

THE HENRY REVIEW OF AUSTRALIA'S FUTURE TAX SYSTEM: **IMPLICATIONS FOR LOCAL GOVERNMENT**

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Preface

One of the most important objectives of the Australian Centre of Excellence for Local Government (ACELG) is to support informed debate on key policy issues. We recognise that many councils and other local government organisations are not always able to undertake sufficient background research to underpin develop sound, evidence-based policy. Local government operates on so many fronts that it is often impossible to keep abreast of all the issues that affect councils and their communities.

ACELG's working paper series aims to help overcome this deficit. ACELG will never be able to provide off-the-shelf solutions to all the issues and problems that might face local government, but we will aim to clear away some of the misconceptions and myths which can arise without research evidence, and offer insights into the ways in which problems can be effectively addressed.

This paper on the findings of the 'Henry' tax review, released in May 2010, takes a medium-long term view of the potential implications for local government. It highlights areas where local government needs to develop soundly-based policy positions, focusing in the first instance on the Tax Forum planned for October 2011. The thrust of the paper is captured neatly in the final paragraph:

... it would be unwise to plan for nothing more than minimal change... The drivers for reform, the vital role local government plays in our society, and the breadth of possible changes, all present opportunities for local government to raise longstanding issues about the adequacy and certainty of its revenue base in a new light, and to seek systemic rather than ad hoc improvements.

ACELG acknowledges the extensive contribution already made by the Australian Local Government Association in responding to the review and analysing its findings. This paper builds on that work. It also provides some commentary on the more recent proposal for a carbon tax.

We regularly seek input from local government practitioners and other stakeholders regarding the list of policy areas that should be researched, and welcome suggestions for future working papers. Please contact our Program Manager Research: stefanie.pillora@acelg.org.au



Graham Sansom
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1. Introduction

The report to the Commonwealth Treasurer on *Australia's Future Tax System* ('Henry Tax Review')¹ was delivered in December 2009. This followed an announcement in the 2008-2009 budget that a comprehensive review would be conducted into the existing tax and transfer system. The findings and recommendations contained in the final report have significant implications for local government. This paper will examine those implications. It is divided into five parts.

This Introduction forms Part One. Part Two sets out the policy context of the review and its recommendations, including local government's financial position. Part Three discusses matters raised in the Henry Tax Review that are most relevant to local government, while Part Four considers some related issues, including constitutional questions and the proposed carbon tax. Part Five identifies those issues which local government might pursue in future discussions and negotiations concerning the review of taxation.

Issues and recommendations canvassed by the Review that are relevant to local government include, amongst other things:

- the need for councils to have sufficient autonomy in setting rates
- integration of rates and land tax
- the distribution of financial assistance grants
- the potential for expanded road user charges
- the problem facing Australians in relation to housing affordability
- the cost of providing aged care in a country with an ageing population
- the longer term financial capacity of the states
- the application of economic rent.

All of these issues are examined in detail in this paper together with suggestions for future action to be undertaken by local government.

As a result of the Review, local government in Australia now has an opportunity to press forward and attend to its concerns about funding and the provision of services to its constituents. Moreover, local government has an ideal opportunity to influence the current and long term debate about the future shape of the Australian taxation and tax transfer system.

The Gillard government proposed that a 'Tax Summit' based on the Review be convened before the end of the 2011 financial year. The Treasurer has since announced that the summit (now termed a Forum) will be held in October 2011. This means that many of the taxation issues previously ruled out of any future debate by the government, or those taxation issues that were not considered to be a high priority, may now become part of the agenda. The analysis of the Review undertaken in this paper covers all relevant issues.

The drivers for the Henry Review included such things as demographic changes within Australia, especially the ageing population; changing revenue bases from income tax to a broader range of taxes; the existence of complicated and numerous taxing regimes spread across the Commonwealth,

¹ Henry et al *Australia's Future Tax System: Report to the Treasurer*, December 2009, Canberra.

States and Territories; international competitiveness; the mobility of capital; climate change; and basic infrastructure and social capital spending. Pressure to reform the tax system to address those challenges will be ongoing.

While many of the Review's recommendations do not specifically relate to local government, over time they could, if implemented, have a profound effect on local government and its role in Australian society. The Government has adopted a cautious approach to the recommendations but ongoing reform seems inevitable, and the Review has laid the seeds for reform well into the future.

It is important, therefore, for local government to develop considered positions on the recommendations contained in the Review. This would include undertaking an ongoing program of familiarisation with the tax issues that may impact on local government, and addressing the ongoing pressure for reform. Local government needs to set its own agenda; make suggestions if appropriate for topics to be discussed at the Tax Summit; and prepare a submission for the Summit once the agenda is finalised, with further input from tax experts if required.

It is strongly suggested that local government revisit its Henry Review submissions and recent Budget submissions. In light of those submissions and the analysis contained in this paper, local government may wish to develop proposals for the Forum that encompass both the specific recommendations of the Review, and the wider issue of a secure revenue base for local government. This could include a possible response to the High Court's decision in *Pape's* case, as discussed below.

2. Context

2.1 Need for tax reform

The Australian tax system has been in a constant process of reform over the last 30 years, driven by the changing nature of the Australian economy and its further opening to global markets. Arguably this ongoing reform has contributed to the resilience of the Australian economy over that period of time, adjusting to changing circumstances and refining or changing policy settings and tax laws that flow from them to strengthen the economy and provide a secure basis for jobs and other benefits for all Australians. Overall, Australia's per capita income has increased and the distribution of income and other rewards has remained equitable.

Over the last decade new challenges have arisen and these require new policies and hence new tax outcomes. Challenges include wider economic shifts such as globalisation. Thus, for example, the re-emergence of Asia as a centre of production and finance and the increasing mobility of capital imply fundamental changes to the tax system to help position Australia to take advantage of those developments and ensure future prosperity.

One of the concerns the Global Financial Crisis highlighted was the high current account deficits being incurred by governments throughout the world and in Australia, and the need for a strong national savings effort. Again, the tax system and tax mix can play a crucial role in encouraging savings.

The tax system must also respond in creative ways to meet community needs and expectations for government services, such as growing demands for child care, health and aged care services, and to encourage business activity. At the same time, tax has an important, if not crucial role to play in addressing environmental issues now and into the future.

The current tax arrangements are unstable and cannot survive in their current form for much longer. A particular concern is how the mix of taxes at all levels of government impinges on economic efficiency. As the Henry Review stated, 'most taxes result in some loss of economic efficiency' because they impact on work and consumption choices.²

Importantly, however, from a local government perspective, a particular study commissioned for the Review found that '[t]he estimated welfare losses of municipal rates and land tax are lower than, or similar to, those of the GST, and a lot lower than for personal tax on labour income and company income tax.'³ In other words, municipal rates and land tax are efficient taxes. Any arguments local government wishes to make about its tax base, namely property rates and possible future in other land taxes, could stress these findings.

By contrast, the Review found state taxes to be among the most inefficient and recommended a number be abolished as part of a move to four efficient tax bases: personal income, business

² *Australia's Future Tax System* Chapter 1: The need for reform

³ *Ibid.*

income, private consumption and economic rent. However, this could reduce the capacity of state governments to support local government.

In total, the Review made 138 recommendations which the federal government released in May 2010. According to various commentators the government adopted up to four of those recommendations, especially a resource rent tax and beginning the process of cutting the company tax rate. At that time, the government also announced that it would look at some of the recommendations during the rest of 2010. However, the federal election in August interrupted that process. The Treasurer said that other matters, 'especially making tax time simpler for everyday Australians, improving incentives to save and improving the governance and transparency of the tax system' would be considered as part of a full second term agenda. Other recommendations were to become part of what the Treasurer, Wayne Swan, called 'a mature tax debate'. He expected them 'to be the subject of much discussion in the coming years.'

2.2 The tax 'summit'

As part of its post-election agreement with the independent members and Greens, the Gillard government agreed to a tax summit by 30 June 2011 to discuss both the Henry Review recommendations and other tax issues.

On 20 March 2011 the Treasurer announced that the summit would be a two-day Forum of 150 invited guests and would be held on 4-5 October 2011.⁴ He ruled out the GST and the Minerals Resource Rent Tax (MRRT) from being on the Forum agenda, and also indicated that by the time of the Summit the government would have settled the design of a 'carbon tax' and would have introduced a Bill into the Parliament. However, the independent MP Tony Windsor has stated that he sees all these matters being discussed.

In addition, there are powerful voices calling for a discussion on the Goods and Services Tax (GST), in particular the removal of the many exemptions such as fresh food and medical services, but also including local government exemptions such as rates. Those voices include some of Australia's leading business figures and economic commentators.⁵ The argument is to extend the base and increase the rate, currently 10%. Although the Government excluded the GST from the ambit of the Henry Review and has ruled out any consideration of it at the Summit, it seems likely that a debate on the GST tax base and rate will need to occur at some stage in the future.

The Forum's agenda and outcomes will be under strict government control. But inevitably holding the Forum means that issues far beyond the government's agenda will be discussed before and after the event itself. This is particularly so given the desire of the independent members and the Greens to have a wide ranging discussion of tax issues, and of the business sector to include the GST, carbon tax and minerals tax in the discussion. It may be appropriate in this 'pressure cooker' tax atmosphere before and after the Forum for local government to raise tax issues of major importance to it and try to have them put on the agenda. One of the aims of this paper is to help contribute to that process.

⁴ Phillip Coorey, 'Tax Forum to follow carbon and mining tax' *Sydney Morning Herald*, 21 March 2011.

⁵ Peter Martin 'Push to have GST on table at tax summit' *Sydney Morning Herald*, 9 September 2010.

2.3 The financial position of local government

Local government is the third sphere of government in Australia. It is democratic and transparent and performs a vital delivery function for many basic services. Most of the services provided are to the local community although roads and road maintenance, for example, also have regional and national significance. Other critical functions include water supply and sewerage (in some states); a wide range of community facilities (swimming pools, libraries, halls, sportsgrounds, children's centres, parks and gardens etc); stormwater drainage; waste management; natural resource management; and emergency and disaster response and relief.

The Australian Local Government Association (ALGA) 2010-11 Budget submission⁶ highlights the crucial role that local government plays in Australian society. It says:

Local government's national significance is underlined by the fact that it employs around 178,000 Australians (almost 10 per cent of the total public sector), owns and manages non-financial assets estimated at \$212 billion (2006-07), raises around 3 per cent of Australia's total taxation revenue per annum⁷ and has an annual expenditure of around \$24 billion (2007-08) (more than 6 per cent of total public sector spending).

This important sector of the economy and society requires an adequate funding base. It also needs to have a sense of the future directions of tax policy in Australia in terms of both possible immediate and long term impacts of tax reform on its operations, and how the sector can enhance its role.

On average 83% of local government funding comes from its own sources. Of this figure, 37% is from property rates, 29% from annual and user charges, 3% from dividends and interest, and 14% from other sources such as fines and infrastructure charges.⁸ This revenue mix is uneven across councils with those in richer urban areas better able to fund their activities from rates and other charges, while small regional and remote councils struggle to do so and as a consequence are more reliant on grants.⁹

Only 17% of total local government funding comes from government grants. Of this amount, 7% is from untied federal Financial Assistance Grants (FAGs) paid through the states and Northern Territory. Tied federal grants paid directly to councils make up 1.5% and the remaining 8.5% is from state and territory grants.¹⁰ Again these are averages and the rich and poor council divide is concealed.

It is only from an ongoing and secure funding base that the priorities of local government and, by extension, state, territory and federal governments can be met. Currently, much of local government is caught in a pincer movement between community needs and expectations on the one hand, and on the other a lack of funding to fully meet those expectations. For example, the 2006 National Financial Sustainability Study of Local Government said that 10-30% of Australia's councils have sustainability issues.¹¹ These less sustainable councils are mostly concentrated in more remote and

⁶ ALGA Budget Submission 2010-11 <http://www.alga.asn.au/policy/finance/BudgetSubs/> p 5, 14 December 2010.

⁷ ABS Cat No. 5506.0 Taxation Revenue series.

⁸ *Australia's Future Tax System Detailed Analysis* - Chapter G: Institutions, governance and administration.

⁹ Productivity Commission *Assessing Local Government Revenue Raising Capacity*, Canberra 2008

¹⁰ *Ibid.*

¹¹ PriceWaterhouseCoopers *National Financial Sustainability Study of Local Government*, 2006 p12

less populous areas. Even after federal and state grants are added to own source income, the funds available to often remain inadequate to address local, regional and national community needs for important infrastructure and services.¹²

Local governments in urban areas are much better placed to fund their activities through their own revenue raising using rates, fees and charges. Indeed, the Productivity Commission indicated that a large number could be self-sustaining by making greater use of their rating (ie taxation) base. It found on average councils raise about 88% of hypothetical benchmark revenues, taking into account community capacity to pay. Although the Commission qualified its remarks by saying this figure should '... not be taken to imply that local governments should increase the revenue they raise', it did go on to observe that '[m]ost councils could do more to help themselves, but a small number will remain highly dependent on grants, despite high levels of revenue-raising effort.'¹³ The Commission also suggested that there is a case to review the current distribution of FAGs, presumably to give more assistance to smaller rural and remote councils.

This may mean that a call for more external funding across the whole of local government, on its own, is likely to be met with a response similar to the exhortation of Jesus: 'Physician, heal thyself.' This is especially so since the Henry Review does offer local government the opportunity to use its rating base more efficiently.

2.4 Taxes or charges?

Councils have only one tax base: rates. However, over several decades the rates component has fallen as a proportion of local government revenue. The Productivity Commission reported a further decline from 1.0% of GDP in 1990/91 to 0.9 percent in 2005/06, and that councils are relying more and more on annual, developer and user charges.

As discussed previously, the Henry Review found rates to be one of the best non-distorting taxes. Although different valuation methods can be and are used, in essence rates are a tax charged on the value of property, with most types of land included in the tax base.¹⁴ The Review confirms that because land is immobile, rates based on land value are an appropriate tax base for local government to fund public goods and services. The Review also accepts that user charges are an appropriate funding mechanism for local government in order to deliver private goods and services.

Local government provides more and more 'private' services such as sporting grounds, aged care facilities, children's centres, swimming pools and the like. The Review argued that drawing a distinction between using rates for public goods and user charges (fees) for cost recovery in the provision of 'private' services takes on more and more importance as extra goods and services are provided. The Review stresses that as long as user fees are set at levels of cost recovery they are appropriate, but that higher charges are in fact a tax and may have distortionary effects. It notes that the same applies to development or infrastructure contributions.¹⁵

¹² Productivity Commission, op cit.

¹³ Ibid.

¹⁴ *Australia's Future Tax System Detailed Analysis - Chapter G: Institutions, governance and administration.*

¹⁵ Ibid.

3. Key issues for local government

The Henry Review examined a broad range of taxation and related issues that are relevant for local government. Several key issues are discussed below. These are:

- the need for councils to have sufficient autonomy in setting rates
- the Review's proposal to integrate rates and land tax
- the distribution of financial assistance grants
- the potential for expanded road user charges
- the problem facing Australians in relation to housing affordability
- the cost of providing aged care in a country with an ageing population
- the longer term financial capacity of the states
- the concept of economic rent.

3.1 Autonomy in setting rates

The Review states in recommendation 120 that States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality.¹⁶ Its reasons for doing so are fairly simple. The Review states that:

If local governments are to be accountable to ratepayers for their expenditures, it follows that they should have full or at least greater autonomy over the setting of the tax rate applied to properties in their jurisdictions.

The logic is sound. The politics are a little more difficult. Nevertheless the recommendation adds further support to local government's campaign for rate setting autonomy and against rate capping and it is recommended that this approach be pursued. It may be that opportunities arise at the tax Forum and in further developments for tax reform emanating from the Review. This recommendation should be used by local government to highlight an issue of vital importance to it.

3.2 Integration of rates and land tax

Recommendation 121 is also of fundamental importance to local government. It suggests that over time State land tax and local government rates should become more integrated. This could be achieved by having an integrated billing method with one bill for both charges or using the same valuation method which would be consistent across the particular state.¹⁷

In relation to this issue, ALGA has noted that the means by which property rates are calculated is different in each state and territory.¹⁸ However, the Review hints at costs savings as its rationale for the need to standardize the valuation methods.

Unless there are genuine policy reasons for doing otherwise and these reasons provide greater benefits than the associated costs, land-based taxes should make use of the same valuation method as this is likely to reduce administration costs. Therefore, as State

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Australian Local Government Association *Taxation Arrangements* <http://www.alga.asn.au/policy/finance/austax/>

governments make more use of the land tax base over the long term (see [Section C2 Land tax and conveyance stamp duty](#)), there should be one valuation method across the State used to calculate the base for both rates and land tax (see Recommendation 121). That is, land valuation would be the same for both taxes. However, local governments could continue to charge a fixed charge to ratepayers and there should not be a low land value threshold for local government rates, as even those who own land with a low per square metre value receive benefits from local government services.

This recommendation also needs to be understood in the context of the Review's recommendation 51 that stamp duties be abolished and the loss of revenue be addressed by increasing and broadening as well as standardising the land tax in each state. This is driven by the reality that stamp duties, while they are big revenue earners for states, are volatile, inefficient and often inequitable taxes, whereas land taxes, properly designed, are more efficient. Land is also immobile, a very important factor in a globalising world with easy mobility for capital and labour – a mobility which makes the Australian tax base less certain and requires a tax orientation to more fixed bases. For these reasons the Review argues that the future Australian tax system should increasingly rely on land values as a tax base.¹⁹

So for local government there is an intersection of the wider land tax debate that Henry raises and the use of rates based on variations of land values to raise revenue. That intersection is highlighted when the Review says:

A redesigned land tax system could be simply administered by aligning local government rates with the land tax. Ideally, landowners should receive just one bill per year covering both and have a single point of contact for enquires, debt management and compliance. **More significant simplification could be achieved if all local government rates had the same base as State land tax.** This would reduce administration and compliance costs for individuals and businesses that pay rates across different councils in the same State and lower the cost of valuation, which is a significant part of the cost of collecting land tax and rates.²⁰ (Emphasis added).

Currently, the valuation base varies and the following table contained in the Henry Tax Review provides a stark reminder of those variations (Table C2-2).

Current valuation methodologies for council rates and land tax

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Council rates	LV	SV, NAV, CIV	UV	Rural: UV Other: GRV	CV, SV, AV	LV, CV, AAV	UCV, AV, ICV	UV
Land tax	LV	SV	UV	UV	SV	LV	Not levied	UV

AV = Annual value, AAV = Assessed Annual Value, LV = Land Value, CV = Capital value, CIV = Capital Improved Value, GRV = Gross Rental Value, NAV = Net Annual Value, SV = Site Value, UCV = Unimproved Capital Value, UV = Unimproved Value, ICV = Improved Capital Value. **Sources:** *Productivity Commission (2008); Mangioni (2006); NSW Treasury (2009).*

¹⁹ *Australia's Future Tax System Detailed Analysis - Chapter G: Institutions, governance and administration.*

²⁰ *Ibid.*

Local government needs to develop a firm position and review any currently existing policies on the standardisation of valuation methods. It should be noted that the Rudd Government, as it then was, specifically rejected a move to a land tax but did not rule out standardising rates across states. However, it is contended in this paper that the overarching drivers of tax reform mentioned above – efficiency and capital mobility, plus demographic changes, will keep or put land taxes and their standardisation across states on the agenda into the future, including at the Tax Forum.

For efficiency and cost saving reasons, the Henry Review also argues for integrated collection of state land tax and council rates, including suggesting one bill and one centre or contact point for both taxes to cover enquiries, administration and compliance.²¹ There is a wider context for this suggestion. The Review sees this tax base integration and sharing of resources as offering the opportunity for a reassignment of tax responsibilities within the federation, as it would be relatively simple to alter the rate of tax charged by each level of government, and hence the revenue each collects, whilst leaving overall revenue from land and property unchanged.²² This offers both opportunities and threats to local government that should be explored – notably the risk that it could undermine the autonomy of councils to set rates at the level considered most appropriate to their communities (thus cutting across recommendation 120).

As an aside, it is relevant to raise in this context the ongoing shift to user charges identified by the Review and to note that this might require other changes on the part of local government. For example, a shift to road user charges imposed and collected by councils could see local government revenues increase, with consequent implications for other sources of funding that would need to be worked through and negotiated.

These issues of tax integration and the related one of realignment are very complex. Again, local government needs to develop a position on land tax and rates integration and sharing that encompasses the wider question of tax responsibility realignment.

3.3 Distribution of financial assistance grants

In discussing Recommendation 121, the Review makes some comments on the concept of a guaranteed minimum financial assistance grant to all councils. The report says:

There seems little reason that local governments with large fiscal capacities should receive a guaranteed minimum grant which allows them to tax their residents less than they otherwise would at the expense of local governments with relatively small fiscal capacities which result in them taxing their residents more than they otherwise would. The current requirement that each council receives 30 per cent of its per capita share of untied financial assistance grants may prevent State grants commissions from redistributing to councils that require greater assistance.

This could be seen as saying that a redistribution of grants from 'well off' councils to less well resourced councils is needed and that the guaranteed minimum grant should be abolished to

²¹ *Australia's Future Tax System* Chapter G: Institutions, governance and administration G3–2 Reform directions for own-source and grant revenue arrangements.

²² *Ibid.*

achieve this. For 'well off' councils the logic is that to cover any shortfall that arises from the removal of an effective subsidy they should increase rates. Given that the Review has put the issue on the agenda, that local government should review its position on guaranteed minimum grants and develop a position that addresses the Review's comments. The following examination may be of assistance in formulating an approach to this important issue.

In discussing the minimum grant principle, the Review argues that since local government delivers by and large state and territory services, it is more appropriate that the states be responsible for ensuring that local governments have access to enough revenue.²³ As the review recognises, this in turn would require states having access to appropriate funding sources and that is part of the drive for the recommendations about land tax. An alternative would be a wider funding base for local government or, more prosaically and realistically, that local government raises its rates and fees and charges as and when it can. As part of its discussion of the principles for distributing untied revenue assistance to local government, the Review makes the point that if the minimum grant principle was removed, the overarching principle for untied assistance could simply be horizontal equalisation within the relevant jurisdiction. The other principles could be considered when determining the distribution needed to achieve horizontal equalisation.²⁴ It should be noted here that horizontal equalisation within the relevant jurisdiction could mean the more 'well off' councils would receive nothing, as previously inferred by the Productivity Commission.

The Review's comments on these issues could assume particular significance in the context of the forthcoming review of financial assistance grants announced in the 2011 federal budget. The budget stated that \$1.2 million will be provided for a review into the equity and efficiency of the total current funding provided by the Australian Government for local government through the Financial Assistance Grants program. The review is expected to be completed in 2012-13.²⁵

As an important corollary, it is in this discussion too that the Henry Tax Review contends that given the expertise that local governments have in the delivery of some goods and services, payments to local government for specific services can represent value for money for higher levels of government. This recognition may be useful in the future in any debate about the value of local government's role in the federal system. However, it might also infer a shift from general purpose to specific purpose assistance.

3.4 Road user charges

Local government owns and maintains about 80 percent of the roads in Australia. The Review's comments and recommendations on road charges are thus of particular importance and may offer a real opportunity for local government to make a claim on additional revenue that would add certainty to the future of road funding across Australia.

The Review made a number of recommendations in relation to road charges. These include a National Road Transport Agreement (NTRA) developed through the Council of Australian Governments (COAG) to establish objectives, outcomes, outputs and incentives to guide

²³ Ibid.

²⁴ Ibid.

²⁵ Australian Government *Budget 2011-12* Budget Paper No.2, Part 2: Expense Measures – Regional Australia, Regional Development and Local Government

governments in the use and supply of road infrastructure.²⁶ Furthermore, the Review recommended that COAG should nominate a single institution to lead road tax reform, and ensure implementation of this agreement. Clearly local government, as both a member of COAG through the ALGA president and owner of the vast majority of Australian roads, has a vital role to play in all aspects of the NTRA, its formulation, application and implementation. It is probable, however, that state governments will argue that the heaviest traffic and congestion occurs in the main on non-council roads and hence the issue is not really one for local government. Local government therefore needs to explore ways to influence the development of the NTRA and the single institution leading road tax reform to ensure that its interests are reflected in the processes, bodies and outcomes.

The Review advocated two main types of road user pays reforms: first, urban congestion charges,²⁷ and second, mass distance location pricing for heavy vehicles.²⁸ Both could have some relevance to local government, even though congestion and heavy vehicle traffic occur principally on state and national roads. For example, in the Review it is envisaged that heavy vehicle charges would be returned to those who own the roads.²⁹ In this case, local councils would be the recipient of some of the revenue raised.

However, the Review warns that even before local government could spend the money there needs to be in place mechanisms to ensure that the user charge actually reflects the marginal social cost of using the roads. For there to be efficient pricing there needs to be comprehensive cost information. Such location-specific information does not currently exist and the Review saw the ascertainment of empirical data to reflect actual costs as fundamental to the imposition of economically efficient charges and the distribution of funds raised.³⁰ A consideration would therefore be whether collecting the data for many roads with only limited heavy vehicle traffic or congestion would be cost effective for local government.

Despite these reservations, ALGA's membership of COAG provides an opportunity to ensure that local councils can have a role to play in determining the user costs on particular roads in their jurisdiction, and to impose appropriate charges. Local government needs to undertake further research to examine its possible role in the administration and collection of any road charges as well as the utilization of revenues raised. Specifically, it will be important for local government to investigate whether the technology currently exists to make collection of charges on local roads a viable option.

As the National Farmers' Federation has noted, congestion taxes could be incorporated under a broader package looking towards regional development and providing an additional incentive to live and work in regional areas that have less congestion.³¹ Such an idea or a variant on it also appears worthy of further exploration by local government.

²⁶ *Australia's Future Tax System* Final Report, Chapter 12 Recommendation 68.

²⁷ *Ibid.* Recommendation 61.

²⁸ *Ibid.* recommendation 62.

²⁹ *Australia's Future Tax System* Final Report Chapter E: Enhancing social and market outcomes E3. Road transport taxes E3–6 Institutions to support efficient use and supply of roads.

³⁰ *Ibid.*

³¹ National Farmers' Federation Henry Taxation Review: analysis and key issues, May 2010.

The then Rudd Government rejected outright the recommendation to impose variable congestion charges on toll roads and other congested roadways. It would be easy to dismiss these recommendations as irrelevant because of that rejection. However, this is not the case. Powerful voices are calling for discussions on road user charges and this is likely to be one of the major issues at the Tax Forum. Given the importance of road funding to local government, it should further pursue the issues of variable congestion taxes and heavy vehicle charges and, if appropriate, seek to bring those issues to the forefront of the agenda in order to promote the possible development, implementation and delivery of any new road user charges in a manner satisfactory to local councils.

3.5 Housing affordability

In a wide ranging discussion of housing affordability, and accepting that taxation is not a major determinant in that regard, the Review stated that as a first step, the Council of Australian Governments should review building and land use policies and infrastructure charges to ensure they do not unnecessarily restrict housing supply.³² Those policies and charges are important to local government and local government needs a strategy for addressing the issues involved.

The Review recognised that Australia faces significant challenges in providing sufficient affordable housing. Apart from taxation, it identified a range of other factors, many of them local government ones, which impact on housing affordability. These include planning and zoning laws; building regulations; environmental regulations; infrastructure provision and pricing; the availability of skilled labour in residential construction; and even transport policy. While acknowledging that there are competing policy objectives in all of these, the Review recommended as follows:

Recommendation 69:

COAG should place priority on a review of institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability.³³

Clearly, this will have implications for local government. In May 2011 the Productivity Commission released a report, commissioned by COAG, on Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments.³⁴ In it the Commission examines the regulatory frameworks of each jurisdiction, the processes for supply of land, the bases for assessing developer contributions, compliance costs for business, and competition issues arising from planning decision-making. Governance of the various planning systems and matters of transparency and accountability are also explored. Key points from the report are presented in Box 1. It is unclear what the process to follow-up the report will involve.

³² *Australia's Future Tax System* Chapter E: Enhancing social and market outcomes E4. Housing affordability

³³ *Ibid.*

³⁴ Productivity Commission *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments*, Canberra, May 2011

Box 1: Productivity Commission Key Points

- Planning systems vary greatly across the states and territories — but all suffer from ‘objectives overload’ which has been increasing.
- The success of local councils in delivering timely, consistent decisions depends on their resources as well as their processes. It is also influenced by the regulatory environment created by state governments — in particular the clarity of strategic city plans, the coherence of planning laws and regulations, and how well these guide the creation of local level plans and the assessment of development applications.
- Significant differences in state and territory planning systems include the degree of integration between planning and infrastructure plans, and how capably the states manage their relationships with and guidance for their local councils.
- Significant differences between jurisdictions are evident for:
 - business costs — such as the median time taken to assess development applications and the extent of developer charges for infrastructure
 - the amount of land released for urban uses
 - the provision made for appeals and alternative assessment mechanisms
 - community involvement in influencing state and city plans, in development assessment and in planning scheme amendments (such as rezoning).
- Competition restrictions in retail markets are evident in all states and territories. They arise: from excessive and complex zoning; through taking inappropriate account of impacts on established businesses when considering new competitor proposals; and by enabling incumbent objectors to delay the operations of new developments.
- Leading practices to improve planning, zoning and assessment include:
 - providing clear guidance and targets in strategic plans while allowing flexibility to adjust to changing circumstances and innovation (so long as good engagement, transparency and probity provisions are in place)
 - strong commitment to engage the community in planning city outcomes
 - broad and simple land use controls to: reduce red tape, enhance competition, help free up urban land for a range of uses and give a greater role to the market in determining what these uses should be rational and transparent rules for charging infrastructure costs to businesses
 - risk-based and electronic development assessment
 - timeframes for referrals, structure planning and rezoning
 - transparency and accountability, including for alternative rezoning and development assessment processes as well as having limited appeal provisions for rezoning decisions
 - limiting anti-competitive objections and appeals, with controls on their abuse
 - collecting and publishing data on land supply, development assessment and appeals.

The Henry Review also considered the relationship between housing affordability and land taxes. While these are state issues, they are relevant to local government, and the Review's comments point to wider thinking in relation to a uniform Commonwealth land tax. As the Review states:

Using the size of holdings and the use of land to determine land tax liabilities has adverse impacts on the housing market. Reforms to levy land tax on all land, based on its value, should reduce these effects.³⁵

Further, the Review found that aggregation approaches to imposing land tax disadvantages, in conjunction with progressive rates, large holders of land and imposes efficiency costs on society as a consequence. The Review also argued that land tax exemptions impose costs that are borne by renters. It suggests broadening land tax to address this. Local government should keep a watching brief on possible land tax changes and developments.

The Review also made recommendations about infrastructure charges, also known as developer charges. Many local governments and some state governments impose such charges. In essence the Review was concerned that the charges went further than recovering infrastructure costs and amounted to taxes, and argued that they were often costly to levy, not transparent and could slow the development processes. The Review also noted that the scope of such charges was expanding. For these reasons it said:

Recommendation 70:

COAG should review infrastructure charges (sometimes called developer charges) to ensure they appropriately price infrastructure provided in housing developments. In particular, the review should establish practical means to ensure that these charges are set appropriately to reflect the avoidable costs of development, necessary steps to improve the transparency of charging and any consequential reductions in regulations.

Local government needs to develop a position on infrastructure charges to put to the COAG review. It should be noted that the COAG meeting of 19-20 April 2010 adopted a housing supply and affordability reform agenda. The agenda included planning and zoning governance reforms and national principles for residential development infrastructure charging.³⁶ The meeting also agreed that the Ministerial Council for Federal Financial Relations and ALGA would look at COAG housing policy work already being conducted to see if that gives the best opportunity for improving housing supply and affordability.

3.6 Aged care

Aged care covers a range of activities, including home and community care, extended aged care and dementia care, for example, as well as accommodation. Specifically ALGA has identified the following services that local government provides, often in partnership with either of the other two levels of government or the private sector:

³⁵ *Australia's Future Tax System* Chapter E: Enhancing social and market outcomes E4–3 The effect of the tax system on housing affordability

³⁶ Craig Johnston *National Urban Policy Shelter* NSW Memo 22 December 2010 p2

- Community centres
- Community transport
- Food services and Meals on Wheels
- Respite care and aged care facilities
- Ageing policies and programs including social inclusion initiatives
- Assistance to the aged through the Home and Community Care program
- Older driver education
- Adaptable housing design
- Community infrastructure that is age-friendly (safe walking paths, recreational facilities, public library services including mobile library services to the home, street lighting, public toilet amenities).³⁷

While the Review deferred to the Productivity Commission Inquiry into aged care, which has just been released, it was mainly concerned with the need 'to align aged care assistance with the principles of user-directed funding to provide assistance in line with recipients' needs, enable their choice of care, and support the fiscal sustainability of the aged care sector.'³⁸ This approach has been reflected in the Productivity Commission draft report on *Caring For Older Australians*, released in January 2011. While it is beyond the scope of this paper to examine in detail the Productivity Commission's proposals, many will impact on local government.

Some of the suggestions for reform in the Commission's Draft Implementation Plan³⁹ in the short term include:

- removing the distinctions between low and high care, and between ordinary and extra-service status
- requiring residential aged care facilities to set accommodation charges consistent with the cost of supply, to disclose the charges and an equivalent accommodation bond (if offered) and remove accommodation bond retention amounts
- introducing an Australian Pensioners Bond
- conducting a public benchmarking study of aged care costs to initially set the scheduled prices, progressively increase the accommodation charge paid by the federal government for supported residents, set regional quotas for supported residents and allow providers to trade those quota obligations.

Longer term suggestions include introducing new co-contribution and stop-loss funding arrangements and an equity release scheme; establishing an Australian Aged Care Regulation Commission (AACRC) and transferring regulatory responsibility to it from the Department of Health and Ageing; setting care prices and the accommodation charge for supported residents based on transparent recommendations from the AACRC; gradually increasing the quantity of residential and community places by 10-20%; and after five years removing supply restrictions in both residential and community care.

³⁷ ALGA *Ageing and our older Australians* <http://www.alga.asn.au/policy/healthAgeing/ageing.php>

³⁸ *Australia's Future Tax System* Chapter F: The transfer system F7–3 Reform directions.

³⁹ Productivity Commission, *Caring For Older Australians*, Draft Report Overview. http://www.pc.gov.au/__data/assets/pdf_file/0005/104882/02-overview.pdf

3.7 Financial capacity of the states

As noted earlier, the Henry Review advocated moving to four robust and efficient tax bases. These included the following forms of taxation:

1. personal income, assessed on a more comprehensive basis
2. business income, with more growth-oriented rates and base
3. private consumption, through broad, simple taxes
4. economic rents from natural resources and land, on a comprehensive basis, noting that revenue from rent taxes will likely be more volatile than from the existing resource royalties it will replace.

As a consequence, the Review argued for the abolition of a raft of inefficient taxes, as follows:

- insurance taxes
- payroll tax
- property transfer taxes
- stamp duties on the purchase of motor vehicles
- resource royalties, replaced by the rent tax
- luxury car tax
- the tax on superannuation contributions in the fund
- income taxes on all government pensions, allowances and benefits
- fuel and vehicle registration taxes, if replaced by more efficient road user charges.

State taxes make up the bulk of those slated for abolition. The process being advocated is one that would further concentrate taxing powers in the hands of the Commonwealth and move away from less efficient state and territory taxes.

Local government needs to be cognisant of this long term vision for taxation in Australia. One consequence may be to shift the locus of vertical fiscal imbalance from Commonwealth and state revenue raising and local government spending, to Commonwealth revenue raising and local government spending. The drivers identified in the Review for centralising tax in four robust bases may well weaken the capacity of the states to assist councils, and at the same time make it even more difficult to argue for decentralisation of revenue powers to local government (putting aside constitutional issues).

State grants make up 8.5% of local government funding.⁴⁰ Any diminution of this amount through abolishing state taxes will require compensatory grants or tax increases elsewhere. The Review said that inefficient state taxes (including the current payroll tax) could be replaced by a low-rate destination cash flow tax, with revenues allocated to fund state services. If that occurs at a rate that both addresses the status quo or even increases funding for local government through state grants, well and good. However, it is often the case that a change of this magnitude would see savings made at higher levels by reducing the funding to the next level or levels.

⁴⁰ *Australia's Future Tax System Detailed Analysis - Chapter G: Institutions, governance and administration*

Local government should thus take note of the potential long term implications of a shift to a more centralized robust Commonwealth tax base and the proposed low-rate destination cash flow tax, recognising the potential need for compensating payments from the Commonwealth to address lost grant funding for local government from the states as a consequence of the abolition of major state taxes. Obviously this is not going to happen overnight but the Review has promoted the issue and it may tax the minds of policy-makers into the future.

3.8 Economic rent

Ideas about the taxation of economic rent have considerable relevance for local government, as taxing the value of land is a good example of such an approach and is the basis of rating in several states. As noted earlier, the Henry Review also advanced arguments for a broader land tax, as well as a resource rent tax. It also suggested cash flow business taxes as a replacement for business income tax, and bequest duties, both of which are arguably further examples of the taxation of economic rents, or in the latter case at least the taxation of unearned gain.

The federal government has since pursued one aspect of economic rent, namely a minerals resource rent tax (MRRT), but to date has rejected both a land tax and a bequest duty, while accepting that some time in the future it may be appropriate to look at a business level expenditure tax or cash flow tax, that is a tax on the economic rents of business.

Economic rent is that return (profit) over and above what is necessary for an activity to take place.⁴¹ For example, what does it take to induce a 'super model' to work? Linda Evangelista once told *Vogue* that 'we don't wake up for less than \$10,000 a day.' While the example is hardly scientific, for the purposes of explanation it is appropriate. If a supermodel were paid anything more than that, and they are, it is economic rent. So a Government could tax almost all of that excess without affecting a supermodel's decisions to work or not work. They would still go to work even if the economic rent tax reduced the return to just \$10,000 a day.

The following comment from Robin Broadway and Michael Keen is another good description of economic rent, and an argument in favour of taxing it.

Economic rent is the amount by which the payment received in return for some action – bringing to market a barrel of oil, for instance – exceeds the minimum required for it to be undertaken. The attraction of such rents for tax design is clear: they can be taxed at up to (just less than) 100 percent without causing any change of behaviour, providing the economist's ideal of a non-distorting tax.⁴²

The Henry Review echoes this and applies the general logic of economic rent to the specifics of minerals. The following passage provides an excellent explanation.

The finite supply of non-renewable resources allows their owners to earn above-normal profits (economic rents) from exploitation. Rents exist where the proceeds from the sale of

⁴¹ W.H. Wessel 'A note on economic rent', *American Economic Review* 57(4) pp873- 885, 1967

⁴² Robin Broadway and Michael Keen, 'Theoretical Perspectives on Resource Design' in Philip Dean, Michael Broadway and Charles McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (2010) p9

resources exceed the cost of exploration and extraction, including a required rate of return to compensate factors of production (labour and capital). In most other sectors of the economy, the existence of economic rents would attract new firms, increasing supply and decreasing prices and reducing the value of the rent. However, economic rents can persist in the resource sector because of the finite supply of non-renewable resources. These rents are referred to as resource rent.⁴³

However, as the Review recognises, it is not just the minerals sector which profits from economic rents. There appears no reason in logic to limit the economic rent analysis to resources since the overriding consideration is above-normal profits. As Professors Garnaut and Clunies Ross put it, the term 'rent' can be applied to any profits of any kind of enterprise that exceed those the investor would have required to invest in the enterprise.⁴⁴ For resources, the reason for that above normal rate of return is, according to the Henry Review, the finite supply of non-renewable resources. Yet monopoly or oligopoly can create the same above average rates of return⁴⁵ and arguably should be taxed in a similar fashion. Indeed, these conditions might actually reflect something even deeper: arguably economic rent arises not from monopoly per se but from monopolised property relations, that is, private property. Exclusive property rights are the ultimate legal expression of monopoly either expressly, through for example ownership of a particular property, or indirectly through the lack of competition elevating the particular property rights to a level of exclusivity or near exclusivity for as long as the monopoly exists. Thus Henry's proposal to tax land rent is based on the idea that luck or position increases the unimproved value of land.

The taxation of land is the taxation of rent because rent is the increment of market gain that accrues to choice land parcels. As mentioned previously the Review proposed a land tax⁴⁶ as part of its vision for the taxation of economic rent, in conjunction with a raft of other taxes mainly on economic rent. This would be levied by the Commonwealth but with an appropriate negotiated sharing of revenue and risk between the Commonwealth and states. It sees the unimproved capital value of land as the surplus over and above the costs of production and adequate returns on them.

For that reason the Review proposed the following:

[A] land tax applying to all land regardless of use. The rate scale would be based on the value per square metre of land. A unit value threshold would effectively exempt most land in agricultural use. Most residential land could be subject to tax of about 1 per cent. A higher rate may apply to the highest value land (per square metre). Land tax revenue would also replace stamp duties on land transfers.

As discussed earlier, the implementation arrangements for such a tax would necessarily involve a major role for local government.

⁴³ *Australia's Future Tax System Detailed Analysis Chapter C: Land and resources taxes C1. Charging for non-renewable resources C1–1 The community's return from the exploitation of its resources.*

⁴⁴ Ross Garnaut and Anthony Clunies Ross *Taxation of Mineral Rents* (1983) p33

⁴⁵ This is at the expense of other business since what is happening is actually a reallocation of value from all sectors of capital to the monopoly and/or resource sectors.

⁴⁶ *Australia's Future Tax System Chapter C: Land and resources taxes C2. Land tax and conveyance stamp duty C2–1 Land is (potentially) an efficient tax base*

The issues facing Australian society mean that an extension of current and proposed taxes on economic rents cannot be dismissed. Indeed, as mentioned previously, the Henry Review and Garnaut and Clunies Ross recognise that, theoretically, there is no reason for limiting the taxation of economic rent to specific examples like resources. This underlying systemic pressure to move to the taxation of economic rent will not go away. Given the importance of economic rent to the Henry Review's vision, it is proposed that issues relating to the taxation of economic rent and its implications should form part of a broader awareness-raising program on local government and taxation.

4. Related issues

4.1 Constitutional recognition

Constitutional issues could arise in relation to a number of the proposals canvassed in the Review, and local government's current legal position as wholly a 'creature of the states' could become a significant factor in its capacity to negotiate advantageous changes to the tax system – or to minimize adverse impacts of other changes.

Local government has long argued for constitutional recognition. This recognition can be symbolic, for example being mentioned in the preamble to the Constitution, and/or purposive, for example defining concrete roles and functions for local government. Given the history of conservatism displayed by the Australian population, having passed only 8 out of 44 proposed constitutional referenda, neither is likely. Indeed Brown⁴⁷ argues that any proposals similar to those relating to local government in 1974 or 1988 would almost certainly be destined to fail. The proposal in 1974 was a substantive one to give the Commonwealth the explicit power to make grants to local government. The proposal in 1988 was largely symbolic. However, in both cases the Opposition Party of the time opposed the proposals and they were, as a result, comprehensively rejected.

The current federal government is committed to pursuing a further referendum, and ALGA put forward proposals in its 2010-11 Budget submission for federal funding of the 'yes and no' cases and education programs to help inform the population more fully about the Constitution and changing it. Subsequently, ALGA received substantial federal funding to develop its case. Thus a real opportunity exists to bring forward debate about the role of local government and strengthen its position. The question remains, however, whether an attempt in effect to re-run either the 1974 or 1988 question will prove to be tilting at windmills.

A new factor in the debate is the recent High Court of Australia decision in the case of *Pape v Commissioner of Taxation* [2009] HCA 23, which has thrown in doubt the constitutional validity of some Commonwealth funding to local government.⁴⁸ As Professor Williams noted in advice to ALGA: '...local government programs affected by *Pape v Commissioner of Taxation* are those that involve direct funding to local government by the Commonwealth.'⁴⁹ He further said that: '[f]unding provided to local government through Specific Purpose Payments made first to State governments and then distributed to individual local government bodies on the basis of an agreed allocation; for example, Financial Assistance Grants to Local Government, Roads Safety Black Spots payments and grants under the Natural Disaster Mitigation Program, are unaffected.'

In relation to specific programs, Professor Williams concluded that '[a]s currently constituted, the Nation Building Roads to Recovery Program as set out in the *Nation Building Program (National Land Transport) Act 2009* (Cth) is likely to be invalid, and payments made under the Program illegal and

⁴⁷ AJ Brown, 'In Pursuit of the 'Genuine Partnership' (2008) 31(2) *UNSW Law Journal* 435, 436.

⁴⁸ George Williams 'High Court casts shadow on Canberra's lofty vision', *Sydney Morning Herald*, 9 July 2009.

⁴⁹ George Williams *Advice Re Pape v Commissioner of Taxation and Direct Federal Funding of Local Government*, Sydney, 2009 http://www.councilreferendum.com.au/site/misc/alga/downloads/PAPE/ALGA_Advice_GeorgeWilliams_130809.doc

thus liable to be repaid.⁵⁰ He came to the same conclusion about the Community Infrastructure Program, now that the Global Financial Crisis cannot be used to justify it under the executive power contained in section 61 of the Constitution. To address this situation, Professor Williams recommended both the use of specific purpose payments under section 96 via the States and the pursuit of an amendment to section 96 to allow direct grants from the Commonwealth to local government. However, this latter suggestion can be seen as 1974 re-visited, and the time and effort involved might be more usefully spent in other pursuits.

While much has been written about the *Pape* case, including its impact on local government, it would seem that any problem, as Professor Williams noted, can be overcome relatively simply through the use of greater indirect grants, including the existing Financial Assistance Grants arrangements that already account for the overwhelming majority of federal payments to councils. It is also highly unlikely that past payments which might theoretically be challengeable will in fact be challenged, but in any event legislative and political mechanisms could probably be developed to validate those payments retrospectively. Indeed, on current indications the federal government plans to continue as before with programs such as Roads to Recovery and evidently does not anticipate further legal challenges in the near term.

This does leave open, however, the question of whether a more substantial form of recognition should be pursued that would, amongst other things, place local government in a stronger position when negotiating matters such as taxation reform. This clearly warrants further consideration.

4.2 Goods and Services Tax

The federal government explicitly excluded the GST from the Review's terms of reference. GST is, however, one of the four pillars of tax reform identified in the Review. Broadening the base and rate of the GST is on the agenda of powerful forces in Australia, especially if it results in income tax rates being reduced for business and individuals. Broadening the GST base will impact on local government especially if rates are subject to GST.

4.3 Fringe benefits tax

Local government should also note that the Review recommended that employees be taxed on readily valued fringe benefits.⁵¹ This will if adopted have implications for the structuring of salary packages for senior local government staff and hence the goal of developing a high quality local government workforce. The recommendation may also present the opportunity to raise the differences in the current tax treatment of fringe benefits for not-for profit organisations and local government.

4.4 A carbon tax

The Henry Review recognised that 'changes to tax policy are required as part of the concerted response to help mitigate emerging environmental pressures.'⁵² At the time of the Review the then Rudd Government was firmly committed to a Carbon Pollution Reduction Scheme (CPRS). However, five months after the Review's report had been delivered to the federal government, the

⁵⁰ Ibid

⁵¹ *Australia's Future Tax System* Recommendation 9

⁵² *Australia's Future Tax System* p3

government decided in April 2010 to postpone implementing the CPRS until 2013. Then, after the August federal election, the new Gillard government joined with the Greens in February 2011 to announce 'an agreed pathway towards a carbon price that should commence on July 1, 2012.'⁵³ The proposal is short on detail but the government's climate change adviser, Professor Ross Garnaut, has indicated that a carbon price of \$20 to \$30 per tonne would be appropriate.⁵⁴

A carbon tax will impact on local government. It will be discussed intensely over the next few months and in all likelihood at the Tax Forum in October. Local government needs to analyse the proposal for a carbon tax and emission trading scheme in order to influence those debates, policy design and the proposed compensation package in order to deliver the best outcome for its constituents. As a corollary, the ongoing debate about the environment and climate change may, after further work, present possibilities for local government to work with federal and state governments to develop plans for large scale renewable energy projects, particularly in regional and remote areas. The International Energy Agency has stated that:

Local governments have the power to influence the energy choices of their citizens. Many cities and towns have already encouraged energy efficiency measures. Even so, as demand for energy services continues to grow, the energy infrastructure that every city and town depends on will need to be expanded, upgraded or replaced. This provides the opportunity to increase the deployment of renewable energy technologies and decentralised energy systems, and hence gain the multi-benefits of increased energy security, climate change mitigation and sustainable development, but also the social benefits of reduced air pollution, such as improved health and employment.⁵⁵

As the federal resources minister has said: 'Australia has one of the best renewable energy resource bases in the world.'⁵⁶ There are already moves underway for local government to take the lead on renewable energy, with for example, the South Australian Renewable Energy Pilot Program launched last year.⁵⁷ The task may be to shift the focus from action by 'well off' councils in the inner and central business districts of major cities to regional and rural councils with cheaper land and large areas suitable for large-scale solar and wind energy developments. Local government could investigate ways for this to occur in the context of a federal government committed to addressing climate change through a range of funding and revenue measures such as its support for renewable energy opportunities and a carbon tax.

The level of the carbon tax, the amount of revenue to be raised and the ultimate beneficiaries of that revenue in the form of compensation and funding, are yet to be announced, although the

⁵³ Senator Bob Brown *Carbon price agreement: The transformation to clean energy can start now* <http://bob-brown.greensmps.org.au/content/media-release/carbon-price-agreement-transformation-clean-energy-can-start-now>

⁵⁴ Lenore Taylor 'Garnaut calls for carbon tax up to \$30 a tonne' *Sydney Morning Herald* 17 March 2011.

⁵⁵ International Energy Agency *Cities, Towns and Renewable Energy: Yes in my front yard* (2009) http://www.iea.org/publications/free_new_Desc.asp?PUBS_ID=2183

⁵⁶ Campaign Media Release *Gillard Labor Government supports renewable energy opportunities in South West Victoria* <http://www.martinferguson.com.au/page15039/Gillard-Govt-Supports-Renewable.aspx>

⁵⁷ Local Government Association of South Australia *Renewable Energy Pilot Program (Solar Councils)*, Update - Circular 36.8, 9 September 2010. <http://www.lga.sa.gov.au/site/page.cfm?c=21473>

responsible minister has indicated that 50% of revenues will be used to compensate households.⁵⁸ What will be done with the other 50% of the tax? Local government may like to consider, if it is not already doing so, what role and position it should take in relation to that as yet unallocated 50%, recognising of course that in practice a large proportion will go as compensation to various industries.

While it is unlikely the carbon tax will be a substantial item on the agenda for the upcoming Tax Forum because its broad design will have been settled beforehand and legislation is likely to have been introduced into Parliament, details of the design and the compensation package for business, consumers, workers, and local government, will undoubtedly continue to be of vital concern and discussion. One of the independent members of the House of Representatives and chair of the Multi-Party Climate Change Committee, Tony Windsor, has indicated he wants the carbon tax and the MRRT to be discussed at the Forum.⁵⁹

It should be noted that the government's agreement with the Greens envisages a carbon tax between 2012 and 2015, with a move after that to an emissions trading scheme. However, the carbon tax will continue after 2015 if there is no international system for carbon permit trading in place by then, and will stay in place until other countries have adopted emissions trading.

The introduction of a carbon tax will directly impact local government through higher energy costs, and the question will be whether and how the Commonwealth will compensate councils and their ratepayers for those costs. Will councils be expected to set an example by cutting energy usage?

Further details on a carbon tax and emissions trading scheme are contained in Box 2.

⁵⁸ Anna Caldwell 'Greg Combet says half of carbon tax revenue will go back to households' *The Courier-Mail* April 13, 2011 <http://www.couriermail.com.au/news/greg-combet-says-half-of-carbon-tax-revenue-will-go-back-to-households/story-e6freon6-1226038541501>

⁵⁹ Phillip Coorey 'Tax Forum to follow carbon and mining tax' *Sydney Morning Herald* 21 March 2011.

Box 2

What is a carbon tax?

A carbon tax imposes a price on the carbon content of fuels. The US Carbon Tax Center describes it as follows:

A carbon tax is a tax on the carbon content of fuels — effectively a tax on the carbon dioxide emissions from burning fossil fuels. Thus, carbon tax is shorthand for carbon dioxide tax or CO₂ tax.

Carbon and hydrogen atoms are present in every fossil fuel — coal, oil and gas. The bond between carbon and hydrogen atoms is the primary source of energy from fossil fuels and of the heat released in fuel combustion. Essentially all carbon atoms are converted to CO₂ when the fuel is burned. Carbon dioxide, an otherwise non-lethal and innocuous gas, rises in the atmosphere and remains resident there, trapping heat re-radiated from Earth's surface and causing global warming and other harmful climate change. In contrast, non-combustion energy sources — wind, sunlight, falling water, atomic fission — do not convert carbon to carbon dioxide. Accordingly, a carbon tax (or CO₂ tax) is effectively a tax on the use of fossil fuels, and only fossil fuels.

The carbon content of every form of fossil fuel, from anthracite to lignite coal, from residual oil to natural gas, is precisely known. So is the amount of CO₂ released into the atmosphere when the fuel is burned. A carbon tax thus presents few if any problems of documentation or measurement. As discussed, administering a carbon tax should be simple; utilizing existing tax collection mechanisms, the tax would be paid far “upstream,” i.e., at the point where fuels are extracted from the Earth and put into the stream of commerce, or imported into the U.S. Fuel suppliers and processors would pass along the cost of the tax to the extent that market conditions allow.

Per unit of energy (or Btu), natural gas emits the least CO₂ of any fossil fuel when burned, and coal the most, with petroleum (oil) products such as gasoline occupying the middle range. Generally, a Btu from coal produces 30% more carbon dioxide than a Btu from oil, and 80% more than from natural gas. A carbon tax would obey these proportions, taxing coal somewhat more heavily than petroleum products, and much more than natural gas.

What is an emissions trading scheme?

The NSW Department of Energy, Climate Change and Water describes an Emissions Trading Scheme as follows:

Emissions trading is a market-based scheme for environmental improvement that allows parties to buy and sell permits for emissions or credits for reductions in emissions of certain pollutants. Emissions trading allows established emission goals to be met in the most cost-effective way by letting the market determine the lowest-cost pollution abatement opportunities. Under such a scheme, the environmental regulator first determines total acceptable emissions and then divides this total into tradeable units (often called credits or permits). These units are then allocated to scheme participants. Participants that emit pollutants must obtain sufficient tradeable units to compensate for their emissions. Those that reduce emissions may have surplus units that they can sell to others that find emission reduction more expensive or difficult. In suitable cases, trading schemes offer significant advantages over other regulatory approaches, both in certainty of environmental outcome and the potential to minimise overall compliance cost.

5. Conclusion

The basic approach of the Henry Tax Review was to move from a multitude of taxes to four robust and efficient tax bases: namely a more comprehensive personal income base; a business income base with more growth-oriented rates; a broad-based and simple private consumption tax (the GST); and taxing economic rents from natural resources and land, on comprehensive basis.

This paper has identified those recommendations of the Review that directly involve local government, other aspects of the Review that raise issues for local government, and a number of related matters that local government needs to consider. The two most significant recommendations to which local government needs to respond are that:

- States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality
- There should be greater integration of state land taxes and local government rates, over time.

Other important issues that require further consideration by local government include:

- Questions raised by the Review concerning the appropriateness of guaranteed minimum financial assistance grants
- The implications of the Review's proposals for the future tax base and financial capacity of the states, and hence their ongoing ability to provide financial support to local government
- The proposed expansion of road user charges which could be imposed and collected in part by local government
- The identified need for further measures to address the problem of housing affordability, potentially impacting on local government's ability to levy infrastructure charges (already being restricted in several states) – a matter since investigated to some extent by the Productivity Commission
- Funding of aged care, also being followed up by the Productivity Commission
- Possible changes to the GST and FBT
- The implications of moves to tax economic rent more widely.

In addition, the government's proposed carbon tax will impose increased costs on local government that councils may or may not be able to recoup. On the other hand, a carbon tax could also create opportunities for local governments to play an important role in promoting alternative energy technologies and new industries of benefit to their areas.

The underlying drivers of tax reform: demographic changes; increasing demand for public goods and government service provision, especially in health care and ageing; wider economic challenges such as globalisation, technological change and the increasing mobility of capital; and the re-emergence of Asia as a centre of production and finance; are not going to disappear overnight. They mean that fundamental changes to the tax system must be considered in order for Australia to take advantage of new opportunities and prosper. No matter what the federal government does or does not do in the short term, pressures for fundamental tax reform will remain. The government's decision to hold

a Tax Forum in October this year supports this view and opens up all the recommendations of the Henry Review for further examination, as well perhaps as the GST, which the government wants to exclude, but is under pressure to discuss.

It is therefore vitally important that local government develops and promotes clear positions on the key issues raised in this paper. Its arguments need to be soundly evidence-based, and need to reflect a longer term view that appreciates the desirability of change and the opportunities that fresh approaches to taxation might offer – as well, of course, as the potential drawbacks of adverse change and disruption to an existing system of rates and charges that generally works quite well and could be enhanced. It is particularly important in that regard that the Henry Review acknowledged the economic efficiency of property rates as a tax, and the effectiveness of local government in service delivery.

Nevertheless, it would be unwise to plan for nothing more than minimal change. These are exciting times for tax reform in Australia. The drivers for reform, the vital role local government plays in our society, and the breadth of possible changes, all present opportunities for local government to raise longstanding issues about the adequacy and certainty of its revenue base in a new light, and to seek systemic rather than ad hoc improvements.

ABOUT ACELG

ACELG is a unique consortium of universities and professional bodies that have a strong commitment to the advancement of local government. The consortium is led by the University of Technology Sydney's Centre for Local Government, and includes the University of Canberra, the Australia and New Zealand School of Government, Local Government Managers Australia and the Institute of Public Works Engineering Australia. In addition, the Centre works with program partners to provide support in specialist areas and extend the Centre's national reach. These include Charles Darwin University and Edith Cowan University.

PROGRAM DELIVERY

ACELG's activities are grouped into six program areas:

- Research and Policy Foresight
- Innovation and Best Practice
- Governance and Strategic Leadership
- Organisation Capacity Building
- Rural-Remote and Indigenous Local Government
- Workforce Development.

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