its commitment that no State or Territory budget will be worse off, the Commonwealth will provide a balancing amount of transitional assistance to those States and Territories.

Explanation of the legislation

3.6 The transitional arrangements are set out in *Schedule 1* of the Bill.

3.7 *Clause 1* specifies that the transitional arrangements will apply for at least three years and other years that may be prescribed by regulation.

3.8 *Clause 2* requires the Treasurer to make a written determination of a *guaranteed minimum amount* for each State and Territory by 10 June in each year. The *guaranteed minimum amount* will be the amount of funding that the new arrangements must at least provide to a State or Territory to ensure that its budget is no worse off. The Treasurer must consult with the States and Territories before making this determination.

3.9 In the first three years of the transitional arrangements, GST revenue grants will be distributed in accordance with the principle that no State or Territory budget will be worse off. *Sub clauses 3(3)(a), 4(3)(a), 5(2) and 5(3)* implement this principle by adjusting the distribution of GST revenue grants on the basis of the difference between a State or Territory's *guaranteed minimum amount* and the amount of a GST revenue grant which it would have received under horizontal fiscal equalisation.

3.10 In these years, if a State's entitlement to GST revenue under *clause 12* exceeds the guaranteed minimum amount, that excess is available for redistribution to States or Territories whose GST entitlements is below their guaranteed minimum amount.

3.11 No State or Territory can receive less than its guaranteed minimum amount. In a year in which GST revenue is less than the sum of the *guaranteed minimum amount* of each State and Territory, the adjustments to GST revenue grants under sub clauses *3(3)(a) and 4(3)(a)* will not satisfy this condition. If this circumstance arises, *sub clauses 3(5) and 4(5)* provide a State and Territory with an entitlement to a balancing amount of transitional assistance. In 2000-01, transitional assistance will be provided as an interest free loan to be repaid in 2001-02. Transitional assistance in following years will be provided as a grant.

3.12 *Sub clause 6(1)* may be used to extend the transitional arrangements to beyond three years by prescribed regulation issued under *clause 21 of Part 4* of the Bill. Under *sub clause 6(2)*, in these years the distribution of GST revenue grants will be in accordance with horizontal fiscal equalisation and transitional assistance will be provided as a grant. The need to extend the transition arrangements will be considered by the Commonwealth and the States and Territories in light of up to date estimates of GST revenues and the guaranteed minimum amounts.

3.13 *Clauses 16 and 17* provide the Treasurer with the authority to determine the frequency and amount of the payments of transitional assistance during a year. This will enable the Treasurer to make payments according to a schedule which is agreed between the Commonwealth and the States and Territories.

3.14 *Clause 15(1)* requires the Treasurer to deduct any overpayments from payments to a State or Territory in the following year. *Clause 15(2)* requires the Treasurer to add the amount of any underpayments to payments to a State or Territory in the following year.

Regulation Impact Statement

3.15 No impacts are expected as the assistance to the State and Territory Governments will be freely available for use for any purpose. No Regulation Impact Statement is required.

Other payments

Overview

4.1 The States and Territories will continue to receive competition payments and any franchise fees windfall tax reimbursement payments.

Summary of the legislation

Purpose of the legislation

4.2 To provide a State or Territory with a continuing entitlement to competition payments and franchise fees windfall tax reimbursement payments.

Date of effect

4.3 States and Territories will continue to be entitled to competition payments and franchise fees windfall tax reimbursement payments from 1 July 2000 following the repeal of the existing *States Grants (General Purposes) Act 1994*.

Background to the legislation

4.4 These payments are currently provided to the States and Territories under the *States Grants (General Purposes) Act 1994* which is to be repealed from the date of commencement of this Bill.

4.5 Competition payments are provided to the States and Territories in accordance with the April 1995 Agreement to Implement the National Competition Policy and Related Reforms (the Agreement). Under the Agreement, the States and Territories are scheduled to receive competition payments (1994-95 prices) of \$400 million in 2000-01 and \$600 million in each following year. The Agreement specifies that competition payments be paid quarterly and be distributed on an equal per capita basis. Each State or Territory's competition payments are subject to satisfactory progress with the implementation of the reform conditions in the Agreement.

4.6 The *Franchise Fees Windfall Tax (Collection) Act 1997* was enacted to protect State and Territory budgets from any repayment of revenues which were collected through the past imposition of business franchise fees. This Act is an ongoing part of the safety net arrangements which were established by the Commonwealth following the August 1997 High Court decision which cast into doubt the Constitutional validity of States and Territory business franchise fees.

The Commonwealth has an undertaking to reimburse the States and Territories for any remittances of franchise fees windfall tax.

Explanation of the legislation

4.7 *Clause 14* specifies the maximum amount of a State or Territory's entitlement to competition payments in each year. The base amount of competition payments is indexed on the basis of year average CPI growth to the March quarter (as specified in *clause 8*) and the per capita share of a State or Territory is based on the Statistician's determination of populations as at 31 December. The base amount is also indexed by a factor of 1.5 in 2001-02 to increase the maximum amount of competition payments from \$400 million to \$600 million (1994-95 prices).

4.8 *Clauses 16 and 17* provide the Treasurer with the authority to determine the frequency and amount of the payments during a year. This will enable the Treasurer to make quarterly competition payments in accordance with the Agreement to Implement the National Competition Policy and Related Reforms.

4.9 *Clause 15(1)* requires the Treasurer to deduct any overpayments from payments to a State or Territory in the following year. *Clause 15(2)* requires the Treasurer to add the amount of any underpayments to payments to a State or Territory in the following year.

4.10 *Clause 13* provides a State or Territory with an entitlement to a payment which is equal to the amount of revenue that the Commissioner of Taxation determines to have been collected and remitted to the Commonwealth by a State or Territory under the *Franchise Fees Windfall Tax (Collection) Act 1997*.

Regulation Impact Statement

4.11 No impacts are expected as the amount appropriated to the State and Territory Governments will be freely available for use for any purpose. No Regulation Impact Statement is required.