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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

STATES (TAX SHARING AND HEALTH GRANTS) AMENDMENT BILL (NO 2) 1982

EXPLANATORY MEMORANDUM

(Circulated by Authority of the Treasurer, the Hon John Howard, MP)

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GENERAL OUTLINE AND MAIN PURPOSE OF BILL

The main purpose of this Bill is to amend the States (Tax Sharing and Health Grants) Act 1981 to provide for:

- (a) the implementation of the State tax sharing relativities adopted at the June 1982 Premiers' Conference for the purposes of calculating States' tax sharing grants for the years 1982-83, 1983-84 and 1984-85;
- (b) the phasing in of those relativities over the three years ending 1984-85 at the rate of 33 1/3 per cent each year; and
- (c) a Commonwealth guarantee that the total tax sharing grants payable to each State will not increase by less than two per cent in real terms in 1982-83 and by one per cent in real terms in both 1983-84 and 1984-85.

REVIEW OF RELATIVITIES

The new tax sharing arrangements are the culmination of a process begun in 1978 when the question of the distribution of the States' tax sharing grants was referred to the Commonwealth Grants Commission for inquiry and report. The Commission was required to assess whether any change was

desirable in the per capita relativities between States' grants on the basis of the principle that each State should have the fiscal capacity to provide standard levels of service without imposing taxes and charges significantly different from those imposed by other States.

The Commission's Report on State Tax Sharing Entitlements 1981 was considered at the 20 June 1981 Premiers' Conference. It was decided that there would be no change in the relativities contained in the States (Tax Sharing and Health Grants) Act 1981 at that time in respect of the year 1981-82 and that the Commission should be asked to produce a further report on its assessment of State relativities in the light of submissions to be put to it by States and by the Commonwealth.

The Commission presented its second report on 31 May 1982. In it, the Commission confirmed the view expressed in its 1981 report that a change was desirable in the existing State relativities.

The June 1982 Premiers' Conference adopted the proposal put by the Commonwealth regarding the distribution of tax sharing grants to apply in 1982-83, 1983-84 and 1984-85.

TAX SHARING ARRANGEMENTS

The new tax sharing arrangements involve

- adoption of the Commonwealth Grants Commission's 1982 assessed relativities, but modified to ensure that South Australia's and Tasmania's hospital cost sharing entitlements, that continue for

the next three years, do not adversely affect their tax sharing grants. Clause 7.1 of South Australia's and Tasmania's continuing hospital cost sharing agreements with the Commonwealth states that any above-average per capita hospital cost-sharing grants paid to them are not to be offset by the Commonwealth against general revenue payments to those States.

- . the phasing-in of the new relativities over the three years ending 1984-85 at the rate of 33 1/3 per cent each year.
- . a guarantee that each State's tax sharing grant would increase by at least 2 per cent in real terms in 1982-83 and 1 per cent in real terms in each of 1983-84 and 1984-85.
- . setting aside an amount from the tax sharing pool, totalling about \$149 million in 1982-83, to be used in the first instance to fund the guarantee, with any portion not required for this purpose being distributed among the six States. The \$149 million represents the escalated value of the \$60 million provided by the Commonwealth in 1981-82 (to the three more populous States in recognition of the likelihood that, following the further review, relativities would be adjusted in favour of those three States) plus the escalated value of the net budgetary gains accruing to South Australia and Tasmania from the Commonwealth payments to those two States in return for the transfer of their railways to the Commonwealth in 1975-76.

To give effect to these decisions, the total tax sharing pool in respect of each of the three remaining years of the tax sharing arrangements is to be equal to 20.72 per cent of total Commonwealth tax collections in the relevant previous year and will comprise:

- i) a basic tax sharing pool (equal to 20.323 per cent of total Commonwealth tax collections in the previous year); and
- ii) a supplementary tax sharing pool (equal to 0.397 per cent of such collections).

The distribution of the basic tax sharing pool among the States in each year will be calculated on the basis of the populations of each State at 31 December in the relevant year weighted by the new phased-in per capita relativities adopted at the June 1982 Premiers' Conference.

The distribution of the supplementary tax sharing pool among the States is, in the first instance, designed to fund the guaranteed minimum tax shares, with any portion not required for that purpose being further distributed among the six States on a specified basis. A State that receives a payment as a result of the guarantee is not entitled to receive a total tax sharing grant greater than the guaranteed amount.

NOTES ON CLAUSES

Clause 1 - Short title, etc

Self-explanatory

Clause 2 - Commencement

Self-explanatory

Clause 3 - Insertion of New Section

The purpose of the clause is to move the general definition of the population of a State for the purposes of distributing tax sharing grants among the States (presently in section 10 of the Act) to Part I of the Act.

Clause 4 - Insertion of New Division Heading

The purpose of the heading is to enable a distinction to be drawn between the method of distributing tax sharing grants in 1981-82 (now under Division 1) and that proposed for 1982-83 and subsequent years. See Clause 7.

Clause 5 - Repeal of Sections 9 and 10

The main purpose of the clause is to delete the presently prescribed method for distributing tax sharing grants between the States in 1982-83 and subsequent years.

Clause 6 - Minimum Entitlements

The effect of the clause is to delete the present guarantee that tax sharing grants payable to each State in 1982-83 and subsequent years be no less, in absolute terms, than in the previous year.

Clause 7 - Insertion of new Division

The clause contains the substantive part of the Bill. It sets out the relativities to be applied in each of the years 1982-83 to 1984-85. It also sets out the methods to be used in determining both the total size and the distribution among the States of the tax sharing grants.

Sub-section 11A(1) defines all the terms used in sections 11B and 11C for the distribution of both the basic and the supplementary tax sharing pools.

In particular, the proposed sub-section:

defines the phased-in per capita tax sharing relativities for each State (termed "adjustment factors"). These relativities so defined, along with the relativities which would apply in the absence of this amendment, are set out in Table 1 below.

TABLE 1: PER CAPITA TAX SHARING RELATIVITIES ("adjustment factors")

Relativities

defined in

Section 11A(1)

	NSW	VIC	QLD	SA	WA	TAS
1982-83	1.01960	1.00000	1.43516	1.49634	1.54073	1.87261
1983-84	1.01880	1.00000	1.48508	1.47567	1.45686	1.75931
1984-85	1.018	1.000	1.535	1.455	1.373	1.646
Repealed relativities (all years)	1.02040	1.00000	1.38524	1.51701	1.62458	1.98592

defines the size of the basic tax sharing pool, which excludes the amount set aside for the purpose of funding the guarantee, as 20.323 per cent of total Commonwealth taxation collections in the previous year.

defines the guaranteed minimum tax sharing amount as the amount determined in accordance with the formula OPQ. The effect of this formula is to provide each State with a guaranteed minimum real terms annual increase in its total (ie basic and supplementary) tax sharing grant of two per cent in 1982-83, and one per cent in 1983-84 and 1984-85, on top of the increase in the All Groups Consumer Price Index number for the capital city of that State for the four quarters ending March in the relevant year over the four quarters ending March of the previous year.

defines the size of the supplementary tax sharing pool, being the amount set aside from the total tax sharing pool, as 0.397 per cent of total Commonwealth tax collections in the previous year.

The purpose of section 11B is to prescribe the method for distributing the basic tax sharing pool among the States in 1982-83, 1983-84 and 1984-85. Each State's share so prescribed is calculated in accordance with the formula $AB \div C$, where A is the basic tax sharing pool in a given year, B the adjusted population figure in relation to that year and C the adjusted total population for the year. The application of this formula effectively involves distributing this basic pool among the States in proportion to the populations of each State at 31 December in each year weighted by their new phased-in per capita relativities.

The calculation involved in the distribution of the basic tax sharing pool is set out in Table 2; it can be seen that a State's share is determined by taking its adjusted population figure in row (3) as a proportion of the adjusted six-State total population figure and applying the resultant proportion (row (4)) to the basic tax sharing pool. For example, for NSW, 5434.8 as a proportion of 17849.3 is 30.44804 per cent which when applied to the basic tax sharing pool of \$7623.6 million yields a share of \$2321.2 million.

Section 11C prescribes the method for distributing the supplementary tax sharing pool among the States in 1982-83, 1983-84 and 1984-85. The main points to note are as follows:

- Sub-section 11C(1) specifies the subsequent sub-sections to

apply (11C(3), (4) and (5)) in the distribution of the supplementary tax sharing pool in any year (such as 1982-83) when the supplementary tax sharing pool is sufficient for the purpose of funding the guarantee.

- Sub-section 11C(2) specifies the subsequent sub-section to apply (11C(6)) in the distribution of the supplementary tax sharing pool in any year when the supplementary tax sharing pool is insufficient for the purpose of funding the guarantee.

- The entitlement under sub-section 11C(3), the initial supplementary payment, is calculated in accordance with the formula $XY \div Z$ and represents each State's share of that part of the supplementary pool remaining after removing from that pool the sum total of guaranteed additional amounts. The guaranteed additional amount is derived in Step 1 of Table 3 below while the distribution of the remainder is shown in Step 2 of the same Table. (Note - Each State is entitled to receive the amounts shown in line 7 of Table 3, but not the amounts shown in line 5 of Table 3.)

- The entitlement under sub-section 11C(4) relates to the payments which need to be added to certain States' initial supplementary payments under 11C(3) to ensure that those States receive the guaranteed minimum tax sharing grant. This amount is taken from the guaranteed additional amount set aside in 11C(3) and is shown in Step 3 of Table 3.

- Each State that is not entitled to receive a payment under 11C(4) is entitled to share in the remaining portion of the amount set aside under 11C(3) after entitlements under 11C(4) have been met. This amount is calculated in accordance with the formula $RS \div T$ and is shown as step 4 in Table 3.

- In circumstances where the supplementary tax sharing pool is insufficient for the purpose of funding the guarantee, sub-section 11C(6) makes provision for the payment of supplementary tax sharing grants to each State sufficient to satisfy the guarantee. This provision would involve the Commonwealth contributing an amount in addition to that available from the supplementary pool should the supplementary pool be insufficient for this purpose.

The complex process for distributing the supplementary tax sharing pool in cases where that pool exceeds the total guarantee requirement is made necessary by the need both to ensure that a State which receives a payment as a result of the guarantee receives only so much by way of its total share of the supplementary pool as is necessary to provide a total tax sharing grant equal to the guaranteed minimum amount and to protect a State such as South Australia in 1982-83 which at Step 1 of Table 3 appears to require a guarantee payment but at Step 2 does not need a guarantee payment.

Table 2—Estimates of Basic Tax Sharing Grants to the States in 1982–83

	New South Wales	Victoria	Queens- land	South Australia	Western Australia	Tasmania	Six State Total
(1) Estimated Population at 31 Dec 1982 ('000 persons) (a)	5330.3	4010.6	2457.6	1334.7	1344.5	431.6	14909.3
(2) Per capita relativities	1.01960	1.00000	1.43516	1.49634	1.54072	1.87261	
(3) Row (1) weighted by Row (2)	5434.8	4010.6	3527.0	1997.1	2071.5	808.3	17849.3
(4) Percentage distribution of Row (3) between States (per cent)	30.44804	22.46929	19.75995	11.18869	11.60560	4.52843	100.0
(5) Estimated Distribution of Basic Tax Sharing Grants (\$ million)	2321.2	1713.0	1506.4	853.0	884.8	345.2	7623.6

(a) Projections of resident population at 31 December 1982. Subject to revision.

Table 3—Estimates of Supplementary Tax Sharing Grants to the States in 1982-83

	New South Wales	Victoria	Queens- land	South Australia	Western Australia	Tasmania	Six State Total
Step 1(a)							
(1) Total tax sharing grants in 1981-82 (\$ million)	2034.6	1502.5	1259.7	761.0	809.9	322.0	6689.7
(2) Estimated guaranteed minimum ratio between grants in 1981-82 and 1982-83 (b)	1.12965	1.12965	1.12965	1.12965	1.12965	1.12965	1.12965
(3) Row (1) multiplied by row (2)	2298.4	1697.3	1423.0	859.7	914.9	363.8	7557.1
(4) States' shares of basic tax sharing pool (\$ million)	2321.2	1713.0	1506.4	853.0	884.8	345.2	7623.6
(5) Guaranteed additional amount (= row (3) minus row (4) for those States where row (3) is greater than row (4)) (\$ million)	..	..	..	6.7	30.1	18.6	55.4
Step 2(c)							
(6) Percentage distribution of basic tax sharing pool	30.44804	22.46929	19.75995	11.18869	11.60560	4.52843	100.0
(7) Distribution of supplementary pool <i>excluding</i> sum total of guaranteed additional amounts (\$ million)	28.5	21.0	18.5	10.5	10.8	4.2	93.5
Step 3(d)							
(8) Net guarantee payment (= row (5) minus row (7) for those States where row (5) is greater than row (7)) (\$ million)	..	..	..	..	19.3	14.4	33.7
Step 4(e)							
(9) Percentage distribution between non-guarantee States	36.30560	26.79191	23.56134	13.34115	..	..	100.0
(10) Distribution of difference between total of row (5) and total of row (8) (\$ million)	7.9	5.8	5.1	2.9	..	..	21.7
Step 5(f)							
(11) Distribution of supplementary pool (= row (7) plus row (8) plus row (10)) (\$ million)	36.4	26.8	23.6	13.4	30.1	18.6	148.9

- (a) Guaranteed additional amounts to States are calculated as the amount by which each State's share of the basic tax sharing pool falls short of a grant necessary to provide a specified minimum rate of increase in such grants over that State's total tax sharing grant received in the previous year.
- (b) Based on the two per cent guaranteed minimum real rate of increase in total tax sharing grants for 1982-83. The estimate used of the rate of increase in the CPI for the year ended March 1983 is 10.75 per cent. Subject to revision.
- (c) The residual amount remaining in the supplementary pool, after the total of any guaranteed additional amounts under step 1 is subtracted from that pool, is then distributed between all six States in the same proportion as the States' shares of the basic tax sharing pool in that year (i.e. by using State populations weighted by the per capita relativities specified for that year).
- (d) Net guarantee payments are only provided to those States where the guaranteed additional amounts under step 1 would be greater than their shares under step 2, with such payments being equal to the amount by which those States' shares under step 2 fall short of that guaranteed additional amount.
- (e) The amount by which the sum total of net guarantee payments under step 3 is less than the sum total of guaranteed additional amounts under step 1 is then distributed between those States not in receipt of a net guarantee payment in proportion to the populations of those States only at 31 December each year weighted by the per capita relativities used for distributing the basic tax sharing pool in that year.
- (f) Each State's share of the supplementary pool is then equal to the sum of its share of the residual supplementary pool under step 2 and *either* its net guarantee payment under step 3 *or* its share of the difference between the sum total of guaranteed additional amounts and the sum total of net guarantee payments under step 4.

