



COMMONWEALTH GRANTS COMMISSION

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FINANCIAL TRANSACTION TAXES

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INTRODUCTION

1. This paper provides an overview of the proposed Financial Transaction Taxes assessment for the 2004 Review. It presents State issues outlined in the 2004 Review submissions concerning methodological and technical aspects of the categories, and Commission staff responses to the issues.

2. The Financial Transaction Taxes category brings together all forms of taxes on financial transactions.

3. The terms of reference for recent updates asked for two sets of relativities:

- (i) one to distribute the GST pool; and
- (ii) one to distribute the notional Financial Assistance Grants (FAG) pool under the guaranteed minimum amount provisions of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA).

4. The GST assessment for Financial Transactions Taxes differs from the FAG assessment because of the changes in the category standard arising from the abolition of the financial institution duties (FID) on 1 July 2001. However, the two assessment methods are similar. Both use total private expenditure data from the Australian Bureau of Statistics (ABS) State national accounts to measure the revenue base.

5. The GST assessment is the main focus of the discussion in this paper because of the increasing importance of and emphasis on the GST relativities.

DESCRIPTION OF THE CATEGORY

6. This category consists of net taxes from stamp duties and taxes on financial transactions. For the GST assessment, it includes:

- (i) stamp duties on mortgages, bonds, covenants, debentures and other loan securities;
- (ii) stamp duties on leases;
- (iii) stamp duties on instalment purchase arrangements, credit transactions and rental or hiring agreements;
- (iv) bank accounts debits tax (BAD) levied on withdrawals from accounts with cheque drawing facilities; and

- (v) miscellaneous taxes and duties, such as the debits duty charged by Tasmania, electronic banking duty, credit card transaction duty in Queensland, taxes on deeds of settlements and so on.

7. Under the IGA, all States abolished financial institutions duty (FID) on credits to accounts with financial institutions, including short term money market transactions, from 1 July 2001. However, the FAG assessment for 2001-02 and later years, will include estimates of FID revenue foregone, as estimated by the Commonwealth Treasury.

State Policies

- 8. States apply a different mix of financial transaction taxes.
 - (i) All States levied BAD tax but they had slightly different rate structures. Tasmania also imposed an additional duty of 15 cents per debit. New South Wales abolished BAD on 1 January 2002.
 - (ii) All States except the ACT and the Northern Territory impose duty on mortgages and loan securities.
 - (iii) Queensland imposes duty on credit arrangements and Tasmania imposes duty on unsecured loans.
 - (iv) Victoria abolished duty on leases of land or premises from April 2001, but it continues in other jurisdictions.
 - (v) Western Australia, South Australia, Tasmania and the Northern Territory impose duty on agreements.
 - (vi) Before 1 July 2001, all States except Queensland levied FID but it was abolished by all States on 1 July 2001 as part of the tax reforms associated with the introduction of the GST.

IMPORTANCE OF CURRENT ASSESSMENT

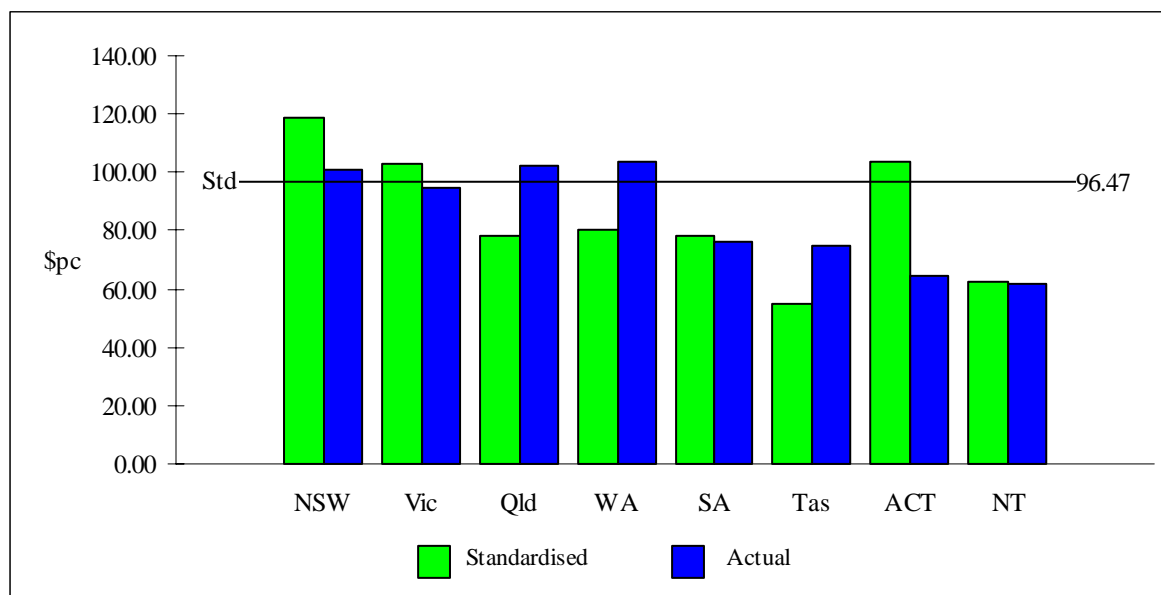
9. The importance of the Financial Transaction Taxes category differs between the GST and FAG assessments because the abolition of FID reduced the category standard for the GST relativities. States' relative revenue raising capacities also differ under the two assessments.

GST Assessment

10. For the GST assessment, revenue from Financial Transaction Taxes in 2000-01 was \$1 859 million (\$96.47 per capita), or about 4.9 per cent of State own-source

revenues¹. The GST assessment redistributed about \$148 million compared with an equal per capita distribution in the 2002 Update. Figure 1 shows the GST assessment for the 2002 Update.

Figure 1 FINANCIAL TRANSACTION TAXES: STANDARDISED, ACTUAL AND STANDARD REVENUES PER CAPITA, 2000-01



FAG Assessment

11. For the FAG assessment, revenue from Financial Transaction Taxes (including actual and notional amounts of FID) was \$3 188 million in 2000-01 (\$165.39 per capita). This was about 6.7 per cent of State own-source revenue. In the 2002 Update, the FAG assessment redistributed \$217 million compared with an equal per capita distribution.

CURRENT METHOD OF ASSESSMENT

12. Both the GST and FAG assessments used the sub-global method. In each case, the revenue base was measured using total private expenditure, adjusted for differences in concentrations of capital market activities and banking activities. The quantification of the revenue base started with an estimate of total private expenditure, defined as:

- (i) total household final consumption expenditure; and
- (ii) total private gross fixed capital formation.

¹ While FID was actually imposed by all States in 2000-01, the GST assessments are based on an assumption that it had been abolished — that is, the abolition of FID was backcast into all assessment years.

Both were sourced from ABS State Accounts, national account aggregates. Total private expenditure was adjusted for two factors — capital market activity and centralised banking.

13. **Capital Market Activity Adjustment.** The level of capital market activity in each State is not reflected in total private expenditure but it affects the State’s capacity to raise financial transaction taxes. To better capture the differences in revenue raising capacity, an adjustment was made to total private expenditure to reflect differences between States in the relative size of their financial sectors. The adjustment was measured as the proportion of factor income in the finance and insurance, and property and business services sectors relative to total factor income. Differences between States in that proportion were discounted to 20 per cent for the FAG assessment and to 30 per cent for the GST assessment, to reflect the share of total financial tax revenue derived from capital market activities. Data used for the calculation of this adjustment were from ABS State national accounts.

14. **Centralised Banking Adjustment.** In the 1999 Review, there was widespread anecdotal evidence that major corporations centralised their banking in the larger jurisdictions to minimise FID liability. This affected States’ revenue raising capacities differently and was not reflected in total private expenditure. Thus, an adjustment was made to capture this effect. The Commission used data on per capita bank deposits² to estimate a relative index. Index differentials were subsequently discounted to 20 per cent as a matter of judgement to better reflect the likely impact of centralised banking on financial transaction taxes.

15. Table 1 shows the importance of each element to overall capacity for the GST assessment in the 2002 Update.

Table 1 CAPACITIES IMPLIED BY ASSESSMENT DATA, GST ASSESSMENT

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Household private expenditure	1.0814	1.0093	0.9247	0.9239	0.9184	0.8623	1.1870	0.8498
Private gross fixed capital expenditure	1.0173	1.0997	0.8829	1.1318	0.9146	0.4997	0.7805	1.0624
Total private expenditure ^(a)	1.0671	1.0294	0.9154	0.9702	0.9175	0.7815	1.0964	0.8972
Capital market adjustment factor	1.0598	1.0307	0.9324	0.9120	0.9549	0.8578	0.9903	0.8529
Centralised banking adjustment factor	1.0853	0.9924	0.9473	0.9395	0.9215	0.8654	0.9810	0.8638
Implied category capacity ^(b)	1.2144	1.0467	0.8004	0.8211	0.7991	0.5617	1.0584	0.6390

(a) Represents an expenditure weighted ratio of the above two components.

(b) Derived by adding the sum of the capital market and centralised banking factors (minus 1), to (a).

² The data were obtained from Australian Banking Statistics, published by the Reserve Bank of Australia and, since July 1998, the Australian Prudential Regulation Authority.

MAJOR DEVELOPMENTS SINCE THE 1999 REVIEW

16. **Financial Institution Duty (FID).** As part of the IGA and national reform of taxes, all States abolished FID from 1 July 2001. For the GST relativities, this change was treated as a change in Commonwealth-State financial relations and was backcast into the assessment period by:

- (i) excluding FID revenue from the standard budget for all assessment years; and
- (ii) reducing the discounting of the capital market adjustment from 80 per cent to 70 per cent in view of the change in revenues in the standard.

17. **Bank Account Debits Tax.** As part of the IGA and the reform of taxes, BAD tax has been scheduled to be abolished by 1 July 2005, subject to a joint review by the parties. However, New South Wales has abolished its debits tax from 1 January 2002.

18. **Other taxes.** There have also been changes to the provisions applying to some other financial transaction taxes. Victoria abolished stamp duty on non-residential leases from 15 May 2001 as part of its *Building Tomorrow's Businesses Today* package. South Australia exempted annual leases of less than \$50 000 from lease duty.

ISSUES IN STATES' SUBMISSIONS

19. New South Wales, Victoria, Queensland and Western Australia made no comments on this category. Other States commented on the measure of the revenue base, the centralised banking adjustment and some data issues.

Measure of Revenue Base

20. **South Australia** submitted that the category should be split into a debits tax component and an other financial taxes component. It said that because all States now levied debits tax (the ACT introduced it from 1 July 1997), the only policy differences related to differences in the rate of tax in Tasmania and the Northern Territory (New South Wales no longer imposes the tax). The effects of those policy differences could be removed by making some adjustments to notional revenues before undertaking an Actual Per Capita (APC) assessment. The other financial taxes should continue to be assessed using the existing sub-global base of adjusted private expenditure.

21. The **ACT** indicated that it was opposed to the existing sub-global base because it was not related to the level of financial transactions taking place. It suggested that since the category was dominated by BAD taxes and they were levied at near uniform rates in all States, the whole category could be assessed on an APC basis. It argued that such an approach would take into account the rate of revenue leakage to those States that have a higher concentration of business and it would be simpler than the existing one.

Centralised Banking Adjustment

22. **Tasmania** supported the continuation of the central banking adjustment even though FID had been abolished because other incentives to centralise banking remained, in particular, the tendency of national companies to centralise head office activities in Melbourne and Sydney and the dominance of these cities as financial centres.

23. It proposed that the data from the Australian Bankers' Association on the number and value of debits in each State would provide a direct measure of the revenue base and could be used to monitor the effect on banking patterns of New South Wales' decision to abolish debits tax. It noted that the abolition by Victoria of duty on non-residential leases from 26 April 2001, and the abolition by New South Wales of debits tax from 1 January 2002, would reduce the national standard revenue and average rate of taxation, but it accepted that this was a consequence of using national standards.

Mobility Adjustment

24. The **ACT** said that if the Commission decided not to adopt an APC assessment, it should reduce the ACT's base by 2 per cent to reflect tax leakages from the ACT to other States.

Adjustment to Private Expenditure

25. The **Northern Territory** supported the existing approach to measuring capacity but noted that there was a flaw in the ABS data for 1998-99. In that year, the ABS reported abnormally high private gross fixed capital formation for the Northern Territory because it included the purchase and installation of the *Northern Endeavour* — a floating production facility in the Laminaria-Coralline oil field. This added about \$1.4 billion to the Territory's private gross fixed capital formation, although the facility is in Commonwealth waters and the Territory was not able to tax it. It argued that this expenditure should be removed from the measure of its base.

ASSESSMENT OPTIONS FOR THE 2004 REVIEW

26. Except for South Australia and the ACT, the States generally seem to accept the existing measure of the revenue base. Taking account of State submissions, there seem to be three options for measuring the revenue base:

- (i) to continue the current method, with some minor changes;
- (ii) to split the assessment into two sub-components with:
 - APC assessment for debits tax; and
 - the existing (adjusted total private expenditure) approach for all other taxes; and

- (iii) to adopt the debits tax revenue each State would raise under common tax rates as a base for the category — that is, apply an APC assessment to the whole category.

The Current Method with Minor Changes

27. The current assessment method for this category uses a sub-global measure for the revenue base. A sub-global assessment is used as a measure for revenue base if there are too many differences in the States' policies and policy contaminations to tax bases or activity levels cannot be easily removed.

28. The financial transactions taxes are in general imposed on the flow of financial transactions. The abolition of FID has removed some policy differences, but other differences still remain.³ Thus the reasons for adopting the current method in the 1999 Review still apply. As a result, there is a strong case to retain the current method, or its basic structure — that is, use total private expenditure as the measure of the revenue base.

29. If the basic structure of the current method is to be retained (and no better independently measured indicator has been suggested), the main task is to review the two adjustments and address the potential data problems.

30. ***The capital market adjustment.*** The capital market adjustment aims to account for inter-state differences in financial investments that attract Financial Transaction Taxes but which are not captured by total private expenditure. These investments include activity relating to the short-term money market, and mortgage and loan securities instruments.

31. Since actual data on the relative size of the financial sector in each State is not readily available, the size of each State's Finance, Property and Business sector in each State (measured as its total factor income) is used as a proxy. Table 3 shows the differences between States in the size of the Finance, Property and Business sector.

³ Examples of the differences include:

- (i) the rates of duty for taxes such as debits tax (New South Wales has abolished the debit tax), duty on mortgages and loans securities, hiring arrangements duty and duty on leases; and
- (ii) the range of financial transaction taxes — for example, the ACT and the Northern Territory do not impose stamp duty on mortgages, Tasmania imposes a debits duty in addition to debits tax, Western Australia and South Australia impose cheque duty, some States impose duty on deeds of settlement.

Table 3 SHARE OF THE FINANCE, PROPERTY AND BUSINESS SECTOR IN THE STATES 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Finance, property & business sector income (\$M)	47 604	31 318	14 315	9 077	6 145	1 059	2 280	814	112 612
Share of sector (%)	42	28	13	8	5	1	2	1	100
Share of total private exp. (%)	36	26	17	10	7	2	2	1	100

Source: Australian Bureau of Statistics, Australian National Accounts, State Accounts, 5220.0, 2000-01, Tables 16 to 24.

32. New South Wales and Victoria have a noticeably larger share of the Finance, Property and Business Services sector than they do of total private consumption. As capital market activity is a source of a large element of revenue from financial transaction taxes, there is a case for retaining the capital market adjustment. Subject to the outcome of the November Conference, Commission staff intend to recommend that the existing capital market adjustment, including the percentages of discount used in both the FAG and the GST assessments, should be retained.

33. *The centralised banking adjustment.* The centralised banking adjustment was introduced in the 1999 Review because corporations tended to centralise their banking activities in the larger States to minimize FID tax liability. Given the abolition of FID, a question arises whether it is still necessary to have the centralised banking adjustment under the GST assessment.

34. Tasmania argued that even after the abolition of FID, the big States retained their advantage in collecting revenue from the remaining financial transaction taxes (debits tax, mortgage duty etc) because of the centralisation of head offices of corporations in the major cities.

35. However, it is not clear that the financial transactions that are subject to the other Financial taxes are either centralised to the same extent as banking deposits or affected by centralised banking at all. To test this, Commission staff compared the share of the debits tax and bank deposits in the States to see if there is any relationship (correlation) between the two. Table 4 indicates that the share of bank deposits in New South Wales is much higher than its population share, but its debits tax share is below its population share. Thus, while duty arrangements appear to have encouraged corporations to centralise their banking deposits, they do not appear to have had the same effect on withdrawals (as measured by debits tax revenue).

Table 4 POPULATION, BANK DEPOSIT AND DEBITS TAX SHARES 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Population share (%)	33.7	24.9	18.7	9.8	7.8	2.4	1.6	1.0	100
Debits tax share (%)	32.7	24.9	20.8	11.2	5.8	2.8	1.4	0.4	100
Bank deposit share (%)	48.4	23.3	13.8	7.0	4.9	0.8	1.4	0.3	100
Debits tax relativity (a)	0.9710	0.9984	1.1131	1.1355	0.7500	1.1558	0.8540	0.3882	1.0000
Bank deposit relativity (b)	1.4354	0.9339	0.7402	0.7158	0.6241	0.3400	0.8926	0.3283	1.0000

(a) Ratio of debit tax share to population share.

(b) Ratio of bank deposit share to population share.

36. Thus, subject to any further discussion, Commission staff intend to recommend that the Commission exclude the centralised banking adjustment from the GST assessment, but retain it in the FAG assessment because FID is notionally included in that assessment.

37. Table 5 shows the effect on the implied GST grant distribution of deleting the central banking adjustment.

Table 5 IMPLIED GRANT CHANGES IF NO CENTRALISED BANKING ADJUSTMENT HAD BEEN ADOPTED IN THE 2002 UPDATE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust	
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	
U2002 Update	10395.9	7364.6	6467.6	3276.1	3143.3	1274.7	626.0	1484.7	34033.1	
Alternative option (a)	10448.0	7361.8	6449.1	3264.2	3132.6	1270.1	625.4	1482.0	34033.1	
Grant change	\$m	52.0	-2.8	-18.5	-11.9	-10.7	-4.6	-0.7	-2.8	0.00
	%	0.50	-0.04	-0.29	-0.36	-0.34	-0.36	-0.11	-0.19	0.0

(a) Excluding centralised banking adjustment.

38. *Adjustment to total private expenditure.* Staff consider that the sort of data issue raised by the Northern Territory regarding activities which could have an impact on the Commission's assessment but not on a State capacity, has merit. Data related to any significant activities that could result in a State's total private expenditure being an unreliable indicator of its revenue capacity should be removed from the revenue base measure.

39. The Commission has been unwilling to make this type of adjustment in an update because it appeared to represent a method change and it was possible that similar data inconsistencies existed in other States even though they had not been brought to its attention. However, in a review the Commission could make adjustments if the States demonstrated their case, they could provide the necessary data, and if the adjustment were material. Subject to any further discussion, staff intend to recommend that the Commission exclude transactions relating to the *Northern Endeavour* from the measure of the revenue base.

Split the Category into Two Sub-components

40. Under this option, the category would be assessed in two parts with:
- (i) an Actual Per Capita (APC) assessment (including adjustments to reflect the revenues that would be raised under uniform tax rates) being made for the debits tax element; and
 - (ii) the existing assessment being used for the other taxes element.

41. Revenue from BAD taxes constitutes roughly 50 per cent of the current total revenue from financial transaction taxes. This option would mean that about half of the category would be assessed by a tax base approach and the other half would be assessed by a sub-global approach.

42. ***Debits Tax assessed using APC method.*** The APC method is usually applied if there is little difference in tax policies between States and the actual revenue represents the revenue raising capacity. Table 6 indicates that the BAD tax may be close to this situation. Most States have identical tax rates. The Northern Territory has the same tax rates over all ranges except the \$1-\$100 range. Tasmania's rates are half of those in most States, but it also includes a 15 cents fixed charge for every withdrawal from cheque accounts. The largest difference between the States is due to New South Wales having no BAD tax.

43. These policy differences could be removed by some adjustments. For example, Tasmania's BAD tax revenue could be increased by about 50 per cent to allow for their lower rates and Northern Territory's by 5 to 20 per cent. For New South Wales, an estimated share based on earlier years information when it had the BAD tax could be used, although any such estimate could become less reliable the longer the tax has been abolished.

44. Table 6 shows the estimates of debits tax in Tasmania and the Northern Territory. Based on the 2002 Update assessment, actual debits tax collection in Tasmania would to be multiplied by 1.5 and that of Northern Territory by 1.2 to make the adjustments.

Table 6 ESTIMATION OF DEBITS TAX FOR TASMANIA AND THE NORTHERN TERRITORY

Amount	\$1-less than \$100	\$100 less than \$500	\$500 less than \$5000	\$5000 less than \$10000	\$100 000 and over	Average
	\$	\$	\$	\$	\$	\$
All States	0.30	0.70	1.50	3.00	4.00	
Tasmania	0.30	0.50	0.90	1.65	2.15	
Proportion	1	1.4	1.7	1.8	1.9	1.5
Northern Territory	0.15	0.70	1.50	3.00	4.00	
Proportion	2	1	1	1	1	1.2

Source: Australian Bankers Association Article.

45. *Sub-global measure for the other financial transaction taxes.* The other half of the financial transaction taxes is mainly composed of stamp duties imposed on various types of documents (instruments) such as transfer of property marketable securities (shares) etc. Total private expenditure adjusted for the different levels of capital market activity in the States could continue to be used as the revenue base. The centralised banking adjustment should be removed for the GST assessment, because the disabilities it was supposed to represent no longer exist (FID is not included in the GST assessment). This adjustment, however, should be retained for the FAG assessment.

46. Table 7 presents the estimated effects of this approach. It shows that New South Wales and the ACT would benefit from the change. All the other States would still be assessed to have below standard capacities but they would be higher than the existing assessment.

Table 7 COMPARISON OF REVENUE RAISING CAPACITY RATIO 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Current	121.4	104.7	80	82.1	79.9	56.2	105.8	63.9	100.0
BAD tax plus adjusted TPE									
(a)	110.3	104.9	89.4	92.4	85.4	74.8	104.6	70.2	100.0
Difference	-11.1	0.2	9.4	10.3	5.5	18.7	-1.2	6.3	0.0

(a) TPE is adjusted for Capital Market Activity only. Centralised Banking Adjustment has been removed

47. The main advantages of this option are that:

- (i) the BAD part of the revenue may be assessed more accurately, provided the adjustments for policy differences are comprehensive and accurate; and
- (ii) it would be easier to deal with the abolition of the BAD tax, if it goes ahead.

48. The disadvantages of this option include the following.

- (i) The data requirements would be more intensive for the debits tax part. BAD tax revenue data have to be supplied by States, if the GFS does not have the required information.
- (ii) Any unnoticed differences in policy would be reflected in needs.
- (iii) Some estimates have to be done for the missing data for New South Wales and for the policy adjustments for Tasmania and the Northern Territory. Those estimates could become less reliable as time passes.
- (iv) The assessment would be more complex than the current one because the category would be split into two parts.

Debits Tax Revenue as the Revenue Base

49. This option was proposed by the ACT. Commission staff think it unlikely that policy adjusted BAD revenue alone would be an accurate reflection of the revenue raising capacities of the States because:

- (i) as shown in Table 8, BAD tax represents between 33 and 70 per cent of the total Financial Taxes revenues (an average of about 54 per cent of total revenue from Financial Transaction Taxes); and
- (ii) there are noticeable differences in tax policies between the States for the remaining financial taxes and it would not be easy to adjust for their effects.

Table 8 PROPORTION OF DEBITS TAX 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Debits tax	331	251	210	113	59	19	14	4	1001
Stamp duties & other financial transaction taxes	326	204	159	83	55	16	6	8	858
Total	657	455	369	196	114	35	20	12	1859
Proportion of debits tax	0.50	0.55	0.57	0.58	0.52	0.54	0.70	0.33	0.54

Source: State Budgets.

MOBILITY ADJUSTMENTS (CROSS BORDER LEAKAGES)

50. The ACT proposed that, if the Commission were to use adjusted total private expenditure as the basis for calculating the revenue base for Financial Transaction Taxes, it should reduce the ACT's revenue base by 2 per cent to reflect tax leakage to other States.

51. At this time, the justification and derivation of the proposed adjustment is not clear. Further information would be required before it could be implemented.

SUMMARY

52. Policy differences remain in financial transaction taxes, even though the largest source of differences (FID) has been abolished. This means the current sub-global approach is still a preferred method. However, staff propose to recommend that the central banking adjustment be abolished for the GST assessment, and that total private expenditure data would be adjusted to remove data related to non-taxable activities. These refinements should better reflect States' relative revenue capacities.

53. An alternative less preferred approach would be to assess the category in two parts: a BAD tax proportion to be assessed by APC, and the other part by the proposed refined sub-global method. It is less preferred because it is more complex than the refined existing approach and making adjustments to remove the effects of policy differences for BAD (especially estimating a revenue base for New South Wales) may not always be simple.