



# **COMMONWEALTH GRANTS COMMISSION**

**DRAFT ASSESSMENT PAPER CGC 2003/4**

## **FINANCIAL TRANSACTION TAXES**

Prepared for the Commission's 2003 Conferences on Draft Assessments

**AUGUST 2003**

## **NOTE**

Included in this paper are the results of preliminary calculations based on the methods proposed throughout the paper and using the data currently available. Those results are indicative only and should be seen as work in progress. Ongoing changes are being made to standards and factor calculations as new data come to hand. Moreover, the calculations have been done using a prototype assessment system and are subject to ongoing revision as checking processes proceed.

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## INTRODUCTION

1. This paper presents a draft assessment for the Financial Transactions Tax category for the 2004 Review. The paper builds on staff proposals set out in Discussion Paper 2002/17 Financial Transaction Taxes and responds to comments in State submissions and at the 2002 conferences.

### 1999 REVIEW ASSESSMENT METHOD

#### *Description of the category*

2. This category comprised net taxes from stamp duties and taxes on financial transactions. It included:

- (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) financial institutions duty (FID) on credits to accounts with financial institutions, including short-term money market transactions.
- (v) bank accounts debits (BAD) tax levied on withdrawals from accounts with cheque drawing facilities; and
- (vi) miscellaneous taxes and duties, such as the debits duty charged by Tasmania, credit card transaction duty in Queensland, electronic banking duty in the Northern Territory, taxes on deeds of settlements and so on.

#### *Implications of tax reform*

3. As part of the tax reforms associated with the introduction of the Goods and Service Tax (GST), the Australian and State Governments signed the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA) in June 1999. Under the IGA, States agreed to abolish FID from 1 July 2001. The IGA also says that, subject to review by Ministerial Council, States will abolish BAD tax from 1 July 2005. Under the transitional arrangements of the IGA, update terms of reference since the 1999 Review have asked for two sets of relativities:

- (i) a set to distribute a combined pool of GST revenue and health care grants — hereafter called *the GST relativities*; and
- (ii) a set to distribute a combined pool of Financial Assistance Grants (FAG) and health care grants (based on the assumption of a continuation of the Australian—State Government financial arrangements which applied in 1999-2000) — hereafter called *the FAG relativities*.

4. For GST relativities, the category excluded FID revenue because States abolished it from 1 July 2001. The Commission backcast the abolition of FID by excluding FID revenue from the category for years prior to 2001-02.

5. For FAG relativities, the category included FID revenue. An estimate had to be made of the revenue that would have been raised from FID for 2001-02. So, the revenue standard for the FAG assessment was larger than the revenue standard for the GST assessment.

6. Table 1 shows the revenue standards for this category for both the GST and FAG assessments. In 2001–02, Financial Transaction Taxes totalled \$1 912.5 million (or \$97.58 per capita) for the GST relativities. This represented 4.98 per cent of State own source revenue in the 2003 Update. For the FAG relativities, Financial Transaction Taxes totalled \$3 108.5 million (or \$158.60 per capita). This represented 6.37 per cent of State own source revenue in the 2003 Update.

**Table 1** STANDARD REVENUE FOR FINANCIAL TRANSACTIONS TAX

		1997-98	1998-99	1999-2000	2000-01	2001-02
<b>GST relativities</b>						
Standard revenue	\$pc	92.31	90.29	96.65	96.15	97.58
Percentage of own source revenue	%	5.50	4.74	4.98	4.97	4.98
<b>FAG relativities</b>						
Standard revenue	\$pc	153.46	151.93	161.77	164.77	158.60
Percentage of own source revenue	%	7.40	6.43	6.68	6.77	6.37

Source: 2003 Update Working Papers, Volume 2, pages 12, 21, 249 and 257.

### *The revenue base*

7. The revenue base was adjusted total private expenditure.<sup>1</sup> Adjustments were made to take account of differences in capital market activities and centralised banking activities.

<sup>1</sup> Total private expenditure is the sum of total household final consumption expenditure (HFCE) and total private gross fixed capital formation (PGFCE).

8. The Commission calculated a capital market adjustment because it considered the capacity to raise financial transactions taxes was affected by capital market activities. However, this capacity was not captured by total private expenditure. It concluded an adjustment was warranted to allow for the effects on revenue from financial transaction taxes of differences between States in the size of their capital markets. It estimated the adjustment by:

- (i) calculating the proportion of total State factor income relating to the finance and insurance, and property and business services sectors;
- (ii) dividing each State's proportion by the Australian proportion; and
- (iii) discounting the resultant factor to 20 per cent for the FAG assessment and 30 per cent for the GST assessment.

9. The discount was applied to ensure the adjustment was applied to the estimated proportion of revenue relating to capital market transactions. A larger discount was used for the GST assessment because the revenues affected by capital market transactions were a larger proportion of the smaller GST category standard.

10. The Commission also calculated a centralised banking adjustment because it considered the capacity to raise financial transactions taxes was affected by the practice of large businesses centralising their banking to minimise their FID tax liability. However, the effect of these actions was not captured by total private expenditure. It concluded a centralised banking adjustment was warranted to allow for the tax induced changes in the level of business banking deposits in each State. It estimated the adjustment by:

- (i) calculating each State's per capita bank deposits<sup>2</sup>;
- (ii) dividing each State's level of per capita bank accounts by the Australian level; and
- (iii) discounting the resultant factor to 20 per cent for both the FAG assessment and GST assessments.

11. The discount was applied to ensure the adjustment was applied only to the average level of business activity. The size of the adjustment was based on judgement, informed by estimates of the proportion of revenue raised from general FID transactions.

12. Table 2 shows the calculation of the revenue base for the FAG assessment for 2001-02. Table 3 shows the calculation for the GST assessment for the same year.

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

**Table 2** REVENUE BASE FOR 2001-02, FAG ASSESSMENT

		NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Household final consumption expenditure <sup>(a)</sup>	\$b	154.9	108.8	76.7	38.8	31.1	8.9	8.2	3.9	428.3
Private gross fixed capital expenditure <sup>(a)</sup>	\$b	41.2	36.1	24.3	15.9	8.3	2.0	1.8	2.2	131.8
A. Total private expenditure	\$b	196.2	144.9	97.9	54.7	39.3	10.9	10.0	6.1	560.0
<b>Capital market adjustment</b>										
Finance sector factor income	\$b	49.7	32.9	14.8	9.7	6.4	1.3	2.3	1.0	118.1
State total factor income	\$b	216.8	158.1	105.6	70.0	41.1	11.0	13.0	8.4	624.1
Proportion	%	0.2290	0.2084	0.1400	0.1387	0.1565	0.1144	0.1771	0.1160	0.1892
Relativity		1.2105	1.1015	0.7402	0.7332	0.8270	0.6044	0.9361	0.6132	1.0000
Discount weight (FAG)										0.2000
B. Capital market adjustment		1.0421	1.0203	0.9480	0.9466	0.9654	0.9209	0.9872	0.9226	1.0000
<b>Centralised banking adjustment</b>										
Bank deposits <sup>(b)</sup>	\$pc	35 912	23 117	17 557	16 963	14 959	8 365	20 445	7 747	24 620
Relativity		1.4587	0.9390	0.7131	0.6890	0.6076	0.3398	0.8304	0.3147	1.0000
Discount weight										0.2000
C. Centralised banking adjustment		1.0917	0.9878	0.9426	0.9378	0.9215	0.8680	0.9661	0.8629	1.0000
Revenue Base (=A*[B+C-1])	\$b	222.4	146.1	87.2	48.3	34.9	8.6	9.5	4.8	561.9

(a) Source: *State National Accounts ABS 5220.0*, Tables 8 to 16.(b) Source: *Australian Banking Statistics*, Australian Prudential Regulation Authority, June quarters.

**Table 3** REVENUE BASE FOR 2001-02, GST ASSESSMENT

		NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
A. Total private expenditure <sup>(a)</sup>	\$b	196.2	144.9	97.9	54.7	39.3	10.9	10.0	6.1	560.0
<b>Capital market adjustment</b>										
Relativity		1.2105	1.1015	0.7402	0.7332	0.8270	0.6044	0.9361	0.6132	1.0000
Discount weight (GST)										0.3000
B. Capital market adjustment		1.0631	1.0305	0.9220	0.9200	0.9481	0.8813	0.9808	0.8840	1.0000
<b>Centralised banking adjustment</b>										
Bank deposits <sup>(b)</sup>	\$pc	35 912	23 117	17 557	16 963	14 959	8 365	20 445	7 747	24 620
Relativity		1.4587	0.9390	0.7131	0.6890	0.6076	0.3398	0.8304	0.3147	1.0000
Discount weight										0.2000
C. Centralised banking adjustment		1.0917	0.9878	0.9426	0.9378	0.9215	0.8680	0.9661	0.8629	1.0000
Revenue Base (=A*[B+C-1])	\$b	226.5	147.6	84.7	46.9	34.2	8.2	9.5	4.5	562.1

(a) Source: *State National Accounts ABS 5220.0*, Tables 8 to 16.

(b) Source: *Australian Banking Statistics*, Australian Prudential Regulation Authority, June quarters.

### ***Importance of the category***

13. The importance of the Financial Transaction Taxes category differs between the GST and FAG assessments because the abolition of FID has reduced the category standard for the GST relativities.

14. Table 4 shows the grant share effects for both assessments in the 2003 Update. Compared with an equal per capita distribution, the GST assessment redistributed \$164.8 million and, because of the larger financial standard, the FAG assessment redistributed \$233.2 million.

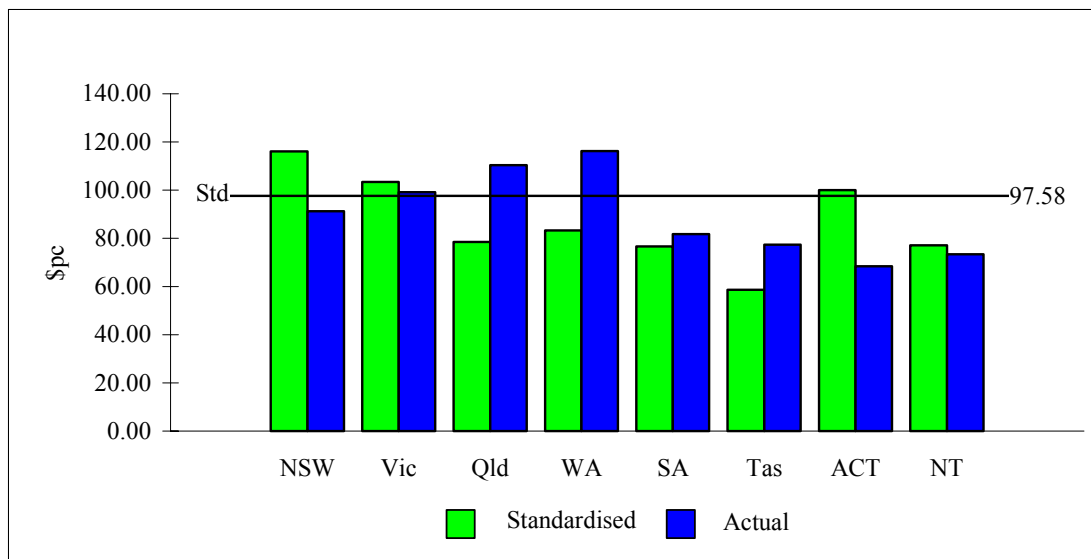
**Table 4** GRANT DISTRIBUTION OF FINANCIAL TRANSACTION TAXES  
COMPARED WITH EPC DISTRIBUTION

Change in grants	NSW	Vic	Qld	WA	SA	Tas	ACT	NT redistributed	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
GST relativities	-140.4	-24.4	79.9	21.4	36.8	21.4	-0.1	5.2	164.8
FAG relativities	-202.2	-30.5	114.1	25.3	55.1	31.7	-0.4	6.9	233.2

Source: 2003 Update Working Papers, Volume 2, pages 97 and 275.

15. Figure 1 shows the GST assessment for 2001-02.

**Figure 1** FINANCIAL TRANSACTION TAXES: STANDARDISED, ACTUAL  
AND STANDARD REVENUES PER CAPITA, 2001-02



### MAJOR DEVELOPMENTS SINCE THE 1999 REVIEW

16. The major developments have been:

- (i) the introduction of the IGA and the agreement to abolish FID from 1 July 2001;
- (ii) the decision by New South Wales to abolish its BAD tax from 1 January 2002, ahead of the review to be completed by 2005;
- (iii) the decision by Victoria to abolish stamp duty on non-residential leases from 15 May 2001; and

- (iv) the decision by South Australia to exempt annual leases of less than \$50 000 from lease duty from 1 January 2002.

### **CATEGORY DEFINITION FOR THE 2004 REVIEW**

17. In *Discussion Paper CGC 2002/17 Financial Transaction Taxes*, Commission staff proposed making no change to the category definition. No State opposed the proposal and the Commission has found no reason to change the definition. The category will continue to comprise net taxes from stamp duties and taxes on financial transactions, including those taxes listed in paragraph 2.

### **MAIN ISSUES FOR THE 2004 REVIEW**

18. The main issues raised by the States for the 2004 Review were:
- (i) whether the revenue base should be assessed as one component or two;
  - (ii) whether adjustments should be made to the data on private gross fixed capital expenditure formation to exclude non-taxable activity;
  - (iii) whether the centralised banking adjustment should be retained for the GST assessment;
  - (iv) whether the discount weight applied to the capital market adjustment should be reduced; and
  - (v) whether there should be a mobility adjustment.

#### ***Measure of the revenue base***

19. In the 1999 Review, the Commission decided that the differences in the way States imposed financial transaction taxes (for example, Queensland did not impose FID), prevented the adoption of a revenue base that measured the underlying value of taxable transactions. It decided it was too problematic to estimate the value of transactions that could have been taxed in those States which did not tax them. The Commission preferred to use a broad indicator of capacity — it decided on adjusted total private expenditure because this captured most financial transactions.

20. ***State views.*** Most States supported the continuation of the 1999 Review approach.

21. ***South Australia*** suggested assessing the revenue base in two components:

- (i) a BAD tax component, assessed by the actual per capita method (APC); and
- (ii) an other financial taxes component, assessed by adjusted total private expenditure.

22. The **ACT** opposed the current approach because it said adjusted total private expenditure did not reflect the level of taxable financial transactions taking place. It suggested assessing the whole category APC because it was dominated by BAD tax, which was levied at near uniform rates in all States.

23. **Preliminary proposal.** In Discussion Paper CGC 2002/17 Financial Transaction Taxes, Commission staff proposed retaining the 1999 Review approach. They said the differences in State policies made it too difficult to make an assessment based on the value of taxable transactions.

24. They did not support assessing BAD tax APC because of the large differences in State policies — New South Wales abolished its BAD tax from 1 January 2002, and Tasmania and the Northern Territory had different rate structures from the other States. Commission staff said that, if an APC assessment was used, it would be difficult to adjust States' actual revenues for those policy differences.

25. **Further State views.** *New South Wales* supported the South Australian proposal. It said that BAD tax should be assessed as a separate component because those taxes had no relationship with the capital market adjustment or the centralised banking adjustment.

26. **Queensland** opposed splitting the category in two because there were significant policy differences with BAD tax since New South Wales abolished it.

27. **Western Australia** supported a single assessment. It opposed assessing BAD tax APC because of the difficulty of estimating notional revenue for New South Wales.

28. **South Australia** reiterated its support for its earlier proposal.

29. **Tasmania** opposed splitting the category. It supported the existing assessment. It acknowledged that the abolition of FID had removed some policy differences, but others remained. These policy differences meant that neither an APC assessment nor an assessment based on BAD tax revenue collections was appropriate.

30. The **ACT** said BAD tax revenue should be used as the basis for calculating the revenue base because:

- (i) it was the largest part of financial transaction taxes;
- (ii) it was applied uniformly across most jurisdictions; and
- (iii) it took account of the impact that technology and mobility had on tax leakages.

31. The *Northern Territory* supported splitting the category in two. It said an APC assessment of BAD tax would reflect the transitory nature of its population and the mobility of its bank accounts.

32. ***Analysis and evaluation.*** The Commission acknowledges the appeal of assessing BAD tax APC. If all States applied BAD tax uniformly, actual revenues would be a reliable indicator of States' underlying revenue capacities. However, the appeal of an APC assessment diminishes if adjustments have to be made because not all States apply the tax uniformly, as is the case here. Adjustments would be required:

- (i) to estimate notional BAD tax revenues for New South Wales, because it has abolished the tax; and
- (ii) to adjust the actual revenues of Tasmania and the Northern Territory for their different rate structures.

33. If another State were to follow New South Wales and abolish its BAD tax an APC assessment would require further adjustments. We doubt whether an APC type assessment could be sustained in that environment.

34. A further consideration is that, as part of the IGA, BAD tax is intended to be abolished from 1 July 2005, subject to a review by the Ministerial Council.

35. ***Commission decision.*** The Commission does not accept that a conceptual case has been established for assessing BAD tax APC. The States do not have uniform policies in this area, New South Wales does not have the tax.

36. Any errors in the estimation of notional revenue for New South Wales or the impact of the policy adjustments for Tasmania and the Northern Territory would have a direct dollar for dollar effect on the assessments for these States. The Commission is not confident the estimates of those effects would be sufficiently accurate. In particular, it is likely that the estimate of revenue foregone by New South Wales would become increasingly less accurate over time. The Commission does not consider equalisation would be improved by separately assessing a BAD tax component APC with adjustments for three of the eight States. Therefore, the Commission has decided to continue to:

- (i) assess all Financial Transaction Taxes using a broad capacity indicator — adjusted total private expenditure.

#### ***Adjustments to private gross fixed capital formation***

37. Total private expenditure is the sum of total household final consumption expenditure (HFCE) and total private gross fixed capital formation (PGFCE).

38. ***State views.*** The Northern Territory noted an anomaly in ABS PGFCE data for 1998-99. In that year, the ABS reported abnormally high PGFCE for the Northern Territory because it included the purchase and installation of the Northern Endeavour — a floating production facility in the Laminaria-Corallina oil field. This added about \$1.4 billion to the Territory's private gross fixed capital formation in 1997-98, 1998-99 and

1999-2000. This facility was, however, located in Australian Government waters and the Territory had no power to tax transactions relating to it. It asked the Commission to remove data relating to this facility from its revenue base.

39. **Preliminary proposal.** In Discussion Paper 2002/17 Financial Transaction Taxes, Commission staff proposed removing amounts of PGFCE relating to any area where States did not have the power to tax, the Northern Endeavour project being an example.

40. **Further State views. Western Australia** said PGFCE should have a reduced influence on the assessment because of the retail-only nature of BAD tax. It proposed discounting PGFCE by 70 per cent for the FAG assessment and 50 per cent for GST assessment, these discounts reflected the proportion that the BAD tax comprised of each category standard.

41. It said it could also identify many large resource industry transactions that contributed substantially to PGFCE, but led to little BAD tax or other financial transaction taxes revenue. It said this would justify removing PGFCE from the revenue base measure altogether.

42. The **Northern Territory** supported the Commission staff's proposal.

43. **Analysis and evaluation.** The Commission views the Northern Territory issue as a special case. It relates to a situation where one jurisdiction's data (in this case the Australian Government) is included as part of another jurisdiction's revenue base measure. In such cases, it would not be appropriate to leave the data in the revenue base measure because it would attribute part of one jurisdiction's capacity to another jurisdiction.

44. The Commission uses total private expenditure as its revenue base because it considers revenue from Financial Transaction Taxes is generated from private consumption and physical investment. Gross fixed capital formation accounts for about 25 per cent of total private expenditure measure. The Western Australia proposal of discounting/removing private gross fixed capital formation assumes that most BAD revenue was paid by individuals rather than companies. The Commission does not have a breakdown of BAD revenue and is unable to determine whether business's share of these revenues has declined. In the absence of this information, the Commission is not inclined change its revenue base measure.

45. **Commission decision.** The Commission accepts that a conceptual case exists for removing from each States' revenue base data which relate to other jurisdictions. The strength of the case in each situation will depend on the data which are available and whether or not, in the Commission's assessment, equalisation would be improved by their removal. The Commission accepts that the impact of removing the Northern Endeavour project would be material for the Northern Territory. Consequently, it has decided to remove the amounts of \$90 million for 1997-98, \$1 061 million for 1998-99 and \$225 million for 1999-2000<sup>3</sup> from the Northern Territory's revenue base.

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<sup>3</sup> Information on the estimated cost of the Northern Endeavour was obtained from Northern Territory Treasury.

46. The Commission does not consider that a conceptual case has been established to remove total private gross fixed capital formation, in total or in part, from the revenue base. In the absence of information showing a decline in business's share of these taxes, it proposes to continue to assess capacity using total private expenditure.

### ***Capital market adjustment***

47. ***State views.*** States did not comment on this issue in their main submissions.

48. ***Preliminary proposal.*** In Discussion Paper CGC 2002/17 Financial Transaction Taxes, Commission staff proposed that the existing capital market adjustment (including the discount weights used in the FAG and the GST assessments) be retained.

49. ***Further State views.*** States generally supported the capital market adjustment.

50. ***New South Wales*** said the discount weights should be reduced to reflect the share of total financial transaction taxes derived from the short-term money market. It said transactions in this market were liable only for FID, not other financial transaction taxes. It said differences in States' capacities to raise revenue from FID were captured by the centralised banking adjustment and, if they were also captured by the central banking adjustment, they would be double counted. It thought a larger reduction would be required in respect of the GST assessment because the affected revenues comprised a larger proportion of the smaller GST financial standard.

51. ***Queensland*** opposed any reduction in the discount percentage. It said that New South Wales and Victoria had a large share of the finance, property, and business services sector.

52. ***Analysis and evaluation.*** In the 1993 Review, the Commission assessed the capital market adjustment to take account of differences in speculative investment that attracted financial transaction taxes. It said that this type of activity generated additional revenue over and above that from private consumption and physical investment. In that Review, the Commission decided to:

- (i) assess a capital market adjustment; and
- (ii) apply it to revenue from FID on short term dealings and stamp duty on mortgages and loans, which it estimated was about 30 per cent of the category.

53. In the 1999 Review, the Commission again assessed a capital market adjustment and again applied it to revenue from FID on short term dealings and stamp duty on mortgages and loans. Data provided by New South Wales showed that these revenues comprised about 18 per cent of the category (see Table 5). As the data were from one State and for one year only, the Commission rounded the figure up to 20 per cent.

**Table 5** COMPOSITION OF FINANCIAL TRANSACTION TAXES, 1996-97, NEW SOUTH WALES

Component	Average
	%
Financial Institutions Duties	
- general transactions below the cap	42.3
- general transactions above the cap	3.1
- short term dealings	1.6
Bank Account Debits tax	37.0
Stamp duty on mortgages and loan securities	16.0
<b>Total</b>	<b>100.0</b>

Source: Commission equalisation budget data and data provided by New South Wales.

54. Table 6 shows the composition of the Financial Transaction Taxes category for 1997-98 and 1998-99. It confirms revenue from FID on short term dealings and stamp duty on mortgages and loans comprises about 18 per cent of the FAG category standard and 33 per cent (15.2 per cent divided by 46.3 per cent) of the GST standard.

**Table 6** COMPOSITION OF FINANCIAL TRANSACTION TAXES, 1997-98 AND 1998-99

	1997-98	1998-99	Average
	%	%	%
FID			
- from short term dealings	3.0	3.2	3.1
- from other transactions	50.4	50.9	50.6
BAD tax	31.1	31.1	31.1
Stamp duty on mortgages and loan securities	15.6	14.9	15.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Commission equalisation budget data and data provided by New South Wales.

55. New South Wales said the discount should not be based on revenue from FID on short term dealings because State's capacity to raise revenue from FID were captured by the centralised banking adjustment. It concluded that it would be double counting to include FID on short term dealings in both adjustments.

56. While FID on short term dealings was used for the capital market adjustment, it was not used for the centralised banking adjustment. The latter adjustment was introduced in the 1999 Review for the first time. It was assessed to take into account the effect on State revenue raising capacities of the centralised banking practices of corporations in the larger States. The Commission decided not to apply the adjustment to all revenue from general FID transactions (about 45 per cent of the category, see Table 5) because businesses did not account for all total private expenditure and not all corporations

engaged in centralised banking practices. The Commission applied the adjustment to less than half of the general FID transactions revenue, it applied the adjustment to 20 per cent of the category. In short, the capital market and centralised banking adjustments were in concept intended to apply to different parts of the revenue base.

57. **Commission decision.** The Commission considered that there was a conceptual basis for making an adjustment for the relative size of capital markets in each State. It considers that the adjustment should relate to revenues from FID on short term dealings and stamp duty on mortgages and loan securities. The data indicate that this proportion is 18 per cent for the FAG assessment and 33 per cent for the GST assessment. In the absence of information to the contrary the Commission proposes to:

- (i) assess a capital market adjustment; and
- (ii) discount it by 82 per cent in its FAG assessment; and
- (iii) discount it by 67 per cent in its GST assessment.

#### ***Centralised banking adjustment***

58. **State views.** Even though FID had been abolished, *Tasmania* supported retaining the central banking adjustment because other incentives to centralise banking remained, in particular, the tendency for national companies to centralise head office activities in Melbourne and Sydney and the pre-eminence of these cities as financial centres.

59. **Preliminary proposal.** In Discussion Paper CGC 2002/17 Financial Transaction Taxes, Commission staff proposed that the centralised banking adjustment be removed from the GST assessment. They said the abolition of FID meant that, even if corporations continued to centralise their activities, there was no revenue raising advantage to the larger States.

60. **Further State views.** New South Wales, Western Australia, and the Northern Territory supported the removal of the centralised banking adjustment from the GST assessment. Queensland, Tasmania, and the ACT supported its retention. Victoria and South Australia did not comment.

61. **New South Wales** said that FID related adjustments were not relevant to a GST assessment because FID had been abolished under the IGA reforms. It said that the centralised banking adjustment should only apply to the FID component of the FAG assessment because there was no relationship between the centralised banking adjustment and the other financial transaction taxes in the category.

62. **Western Australia** supported the removal of the centralised banking adjustment. It said that while it was likely that many national businesses, including the major retailers, would continue to centralise their banking in Sydney or Melbourne, this would not necessarily provide New South Wales or Victoria with a significant revenue raising advantage now that FID has been abolished.

63. *Tasmania* said that in the absence of any evidence that businesses had changed their banking practices in response to the abolition of FID, the centralised banking adjustment should be retained for both the FAG and GST assessments. It said it was too early to determine whether the abolition of FID has had any impact on the distribution of deposits between jurisdictions. It argued that a significant proportion of BAD tax arose from non-cheque withdrawals from accounts with cheque drawing facilities.

64. The *ACT* said that despite the abolition of FID, national corporations continued to centralise their banking activities in order to reduce tax burden and this reduced the revenue raising capacities of the smaller States. The ACT said that because New South Wales' share of non-personal bank deposits was 1.6 times its population share, there was a strong rationale for retaining the centralised banking adjustment for both the FAG and GST assessments.

65. The *Northern Territory* supported the removal of the centralised banking adjustment. It said that while many large corporations and businesses have centralised their banking arrangements in the larger States, this did not have a major effect on those State's capacities to raise BAD tax. It argued that corporations' increased usage of EFTs and their ability to avoid BAD tax by not having a cheque facility attached to accounts meant their centralised banking practices did not translate into higher a BAD tax capacity.

66. *Analysis and evaluation.* The centralised banking adjustment was introduced in the 1999 Review to take account of the practice of corporations to centralise their banking activities to minimise FID tax liability. The standard FID rate structure had a cap of \$1 200. The cap provided an incentive for corporations to aggregate their receipts into a single deposit to minimise their liability.

67. There is no necessary nexus between where deposits are made and where withdrawals from accounts with cheque-drawing facilities (the base for BAD tax) are made. For the Commission, the issue is whether centralised banking practices provide some States with a revenue raising advantage now that FID has been abolished. There is no evidence that State's shares of other financial transaction taxes (like BAD tax) are influenced by centralised banking practice. For example, while New South Wales's share of bank deposits was much higher than its population share, its share of BAD tax (prior to it being abolished) was below its population share.

68. *Commission decision.* The Commission accepts that a conceptual case has been established for removing the centralised banking adjustment from the GST assessment. The Commission considers that while the corporations' centralised banking practices affected States' FID revenue capacities, evidence suggests that they have not had the same effect on States' capacities to raise other financial transaction taxes. Consequently, the Commission proposes to:

- (i) remove the centralised banking adjustment from its the GST assessments;
- (ii) retain the adjustment for the FAG assessments; and
- (iii) retain the existing discount for the FAG assessment (80 per cent).

### ***Mobility adjustments (cross border leakages)***

69. ***State views.*** The ACT said that, if the Commission were to continue the existing revenue base, it should reduce the ACT's revenue base by two per cent to account for leakages of its tax base to other States.

70. ***Preliminary proposal.*** In Discussion Paper CGC 2002/17 Financial Transaction Taxes, Commission staff asked for additional information to evaluate the ACT's proposal.

71. ***Further State views.*** *New South Wales* said it was not clear how the ACT has arrived at the figure of two per cent and it needed to substantiate that figure.

72. The *ACT* said that the two per cent figure reflected the leakage of BAD tax. The figure was the loss of BAD tax revenue which occurred when certain financial institutions closed their operations in the ACT.

73. The *Northern Territory* did not support a mobility adjustment for the ACT, because of a lack of data to substantiate the adjustment and because technology (such as EFTPOS facilities) had reduced the demand for cheque accounts and reduced the BAD tax revenue base.

74. ***Analysis and evaluation.*** Revenue capacity is assessed in this category using a broad indicator of capacity. The ACT proposal implies that this measure does not adequately capture its capacity and that an adjustment should be made because of closure of operations. All States experience closures of operations. If the Commission were to make this type of adjustment, it is unlikely that it would limit it to the ACT (which would happen if it was assessed as a cross border adjustment). There is no information on closures across States which would allow the Commission to determine whether an adjustment of this type would be material and would improve the assessment.

75. ***Commission decision.*** The Commission does not consider that the conceptual case has been established for assessing a cross border adjustment. The Commission does not accept that the existence of closures of operations in the ACT is sufficient justification for assessing a cross border adjustment. The Commission is not satisfied by the strength of the conceptual case and there is insufficient evidence to determine whether an adjustment for closures in operations would improve equalisation. The Commission has, therefore, decided not to introduce a cross border adjustment into this category.

### **PROPOSED ASSESSMENT METHOD FOR THE 2004 REVIEW**

76. The Commission's assessment method for the 2004 Review will be similar to that used for the 1999 Review. The revenue base will be adjusted total private expenditure. The assessment includes policy adjustments to remove the effects of non-standard policy. A capital market adjustment would be made for the GST assessment.

A capital market and centralised banking adjustment would be made for the FAG assessment.

### *Calculation of the revenue base*

77. Attachment A sets out the calculation of the revenue base for the GST assessment.

## 2004 REVIEW DRAFT CALCULATIONS

### *Grant share effects*

78. Table 7 shows the grant share effect of the proposed method of assessment. The change to the FAG relativities captures the adjustment to the Northern Territory's gross fixed capital formation data and the change in the discount to the capital market adjustment. The change to the GST relativities captures those adjustments and the removal of the centralised banking adjustment.

**Table 7** GRANT DISTRIBUTION OF FINANCIAL TRANSACTION TAXES COMPARED WITH EPC DISTRIBUTION

Change in grants	NSW	Vic	Qld	WA	SA	Tas	ACT	NT redistributed	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
<b>(a) GST Relativities</b>									
2003 Update	-140.4	-24.4	79.9	21.4	36.8	21.4	-0.1	5.2	164.8
Draft 2004 Review calculation	-85.6	-30.5	61.5	9.7	25.7	16.8	-1.0	3.5	117.1
Difference	54.8	-6.1	-18.4	-11.8	-11.2	-4.6	-0.9	-1.8	54.8
<b>(b) FAG Relativities</b>									
2003 Update	-202.2	-30.5	114.1	25.3	55.1	31.7	-0.4	6.9	233.2
Draft 2004 Review calculation	-198.1	-29.1	110.9	23.3	54.2	31.2	-0.5	8.2	227.7
Difference	4.1	1.4	-3.2	-2.0	-0.9	-0.5	-0.1	1.3	6.8

Source: 2003 Update Working Papers, Volume 2, pages 97 and 275.

### *Revenue raising capacity ratios*

79. Table 8 shows actual and standardised revenue for 2001-02 using the 2003 Update revenue base and the draft 2004 Review revenue base for the GST relativities.

**Table 8** REVENUE RAISING CAPACITY RATIOS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT Standard	
2003 Update	1.1894	1.0599	0.8043	0.8528	0.7856	0.6014	1.0243	0.7909	1.0000
2004 Review draft	1.1043	1.0786	0.8525	0.9090	0.8541	0.6996	1.0617	0.9261	1.0000

***Standardised revenue***

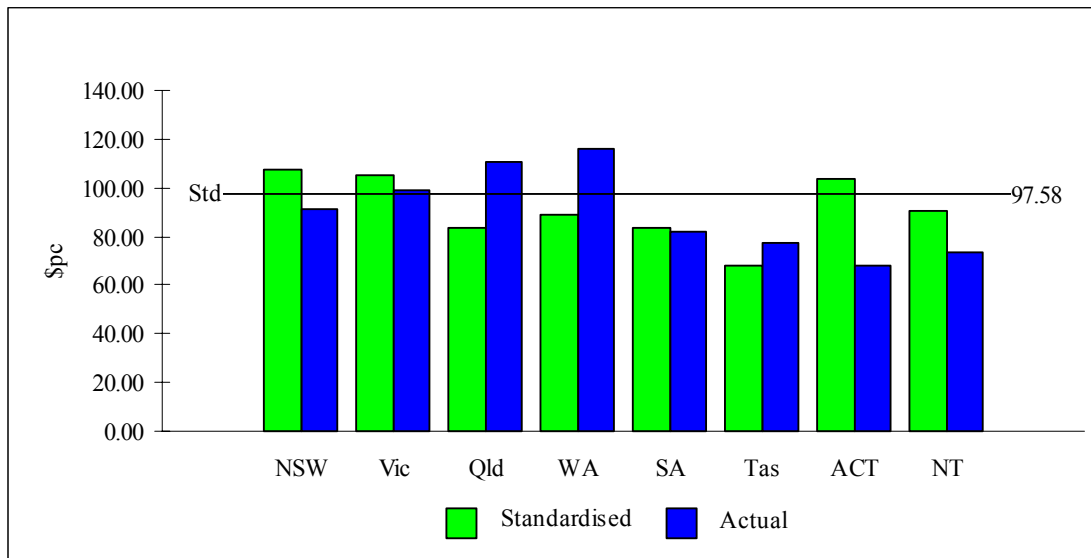
80. Table 9 shows actual and standardised revenue for 2001-02 using the 2003 Update revenue base and the draft 2004 Review revenue base for the GST relativities.

**Table 9** ACTUAL AND STANDARDISED REVENUE 2001-02 (GST)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT Standard	
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	
<b>Actual revenue</b>									
2003 Update	91.24	99.10	110.34	116.25	81.69	77.43	68.36	73.39	97.58
2004 Review draft	91.24	99.10	110.34	116.25	81.69	77.43	68.36	73.39	97.58
<b>Standardised revenue</b>									
2003 Update	116.06	103.43	78.48	83.22	76.66	58.68	99.95	77.17	97.58
2004 Review draft	107.76	105.25	83.19	88.70	83.34	68.27	103.60	90.37	97.58

81. Figure 2 shows the standardised actual and standard per capita for the Financial Transactions Taxes draft 2004 Review assessment for 2001-02.

**Figure 2** FINANCIAL TRANSACTION TAXES: STANDARDISED, ACTUAL AND STANDARD REVENUES PER CAPITA, PRELIMINARY



**Reality check**

82. The figure shows actual revenues for New South Wales, Victoria, the ACT and the Northern Territory are below their standardised levels. It is difficult to make precise explanations because of the broad nature of the assessment, the variety of taxes included in the category, and the different tax regimes that apply in the States. However, the following observations suggest the assessments appear to be in the right direction:

- (i) some states have narrower tax policies:
  - New South Wales does not impose a BAD tax.
  - Victoria does not impose duty on leases.
  - The ACT and the Northern Territory do not levy mortgage duty.
- (ii) some States have broader tax policies or have above average charges in some cases:
  - Western Australia and South Australia levy cheque duty.
  - Queensland and Tasmania levy loan duty.
  - Queensland levies credit card transactions duty and discount transactions duty.
  - Tasmania imposes an additional BAD duty of 15 cents per debit.

### *Updateability*

83. The proposed revenue base for Financial Transactions mainly uses a broad capacity measure based on data from the annual publication State National Accounts ABS 5220.0. The ABS publication contains data for a number of years and data for previous years are subject to revision in each new issue. The Commission updates data using the latest available issue each update.

## ATTACHMENT A

### 2004 REVIEW DRAFT REVENUE BASE

1. Table A-1 to Table A-4 show the data and the calculation of the revenue base for the 2004 Review draft GST assessment.

**Table A-1** TOTAL PRIVATE EXPENDITURE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
A. Household final consumption expenditure									
1997-98	120 736	84 457	57 108	31 622	24 433	7 548	6 226	2 972	335 102
1998-99	128 757	89 152	60 776	33 028	25 392	7 707	6 474	3 134	354 420
1999-2000	136 902	94 880	63 788	34 409	26 618	7 998	6 947	3 380	374 922
2000-01	147 764	101 793	69 070	36 490	28 880	8 502	7 808	3 566	403 873
2001-02	154 925	108 814	73 663	38 775	31 067	8 923	8 216	3 877	428 260
B. Private gross fixed capital formation(1)									
1997-98	35 643	25 326	18 140	18 552	6 652	1 525	1 382	1 415	108 635
1998-99	38 241	28 988	19 685	15 553	6 006	1 285	1 422	1 483	112 663
1999-2000	43 623	31 747	20 746	14 948	10 163	1 400	1 606	1 401	125 639
2000-01	40 075	31 954	19 676	13 777	8 522	1 490	1 432	1 524	118 450
2001-02	41 238	36 130	24 252	15 922	8 281	1 969	1 795	2 195	131 782
C. Total private expenditure = A + B									
1997-98	156 379	109 783	75 248	50 174	31 085	9 073	7 608	4 387	443 737
1998-99	166 998	118 140	80 461	48 581	31 398	8 992	7 896	4 617	467 083
1999-2000	180 525	126 627	84 534	49 357	36 781	9 398	8 553	4 781	500 556
2000-01	187 839	133 747	88 746	50 267	37 402	9 992	9 240	5 090	522 323
2001-02	196 163	144 944	97 915	54 697	39 348	10 892	10 011	6 072	560 042

(1) Data for the Northern Territory for 1997-98 to 1999-2000 have been adjusted to remove the PGFCE related to the Northern Endeavour project.

Source: Australia Bureau of Statistics, *Australian National Accounts, State Accounts, 5220.0, 2001-02*, Tables 8 to 16.

**Table A-2** FINANCE SECTOR PROPORTION

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
D. Factor income — finance and insurance									
1997-98	13 465	8 882	4 046	1 984	1 771	448	372	171	31 139
1998-99	14 071	9 364	3 773	2 130	1 739	463	362	152	32 054
1999-2000	17 123	10 212	4 087	2 405	2 097	517	498	194	37 133
2000-01	18 229	11 460	4 779	2 660	2 383	559	534	211	40 815
2001-02	19 834	13 025	5 273	3 035	2 528	652	521	216	45 084
E. Factor income — property and business services									
1997-98	22 170	14 177	6 918	5 108	3 013	503	1 355	415	53 659
1998-99	24 317	16 098	7 684	5 333	3 351	508	1 437	505	59 233
1999-2000	26 364	17 889	8 398	5 923	3 423	514	1 504	552	64 567
2000-01	29 336	19 717	9 362	6 480	3 751	562	1 666	592	71 466
2001-02	29 823	19 916	9 520	6 681	3 898	610	1 790	757	72 995
F. Total Factor income — finance sector = D + E									
1997-98	35 635	23 059	10 964	7 092	4 784	951	1 727	586	84 798
1998-99	38 388	25 462	11 457	7 463	5 090	971	1 799	657	91 287
1999-2000	43 487	28 101	12 485	8 328	5 520	1 031	2 002	746	101 700
2000-01	47 565	31 177	14 141	9 140	6 134	1 121	2 200	803	112 281
2001-02	49 657	32 941	14 793	9 716	6 426	1 262	2 311	973	118 079
G. Total State factor income									
1997-98	175 698	123 477	81 740	55 259	34 841	9 637	10 373	5 649	496 674
1998-99	184 631	130 980	86 757	57 134	35 106	10 168	11 052	6 247	522 075
1999-2000	197 206	139 695	91 547	61 437	36 479	10 228	11 756	6 961	555 309
2000-01	205 861	147 560	97 635	66 239	38 711	10 508	12 254	8 224	586 992
2001-02	216 815	158 055	105 633	70 037	41 068	11 036	13 048	8 386	624 078
H. Finance sector proportion = F / G									
1997-98	0.2028	0.1867	0.1341	0.1283	0.1373	0.0987	0.1665	0.1037	0.1707
1998-99	0.2079	0.1944	0.1321	0.1306	0.1450	0.0955	0.1628	0.1052	0.1749
1999-2000	0.2205	0.2012	0.1364	0.1356	0.1513	0.1008	0.1703	0.1072	0.1831
2000-01	0.2311	0.2113	0.1448	0.1380	0.1585	0.1067	0.1795	0.0976	0.1913
2001-02	0.2290	0.2084	0.1400	0.1387	0.1565	0.1144	0.1771	0.1160	0.1892

Source: Australia Bureau of Statistics, Australian National Accounts, State Accounts, 5220.0, 2001-02, Tables 18 to 26.

**Table A-3** CAPITAL MARKET ADJUSTMENT

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
I. Finance sector proportion = H from Table A-2									
1997-98	0.2028	0.1867	0.1341	0.1283	0.1373	0.0987	0.1665	0.1037	0.1707
1998-99	0.2079	0.1944	0.1321	0.1306	0.1450	0.0955	0.1628	0.1052	0.1749
1999-2000	0.2205	0.2012	0.1364	0.1356	0.1513	0.1008	0.1703	0.1072	0.1831
2000-01	0.2311	0.2113	0.1448	0.1380	0.1585	0.1067	0.1795	0.0976	0.1913
2001-02	0.2290	0.2084	0.1400	0.1387	0.1565	0.1144	0.1771	0.1160	0.1892
J. Relativity of finance sector proportion — State proportion divided by Australian proportion									
1997-98	1.1879	1.0938	0.7856	0.7517	0.8042	0.5780	0.9752	0.6076	1.0000
1998-99	1.1891	1.1118	0.7552	0.7470	0.8292	0.5461	0.9309	0.6015	1.0000
1999-2000	1.2041	1.0984	0.7447	0.7402	0.8262	0.5504	0.9299	0.5852	1.0000
2000-01	1.2079	1.1046	0.7572	0.7214	0.8284	0.5577	0.9386	0.5105	1.0000
2001-02	1.2105	1.1015	0.7402	0.7332	0.8270	0.6044	0.9361	0.6132	1.0000
K. Discount weight									0.3300
L. Capital market adjustment factor = $\{(J - 1) \times \text{Discount}\} + 1$									
1997-98	1.0620	1.0310	0.9293	0.9181	0.9354	0.8607	0.9918	0.8705	1.0000
1998-99	1.0624	1.0369	0.9192	0.9165	0.9436	0.8502	0.9772	0.8685	1.0000
1999-2000	1.0673	1.0325	0.9157	0.9143	0.9427	0.8516	0.9769	0.8631	1.0000
2000-01	1.0686	1.0345	0.9199	0.9081	0.9434	0.8540	0.9797	0.8385	1.0000
2001-02	1.0695	1.0335	0.9143	0.9120	0.9429	0.8694	0.9789	0.8724	1.0000

**Table A-4 REVENUE BASE FOR 2004 REVIEW DRAFT CALCULATION**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
R. Total private expenditure (C from)									
1997-98	156 379	109 783	75 248	50 174	31 085	9 073	7 608	4 387	443 737
1998-99	166 998	118 140	80 461	48 581	31 398	8 992	7 896	4 617	467 083
1999-2000	180 525	126 627	84 534	49 357	36 781	9 398	8 553	4 781	500 556
2000-01	187 839	133 747	88 746	50 267	37 402	9 992	9 240	5 090	522 323
2001-02	196 163	144 944	97 915	54 697	39 348	10 892	10 011	6 072	560 042
S. Capital market adjustment Factor (L from Table 8)									
1997-98	1.0620	1.0310	0.9293	0.9181	0.9354	0.8607	0.9918	0.8705	1.0000
1998-99	1.0624	1.0369	0.9192	0.9165	0.9436	0.8502	0.9772	0.8685	1.0000
1999-2000	1.0673	1.0325	0.9157	0.9143	0.9427	0.8516	0.9769	0.8631	1.0000
2000-01	1.0686	1.0345	0.9199	0.9081	0.9434	0.8540	0.9797	0.8385	1.0000
2001-02	1.0695	1.0335	0.9143	0.9120	0.9429	0.8694	0.9789	0.8724	1.0000
Revenue base = R x (S)									
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
1997-98	166 078	113 181	69 925	46 063	29 077	7 809	7 546	3 819	443 498
1998-99	177 419	122 497	73 962	44 526	29 628	7 645	7 716	4 010	467 403
1999-2000	192 682	130 738	77 411	45 125	34 672	8 004	8 355	4 127	501 114
2000-01	200 728	138 362	81 635	45 645	35 284	8 534	9 053	4 268	523 507
2001-02	209 788	149 800	89 519	49 881	37 102	9 470	9 800	5 297	560 657
Standardised Revenue									
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
1997-98	644 553	439 260	271 381	178 772	112 848	30 309	29 285	14 821	1 721 229
1998-99	646 869	446 625	269 667	162 341	108 025	27 875	28 133	14 620	1 704 154
1999-2000	710 065	481 791	285 272	166 292	127 772	29 495	30 790	15 207	1 846 683
2000-01	713 608	491 892	290 220	162 273	125 438	30 338	32 183	15 172	1 861 125
2001-02	715 614	510 988	305 361	170 152	126 558	32 303	33 429	18 069	1 912 473
Revenue capacity Ratio									
1997-98	110.42	102.86	85.80	106.91	82.25	69.39	102.40	84.89	100.00
1998-99	111.91	105.77	85.79	97.62	80.02	65.36	99.81	84.10	100.00
1999-2000	113.37	105.36	83.39	92.09	87.92	64.63	101.00	80.36	100.00
2000-01	113.02	106.75	83.78	89.12	86.35	66.79	104.82	79.44	100.00
2001-02	110.43	107.86	85.26	90.90	85.40	69.96	106.17	92.61	100.00