

COMMONWEALTH GRANTS COMMISSION (CGC) 2010 REVIEW

COMMISSION POSITION PAPER CGC 2008/05

PAYROLL TAX

NEW SOUTH WALES TREASURY COMMENTS

FEBRUARY 2009

New South Wales generally agrees that a payroll tax assessment based on the 2004 Review approach is preferable to a more complicated method of applying weights to compensation of employee data by industry.

However, New South Wales has two specific concerns with the proposed assessment.

- State compensation of employee data includes employer payments in respect of workers' compensation insurance premiums, which will be affected by State policies on workers' compensation premiums. This could account for the varying "match" across the States of adjusted compensation of employees data used as the payroll tax base and the wages and salaries/gross earnings data that are used to calculate the taxable proportion of compensation of employees.
- The threshold adjustment uses ABS data on wages of employers exempt from payroll tax and the tax-free element of taxable payrolls of employers that do pay payroll tax. That data may not reflect State policies of grouping associated employers for payroll tax purposes.

Additionally, developments in State payroll tax policies over the last decade have led to a wide divergence in the level of the tax free threshold between the States, from a low of \$550,000 to a high of \$1.5 million.

Rather than a "standard" policy, the threshold could now be simply an element of payroll tax policy which, like the rate of tax, varies markedly between the States and which, like the rate of tax, should be "averaged" across the States in the ratio of total payroll tax revenue to the total payroll tax base.

Recognising the threshold as non-standard policy would further simplify the payroll tax assessment, avoid the need for continual adjustment of the threshold to reflect changing State policies, and avoid the need for customised ABS data which may suffer from problems of data comparability and sample error across the States.

Background

New South Wales Treasury considers that in assessing States' capacity to raise revenue from payroll tax the aim should be to measure a revenue base for each State that reflects the non-policy influenced size of the payrolls that could be subject to payroll tax in each State.

Applying "average" policy expressed as an average tax rate to non-policy influenced revenue bases then produces assessed payroll tax revenue for each State.

In response to largely negative State views on earlier Commission staff proposals for a new payroll tax assessment method, the Commission is proposing to continue the 2004 Review assessment method for the 2010 Review, with three changes:

- removing the adjustment for the agriculture, forestry and fisheries industry
- increasing the "average" tax-free threshold, on a compensation of employees basis, from \$650,000 to \$700,000 and
- updating the "average" tax-free threshold every year in line with States actual tax-free thresholds.

The 2004 Review method

The 2004 Review method estimates State revenue bases as follows.

- (1) The starting point is total compensation of employees contained in the State Accounts (published by the ABS), excluding defence forces' and Australian employees' of Australian diplomatic missions overseas compensation, which are not subject to payroll tax
- (2) The agriculture, forestry and fishing sector is also removed from total compensation of employees at this stage (and added back later) "to better match the compensation of employees data to the coverage of the private sector wages data used to calculate the taxable proportions"¹ of compensation of employees.
- (3) The taxable proportion of compensation of employees data is then calculated using a taxable proportion ratio derived from data on private sector wages and salaries and public sector gross earnings. This taxable proportion essentially adjusts for general government sector employment and for an "average" tax-free threshold.
- (4) The average Australian tax "rate" – derived as total Australian payroll tax revenue as a percentage of the total Australian payroll tax base – is then applied to States' assessed payroll tax bases to derive assessed payroll tax revenue for each State.

¹ Commonwealth Grants Commission (CGC), 2008 Update Report Working Papers, Volume 2, *Payroll Tax*, para. 31.

The agriculture, forestry and fisheries adjustment

NSW Treasury notes that the taxable part of one “payroll” measure – compensation of employees – is calculated using taxable percentages derived from a combination of two other “payroll” measures – private sector wages and salaries and public sector gross earnings (hereafter shortened to wages and salaries).

As shown in a comparison of lines 3 and 7 in Table 1, based on 2006-07 data contained in the CGC’s Payroll Tax working paper from the 2008 Update, removing agriculture, forestry and fishing from the compensation of employees improved the match between compensation of employees data on the one hand and wages and salaries data on the other.

Table 1: Matching measures of “payroll”: 2006-07

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	TOTAL
(1) Compensation of employees (\$ m) ^(a)	171,696	123,389	91,764	50,469	32,317	8,891	12,593	4,746	495,864
(2) Wages and salaries (\$ m)	139,471	100,650	77,237	41,434	26,689	7,462	10,112	4,121	407,177
(3): (1) / (2)	1.231	1.226	1.188	1.218	1.211	1.192	1.245	1.152	1.218
(4) Variation of State values for (3) from Australian total value (%)	1.1	0.7	-2.4	0.0	-0.6	-2.2	2.3	-5.4	
(5) Compensation of employees: agriculture, forestry and fishing (\$ m)	1,618	1,020	1,557	873	510	203	4	72	5,857
(6) Compensation of employees excluding agriculture, forestry and fishing (\$ m)	170,078	122,369	90,207	49,596	31,807	8,688	12,589	4,674	490,007
(7): (6) / (2)	1.219	1.216	1.168	1.197	1.192	1.164	1.245	1.134	1.203
(8): Variation of State values for (7) from Australian total value (%)	1.3	1.0	-3.0	-0.5	-1.0	-3.2	3.5	-5.7	

1. Excluding defence forces and Australian employees of overseas embassies.

NSW Treasury also notes the Commission’s conclusions that removing the agriculture, forestry and fishing adjustment does not make a material difference, using the \$10 materiality threshold, to the payroll tax assessment and that removing it would simplify the assessment.

On those grounds, NSW Treasury has no objection to removing the agriculture, forestry and fishing adjustment.

Policy influences on compensation of employees

However, as also shown in Table 1 (line 3), the “match” between compensation of employees and wages and salaries is variable across the States. With agriculture, forestry and fishing included in compensation of employees, the State ratios calculated by dividing State compensation of employees by State wages and salaries vary from the Australian “average” (1.218) by a maximum of 2.3 per cent in the ACT and a minimum of -5.4 per cent in the Northern Territory.

The extent of variability of the ratio between the two measures across the States is a little surprising. This variability suggests that the differences in the two measures are not consistent across the States.

An important question is whether this arises for non-policy or policy related reasons.

Table 2 provides an overview of the components of the various “payroll” measures.

Table 2: Components of “payroll” measures

Component of compensation	Compensation of Employees ^(a)	Private wages and salaries ^(a)	Public Sector Earnings ^(c)
Wages and salaries, including			
Cash incomes (before tax and other deductions), including	X	X	X
Commissions	X	X	X
Tips	X	X	X
Sick pay	X	X	X
Pay for annual and long service leave	X	X	X
Penalty pay	X	X	X
Shift allowances	X	X	X
Severance, termination and redundancy payments	X	X	X
Payments for other forms of leave other than annual and long service leave	X	X	X
Income in kind	X	X	
Food and accommodation (excluding travel for business)	X	X	
Motor vehicles for private use	X	X	
Education expenses	X	X	
Subsidised loans	X	X	
Salary sacrificed amounts	X	X	X
Employers' social contributions			
Contributions to pension and superannuation funds	X		
Premiums to workers' compensation schemes for occupational injuries and diseases	X		
Direct cost of workers' compensation to employers who are permitted to self-insure	X		
Payments to separately constituted industry funds for long service leave	X		

(a) ABS, *Australian National Accounts: Concepts, Sources and Methods*, 2000, (Cat. No. 5216.0), Chapter 19.

(b) ABS, *Business Indicators, Australia*, September 2008 (Cat. No. 5676.0) notes that from the March quarter 2002, estimates of wages and salaries from the Quarterly Business Indicators Survey are being used to compile estimates for compensation of private sector employees in the Australian National Accounts. We therefore have assumed the coverage of private sector wages and salaries is similar in the two publications.

(c) ABS, *Labour Statistics: Concepts, Sources and Methods*, April 2007, (Cat. No. 6102.0.55.001), Chapter 12.

The main difference between the compensation of employees measure and the wages and salaries measure is the inclusion in compensation of employees of employers' social contributions. These social contributions cover contributions to pension and superannuation funds, payments to separately constituted industry funds – such as those constituted for the building and construction industry – for long service leave, premiums to workers' compensation schemes for occupational injuries and diseases and the direct cost of workers' compensation to employers who are permitted to self-insure.²

² As noted above we use “wages and salaries” to include private sector wages and salaries and public sector gross earnings. The public sector gross earnings measure does not include income in kind, though it does include salary sacrificed amounts. Since payment in kind is not significant in the public sector, private wages and salaries and public sector earnings are probably fairly consistent.

Of these payments, workers' compensation premiums are subject to varying degrees of policy influence across the States. All States have agencies (WorkCover or WorkSafe) which manage or oversee the workers' compensation and injury management system in that State. These agencies approve private companies for the provision of workers' compensation insurance or provide permits for employer self-insurance. In some States, the agencies play a role in establishing or approving premiums charged by private insurers.

Employer payments to separately constituted industry funds for long service leave may also be influenced by State policies. Employer contributions to pension and superannuation funds are likely to be less influenced by State policies given national superannuation legislation.

Workers' compensation premiums are not subject to payroll tax in New South Wales and given recent efforts to harmonise payroll tax across the States this also is likely to be the case in other States. If this is the case, workers' compensation premiums could be removed from the compensation of employees measure used as the proxy for the payroll tax base.

If it is not possible to remove workers' compensation premium payments from the compensation of employees data, the data should be adjusted to take into account the likely policy influence from workers' compensation premiums.

One way to do this would be to apply the "national average" ratio of compensation of employees to wages and salaries to the State compensation of employees data. For example, in Table 1, the "national average" figure for total Australian compensation of employees (excluding defence forces and Australian employees of Australian missions overseas) divided by wages and salaries for 2006-07 is 1.218. State data for wages and salaries, the least policy affected measure, could be multiplied by this "Australian average" figure to arrive at State figures for compensation of employees that would reflect the "national average" impact of State policy influences on the ratio between the two.

Table 3 shows how this adjustment could be done. Line 11 of Table 3 shows the removal of likely policy impacts on compensation of employees through this method was material in 2006-07, using the \$10 materiality threshold, for four States (though only marginally so for one of those States.)

Table 3: Compensation of employees adjusted for “average” compensation of employees/wages and salaries ratio, 2006-07

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	TOTAL
(1) Unadjusted compensation of employees (\$ m) ^(a)	171,696	123,389	91,764	50,469	32,317	8,891	12,593	4,746	495,864
(2) Wages and salaries (\$ m)	139,471	100,650	77,237	41,434	26,689	7,462	10,112	4,121	407,177
(3): (1) / (2) national average									1.218
(4) Adjusted compensation of employees (\$ m) (2) x (3)	169,850	122,573	94,061	50,459	32,503	9,087	12,314	5,018	495,864
(5) Taxable proportion of Adjusted compensation of employees (%)	56.7	55.7	50.6	55.1	51.5	46.2	27.6	43.2	53.7
(6) Assessed revenue base (\$ m)	96,262	68,266	47,581	27,818	16,752	4,200	3,398	2,169	266,445
(7) Actual revenue (\$ m)	5,654	3,479	2,232	1,587	845	219	220	128	14,364
(8) Average tax rate (%)									5.391
(9) Assessed revenue (\$ m)	5,189	3,680	2,565	1,500	903	226	183	117	14,364
(10) Assessed revenue per capita (\$)	756.94	712.18	620.25	720.27	572.81	460.55	544.02	549.39	688.63
(11) Difference in assessed revenue per capita from proposed method (\$)	-7.89	-4.43	15.41	0.18	3.52	10.14	-12.07	30.11	0.00

(a) Excluding defence forces and Australian employees of overseas embassies.

Adjusting for the tax-free threshold

NSW Treasury also has concerns about the threshold adjustment. This adjustment is done using data provided by the ABS, for each State, on wages and salaries paid by employers that are exempt from payroll tax because their total payroll is below the “average” tax-free threshold, and that part of the wages and salaries paid by employers that pay payroll tax that is below the tax-free threshold.

The ABS data appears somewhat volatile, particularly for smaller jurisdictions in relation to the amount of wages below the tax-free threshold paid by employers that pay payroll tax.

Charts 1 shows the share of total wages and salaries in each State accounted for by employers whose total salaries are below the “average” payroll tax threshold of \$550,000. The data is from the CGC’s 2008 Update Report Working Paper on payroll tax.

It is to be expected that the share of total wages and salaries accounted for by businesses below the threshold would vary from year to year depending on the relative performance of the small business sector in wages and employment growth. The smaller jurisdictions show the most volatility, probably reflecting their smaller bases. The larger jurisdictions show less volatility and fairly comparable shares of total wages and salaries accounted for by small

business, and gradually declining shares over time as the threshold is constant but wages and salaries rise.

Chart 1: Wages and salaries of businesses with total wages below the payroll tax threshold as a share of total wages and salaries

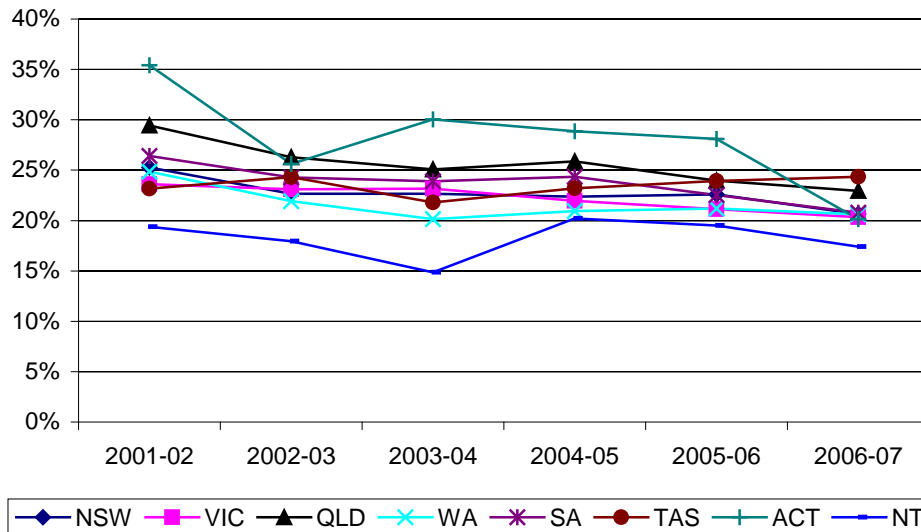
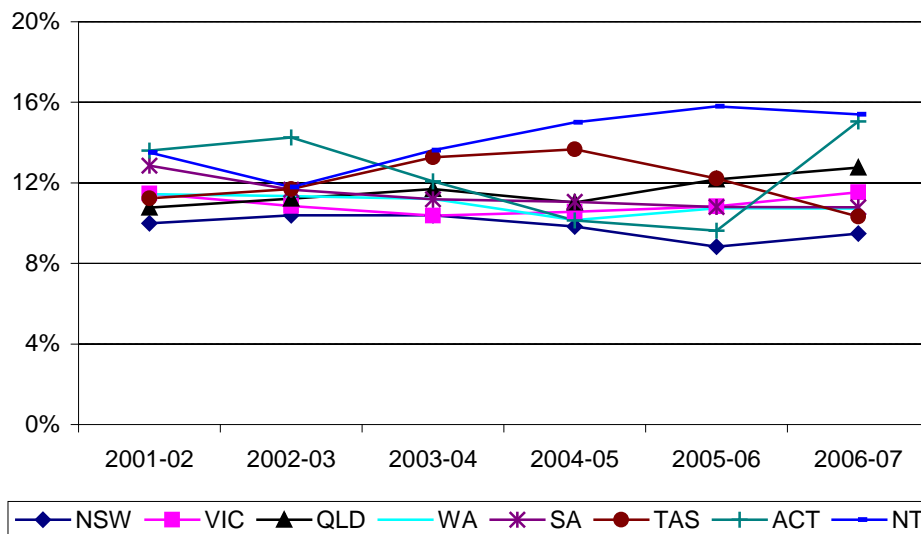


Chart 2 shows the share of total wages and salaries accounted for by that portion of wages and salaries that is below the \$550,000 tax-free threshold paid by employers that pay payroll tax.

Chart 2: Wages and salaries below the threshold of payroll tax paying businesses as a share of total wages and salaries



Again some year to year variability is apparent. However, the degree of variability shown in Chart 2 particularly for the smaller jurisdictions is surprising given that these employers would be larger employers which would account for the majority of wages paid and whose

economic performance perhaps could be expected to be more stable than that of small business.

The year-to-year movements of the various elements of total wages and salaries also appear contradictory, implying that “large” employers had a very different economic experience to “small” employers in some States. These movements, again based on data from the CGC’s 2008 Update Report Working Paper on payroll tax are shown in Table 4.

In Tasmania, for example, in 2006-07 the wages of employers below the threshold increased by 5.6 per cent, but the below threshold wages of payroll tax paying employers declined by 12.3 per cent. In the ACT in 2006-07, the wages of employers below the threshold fell by 17.9 per cent, while the below threshold wages of payroll tax paying employers increased by 79.3 per cent.

Table 4: Annual changes in total wages and salaries and wages below the threshold

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	TOTAL
Total private and PTEs (net industry) wages and salaries/gross earnings: % change on previous year									
2002-03	3.9	4.8	7.7	8.2	5.3	5.6	7.4	5.8	5.3
2003-04	5.4	7.2	10.2	4.9	3.2	13.1	5.4	12.5	6.6
2004-05	4.8	4.8	8.7	6.6	10.1	12.4	-3.8	28.6	6.2
2005-06	5.3	8.1	13.5	11.7	2.6	10.1	5.9	5.2	8.0
2006-07	6.5	7.4	11.4	12.9	8.3	3.8	14.6	2.8	8.4
Wages of exempt businesses: % change on previous year									
2002-03	-6.8	2.4	-3.9	-4.5	-3.3	10.8	-22.3	-1.9	-3.6
2003-04	5.4	7.6	5.2	-3.6	1.5	1.5	23.7	-6.9	5.0
2004-05	3.5	-0.7	12.0	10.9	12.3	19.6	-7.7	74.8	5.6
2005-06	6.4	4.0	5.2	13.0	-5.1	13.5	3.2	1.7	5.4
2006-07	-2.7	3.4	6.7	9.9	-0.1	5.6	-17.9	-8.3	1.9
Below threshold wages of taxable businesses: % change on previous year									
2002-03	8.1	-0.8	12.2	7.3	-4.5	9.9	12.5	-7.6	5.2
2003-04	5.4	2.5	14.9	3.6	-1.0	28.4	-10.7	29.9	5.9
2004-05	-0.8	6.6	2.4	-3.5	8.8	15.8	-19.2	41.7	2.4
2005-06	-5.5	11.0	25.3	18.3	0.3	-1.6	0.6	10.8	7.5
2006-07	14.5	14.3	16.7	12.7	8.1	-12.3	79.3	0.3	14.4

The number of employers implied by the ABS data for below threshold wages of payroll tax paying employers also seems strange. For New South Wales, for example, assuming each employer is eligible for a full average tax-free threshold of \$550,000, the ABS data for 2006-07 implies there were around 19,700 employers paying payroll tax. NSW Office of State Revenue data indicates around 28,000 employers pay payroll tax in New South Wales.

One of the problems in the ABS data could relate to employer grouping for payroll tax paying purposes. In all jurisdictions related employers are grouped to allow only one threshold deduction for the members of a group of associated companies. Therefore, not all employers surveyed by the ABS may be entitled to a full threshold deduction. The ABS may pick up the same company operating across several States through matching ABN numbers, but may

not pick up related or associated companies, operating across or within States, where those companies have different ABN numbers.

The tax-free threshold as “standard” policy

In addition to possible difficulties in adjusting for the tax-free threshold, in light of recent developments it can be questioned whether the tax-free threshold is a “standard” policy designed to assist small business.

In the 2004 Review, the Commission essentially continued with the 1999 Review’s decision to remove the compensation of “employees of small employer units because it was standard policy to exempt businesses below a payroll threshold.”³ At the time of the 1999 Review the size of the tax-free threshold ranged from \$456,000 in South Australia to \$800,000 in Queensland (1997-98 figures).

As the Commission notes, tax-free thresholds have been the subject of substantial policy change in recent years, with three States having recently announced increases to their thresholds for 2008-09.⁴

In its 2008-09 Budget, the NSW Government announced the payroll tax threshold will be indexed annually from 1 July 2008 in line with movements in the Sydney Consumer Price Index, with the threshold from 1 July 2008 set at \$623,000. The Government announced also that the rate would be reduced to 5.75 per cent from 1 January 2009, 5.65 per cent from 1 January 2010 and 5.5 per cent from 1 January 2011.

So for the 2008-09 year, the tax-free threshold will range from \$550,000 in Victoria to \$1.5 million in the ACT. In addition to the ACT, three other jurisdictions – Queensland, Tasmania and the Northern Territory –will have thresholds at or in excess of \$1 million.

At these levels it could be argued that the tax-free threshold now is not so much a “standard” concession for small business, but simply a device to exempt some employers from payroll tax, with the definition of employers receiving the exemption varying greatly between the States. As the Commission notes:

. . . the reasons for the differences between States in [payroll tax] revenues per capita include: policy influences on revenue effort such as rates of tax; differences in thresholds; classes of employers exempt from tax . . . ; classes of payments exempt from tax . . .

. . . differences in threshold provisions mean that one State might exempt an employer that would be taxed elsewhere.”⁵

³ CGC, 2004 Review, Working Papers, Volume 3, *Payroll Tax*, para.10.

⁴ CGC, Commission Position Paper CGC 2008/05, *Payroll Tax*, September 2008, para. 22.

⁵ Commonwealth Grants Commission (CGC), 2008 Update Report Working Papers, Volume 2, *Payroll Tax*, paras. 9 and 23.

On this view, it could be argued that “standard” policy is to have a payroll tax base of compensation to employees and the widely different thresholds are departures from the “standard” policy. Rather than a structural element of the tax across States, the threshold is simply another aspect of policy relating to payroll tax that varies from State to State for no specific unifying or structural reason. Much as States chose different tax rates to apply to employers for payroll tax, they also chose different threshold amounts to determine what employers pay the tax and the amount taxed employers can deduct from taxable payrolls.

The Commission notes it is “the policy of most States to have a tax-free threshold so that some employers were exempt altogether and others were allowed to deduct the threshold amount *from taxable payrolls*.”⁶ [Our emphasis]

New South Wales suggests that, as that quotation implies, the taxable payroll base should be considered to be payrolls inclusive of the tax-free threshold. The payroll tax yield across States varies because of differing tax rates and differing States’ policies on whether elements of its tax base are exempt from the tax entirely or particular segments of taxable payrolls are permitted to be deducted.

Not removing the tax-free threshold from the tax base would mean that, as is the case with differences in rates, varying State policies would be reflected in the average Australian tax “rate”. It would further simplify the payroll tax assessment, avoid the need for continual adjustment of the threshold to reflect changing State policies, and avoid the need for customised ABS data which may raise issues of data comparability and sample error across the States.

On 2006-07 figures, the payroll tax assessment, without the tax-free threshold adjustment, would still redistribute around \$560 million.

⁶ Commonwealth Grants Commission (CGC), 2008 Update Report Working Papers, Volume 2, *Payroll Tax*, para. 26.