The "review of Australia's future tax system": implications for local government in Australia and recommendations

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Abstract
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INTRODUCTION

The report to the Treasurer on Australia’s Future Tax System (Henry Tax Review) was delivered in December 2009 after the government announced in the 2008-2009 budget that a comprehensive review would be conducted into the existing tax and transfer system currently used in Australia. The findings and recommendations contained in the final report have serious implications for local government in Australia. This article will examine the implications for local government in five parts.

The first part of the article will provide a summary of the policy reasons for the need to conduct a review into the shape of a future tax system for Australia. The second part of the article will provide a background to local government in Australia and in particular the financing of services. The third part of the article will identify matters raised in the Henry Tax Review that are relevant to local government and the fourth part will discuss the consequences of the Henry Tax Review for local government. The fifth part of the article will identify those issues which local government might pursue in future discussions and negotiations with both State Governments and the Federal Government concerning the review of taxation.

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

The drivers for the original Review of Australia’s Future Tax System included such things as demographic changes within Australia especially the ageing population; changing revenue bases from income tax to a broader range of taxes; the existence of complicated and numerous taxing regimes spread across the Commonwealth, States and Territories; international competitiveness; the mobility of capital; climate change; and basic infrastructure and social capital spending. Pressure to reform the tax system to address those challenges will be ongoing. Dr Ken Henry has laid the seeds for that reform into the future with the report.

THE NEED TO REVIEW THE TAXATION SYSTEM

The recommendations relevant to local government that were made in the Henry Tax Review include the need to standardise land valuations between States and local government; that councils should have a discretion to charge rates at the level that they consider appropriate; the need to review the distribution of untied revenue assistance to local government; the possibility of introducing road user charges; housing affordability; and the future of aged care. All of these issues are examined in detail in this article together with suggestions for future action to be undertaken by local government in Australia. Prior to discussing these issues it is important to consider the background factors that led to the review of the Australian taxation system.

Background to the Henry Tax Review

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

Over the last decade new challenges have arisen and these required new policy and hence new tax outcomes. These included demographic changes and increasing health care costs, their impacts on the Budget and wider economic challenges such as globalisation and service provision all of which actually call into question the current tax policy and legislative settings. Thus, for example, internationally the re-emergence of Asia as a centre of production and finance and the increasing mobility of capital are matters that mean that fundamental changes to the tax system here can help position Australia to take advantage of those developments and prosper.

In essence this new world required a tax system that attracts global investment and encourages the expansion of Australian business around the globe. In addition the changing nature of the Australian workforce, more women and more part-time work, creates demands for a range of services such as childcare. Couple this with rising expectations about public delivery of services and the tax system must respond in creative ways to meet those expectations and encourage business activity at the same time. Tax too has an important, if not crucial, role to play in addressing environmental issues and possible developments now and into the future.

Further, the current tax arrangements are themselves unstable and cannot survive in their current form for much longer. This mix of taxes at all levels of government impinges on economic efficiency and is a “deadweight” on the economy. In other words, income tax is inefficient in that people are reluctant to earn more income if the marginal benefit is only slight as a result of a high tax rate. High rates of tax discourage economic activity. Finally one of the concerns the global financial crisis highlighted was the high current account deficit and the need for a strong national savings effort. Again tax can play a role in encouraging that effort.

It was in this context and against this background that the government commissioned Dr Ken Henry to head the Tax Review. While many of the recommendations do not specifically relate to local government, they will if implemented over time have a profound effect on local government and its
role in Australian society. The Commonwealth Government has adopted a cautious approach to-date to the recommendations but the circumstances outlined above, and the tax outcomes Henry suggests to address or ameliorate those circumstances are ongoing and the pressure to act and implement fundamental tax reform will remain. Unfortunately the Tax Summit held in October 2011 did not pressure the government sufficiently to implement any of the tax reforms contained in the Henry Tax Review and in particular those recommendations relating to local government.

The Henry Tax Review recommendations

The article will now examine the specific local government recommendations of the Henry Tax Review. This will consist of an examination of the specific recommendations such as a land tax and road charges which will or may impact on local government. The article will also consider the more general direction of tax reform in Australia as a result of the Review and the possible implications for local government as both influencer and implementer of tax reform.

Henry made 138 recommendations which the government released on 2 May 2010. According to various commentators the government adopted up to four of those recommendations, especially a resource rent tax and beginning the process of cutting the company tax rate. Unfortunately the Bill introducing this amendment was not passed by the Senate and did not eventuate. The government also announced that it would look at some of the recommendations during the rest of 2010. The Federal Election in August 2010 interrupted that process. The Prime Minister and Treasurer said that other matters, “especially making tax time simpler for everyday Australians, improving incentives to save and improving the governance and transparency of the tax system” would be considered as part of a full second term agenda. Other recommendations were to become part of what the Treasurer Wayne Swan called “a mature tax debate”. He expected them “to be the subject of much discussion in the coming years”.

LOCAL GOVERNMENT IN CONTEXT

Local government is the third tier of government in Australia. It is democratic and transparent and the tier of government closest to the people. It performs a vital delivery function for many basic services. Most of the services provided are to the local community although for roads and road maintenance, for example, they also have regional and national significance. Housing and community amenities; transport and communications; recreation and culture; and social security and welfare are among the most important services provided by local government. Specifically included are infrastructure and services such as:

- roads,
- swimming pools, libraries, halls, sports grounds, children’s centres, neighbourhood centres, parks and gardens, stormwater drains and streetscapes;
- waste disposal facilities and natural resource management;
- community education and information campaigns;
- regulation and compliance; and
- emergency and disaster responses and relief.

There are about 560 local councils in Australia. To illustrate the importance of the local government sector economically, the Australian Local Government Association (ALGA) 2010-2011

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3 Prime Minister Rudd and Deputy Prime Minister Swan, n 2.
4 Prime Minister Rudd and Deputy Prime Minister Swan, n 2.
7 Henry et al, n 1, p 689.
Budget submission said that local government “employs around 178,000 Australians (almost 10% of the total public sector), owns and manages non-financial assets estimated at $212 billion (2006-2007), raises around 3% of Australia’s total taxation revenue per annum and has an annual expenditure of around $24 billion (2007-2008) (more than 6% of total public sector spending”). It delivers a number of services, including housing and community amenities, transport and communications, recreation and culture, and social security and welfare. Specifically this includes areas like roads (which have both a local and regional or even national significance), waste disposal centres, swimming pools, garbage collection, drains and streets, libraries, sports grounds and parks and gardens to name a few.

The health of the local government sector is important for Australian society and its democracy. Part of any consideration of that health must be the adequacy of the funding base for the sector and changes both positive and negative that might flow from any tax reform. Part of the purpose of this article is to help local government players make informed arguments in the tax reform debates for the benefit of the sector and Australian society more generally as a consequence. This necessitates an examination of current funding.

Current funding
The financial sustainability of local councils must be and is at the forefront of any discussion of not just funding but local government itself. Dollery, Crase and Byrnes, for example, offer what for many in the sector might appear a bleak assessment of local government funding in Australia. It has, they say, “been falling relative to other tiers of government for the past 30 years with various adverse consequences, especially the decline of local government infrastructure”. For example, local government’s take of overall revenue has fallen from 6% of national income in 1970-1971 to 4.18% in 2003-2004. Australian Government Financial Assistance Grants (FAGs) have declined from 1.18% of Commonwealth revenue in 1993-1994 to 0.77% in 2007=2008.

Any discussion of local government funding has to start with the fact that there are big differences between councils in terms of their revenue raising capacity. To talk of averages disguises those differences and those differences can be summarised up by stating that wealthy suburban and city councils can fully fund their spending from their own sources but that regional and remote councils cannot and must rely on grants from the other tiers of government.

A 2006 PricewaterhouseCoopers’ National Financial Sustainability Study of Local Government, commissioned by ALGA, said that approximately 10% to 30% of Australia’s councils had sustainability issues. This reflected State-based reports that between 25% and 40% of councils may not be sustainable. Given the differences in the wealth and the resource base of councils across Australia, these less sustainable

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9 ALGA, n 5.

10 ALGA, n 6, Fact Sheet 11.


17 PwC, n 16.
councils are often likely to be in more remote and less populous areas. Local governments in urban areas mainly fund their activities through their own revenue raising using rates, fees and charges. Those in rural and remote regions rely more heavily on Financial Assistance Grants. In terms of which councils were most at risk, PwC put it this way:

The less financially viable councils tend to be smaller (often rural, remote or small metropolitan), usually with constrained own-source revenue streams and a lack of economies of scale compounded by weaknesses in financial and asset management capabilities.

While rates make up about on average 45% of councils’ own source income, disparities across local governments can be indicative of funding distress. Thus PwC note that “87% and 54% of rural remote and rural agricultural councils respectively have rates covering less than 40% of costs creating a dependence on government grants”. Local government dependence on Federal and State funding is substantial. Keeping in mind regional differences, such grants made up on average 17% of local government funding in 2005-2006. Australian Government Financial Assistance Grants made up 7% of that but such grants are paid through the States. On top of that 8.5% is from direct State and Territory grants. The final 1.5% is from tied Australian Government grants paid direct to local government. With, on average, 17% of funding coming from external services, and recognising that the percentages vary over time, on average 83% of local government funding came from its own sources in 2005-2006. According to the Review, 37% was from rates, 29% from annual and user charges, 3% from dividends and interest, and 14% from other sources, mainly fines and developer charges.

The contribution of rates as a revenue source has fallen over time, with user charges increasing more rapidly as a source of revenue for local councils than other sources. This arguably is because of councils receiving less Federal and State government funding and the decline in rates as a source of funding. Rates are a tax and the only tax base local councils have to ensure all of the community pays for public goods and services like parks and libraries and garbage services. But local councils also provide essentially private goods and services such as sporting grounds and water and sewerage services, for which a fee for service is appropriate to recover the costs.

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18 Productivity Commission, n 15.
19 Productivity Commission, n 15.
20 Productivity Commission, n 15.
21 PwC, n 16, p 10.
22 Henry et al, n 1, p 689.
23 PwC, n 16, p 9.
24 Henry et al, n 1, p 691.
25 Henry et al, n 1, p 691.
26 Henry et al, n 1, p 691.
27 Henry et al, n 1, p 691.
28 Henry et al, n 1, p 690.
29 Henry et al, n 1, p 691.
30 Productivity Commission, n 15, p 7.
31 Dollery et al, n 12 at 341.
32 Dollery et al, n 12 at 341-342.
33 Dollery et al, n 12 at 341; Henry et al, n 1, p 691.
34 Henry et al, n 1, p 690.
35 Henry et al, n 1, p 693.
36 Henry et al, n 1, p 693.
Local government is struggling to meet community expectations for more services and, as discussed, often a lack of funding to fully meet those expectations. One way is to increase user charges and infrastructure charges as some form of “backdoor” taxes. The trend over the last 40 years for local government has been to provide welfare services, nominally the function of the States and Commonwealth. This, as well as falling income contributions from State and Federal Governments, may in part explain the greater council reliance on user charges.

Local government spent $27.9 billion in 2009-2010 on providing various services, the nature of which is changing over time from the traditional roads and property services to encompass a range of human services and planning and regulatory functions. According to the Australian Bureau of Statistics “the major contributors to the $27.9 billion spending were housing and community amenities (24.4%), transport and communications (22%), general public services (18.8%) and recreation and culture (14.6%)”.

Given the financial insecurity of some local councils as discussed above, the question of an ongoing and secure funding base for local government is crucial. The Henry Tax Review offers some possibilities for a more robust tax system, including various specific recommendations and suggestions for local government. These include continuing to use rates, (a type of land tax), more closely integrating State and Territory land taxes and rates, freeing up the sector from restrictions on rate setting, using user charges and using them appropriately and reviewing the distribution of untied financial grants. The sector may be able to influence the debates and discussions that will arise over the long term, in part hopefully armed with some of the detail here. Further such discussion and debate could lead to an examination of the function and role of local government in Australian democracy, the economy and politics and so offers the opportunity to broaden out the discussion into ones about those roles and the place of local government in the body politic and civil society and the functioning of Australian democracy. Such issues are beyond the scope of this article but the authors believe the expertise and will exist for local government to skilfully utilise the tax debate to its own democratic and funding ends.

One argument that will be raised in response to claims about the lack of funding for some councils is that financial security currently exists for many and that for those which are borderline the solution is in their own hands. Local government is likely to be told to improve efficiency and/or its own revenue raising. Enquiries by the Productivity Commission and the Standing Committee on Economics, Finance and Public Administration (the Hawker Report) have for example commented respectively that councils raise “about 88 per cent of their hypothetical [revenue] benchmarks, on average” and that there should be a review of “the way our taxes, including rates, are spent”.

Although the Productivity Commission qualified its remarks by saying this 88% of revenue

38 For an introduction to some recent studies see Dollery et al, n 11 at 162-163. See also PwC, n 16, p 12.
39 PwC, n 16, p 27.
40 PwC, n 16, p 28.
42 Productivity Commission, n 15, p xix; see also Crase and Dollery, n 37, p 27.
43 ABS, n 41.
44 Henry et al, n 1, p 689.
45 Productivity Commission, n 15, p 87.
47 Productivity Commission, n 15, p 87.
benchmark figure should “not be taken to imply that local governments should increase the revenue they raise”⁴⁹; it did go on to say that “[m]ost councils could do more to help themselves, but a small number will remain highly dependent on grants, despite high levels of revenue-raising effort”.⁵⁰

The Henry Tax Review does offer local government the opportunity to use its rating base more efficiently through eg autonomy in rate setting⁵¹ and the convergence of rates and State land tax administration and valuations.⁵² Couple these with an overall move to land tax as part of taxing economic rent, something at the heart of the Henry Tax Review and future State tax reform directions suggested by the Review, if adopted, will impact on the funding mix for all levels of government. For example, Henry says:

[T]he Australian government should have control of taxes with more mobile tax bases and taxes used for redistribution and macroeconomic stabilisation. The States should have control of taxes on more immobile bases.⁵³

Any increase or broadening and rationalisation of current State and Territory immobile base taxes (such as State and Territory broad-based land taxes to replace inefficient taxes like stamp duty on housing and insurance)⁵⁴ and suggested moves by the States and Territories to a cash flow tax⁵⁵ will have an effect on local government, given its dependence on State and Commonwealth grants. Further, given local government’s rates expertise and the Review recommendation for more integration over time of the administration of State land taxes and local government rates and their valuation⁵⁶ this too if eventually adopted will have consequences for local government. Some strategic thinking on the part of the sector about how it could best position itself in this regard might therefore be appropriate.

Just as importantly such moves could create uncertainty about the level of tax revenue raised and the amount available for distribution to the local government sector. While this shift is not immediately on the agenda the local government sector should be aware of the possibility, especially as more and more of the Henry Tax Review recommendations take effect. Local government should therefore prepare itself to have input into and to take advantage of any possible changes.

Only one local government tax base

Councils have only one tax base: rates.⁵⁷ Although different valuation methods can and are used, in essence rates are a tax charged on the value of property, with most types of land included in the tax base.⁵⁸ The Henry Tax Review confirms that because land is immobile, rates based on land value are an appropriate tax base for local government to fund public goods and services. The review does not take up the issue of whether they should be the only tax base for local government. On the other hand Dr Henry accepts that user charges are an appropriate funding mechanism for local government in order to deliver private goods and services.

Local government provides more and more private services such as sporting grounds; aged care; pre-schools; pools and the like. The Henry Tax Review takes the view that the distinction between rates for public goods and user charges for cost recovery in the provision of services takes on more and more importance. Dr Henry stresses that as long as the charges are set at levels of cost recovery they are appropriate but that higher charges are in fact a tax and may have distortionary effects.

⁴⁸ The Hawker Report, n 46, p vii.
⁴⁹ Productivity Commission, n 15, p 87.
⁵⁰ The Hawker Report, n 46, p vii and xviii.
⁵¹ Henry et al, n 1, pp 103, 695.
⁵² Henry et al, n 1, p 695.
⁵³ Henry et al, n 1, p 673.
⁵⁴ Henry et al, n 1, pp, 48, 680.
⁵⁵ Henry et al, n 1, pp 680, 681.
⁵⁶ Henry et al, n 1, p 103.
⁵⁷ Henry et al, n 1, p 103.
⁵⁸ Henry et al, n 1, p 103.
Recommendation 121 is also of fundamental importance to local government. It says:

There seems little reason that local governments with large fiscal capacities should receive a guaranteed minimum grant (which allows them to tax their residents less than they otherwise would) at the expense of local governments with relatively small fiscal capacities (which result in them taxing their residents more than they otherwise would). The current requirement that each council receives 30 per cent of its per capita share of untied financial assistance grants may prevent State grants commissions from redistributing to councils that require greater assistance.\(^{69}\)

It is recommended that local government develop a position that addresses this view. As local government has noted the means by which property rates are calculated is different in each State and Territory.\(^{60}\) The Henry Tax Review agrees\(^ {61}\) and wants a move at State and local levels to a standard measure of land tax. The Review says:

Unless there are genuine policy reasons for doing otherwise and these reasons provide greater benefits than the associated costs, land-based taxes should make use of the same valuation method as this is likely to reduce administration costs. Therefore, as State governments make more use of the land tax base over the long term (see Section C2 Land tax and conveyance stamp duty), there should be one valuation method across the State used to calculate the base for both rates and land tax (see Recommendation 121). That is, land valuation would be the same for both taxes. However, local governments could continue to charge a fixed charge to ratepayers and there should not be a low land value threshold for local government rates, as even those who own land with a low per square metre value receive benefits from local government services.\(^ {62}\)

This opens up the possibility for the standardisation of valuation methods across Australia, and indeed that standardisation is more fully developed in the Review’s proposals for a Commonwealth land tax. It is recommended that local government develop a position on the standardisation of rates valuation methods. For efficiency and cost saving reasons, the Henry Tax Review also argues for the better integration of State land tax and council rates, including suggesting one bill and one centre or contact point for both taxes to cover enquiries, administration and compliance.\(^ {63}\) There is a wider context for this suggestion. The Henry Tax Review sees this tax base integration and sharing of resources as offering the opportunity for a reassignment of tax responsibilities within the federation, as it is relatively simple to alter the rate of tax charged by each level of government leaving overall revenue collected unchanged to alter the amount of revenue received by each level of government.\(^ {64}\) This offers both opportunities and threats to local government.

**LOCAL GOVERNMENT ISSUES – HENRY TAX REVIEW**

The Henry Tax Review also examined a number of taxation issues that may be relevant for local government. Specifically, the following four issues have been identified as having consequences for local government. The main issue discussed first in this section of the article is the setting of rates and the need for council’s to have a degree of autonomy. The other issues comprise, first; the potential opportunity for the introduction of road user charges; secondly, the problem facing Australians of housing affordability; and thirdly, the cost of providing aged care in a country with an ageing population. These issues will now be examined in detail.

The Henry Tax Review states in its Recommendation 120 that States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their

\(^{69}\) Henry et al, n 1, p 694.


\(^{62}\) Henry et al, n 1, Ch G: Institutions, governance and administration, G3. Local government, G3-2. Reform Directions for Own-Source and Grant Revenue Arrangements.

\(^{63}\) Henry et al, n 1, Ch G, G3-2.

\(^{64}\) Henry et al, n 1.
municipality. If local governments are to be accountable to ratepayers for their expenditures, it follows that they should have full (or at least greater) autonomy over the setting of the tax rate applied to properties in their jurisdictions.

The logic is sound. The politics are a little more difficult. Nevertheless the recommendation adds further support to local government’s campaign for rate setting autonomy and against rate capping and it is recommended that this approach be pursued.

Recommendation 121 is also of fundamental importance to local government. It suggests that over time State land tax and local government rates should become more integrated. This could be achieved by having an integrated billing method with one bill for both charges or using the same valuation method which would be consisted across all States. This is the situation in the Australian Capital Territory where the ACT Government also acts in the capacity as the local government. There are no municipalities in the ACT.

In relation to this issue, local government is well aware that the means by which property rates are calculated is different in each State and Territory. The Review hints at costs savings as its rationale for the need to standardise the valuation methods.

An ongoing shift to user charges that the Henry Tax Review identified might, as Dr Henry suggests, necessitate a shift in attitude or at least its serious consideration. For example, a shift to road user charges imposed and collected by local government would likely see local government revenue increase, with consequent funding and other changes needing to be worked through and negotiated. However the issue of integration and the related one of realignment is very complex. For that reason it is recommended that local government develop a position on land tax and rates integration and sharing that encompasses the wider question of tax responsibility realignment.

In discussing the minimum grant principle, the Henry Tax Review contends that since local government delivers State and Territory services, it is more appropriate that the States be responsible for ensuring that local governments have access to enough revenue. This in turn would require States having access to appropriate funding sources. An alternative would be a wider funding base for local government.

As part of its discussion of the principles for distributing untied revenue assistance to local government, the Henry Tax Review makes the point that “if the minimum grant principle was removed, the overarching principle for untied assistance could simply be horizontal equalisation within the relevant jurisdiction. The other principles could be considered when determining the distribution needed to achieve horizontal equalisation”. The Henry Tax review also argues that there is a strong case for reviewing the principles for distributing untied revenue assistance to local government. This is a fundamental point and once again offers opportunities and threats to local government. It is recommended that local government develop a position that addresses the call for a review of the principles for distributing untied revenue assistance to local government perhaps using the opportunity to reignite debate about the inadequacies or otherwise of the current arrangements and proposing alternatives to overcome vertical fiscal imbalance and which specifically deals with the calls to abolish the minimum grant principle.

As an important aside, it is in this discussion too that the Henry Tax Review remarks that given the expertise that local governments have in the delivery of some goods and services, these payments...
to local government for specific services can represent value for money for higher levels of government. This recognition will be useful into the future, eg in positioning local government as the first choice provider in times of national reconstruction such as the recent floods in Queensland.

**Road user charges**

Local government owns and maintains 80% of the roads in Australia. Yet the main tax collected through this activity is a combination of excise, a state fuel tax, and the Goods and Services Tax (GST) which is predominantly a Commonwealth responsibility and the funding comes from both the Commonwealth and the States. It is strongly contended that the Henry Tax Review recommendations on road charges offer a real opportunity for local government to make a claim on that revenue which will add certainty to the future of road funding across Australia.

The Henry Tax Review made a number of recommendations in relation to road charges. These include a National Road Transport Agreement (NTRA) developed through the Council of Australian Governments (COAG) to establish objectives, outcomes, outputs and incentives to guide governments in the use and supply of road infrastructure. Furthermore, the Henry Tax Review recommended that COAG should nominate a single institution to lead road tax reform, and ensure implementation of this agreement. Clearly local government, as both a member of COAG through its president and owner of the vast majority of Australian roads, has a vital role to play in all aspects of the NTRA, its formulation, application and implementation. It is recommended that local government explore ways to influence the development of the NTRA and the single institution leading road tax reform to ensure its interests are reflected in the processes, bodies and outcomes.

The Henry Tax Review advocated two main types of user pays reforms that are relevant for local government: first, a congestion charges to deal with urban congestion and secondly, a mass distance location pricing for heavy vehicles. Since local government owns and maintains 80% of the roads in Australia both recommendations would impact on local councils, as potential determiners of the level of the charges, as the imposers of the charges, collectors, and users of the earmarked road funds. For example, in the Henry Tax Review it is envisaged that heavy vehicle road user charges would be returned to those who own the roads. In this case, local councils would be the recipient of revenue raised in this situation.

But the Henry Tax Review warns that even before local government can spend the money there needs to be in place mechanisms to ensure that the user charge actually reflects the marginal social cost of using the roads. For there to be efficient pricing requires comprehensive cost information. Such location specific information does not currently exist and the Henry Tax Review saw the ascertainment of empirical data to reflect actual costs as fundamental to the imposition of economically efficient charges and the distribution of funds raised. Arguably, with local government

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72 ALGA, n 6, Fact Sheet 11.
73 Henry et al, n 1, Ch 12, Recommendation 68.
74 Henry et al, n 1, Recommendation 68.
76 Henry et al, n 1, Recommendation 61.
77 Henry et al, n 1, Recommendation 62.
78 ALGA, n 6, Fact Sheet 11.
80 Henry et al, n 1, Ch E, E3-6.
81 Henry et al, n 1, Ch E, E3-6.
82 Henry et al, n 1, Ch E, E3-6.
being a member of COAG through its president, the Henry Tax Review recommendation that COAG develop a National Road Transport Agreement would cover this, so that local government would have a role to play in determining the user costs on particular roads in their jurisdiction based on things like the type of vehicle; their weight; amount of use. There would also need to be in place some overarching regulation to ensure for that there was no overcharging. It is strongly recommended that local government consider ways to favourably influence the National Road Transport Agreement through its membership of COAG.

As the National Farmers’ Federation has noted, congestion taxes could be incorporated under a broader package looking towards regional development and providing an additional incentive to live and work in regional areas that have less congestion. Such an idea or a variant on it might be worthy of further exploration by local government. It is recommended that local government investigate ways to incorporate congestion taxes into a broader regional or other package as appropriate.

There are questions about who would administer congestion and road user charges. However, it is strongly recommended that local government undertake further research to examine its possible role in the administration and collection of any road charges as well as the utilisation of the congestion and road user charges. It is important for local government to investigate whether the technology currently exists to make this recommendation a viable option.

One of the issues the Henry Tax Review raised was that short-run marginal cost pricing on congested urban roads is expected to yield sufficient revenues to cover the full costs of the roads concerned, and may generate additional revenue. However, for most of the road network, short-run marginal cost pricing will lead to major under-recovery of costs. Irrespective of the ultimate funding split, the fact remains that local government would be the main spender. The user charge principle, for both congestion and heavy vehicle road use, would give local councils some flexibility in revenue raising but the concern must be that Federal and State Governments would see this funding as sufficient to address road maintenance and development. The Henry Tax Review clearly recognised that this was not the case. Road user charges should be seen as a source of extra funding to address past Federal and State underfunding on roads through local government and to address this underfunding issue into the future, not as a mechanism to cut other funding to local government.

**Housing affordability**

In a wide ranging discussion of housing affordability, and recognising that taxation is not a major determinant in that regard, the most relevant part of that discussion from the local governments’ point of view was when the Henry Tax Review stated that “as a first step, the Council of Australian Governments should review building and land use policies and infrastructure charges to ensure they do not unnecessarily restrict the supply of housing”. These policies and charges are an important component of local government and it is recommended that local government develop a strategy for addressing these issues prior to the Review occurring (if it does in fact occur).

The Henry Tax Review recognised that “Australia faces significant challenges in providing sufficient affordable housing”. Apart from taxation, the Henry Tax Review identified a range of other factors; many of them local government ones, which impact on housing affordability. These include “planning and zoning laws, building regulations, environmental regulations, infrastructure provision and pricing, the availability of skilled labour in residential construction, and even transport policy”. So many local government responsibilities and policies developed at the local level impact on housing affordability. While recognising there are competing policy objectives in all of these, the Henry Tax

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83 Samson, n 71.
85 NFF, n 84.
86 Henry et al, n 1, Ch E, E3-4. *How Should Roads be Financed?*
87 Henry Ch E, E4. *Housing Affordability*.
88 Henry Ch E, E4, E4-1. *The Role of Housing in Australia*.
89 Henry et al, n 1, Ch E, E4, E4-2. *What is Housing Affordability?*
Review solution was as follows:

**Recommendation 69:**

COAG should place priority on a review of institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability.\(^{90}\)

This will have implications for local government and it is recommended that local government keep a watching brief on COAG action in this regard and develop an agreed position if possible before any review begins and after extensive consultation with its Councils.

In relation to taxes, the Henry Tax Review discusses other things about housing affordability and land taxes. While these are State issues, they are relevant for funding and, tangentially rates issues and they point to wider thinking in relation to a uniform Commonwealth land tax. As the Henry Tax Review states:

Using the size of holdings and the use of land to determine land tax liabilities has adverse impacts on the housing market. Reforms to levy land tax on all land, based on its value, should reduce these effects.\(^{91}\)

Further, the Henry Tax Review finds that aggregation approaches to imposing land tax disadvantages, in conjunction with progressive rates, large holders of land and imposes efficiency costs on society as a consequence. The Henry Tax Review argues that exemptions impose costs that are borne by renters. The review suggests broadening land tax to address this. It is recommended that local government keep a watching brief on possible land tax changes and developments.

The Henry Tax Review suggested stamp duty on property transactions be abolished, and recommended that net rental income be discounted at the same level as capital gains. The latter proposal here from the Henry Tax Review was to apply “a 40 per cent discount to most interest income, net residential rental property income, capital gains and certain interest expenses”.\(^{92}\) The net residential rental property income discount would apply to negatively geared rental incomes.\(^{93}\) These measures would arguably increase the supply of housing and as such indirectly increase local government funding through rates and perhaps grants from the States, but to be offset against the immediate loss of stamp duty revenue by State Governments.

The Review also made recommendations about infrastructure charges (developer charges.) Many local governments and some State Governments impose them. In essence the Henry Tax Review was concerned that the charges went further than recovering infrastructure costs and amounted to taxes, and that they were often costly to levy, not transparent and could slow down development processes. It also noted that the scope of such charges was expanding. For these reasons the Henry Tax Review stated:

**Recommendation 70:**

COAG should review infrastructure charges (sometimes called developer charges) to ensure they appropriately price infrastructure provided in housing developments. In particular, the review should establish practical means to ensure that these charges are set appropriately to reflect the avoidable costs of development, necessary steps to improve the transparency of charging and any consequential reductions in regulations.\(^{94}\)

Given the fact that local government imposes such charges and they are part of the basket of charges which contribute 14% of local government funding annually, it is recommended that local government develop a position on infrastructure charges to put to the COAG review.

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\(^{90}\) Henry et al, n 1, p 422.

\(^{91}\) Henry et al, n 1, Ch E, E4, *E4-3. The Effect of the Tax System on Housing Affordability.*


\(^{93}\) Henry et al, n 1, Recommendation 14.

\(^{94}\) Henry et al, n 1, p 428.
Aged care
Aged care covers a range of activities, including home and community care, extended aged care and dementia care, as well as accommodation. Some of the services and infrastructure that councils provide, often in partnership with either the other two levels of government or the private sector, include the following:

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

While the Henry Tax Review deferred to the Productivity Commission Enquiry into aged care, the Henry Tax Review was mainly concerned with the need “to align aged care assistance with the principles of user-directed funding to provide assistance in line with recipients’ needs, enable their choice of care and support the fiscal sustainability of the aged care sector”.

This has been reflected in the Productivity Commission Report. It is recommended that local government examine the impact of the Productivity Commission Report on the provision of services which impact on the aged as outlined above.

Economic rent – its future as a mechanism for raising revenue
The taxation of economic rent has relevance for local government especially if a wealth tax or inheritance tax is introduced based on the value of land. It may also provide an opportunity for local government to be involved in the administration of such taxes. It is for this reason that this part of the article will provide a brief overview of an economic rent tax.

Taxing resource rents and unimproved land values are examples of the taxation of economic rents. The Henry Tax Review also advanced arguments for cash flow business taxes as a replacement for business income tax, and for bequest duties, both of which are arguably further examples of the taxation of economic rents, or in the latter case at least of the taxation of unearned gain. This is an important part of the thinking underpinning economic rent. Indeed, it has been argued that the Henry Tax Review has as one cornerstone of its vision for the Australian tax system the taxation of economic rents rather than income and capital. The government has adopted one small part of such a tax, namely a minerals resource rent tax and to date has rejected two other aspects of such a tax, a land tax and a bequest duty, while accepting that some time in the future it may be appropriate to look at a business level expenditure tax or cash flow tax, ie a tax on the economic rents of business.

Economic rent is that return over and above the return necessary for the activity to take place. For example, what does it take to get a supermodel to work? Linda Evangelista told Vogue that “we don’t wake up for less than $10,000 a day.” While the example is hardly scientific, for the purposes of exposition it is appropriate. If a supermodel were paid anything more than that, and they are, it is economic rent. So a government could tax almost all of that excess without affecting a supermodel’s work decisions at all. They would still go to work even if the economic rent tax reduced the return to “just” $10,000 a day.

The following comment from Robin Broadway and Michael Keen is a good description of

96 Henry et al, n 1, Ch F: The Transfer System, F7. Funding Aged Care, F7-3. Reform Directions.
economic rent, and an argument in favour of taxing it. Economic rent is the amount by which the payment received in return for some action – bringing to market a barrel of oil, for instance – exceeds the minimum required for it to be undertaken. The attraction of such rents for tax design is clear: they can be taxed at up to (just less than) 100 percent without causing any change of behaviour, providing the economist’s ideal of a non-distorting tax.\(^9\)

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

The finite supply of non-renewable resources allows their owners to earn above-normal profits (economic rents) from exploitation. Rents exist where the proceeds from the sale of resources exceed the cost of exploration and extraction, including a required rate of return to compensate factors of production (labour and capital). In most other sectors of the economy, the existence of economic rents would attract new firms, increasing supply and decreasing prices and reducing the value of the rent. However, economic rents can persist in the resource sector because of the finite supply of non-renewable resources. These rents are referred to as resource rent.\(^10\)

However, as the Henry Tax Review recognises,\(^11\) it is not just the minerals sector which profits from economic rents. There appears no reason in logic to limit the economic rent analysis to resources since the overriding consideration is above-normal profits. As Garnaut and Clunies Ross put it, the term “rent” can be applied to any profits of any kind of enterprise that exceed those whose prospect the investor would have required to induce him to invest in the enterprise.\(^12\) For resources, the reason for that above normal rate of return is, according to the Henry Tax Review, the finite supply of non-renewable resources.\(^13\) Yet monopoly or oligopoly can create the same above average rates of return\(^14\) and arguably should be taxed in a similar fashion. Indeed, these conditions might actually reflect something even deeper: arguably economic rent arises not from monopoly per se but from monopolised property relations, ie private property. Thus Garnaut and Clunies Ross say that most discussion of economic rent talks about windfall profits, barriers to entry and transfer rents but that these terms are inadequate. For them windfall profits do not come necessarily as a surprise.\(^15\)

The “barrier to entry” that gives rise to what might appear to be transfer rent is the institution of property rights itself. Exclusive property rights are necessary to the emergence of mineral rent in the same way as they are to land rent.\(^16\)

This is true too of business monopolies or oligopolies. Exclusive property rights are the ultimate legal expression of monopoly either expressly, through eg, ownership of particular property or indirectly through the lack of competition elevating the particular property rights to a level of exclusivity or near exclusivity for as long as the monopoly exists. Thus Henry’s proposal to tax land rent is based on the idea that luck or position increases the unimproved value of land.

The taxation of land is the taxation of rent because rent is the increment of market gain that accrues to choice land parcels.\(^17\) The Henry Tax Review proposed a land tax\(^18\) as part of its vision for the taxation of economic rent, in conjunction with a raft of other taxes mainly on economic rent. It

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\(^10\) Henry et al, n 1, Ch C: Land and Resources Taxes, C1. Charging for Non-renewable Resources, C1-1. The Community’s Return from the Exploitation of its Resources.

\(^11\) Henry et al, n 1, Ch C, C1, C1-1.


\(^13\) Henry et al, n 1 or Garnaut and Clunies Ross, n 102.

\(^14\) This is at the expense of other business since what is happening is actually a reallocation of value from all sectors of capital to the monopoly and/or resource sectors.

\(^15\) ALGA, n 6, Fact Sheet 11, p 34.

\(^16\) ALGA, n 6. This wouldn’t change with nationalisation by the capitalist State since this merely replaces one rent seeker (private enterprise) with another (the State).

sees the unimproved capital value of land as the surplus over and above the costs of production and adequate returns on them. So at the heart of the Henry Tax Review’s ideas about land tax is the concept of economic rent. An unimproved land value tax does not seemingly tax the labour and capital input into land because it arguably removes from the calculation process those inputs into the value of land itself. The specifics of land tax and the positive role local government can play in its administration.

The issues facing Australian society mean that an extension of current and proposed taxes on economic rents cannot be dismissed. Indeed, as mentioned previously, the Henry Tax Review as well as Garnaut and Clunies Ross recognise theoretically, there is no reason for limiting the taxation of economic rent to specific examples like resources. This underlying systemic pressure to move to the taxation of economic rent will not go away. It is possible that the infrastructure money from a Mineral Resources Rent Tax will in part be spent by local government and that local government will play a major role in any land tax in terms of valuation, assessment and collection. Given the importance of economic rent to the Henry Tax Review’s vision, and the likelihood the review will be the touchstone in the future for such a tax system, it is recommend that as part of a wider local government and taxation education program which could be developed, that the taxation of economic rent and its implications for local government be an important part of such a program. It is recommended that local government develop a basic awareness of economic rent as part of the wider local government and tax policy awareness program recommended earlier.

ISSUES TO BE ADVANCED AND CONCLUSION

This article has identified recommendations of the Henry Tax Review that directly relate to local government. The first is that “States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality”. The second is for the greater integration of State land taxes and local government rates, over time.

Other suggestions, for example, the shift to road user charges which could be imposed and collected by local government; housing affordability; and aged care will impact on local government and are therefore of vital interest to it. Further, the general direction of tax reform that the Henry Tax Reform proposes will impact on local government through both funding and collection arrangements.

The basic approach of the Henry Tax Review was to move from a multitude of taxes to four robust and efficient tax bases: namely, a more comprehensive personal income base; a business income base with more growth-oriented rates; a broad-based and simple private consumption tax; and taxing economic rents from natural resources and land, on a comprehensive basis. In all cases it is contended that the direct and less direct recommendations present opportunities for local government to raise its own voice in the tax debates and to develop a wide ranging tax reform response based on those recommendations and the wider issues of the role of local government in Australian society. This also includes the lack of constitutional certainty about funding arrangements; the necessity for secure and adequate funding whether as recipient or imposer; a base for spending support; and recognition for the Commonwealth and the States of the impact of tax reform on local government.

The article argues strongly that the underlying drivers of tax reform: demographic changes; increasing health care costs; wider economic challenges such as globalisation and increasing demand for public goods and government service provision, the re-emergence of Asia as a centre of production and finance, technological change and the increasing mobility of capital, are matters that mean that fundamental changes to the tax system can help position Australia to take advantage of those developments and prosper.

These drivers are not going to disappear overnight. No matter what the Commonwealth Government does in the short term the pressures for fundamental tax reform will not disappear. These are exciting times for tax reform in Australia. The drivers for reform, the vital role local government

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plays in our society, the breadth of possible changes, all present opportunities for local government to raise long standing issues of funding, spending and constitutional certainty to be addressed in a systemic rather than an ad hoc fashion