

Reforming Tasmania's state tax system

Some options

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Contents

Executive Summary.....	1
1. Introduction: why is state tax reform important for Tasmania?.....	4
2. Property taxes: stamp duty and land tax	15
3. Payroll tax	27
4. Inheritance or estate taxes.....	40
5. Conclusion	48
References	50

Executive Summary

There hasn't been *any* wide-ranging public discussion concerning the need for reform of the Tasmanian state taxation system, or what such reform might look like, since the State Tax Review Panel process initiated by then-Treasurer Michael Aird in 2010, and which was abruptly terminated in November 2011.

Tasmania's state tax system contributes a smaller proportion of the revenue required to fund the public goods and services provided by the state government than that of any other state or territory except the Northern Territory – as a result of which, Tasmania's public finances are more exposed to factors beyond the control of the Tasmanian Government (in particular, changes in the total amount of revenue from the GST and the way it is distributed among the states and territories, and in the conditions attaching to other grants from the Commonwealth) than any other jurisdiction (except the NT).

While all state and territory governments are circumscribed in the ways in which they can raise revenue by the words of the Australian Constitution (and the interpretation of them by the High Court), and by the conditions attaching to Commonwealth grants, successive previous Tasmanian governments have made that problem worse by *their own* decisions with regard to the taxes which they are allowed to impose.

As a result, Tasmania derives a *higher* proportion of the revenues it is able to collect in state taxes from what have long been recognized in both official enquiries and academic studies as '*bad taxes*' (stamp duties on property transfers, also known as conveyance duties, and taxes on insurance) than any other state or territory except Victoria.

Conversely, Tasmania derives a *lower* proportion of the revenues it is able to collect in state taxes from what have long been recognized in both official enquiries and academic studies as '*good taxes*' (payroll tax and land tax) than any other state or territory except Queensland.

This Report proposes three options for wide-ranging reform of Tasmania's state taxation system:

- the *abolition of conveyance duty*, and its replacement with a *broadly-based land tax*, which would (in particular) include owner-occupied homes and shacks which are currently zero-rated or exempt from land tax – with transition provisions to prevent 'double taxation' of recent property purchasers, and deferral provisions for 'asset rich but income poor' households (such as pensioners and retirees);

- a *reduction in the tax-free threshold for payroll tax* to an amount equivalent to the average annual earnings of five employees in Tasmania, with the resulting revenue used to *lower the rate of payroll tax* to what would likely be the lowest or second-lowest of any state or territory, and the provision of an *exemption for new businesses* (either new businesses started in Tasmania, or established businesses from other states or territories which transfer some or all of their operations to Tasmania) for a prescribed period; and
- the *re-introduction of estate duties* (which Tasmania abolished in the late 1970s), to apply only to the 9% of estates with a gross value exceeding \$1 million, but with a provision to allow people whose estates would be liable to estate duties to offset their prospective liability, on a dollar-for-dollar basis, by making *gifts or bequests to Tasmanian-based Deductible Gift Recipients* – up to the point of extinguishing their liability altogether, if they so wished.

Reforms such as this would make Tasmania's state tax system *fairer* – by ensuring that those who currently do not make much contribution to the cost of providing public goods and services (people such as those who haven't moved house for decades) do make a contribution.

And they would make Tasmania's state tax system more *efficient* – in the economic sense – by removing or reducing taxes which distort the decisions which people and businesses make with regard to how they invest their savings or their capital, whether they buy a home and how much they pay for it, the uses to which they put the land which they own, how many people they employ, and what they do with the assets they have accumulated over the course of their lifetimes.

This report challenges the *widely-accepted propositions that payroll tax and estate duties are 'bad taxes'*, drawing on a wide range of official enquires, academic studies and statistical evidence. It challenges the almost universally-accepted notion that *preferential tax treatment for 'small businesses'* has done anything to create employment, or to encourage innovation and entrepreneurship.

This report does *not* advocate that the overall level of state taxation should be either raised or lowered. Either of those options would be open to a government which, alternatively, wished to fund the provision of more public goods and services, or to lower the burden of taxation on households or businesses – either of which are inherently political choices. It would also be open to a government to raise more revenue from any of the options advocated here in order to pursue other taxation reforms which this report hasn't contemplated – such as the abolition of taxes on insurance policies.

Finally, it is *not* the intention of this report to advocate that reform of Tasmania's state taxation system should be undertaken *now*.

Apart from the obvious difficulties of doing so during a pandemic and a recession, this report argues that wide-ranging taxation reform shouldn't be undertaken without a mandate from the Tasmanian people at an election – a mandate by which those who do form the government after an election should feel emboldened; and a mandate which those who do not form the government should feel under an obligation to respect.

On the contrary, the purpose of this report is to encourage and assist Tasmanians, and their political, business and community leaders, to participate in a *wide-ranging discussion about our state tax system* of the sort that we haven't had for almost a decade – so that a mandate for reform can be an outcome of the next state election due in March 2022.

1. Introduction: why is state tax reform important for Tasmania?

Australia's federal system stands out from other federations (the United States, Canada, Germany, and Switzerland among others) for the magnitude of the imbalances between the expenditure responsibilities and the revenue-raising powers of its different levels or spheres of government.

The Commonwealth Government typically raises more than 80% of the revenue raised by all three levels of government; but it is directly responsible for about 53% of total 'operating' spending and 19% of 'capital' spending by all three levels of government (ABS 2020a). Conversely, the states and territories are directly responsible for about 42% of all government 'operating' spending and 53% of total 'capital' spending, but raise only 15% of total taxation revenue (or about 20% of total revenue from taxation, mineral royalties and charges for government services).

Measured by the degree to which sub-national governments are dependent on grants from the central or national government, Australia's federation is more 'vertically fiscally imbalanced' than any other among 'advanced' economies with the exception of Austria (Department of Prime Minister and Cabinet 2015: 92).

This is not necessarily a Bad Thing, in and of itself. Indeed, precisely because the degree of vertical fiscal imbalance in the Australian federation is so large, Australia has been able to undertake a greater degree of 'horizontal fiscal equalization' – that is, to 'even out' the capacity of state and territory governments to provide public services at a broadly similar standard despite the often very large differences among the states and territories in the costs of providing them, and in their capacity to raise revenues – than any other federation (Garnaut and FitzGerald 2002; Pincus 2009).

And that in turn is one of the principal reasons why the differences in living standards (and other measures of well-being and opportunity) between Australia's poorest and richest states and territories are smaller (and in many cases much smaller) than in other federations (Eslake 2017). Tasmania has long been a particular beneficiary of these arrangements.

The downside of this high degree of 'vertical fiscal imbalance' is that state and territory governments are much more restricted than their counterparts in other federations in devising their own solutions to the problems and challenges which they face: and are subject to a high degree of control from the Commonwealth Government as to what they can (or what they must) spend in various areas, and how they can (or must) spend it.

State Governments have long been constrained by the provisions of the Australian Constitution – in particular, section 92, which provides that “trade, commerce and intercourse among the states ... shall be absolutely free” and which has been interpreted by the High Court to preclude state governments from levying any kind of tax on the production, distribution or sale of any goods or services (apart from property and gambling); and section 96, which gives the Commonwealth the power to impose whatever “terms and conditions as it thinks fit” on “grants to any state”, terms which since 1942 have included (initially as a ‘temporary war time measure’) a requirement that states (and subsequently territories) not levy any form of income tax.

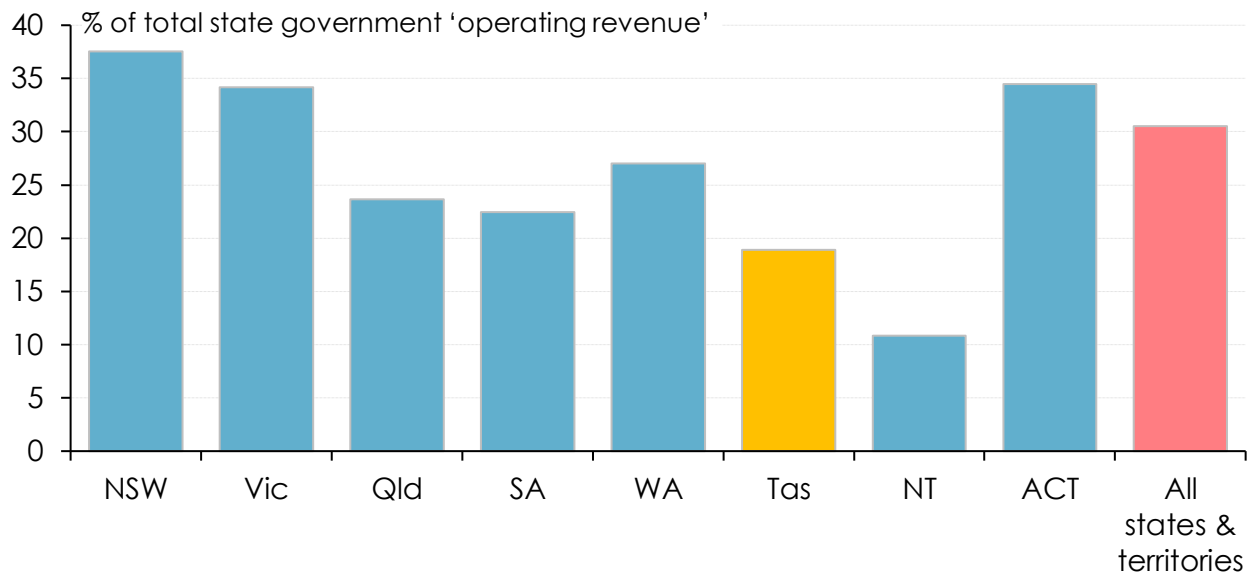
These clauses – and the ways in which they have been interpreted by the High Court in a series of landmark cases between 1920 and 1997 – have prevented Australia’s states and territories from levying taxes which are commonly levied by American states, Canadian provinces, German Länder and Swiss cantons.

Australian states and territories haven’t helped themselves by significantly narrowing the bases of the three most important taxes which they are allowed to impose (payroll tax, stamp duty on the transfer of property, and land tax), or abolishing them altogether, as in the case of estate duties – in order to win electoral support from numerically large constituencies such as small businesses, home-owners, first-home buyers, older voters and their intended beneficiaries – or in (ultimately fruitless) competition with each other (see eg Banks 2002).

These issues are particularly relevant in the Tasmanian context. And they are the reason why this report focuses on three areas where previous Tasmanian governments have made ‘bad choices’ in the past, and where the current or a future Tasmanian government could make ‘better’ or ‘good’ choices – property taxes (conveyance duty and land tax); payroll tax; and estate, inheritance or bequest taxes.

The Tasmanian Government derives less of its revenue from state taxes than any other jurisdiction apart from the Northern Territory (Chart 1).

Chart 1: State taxation revenue as a percentage of total state general government 'operating revenue', 2018-19



Source: ABS (2020a).

This is largely the result of Tasmania's below-average incomes, below-average rates of participation in employment, below-average land values, and below-average endowment of mineral resources – all of which are reflected in the Commonwealth Grants Commission's annual assessments of each state and territory's 'revenue-raising capacity', as shown in Chart 2.

Chart 2: 'Revenue-raising capacity', states and territories, 2018-19



Source: Commonwealth Grants Commission (2020), Table S6-1.

Tasmania’s below-average capacity to generate revenue from its own sources (state taxes, mineral royalties and dividends from government business enterprises) is one of the three principal reasons why Tasmania gets a larger share of the revenue from the GST than it would if that revenue were distributed among the states and territories on an equal-per-capita basis (the other reasons are the greater-than-average need for spending on most state public services in Tasmania, and the higher-than-average unit cost of providing many of them in Tasmania).

However successive Tasmanian Governments have also *chosen* to raise less by way of revenue from the sources which are available to them, than they could have done if they had levied taxes at the same rate and over the same base as the average of all states and territories, as shown by the Commonwealth Grants Commission’s annual assessments of each state and territory’s ‘revenue-raising effort’ (Chart 3 on page 6).

This reflects the desire of successive Tasmanian Governments (of both major political persuasions) to ensure that Tasmania’s capacity to attract investment (in competition, inevitably, with other states and territories) is not adversely affected by the prospect that businesses (who pay the bulk of state taxes in Tasmania, as in every state and territory) would face above-average taxes in Tasmania, especially given some of the other cost disadvantages faced by many Tasmanian businesses (such as transport and fuel costs).

This report does not seek to challenge that choice. It is emphatically *not* arguing that there is any need for Tasmania to raise the overall level of state taxes which it collects. The level of state taxes is inherently a *political* choice – one which may be *influenced* by a variety of economic considerations, but is not solely determined by them.

Chart 3: ‘Revenue-raising effort’, states and territories, 2018-19



Source: Commonwealth Grants Commission (2020), Table S6-2.

However the overall *level* of taxation is not the only way in which Tasmania's tax system affects the competitiveness of Tasmanian businesses – or, for that matter, the living standards of, and the choices made by, individual Tasmanians and the families with or households in which they live.

How Tasmania collects the taxation which it does – the particular taxes which it levies, the rates of those taxes, the bases on which they are imposed, and the exemptions and concessions which the state government grants from those taxes – is at least as important as *what* Tasmania collects by way of state taxation.

The choices made by previous state governments, and the present one, as to how it collects state taxes affect the *fairness* of the state tax system – how it treats individuals or families and businesses in similar, or different, positions. And those choices also affect the *efficiency* of the state tax system – how tax considerations influence the decisions which businesses and individuals or families make, and the costs which they have to bear in order to comply with the requirements of the tax system.

Different taxes inevitably have different characteristics:

- some are simple to administer (on the part of the State Revenue Office) and to comply with (on the part of the businesses or people who have to pay them) – while some are complex, either to administer or to comply with;
- some are 'progressive' – in the sense that those with a greater capacity to pay them (as measured, for example, by their size or profitability – in the case of businesses – or their income or wealth, in the case of individuals and households) pay more than those with a lesser capacity to pay: and some are 'regressive';
- some taxes can affect the choices which individuals, families and businesses make – how they invest their capital, whether to buy a home (and how much they can afford to pay for it), whether and how often they choose to move home, whether to hire an extra employee, whether to make improvements to a piece of land, whether to take out insurance – and some do not.

Fairness (or *equity*) is usually a subjective construct. Although there are some generally accepted principles of 'equity' – such as that the tax which individuals pay should be at least in proportion to their capacity to pay (as measured for example by their income and/or wealth – whether a particular outcome is 'fair' or 'equitable' is often in the eye of the beholder.

Nonetheless, there are aspects of state tax systems which *do* seem to offend widely-shared notions of fairness: for example, the fact that people who move home frequently contribute far more to the cost of paying for schools, hospitals and police services (through stamp duties on the transfer of properties) than people who remain in the same home for many

decades; or that property-owners who take the trouble to insure their properties contribute more to the cost of providing public services than those who don't.

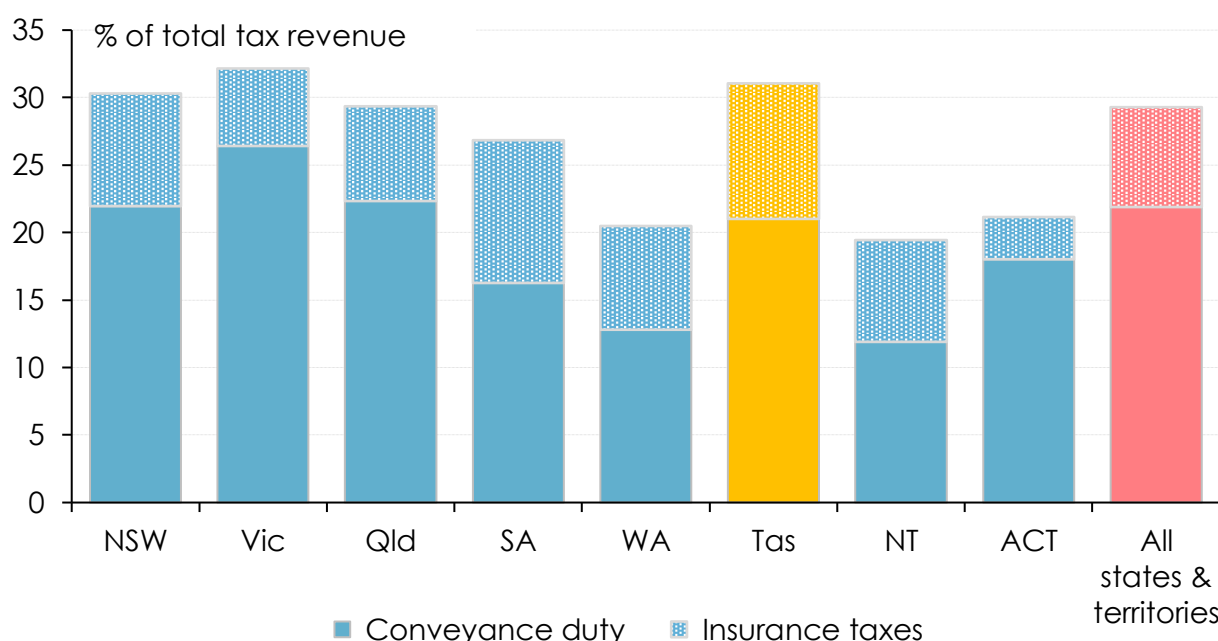
But *efficiency* is more commonly something which can be measured according to more objective criteria. Economists assess the efficiency of different taxes according to the 'marginal excess burden': that is, the change in some measure of welfare resulting from a marginal change in the rate of some tax, or the base to which it is applied.

Almost without exception, economists who have estimated the 'marginal excess burden' of taxes levied by Australian governments have concluded that conveyancing duties or stamp duties have by far the highest 'marginal excess burden' of any tax levied by the Commonwealth, state or territory governments, followed by taxes or stamp duties on insurance premiums.

Conversely, these studies have uniformly found that the GST, payroll tax and land tax have amongst the lowest 'marginal excess burden' of any of the taxes currently levied by the Commonwealth, state or territory governments (see, for example, Freebairn 2005, Henry et al (2008: 292), Cao et al (2015: 41-51), Murphy (2016: 32) and Thodey et al (2020: 41, 65 and 75).

What is striking from this perspective is that Tasmania raises 31% of its total state tax take from 'bad' taxes – conveyancing duty and taxes or levies on insurance premiums – more than any other state or territory except Victoria, and 1.8 percentage points above the average for all states and territories (Chart 4).

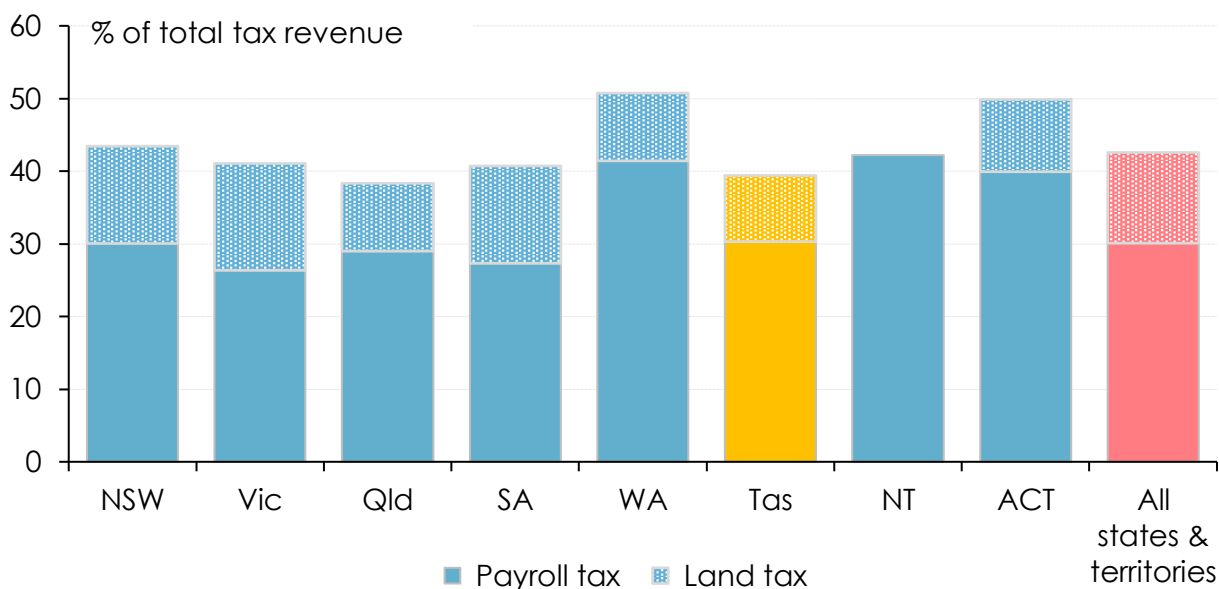
Chart 4: Revenue from 'bad' taxes – conveyancing duty and insurance taxes, states and territories, 2018-19



Source: ABS (2020b), Tables 2-10.

And, conversely, only 39.4% of Tasmania’s total state tax take is generated by ‘good’ taxes – payroll tax and land tax – less than any other state except Queensland, and 3.2 percentage points below the average for all states and territories (Chart 5).

Chart 5: Revenue from ‘good’ taxes – payroll tax and land tax, states and territories, 2018-19



Source: ABS (2020b), Tables 2-10.

What this suggests is that there are potentially significant gains – in terms of both *equity* and *efficiency* – to be had from reform of Tasmania’s tax system: both from shifting from ‘bad’ taxes to ‘good’ taxes, and from improving the design of every tax which the state government imposes.

This report seeks to illustrate how changes in the structure of Tasmania’s state taxation system could produce outcomes which are both *fairer* and *more efficient*:

- it argues that conveyancing duties should be abolished, and a similar amount of revenue should instead be raised from a broadly-based land tax, levied at progressive rates on the per-square-metre value of individual (rather than aggregated) landholdings, with no exemption for owner-occupied homes, but with transitional provisions to prevent ‘double taxation’ of people who have paid stamp duty on recently-acquired land, and deferral provisions for people who are “asset rich but income poor” (such as pensioner home-owners);
- it challenges the ‘conventional wisdom’ that payroll tax is a ‘bad tax’, arguing that there is no basis for the assertion that payroll tax adversely affects employment, demonstrating that concessions for small businesses (which are much more generous in Tasmania than in any other state) have done nothing to promote employment;

- it recommends that the threshold for payroll tax should be lowered to the equivalent of average annual earnings for five employees, with the resulting revenue gains used to lower the rate of payroll tax (to what would probably be the lowest of any state or territory) and to provide exemptions for *new* businesses (including businesses relocating to Tasmania from the mainland);
- it proposes that Tasmania should consider re-introducing estate duties for estates valued at over \$1 million (which would apply to less than 10% of all Tasmanian estates granted probate in the past three years);
- but it also suggests a mechanism by which people whose estates would be liable to such duties could choose to reduce their liability, or avoid it entirely, by making bequests or gifts of equivalent value to registered Tasmanian charities or not-for-profit institutions.

Importantly, these are recommendations which a Tasmanian government can implement *on its own*: without running foul of the Australian Constitution, and the ways in which it has been interpreted since Federation by the High Court, to circumscribe the revenue-raising options open to state governments.

They are recommendations which a Tasmanian government can pursue without needing to wait for other, larger states to move first.

Indeed, they are reforms which could allow Tasmania to serve as a ‘role model’ for other states and territories.

The recommendations in this report have been framed so as to be ‘revenue neutral’. That is, it suggests that:

- in order to abolish conveyancing duty, land tax should be broadened and the rate scale set so as to raise the same amount of additional revenue as previously collected through conveyancing duty (after allowing for the costs of transitional arrangements);
- that payroll tax should be set at a rate which, after allowing for the much lower threshold for small businesses, and the introduction of an exemption for new businesses which this report recommends, raises the same amount of revenue as would be raised by the current payroll tax system; and
- that people whose estates are large enough to be subject to the estate duty proposed in this report should have the option of eliminating their liability by making gifts or bequests equivalent to their liability – which, if fully taken up, would imply that the estate duty didn’t raise any revenue (although of course charities and not-for-profits would have access to more resources).

However, it would be open to a government (or parties seeking to form government) to select rates of tax, to set thresholds, to reduce the scope of exemptions or otherwise to define the tax base in ways which generated *more* revenue – which could in turn be used to abolish other state taxes not addressed in this report (the most obvious candidate being insurance taxes), or, alternatively, to fund higher levels of spending on the provision of services.

This is something that may be required if growth in revenue from the GST continues to fall well short of expectations – as it had been doing prior to the onset of the pandemic, and as it is highly likely to in 2020-21 as a result of substantial declines in consumer spending, especially on items which are subject to the GST. Tasmania’s state budget is more vulnerable to shortfalls in total GST collections than that of any other jurisdiction except the Northern Territory.

Similarly, the revenue which Tasmania receives from the GST could be adversely affected by developments in other states which result in a reduction in Tasmania’s share of total GST revenue (as recommended by the Grants Commission); or by efforts by other states, with more seats in the Federal Parliament at stake in Federal elections than Tasmania has, to have the Federal Government direct the Grants Commission to change the methods it uses to determine how the revenue from the GST is carved up among the states and territories, in ways that would advantage them and disadvantage Tasmania.

In any of those circumstances, the Tasmanian Government would have to choose between making potentially swingeing cuts in government service provision; increasing state taxes which, as they stand today, are in aggregate more unfair and less efficient than those of other states; or running bigger budget deficits. A more efficient and equitable state tax system would make those choices less unpalatable.

A more efficient and equitable state tax system would also provide Tasmania with greater ‘insurance’ against the possibility that a future Commonwealth government may seek to improve its own financial position by cutting payments to state and territory governments; or that interest rates at some point return to levels that, in the pre-Covid world, would have seemed ‘normal’, but with all governments (including Tasmania’s) carrying much higher levels of debt than prior to the onset of the pandemic, would likely result in a significant increase in the proportion of revenue being pre-empted by debt service costs.

However, in other situations it would be equally open to a government (or parties seeking to form government) to implement any or all of the recommendations in this report in such a way as to reduce the overall level of state taxation, in the expectation that this might favourably affect Tasmania’s competitiveness and desirability as a destination for investment.

Quite intentionally, this report makes no recommendations in either of these directions: they are political choices open to any government to make, according to its preferences and its interpretation of the best interests of Tasmanians.

Nor does this report make any strong recommendations as to the timing of the changes which it advocates. While some reform advocates take the view that a ‘crisis’ – such as the one which Tasmania, in company with the rest of the nation and indeed the rest of the world, is currently experiencing – presents an ‘ideal opportunity’ to pursue reforms that might be politically unworkable in more benign circumstances, this report does not take that stance.

Apart from anything else, the current Government hasn’t sought, and so doesn’t have, an electoral mandate for wide-ranging reform of the state taxation system: and nor has any other political party as yet indicated that it is seeking one.

Indeed there hasn’t been any wide-ranging public debate about state taxation reform in Tasmania since the aborted State Tax Review Panel process in 2010-11 (and the papers produced during that process appear to have been removed from the Tasmanian Treasury’s website).

This report emphatically *does not* advocate that this Government, or indeed any government, seek to enact wide-ranging tax reform without having first sought and obtained a ‘mandate’ from the people of Tasmania at an election.

Rather, its purpose is to encourage a wider discussion of options for state taxation reform ahead of the next state election, due in March 2022 – so that it might be possible for any, or all, of the parties seeking to form government after that election to seek and obtain such a mandate. And by then, one would certainly hope, the difficulties resulting from the Covid-19 pandemic and the recession induced by it – which would have posed an insuperable obstacle to any major reforms even if the Government did have an electoral mandate for them – will have substantially lessened.

This report also acknowledges the ‘political reality’ that it is impossible to implement meaningful reforms to *any* tax system without creating ‘winners’ and ‘losers’.

When governments are in the fortuitous position of sitting on large budget surpluses – as the Howard Government was in 2000 – then tax reform can be ‘revenue-negative’: the surpluses can be used to ‘compensate’ the ‘losers’, and thereby purchase their acquiescence, if not their outright support.

But no state government is likely to be in that position any time soon.

In which case, Niccolò Machiavelli’s five-hundred-year-old warning that “[there is nothing more difficult to plan, more doubtful of success, nor more dangerous to manage than a new system – for the initiator has the enmity of all who would profit by the preservation of the](#)

old institution and merely lukewarm defenders in those who gain by the new ones” (1515: 21) is very applicable to the challenge of reforming any system of taxation.

Overcoming the hurdles identified by Machiavelli will take both patience and time. It will necessitate extensive and widespread consultation and communication with the Tasmanian community. And it will require a persuasive set of arguments.

This report takes up Machiavelli’s challenge, by setting out arguments which those who, whatever their political leanings, seek to build a more prosperous and fairer Tasmania, can use to further those objectives.

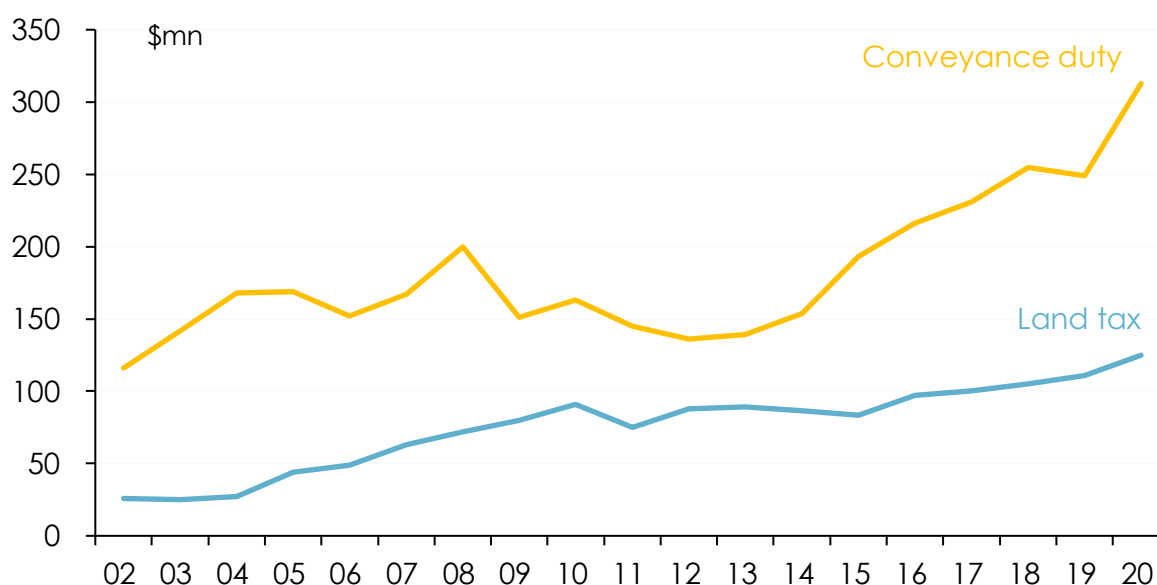
2. Property taxes: stamp duty and land tax

Like their counterparts in every other state or territory, Tasmanian governments have long relied on taxes on property as one of the most important sources of revenue under their direct control.

Over the ten years to 2019-20, successive Tasmanian governments have collected \$2,991 million in revenue from property-related taxes, which represents 14.8% of total 'own source revenue' (that is, revenue from sources other than the federal government, including Tasmania's share of revenue from the GST), or 5.4% of total revenue.

Of this amount, \$2,031 million (or just over two-thirds) came from taxes on the *transfer* of land (described in Budget papers as 'conveyance duty', and more commonly referred to as 'stamp duty'), and \$960 million (or just under one-third) came from taxes on the *ownership* of land (generally referred to as 'land tax') (Chart 6).

Chart 6: Revenue from conveyance duty and land tax, Tasmania, 2001-02 to 2019-20



Source: Tasmanian Government (2020, 2019b and previous issues).

Although both land tax and stamp duties can be regarded as 'property taxes', they are in practice very different, whether viewed from the perspective of those who pay them, or from that of the government which collects them. They have very different economic consequences. They have very different relationships with economic (and especially property market) cycles. And they have very different implications for equity or 'fairness'.

It's hard to think of any other tax which is so widely regarded as a 'bad tax' as stamp duties on the transfer of property. What follows is a representative sample of a large number of official enquiries and academic studies which have considered the impact of stamp duties on land transfers.

A decade ago, the *Australia's Future Taxation System Review* put it bluntly:

"Ideally, there is no place for stamp duty in a modern Australian tax system. Stamp duties generate large inefficiency costs, as they discourage turnover in property and tax improvements as well as land. The tax also imposes a higher burden on people who need to move, which is not equitable. The only positive feature of stamp duty – its relative simplicity – has long ceased to justify its continued use in the face of the costs it imposes on Australian society" (Henry et al 2010, Volume 1: 263).

One of Australia's foremost specialists in tax economics, John Freebairn, has written:

"Conveyance duties are among the most inefficient taxes; they are ... inequitable to frequent property transferees and the most volatile of state revenue sources ... Conveyance duty distorts the reallocation of property from lower value to higher value uses when circumstances change" (Freebairn, Stewart and Pei 2015: 19).

Modelling by the Commonwealth Treasury published in 2015 concluded that stamp duty on conveyances has a 'marginal excess burden' of (that is, it reduces 'welfare' by) 72 cents for every dollar of revenue it raises (Cao et al 2015: 50) – more than any of the five other major taxes for which they derived equivalent estimates. Prominent economic modeller Chris Murphy calculated the 'marginal excess burden' of conveyance duty as being 87 cents for every dollar raised from transactions in residential property, and 196 cents for every dollar raised from transactions in commercial property – a finding which prompted him to conclude that "these taxes should be abolished" (2016: 44).

The Productivity Commission's 2017 Report *Shifting the Dial* concluded that:

"Stamp duties on residential property add to the price of houses, and can discourage people from moving to locations that may be closer to preferred jobs, family networks and schools ... Stamp duties on commercial property further discourage businesses from investing in existing land and capital, and stamp duties on residential property can discourage people from downsizing and encourage over-investment in upgrading property. All of these factors result in the retention of land for relatively unproductive purposes" (Productivity Commission 2017: 149).

The University of Tasmania's Richard Eccleston, Julia Verdow and Kathleen Flanagan, together with another of Australia's foremost tax economists, Neil Warren, wrote in 2017 that:

“taxing transactions acts as a disincentive for owners wanting to move to more appropriate accommodation, hindering labour mobility and acting as a barrier to ‘downsizing’ [and that] revenue from transaction-based property taxes can be extremely volatile (Eccleston et al 2017: 22).

The most recent official enquiry to touch on the subject, the *Review of Federal Financial Relations* commissioned by the NSW Government and chaired by former Telstra CEO David Thodey, noted that:

“Transactions are an arbitrary basis for taxation, and this way of distributing the tax burden is poorly justified on equity grounds ... [S]ome 26% of owner-occupiers [who] have remained in the same property for at least 20 years ... have contributed very little towards essential services and critical infrastructure via property taxation. Others who have moved to find a job, be closer to schools, or to match housing size to their family situation ... have picked up the tab. This approach just doesn’t seem fair” (Thodey et al 2020: 39).

By contrast, there is a long-standing and widespread consensus among economists that land tax is a ‘good tax’. Indeed, this view dates back to Adam Smith, often regarded as the ‘father of economics’, who in 1776 wrote:

“the aggravation of the [land] tax ... is always so very small, that it can never discourage [the landowner’s] improvements, nor keep down the produce of the land below what it would otherwise rise to. As it has no tendency to diminish the quantity, it can have none to raise the price of that produce. It does not obstruct the industry of the people: it subjects the land[owner] to no other inconveniency besides the unavoidable one of paying the tax (Smith 1776: 538).

The Henry Review made essentially the same argument in more contemporary terms:

“When a land tax is introduced ... potential buyers of the land will reduce how much they are willing to pay for land by the value of the expected land tax payments ... Potential buyers will expect to get at least the same risk-adjusted return from land as they could from alternative investments ... this means that land tax does not distort investment decisions.

Someone must use the land, though; because it is immobile, it cannot be shifted out of supply. This makes land an efficient tax base.

Land tax therefore differs from taxes on other productive resources: taxes on labour reduce people’s work effort; and taxes on capital can cause the capital to be employed elsewhere (particularly overseas). In contrast, a broad land tax is borne by landowners and the supply of land is unchanged” (Henry et al 2010, Volume 1: 248).

The Treasury modelling referred to earlier found that a broad land tax had a ‘marginal excess burden’ of *minus* 10% - that is, it *increases* welfare by 10 cents for every dollar of revenue it raises (Cao et al 2015: 43). This result arises because about 10% of land in Australia is owned by foreigners, so that a broad land tax results in a transfer of income from foreigners to the Australian community. A similar conclusion was reached by a study undertaken in 2014 for the Housing Industry Association (Independent Economics 2014).

The Productivity Commission’s *Shifting the Dial* report supported the arguments of the Henry Review:

“Taxes based on land values avoid the imposition of penalties for moving and the inequity of the tax burden falling on those who choose to move, whether for work or lifestyle reasons. Tax revenue is more stable because it is not exposed to the volatility of the housing market” (Productivity Commission 2017: 150).

As did the most recent review of federal financial relations undertaken for the NSW Government:

“A tax on land enacts a more equitable approach to funding government services, based on the principle of the beneficiary pays. The value of land is a measure of the benefits accruing to particular locations from infrastructure, services, regulation, access to markets, amenity, culture and community. A tax on land is therefore like a generalized user charge for the benefits society at large provides the landowner, which is a principled way of funding public services” (Thodey et al 2020: 40).

In considering these findings of academic research and public enquiries, it is important to note that, in practice, the land taxes imposed by Australia’s state governments (including the Tasmanian government) depart significantly from the ideal of a ‘broad’ land tax.

In Tasmania, as in every other state, land on which people’s principal place of residence (‘the family home’) is situated is exempt from land tax: as is land classified as being for primary production, land used for religious purposes or owned by a charitable institution, land used for medical establishment (other than general practice), land used to operate a retirement village, land subject to a conservation covenant, and Aboriginal land used principally for Aboriginal cultural activities. More recently the Tasmanian Government has also exempted from land tax new dwellings rented for fixed periods of at least 12 months, and (for one year only) properties formerly used for short-term visitor accommodation which have been converted to longer-term (12 months or more) rental (State Revenue Office 2020).

The Tasmanian Treasury estimates that exemptions from land tax cost \$232mn in terms of revenue foregone in the 2018-19 financial year (Tasmanian Government 2019a: 109). This compares with actual land tax collections in 2018-19 of \$108mn (Tasmanian Government 2019b: 45).

In other words, the Tasmanian Government collects only 32% of the revenue it *could* raise from land tax if there were no exemptions. The difference is in effect made up from higher revenues from other forms of taxation, lower spending than would otherwise have been possible, or a smaller budget surplus (larger budget deficit) than would have been obtained in the absence of those exemptions.

These very large exemptions from the land tax base detract from the purported advantages of land tax noted by the academic research and public enquiries cited earlier. In particular, they mean that land tax as it is applied in Tasmania (and in other states) *does* distort investment decisions, because the amount of land tax payable (or, indeed, whether land tax is payable at all) *is* affected by decisions as to how land is used.

There are of course also exemptions from conveyance duty – for first home buyers, pensioners down-sizing, transfers of family farms and transfers of property consequent upon relationship breakdowns. But the cost in terms of revenue foregone of these exemptions is much smaller - \$33mn in 2018-19, according to Tasmanian Treasury (2019b: 46) estimates, or 13% of the revenue actually raised (compared with 205% of the revenue actually raised from land tax).

Rather perversely, therefore, successive Tasmanian governments have (like governments in every other state) granted very large exemptions from a tax whose principal advantages as a revenue-raising measure accrue when it is levied across as broad a base as possible: while granting relatively small exemptions from a tax which is almost universally condemned as the ‘worst’ of the 125 different taxes (Henry et al 2008: 10) that are levied by the three tiers of government in Australia.

In addition, the imposition of land tax at progressive rates on the aggregate value of all the (non-exempt) land owned by each taxpayer creates a significant bias against large-scale land holdings – whilst having absolutely no impact at all on the amount of tax paid by owners of expensive homes relative to that paid by owners of more modest dwellings (since owner-occupied homes are exempt from land tax).

This is one of the main reasons why institutional investors (such as superannuation funds and real estate investment trusts) have long shied away from investment in rental housing – with adverse consequences for the supply of rental housing, as noted, for example, by the Henry Review:

“Policies that discourage large-scale investors from participating in the housing market are likely to have adverse effects on the supply of rental housing and its affordability for tenants. By favouring small investors, housing investment forgoes the potential for lower costs from economies of scale in housing supply ... [L]arge-scale investors are more likely to invest over longer time horizons, as they are less likely to face cash-flow problems or the need for portfolio diversification that can

force sales by small-scale investors. For long-term investors, longer leases would also reduce negotiation costs and provide certainty of income. Such arrangements would be particularly beneficial to some tenants who currently face high costs from insecure tenure, such as many elderly people and low-income families. The security of tenure provided by longer leases would have positive effects for tenants' social integration and for high levels of social capital within communities" (Henry et al 2010, Volume 2: 417).

The same point has also been made more recently by Industry Super Australia, the research and advocacy body for industry superannuation funds (Anthony and Lu 2020: 54).

In short, the manner in which the Tasmanian government, no less than the governments of other states, taxes property (and property owners):

- is *unfair* in the way it makes (or doesn't make) demands on people to pay for government services;
- *detracts unnecessarily* from the *efficiency* and *performance* of the Tasmanian economy, with adverse consequences for the *living standards* of the people of Tasmania;
- *irrationally distorts the choices* which Tasmanian households and businesses make as to how they allocate capital and/or use land, again with adverse consequences for the welfare of Tasmanians;
- *adds to the cost of housing* and *encourages over-investment* in owner-occupied housing;
- *discourages* large-scale investment in rental housing, and thus *adversely affects* the supply of rental housing; and
- *unnecessarily exposes* the Tasmanian government to volatility in its revenues, making *budget forecasting* more difficult than it needs to be, and *increasing the risk* that governments find themselves having to make *arbitrary cuts in spending* or incur *needless budget deficits* when confronted with unforeseen (and unforeseeable) declines in revenue.

It is for some or all of these reasons that successive public enquiries, research reports, industry associations, and community groups from across the political spectrum have called for the replacement of taxes on property transfers with a broad-based land tax.

Thus the Henry Review recommended that conveyancing duties should be removed, and replaced with a land tax "levied on as broad a base as possible ... to eventually include all land", with tax being applied to each land holding separately (as opposed to an individual's or an entity's entire land holdings) using a progressive rate scale with thresholds determined not by the total value of each holding, but rather by the value per square metre of each holding (Henry et al 2010: 263-267).

The Review noted that applying a progressive rate scale based on values per square metre with a zero rate for land in the lowest value range would, in effect, exempt almost all land used for primary production, and would not discriminate against large-scale investors in rental housing, but would impose higher tax rates on land situated in the most expensive areas.

This recommendation was endorsed by the Productivity Commission in its *Shifting the Dial* report (Productivity Commission 2017: 20 and 152) and by the NSW *Review of Federal Financial Relations* (Thodey et al 2020: 49).

The non-aligned Grattan Institute has also recommended the replacement of stamp duty on land transfers with a broad-based land tax, and estimates that doing so would boost Australia's GDP by \$17bn a year, equivalent (in the year to which the estimate applied) to a gain of about 1.0% (Daley et al 2018: 121). On a pro-rata basis, the benefit to Tasmania's economy from replacing conveyance duty with a broadly-based land tax would be of the order of \$285mn a year (in 2019-20 prices).

Replacing stamp duty on land transfers with a broadly-based land tax has attracted support from across the spectrum of political and community opinion.

The McKell Institute, which describes itself as 'progressive', characterizes the case for replacing stamp duty with a broadly-based land tax as "overwhelming", arguing that "while stamp duty is inequitable, inefficient and volatile, land tax is the opposite ... [it] is one of the most equitable, efficient, simple and stable forms of taxation available to governments" (Bentley and D'Cruz 2016: 32).

The Centre for Independent Studies, which according to its Mission Statement "promotes free choice and individual liberty", has stated that "the best possibility of land tax reform would be a package that combined land tax base broadening with the removal of property transfer duty" (Carling 2008: 9).

The Australian Institute of Company Directors has recommended that "state governments replace stamp duties on property with different forms of land tax" (2017: 20), as has the Business Council of Australia (2016: 30), the Australian Chamber of Commerce and Industry (2020) and the Housing Industry Association (2015: 1).

Replacing stamp duty on land transfers with a broadly-based land tax also enjoys widespread support among community groups, including the Australian Council for Social Service (2016), National Shelter (2018) and the Community Housing Industry Association (2018: 18).

Despite this almost unanimous endorsement of the idea of replacing conveyancing duties with a broadly-based land tax, the only jurisdiction which has actually embraced a reform of this kind is the Australian Capital Territory.

Over a 20-year period beginning in 2012, the ACT Government is progressively phasing out conveyancing duty on residential land (having abolished conveyancing duty on all commercial property transactions of \$1.5mn or less from 1st July 2018), and replacing the revenue foregone by increasing municipal rates, which operate as a broad-based land tax (from which owner-occupied properties are *not* exempt) (ACT Government 2019: 37).

The ACT Government has been able to raise municipal rates to replace the revenue foregone by phasing out stamp duties – rather than having to impose land tax on owner-occupied properties – because it is also, in effect, the Canberra City Council. This option is not open to state governments – which would have to bite the politically difficult ‘bullet’ of extending land tax to hitherto exempt owner-occupied residences.

Any state government which sought to replace conveyancing duty with a broad-based land tax would need to do so in a way which avoided ‘double taxing’ people who had recently purchased property (and paid stamp duty on it). In current circumstances, when all states are incurring large budget deficits as a result of the Covid-19 recessions, governments contemplating a reform of this nature would also need to minimize any loss of revenue associated with the transition, a loss which would otherwise result in increases in other forms of taxation, spending cuts or even larger budget deficits.

There are a number of ways in which the transition from conveyancing duty to a broad-based land tax can be implemented so as to minimize or avoid altogether ‘double taxation’ of recent property purchasers.

One is the long phase-in period being used by the ACT. This can also be tailored to minimize the initial adverse impact on total revenue. But it does have the disadvantage of being vulnerable to political campaigns to reverse the change, as has occurred (thus far unsuccessfully) in the ACT.

An alternative is to provide owners of land currently exempt from land tax with a ‘credit’ for any stamp duty paid on acquiring that land in the past ‘x’ years (where ‘x’ could be three, five or some other number), which could then be offset against the new annual land tax liabilities until it has been exhausted. A variant of this could be to provide that 100% of conveyancing duty paid in the 12 months prior to the commencement of a broad-based land tax could be used as a credit against the land tax now payable, 90% of any duty paid between 24 months and 12 months previously, 80% of any duty payable between 3 years and 2 years previously, and so on down to 10% of any duty paid between 10 and 9 years previously – or some variant of this ‘sliding scale’.

The only significant disadvantage of this transition model is that it may entail a significant overall revenue loss in its early years.

A third possibility is to abolish conveyance duty but provide that currently exempt properties only become subject to the new broad land tax when they are next sold.

This would completely eliminate ‘double taxation’, but at a significant cost to revenue, one which would endure for much longer than the ‘credit’ alternative. It would also potentially create a perverse incentive for existing landowners to defer selling their land, thus eroding one of the principal benefits expected to be generated by the reform.

A final alternative, and the one which appears to be favoured by the NSW State Treasurer who is contemplating replacing conveyancing duty in that state with a broad land tax, is to allow property buyers to elect whether to pay conveyancing duty at the time of purchase, or to opt-in to the annual land tax. The presumption is that most buyers would choose the latter option (especially if existing stamp duty exemptions for first home buyers were to be removed). But the potential revenue losses from this option would be large; and the equity and efficiency gains from extending land tax to long-standing owners of existing properties would take a very long time to be realized.

Of all of these options the second – the provision of a ‘credit’ for stamp duty paid in previous years against the annual land tax that would become payable – appears to offer the best compromise, although as noted it does potentially entail a significant revenue shortfall in its early years. One way of overcoming that could be to impose a higher rate of land tax initially than would be required once all outstanding credits for previously paid stamp duty has been exhausted, and then cut the rate of land tax at that point in time.

In choosing a transition path it is important to bear in mind that, as the Thodey Review put it, “governments will not be able to design their way out of the fact that some properties bearing an unfairly small share of the tax burden at present, will see a change, and nor should governments try to (Thodey et al 2020: 48).

A state government contemplating replacing stamp duties with a broad land tax would inevitably need to provide special arrangements for ‘asset rich but income poor’ households – in particular, older citizens whose homes situated on land with a high taxable value (which they may have purchased many years earlier) but whose income is relatively low – so that their living standards are not compromised by having to pay land tax.

This could be achieved by providing for those in this position (such as age pensioners) to elect to defer their land tax payment obligations, and arrange for them to be settled if and when they sell their homes, or alternatively out of the proceeds of their estates. Many local governments already allow this with regard to the payment of municipal rates.

Finally, a state government which was considering undertaking this kind of reform unilaterally (rather than in conjunction with other states) would need to consider the possible adverse impact of such a change on its share of GST revenues.

This risk was identified by the Productivity Commission in its 2018 report on Horizontal Fiscal Equalization (Productivity Commission 2018: 108-9). According to the PC, a state which unilaterally reduced or abolished stamp duties and offset the revenue thereby lost by

increasing land tax would see its GST share reduced, because its *assessed capacity* to raise revenue from stamp duties would increase as a result of the increase in the volume of transactions likely to be induced by such a ‘tax mix switch’.¹

This would be an especially important consideration for Tasmania given that its share of GST revenues accounts for a larger proportion of its total revenue than that of any other jurisdiction except the Northern Territory.

The risk would be significantly reduced if Tasmania were to act in concert with other states: indeed, if the other states (or even just the two largest states, New South Wales and Victoria) were to adopt such a reform and Tasmania chose *not* to participate, then Tasmania could experience a *reduction* in its GST share as a result, depending on how the Commonwealth Grants Commission changed its methods of assessing states’ revenue-raising capacity.

Alternatively, if Tasmania chose to ‘go it alone’ on reforming its property taxation system, it could ask the Federal Treasurer to issue a directive to the Grants Commission to discount the impact on states’ GST shares, something which the Federal Government should be prepared to do given its previous encouragement for the states to undertake productivity-enhancing tax reforms (Frydenberg 2019).

Subject only to that caveat, replacing conveyance duty with a broadly-based land tax, levied on individual (rather than aggregate) land holdings at progressive rates based on values per square metre, with transitional arrangements that provide people who have paid stamp duty on recently-acquired properties and with deferral arrangements for ‘asset rich but income poor’ landowners such as age pensioners, is a reform which the Tasmanian government should pursue, preferably in conjunction with other states but, if they are unwilling, on its own.

If Tasmania were to pursue this reform on its own, it could be a significant ‘selling point’ in attracting migrants from other states (or from overseas, in competition with other states) to be able to say that “if you purchase a home in Tasmania, whether it’s your first home, the home in which you want to raise your growing family, or your last home, you won’t pay any stamp duty on it”. While these purchasers would of course be required to pay an annual land tax, it is quite possible that people moving to Tasmania from Sydney, Melbourne, Brisbane or Canberra would be paying less in land tax and council rates combined in Tasmania than they were previously paying in council rates alone.

¹ A state’s capacity to raise revenue from stamp duty on land transfers would continue to form part of the Commonwealth Grants Commission’s annual assessment of its overall revenue-raising capacity (a factor in its determination of that state’s share of GST revenues), even after it had abolished stamp duty, for as long as other states were still levying stamp duties. The effects would be less if all states were to make the ‘tax mix switch’ at the same time.

Box 1 seeks to answer the question, “how much land tax would I pay as a result of such a reform, compared with the amount of stamp duty I have to pay under the present system?”. It should be noted that the calculations presented in this box are based on incomplete information and hence should be seen as no more than indicative.

Box 1: How much land tax would I have to pay, compared with the stamp duty I have to pay now?

It is impossible to answer this question without access to detailed information on the number and value of properties in Tasmania, and on those which are currently subject to land tax and those which are exempt from it or zero-rated – information which is not publicly available.

However it is possible to make some ‘back-of-the-envelope’ calculations which give an indication of the likely *maximum* annual land tax bill which might be faced by a ‘typical’ Tasmanian home-owner who currently doesn’t have to pay land tax, if the aim of the reform was to generate the same amount of revenue currently raised from conveyance duty (on all property, including commercial property) with a land tax which included properties currently exempted or zero-rated.

According to the [2016 Census](#), there were 136,662 owner-occupied private dwellings in Tasmania, which would have been zero-rated for land tax. There were also 32,135 ‘unoccupied’ private dwellings – some of which would have been rental dwellings (which would have been subject to land tax), some would have been homes from which their owners were absent at the time of the census, but a large proportion would have been ‘shacks’ (which are exempt from land tax).

Between the September quarter of 2016 (when the census was conducted) and the June quarter of 2018, 4,493 [new dwellings](#) were completed. Assuming that the same proportion of these were ‘owner-occupied’ as were the number of ‘occupied private dwellings’ at the 2016 Census (ie, 69%), and that there were no demolitions, this means that there would have been 171,897 residential properties on which no land tax was payable in the 2017-18 financial year.

In the 2017-18 financial year, the state government collected \$255mn in revenue from conveyance duty – an unknown proportion of which would have been from transactions in commercial, as distinct from residential, properties. Assume however that the government seeks to replace this revenue *entirely* from land tax on currently exempt or zero-rated residential properties. To raise that amount, the wider land tax would have had to collect an average of \$1,484 from each of the 171,897 land-owners who (it is assumed here) didn’t pay land tax in 2017-18.

To put that figure in some context, according to the [Councils Consolidated Data Collection](#) published by the Local Government Division of the Department of Premier and Cabinet, Tasmania’s 29 councils collected \$452mn in rates in 2017-18 (excluding the state government’s fire levy). From the summary information for each council published on [Land Information System Tasmania](#), the total number of rateable properties in Tasmania was 279,342 – implying an average rate per property of \$1,619 (though this figure would also include rates on commercial properties).

Note that this is a *maximum* figure for an *average* home-owner. There would be some currently exempt or zero-rated property owners who would pay more than this, partly of course because the estimate relates to the *average* property-owner, but also because the proposal here is for the land tax to be levied at progressive rates on the per-square metre value of individual land-holdings, so that owners of more valuable properties in expensive locations would pay more: that is intentional.

But there are several reasons why the amount payable by an *average* property-owner would likely be less than this maximum:

- owners of properties with below-average values-per-square-metre would be paying lower rates of land tax under this proposal – as opposed to the flat percentages of assessed annual value at which council rates are levied;
- those property-owners who have purchased their property in recent years (how many years constitutes ‘recent’ would be determined by the government) would have a credit for the conveyance duty they’d paid, to offset against their land tax liabilities, until that credit was exhausted;
- property-owners who were ‘asset-rich but income poor’ would be able to defer their land tax liabilities until they sold their properties or until death (as some councils allow with regard to municipal rates); and
- the calculations here assumed that the government would seek to recoup *all* of the revenue foregone by abolishing stamp duty from land tax on currently exempt or zero-rated residential property owners: but in practice, the government could recoup some or all of the stamp duty foregone on commercial property transactions by increasing land tax on commercial property owners – with the same transitional provisions to avoid ‘double taxation’ of recent purchasers as is proposed here for recent purchasers of residential properties.

Finally, it should of course be noted that these indicative estimates of the annual amount of land tax that a currently exempt or zero-rated property-owner would have to pay should be compared with the conveyance duty which would no longer be payable on the purchase of properties.

According to CoreLogic the median sale price of houses transacted in Tasmania during the 2019-20 financial year was \$389,167. According to the State Revenue Office’s [Property Transfer Duty Calculator](#) the conveyance duty payable on a property of that value (other than by a first-home buyer or a pensioner) is \$13,538.50. So it would be nine years before an ‘average’ property-owner paid more in land tax than she or he would have paid in conveyance duty on the purchase of that property. And the argument of this report is that, in those circumstances, he or she *should* be paying more.

3. Payroll tax

Payroll tax is the Tasmanian Government's most important 'own' source of revenue – that is, under its direct control rather than being determined by an outside agency, as with the revenue from Tasmania's share of the GST (which depends on the size of the GST 'pool' and the recommendations of the Commonwealth Grants Commission as to how it should be divided up among the states and territories).

Over the ten years to 2019-20, successive Tasmanian governments have collected \$3,227 million in revenues from payroll tax, which represents 16.0% of total 'own source revenue' (that is, revenue from sources other than the federal government, including Tasmania's share of revenue from the GST), or 5.9% of total revenue.

Payroll tax was first levied by the Menzies federal government in 1941 to fund 'child endowment' payments (Mathews and Jay 1972: 177). It was levied at a rate of 2½% on payrolls in excess of \$40 per week. At that time, average weekly earnings were \$10.40 for men (ABS 1992: 5): so payroll tax would have been paid by most businesses with four or more employees.

By September 1971, when the McMahon Government handed the power to levy payroll tax over to the states in response to their repeated agitation for access to a 'growth tax', the 'threshold' had risen to \$20,800 per annum (Government of Western Australia 2018: 4). At that time, average weekly male earnings were \$84.30 per week (ABS 1992: 5), equivalent to \$4,384 per annum: so payroll tax was typically payable by businesses with 5 or more employees, scarcely different from 30 years earlier.

Upon taking over payroll tax, state governments immediately increased the rate to 3½%, and then in several steps to 5% by 1975 (Reinhardt and Steel 2006: 9). Subsequently, states responding to pressure from business groups and to competition from other states to entice businesses to move, progressively raised the thresholds at which payroll tax became payable, to the point where less than half of all payrolls are now subject to payroll tax (Freebairn 2005: 12).

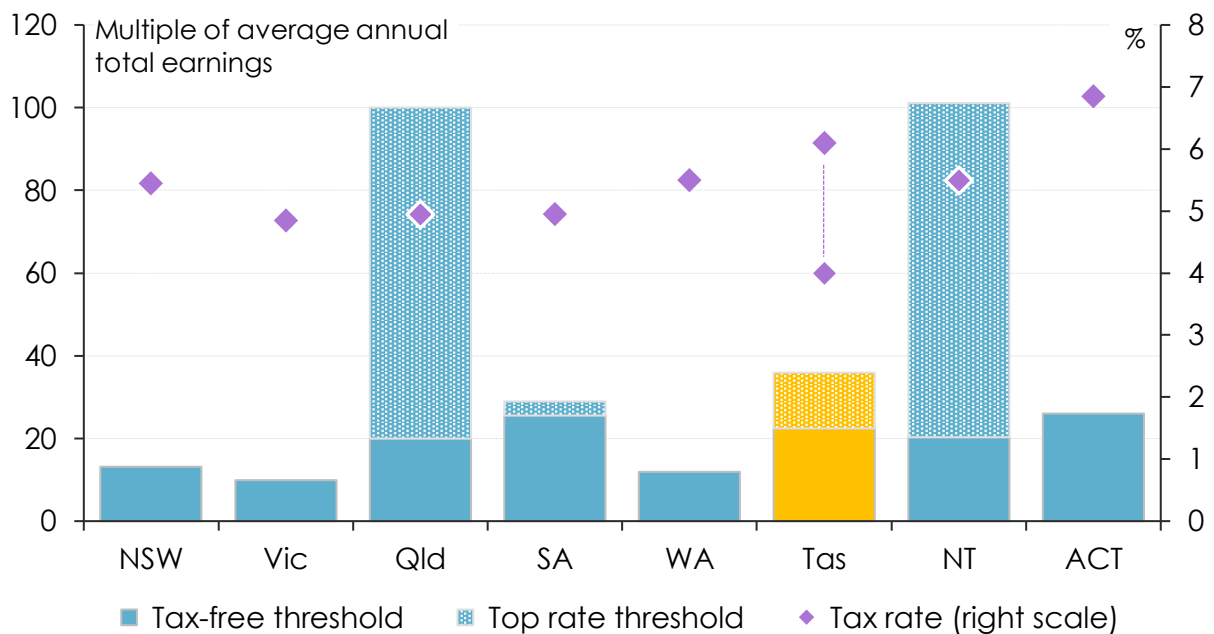
Collectively these actions on the part of state governments, of both major political persuasions, have flown in the face of one of the cardinal principles of 'good tax design', which is to impose the lowest possible rates of tax (consistent with raising the required amount of revenue over the broadest possible tax base – the argument which underpinned the replacement of wholesale sales tax, and a range of state indirect taxes, by the GST in 2000 (Costello 1998: 69-83).

And Tasmania is one of the most egregious offenders against this 'cardinal principle'.

Tasmania has the *third-highest* payroll tax rate of any state or territory, at 6.1% (exceeded only by Western Australia, which has a ‘temporary’ surcharge of 1.0 percentage point above its normal rate of 5.5% on payrolls above \$1.5 billion (per annum), and 0.5 percentage point on payrolls of between \$100 million and \$1.5 billion, until 30 June 2023; and the ACT, where the rate is 6.85%).

Tasmania’s tax-free payroll tax *threshold* of \$1.25 million (per annum) is the fourth-highest of any state or territory, exceeded by Queensland (\$1.3 million), South Australia and the NT (\$1.5 million) and the ACT (\$2 million): although because average earnings in Tasmania are 16½% below the national average, Tasmania’s threshold is higher (as a multiple of average earnings) than Queensland’s or the Northern Territory’s, and exceeded only by South Australia’s and the ACT’s (see Chart 7).

Chart 7: Payroll tax rates and thresholds, states and territories, 2019-20



Note: ‘Average annual total earnings’ is the average of average earnings of all employees (irrespective of age, gender or full-time/part-time status), in November 2019 and May 2020, multiplied by 52. In Tasmania, a payroll tax rate of 4% applies to payrolls of between \$1.25mn and \$2mn (ie between 22½ and 36 times average annual earnings for all employees).

Source: Government of Western Australia (2019: 6); ABS (2020e: Tables 2 and 12a-h).

Like Queensland and South Australia, Tasmania has an ‘intermediate zone’ of payrolls at which a lower marginal rate is payable: in Tasmania’s case this is 4% on payrolls of between \$1.25 million and \$2 million. Tasmania’s \$2 million threshold for the statutory payroll tax rate is, together with the ACT’s, the highest of any state or territory apart from Queensland, where it is \$6.5 million (excluding WA’s temporary surcharge). As a multiple of average earnings, the threshold for Tasmania’s statutory payroll tax rate is considerably higher, at 36, than the ACT’s, which is 26 times average earnings.

Tasmania’s combination of a relatively high tax rate and a relatively high tax-free threshold means that a higher proportion of Tasmanian employers are exempt from payroll tax than in most other states and territories, and that employers who are liable to payroll tax but who nonetheless have relatively few employees pay less tax than employers of similar size in other states and territories; but it also means that larger employers pay more in payroll tax than employers in other states and territories (see Table 1).

In other words, by comparison with the other states (though not with the two territories), Tasmania’s payroll tax system imposes a *high rate* of tax over a *narrow base* – the opposite of ‘good tax design’ – rather than a *low rate* of tax over a *broad base*.

Table 1: Payroll tax payable (\$000) on selected payrolls, states and territories, 2019-20

Annual payroll (\$000)	NSW	Vic	Qld	SA	WA	Tas	NT	ACT
700	Nil	2	Nil	Nil	Nil	Nil	Nil	Nil
1,000	5	17	Nil	Nil	Nil	Nil	Nil	Nil
2,000	60	65	42	25	69	30	34	Nil
5,000	223	211	220	173	256	213	241	206
10,000	496	453	495	421	550	518	550	548
50,000	2,676	2,393	2,475	2,401	2,750	2,958	2,750	3,288
100,000	5,401	4,818	4,950	4,876	5,500	6,008	5,500	6,713

Source: Government of Western Australia (2019: 7).

Thus, for example, a firm with a payroll of just under \$2mn – enough to employ 36 Tasmanians at average earnings – pays less payroll tax than anywhere else in Australia except South Australia. But a Tasmanian firm with 180 employees – which implies an annual payroll of just over \$10 million if each employee was paid the Tasmanian average – would pay more by way of payroll tax than a firm with the same payroll in any other state except Western Australia (and the two Territories). A Tasmanian firm with 900 employees would pay more in payroll tax than a firm with the same payroll in any of the other five states (though again, less than in the two territories). And the handful of Tasmanian firms (or mainland firms operating in Tasmania) with payrolls exceeding \$100 million would be paying more in payroll tax than similar firms in any other jurisdiction except the ACT (if there are any).

Tasmania’s divergence from well-established principles of ‘good tax design’ when it comes to payroll tax would be defensible if it brought significant benefits in terms of employment creation. But there is *absolutely no evidence* that it has.

It is true that ‘small’ businesses, which the Australian Bureau of Statistics defines as firms with fewer than 20 employees, account for a slightly larger proportion of private sector² employment in Tasmania (44.4% as of June 2019) than in any other state or territory (ranging from 36.7% in the Northern Territory to 42.6% in New South Wales) or than the national average (of 41%) (ABS 2020b).

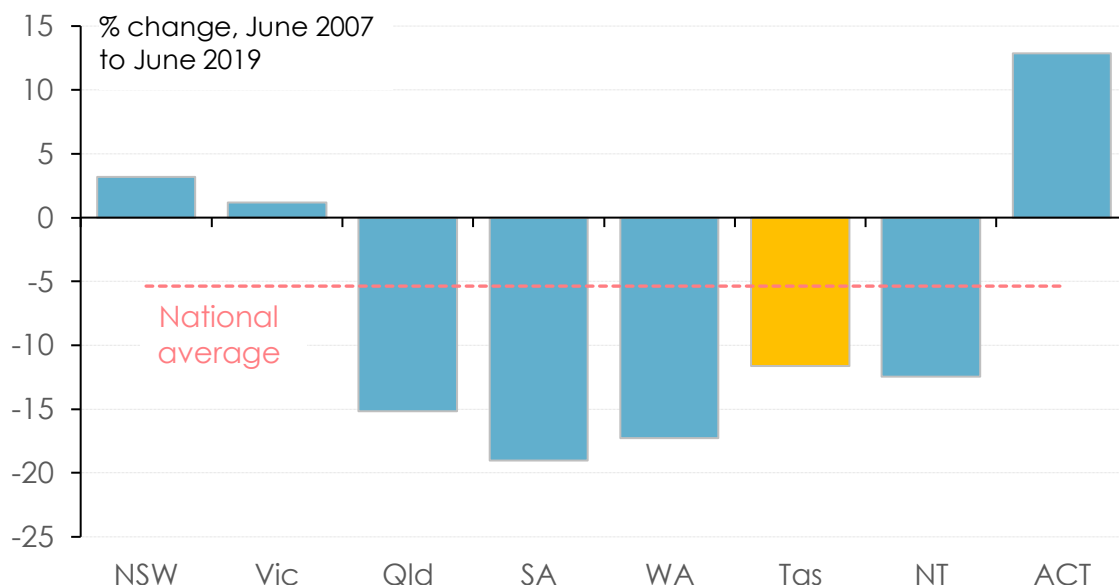
That is probably due to the facts that the public sector employs a larger proportion of the total workforce in Tasmania (21.4% as at June 2019) than in any other state (though not the two territories) or the national average (16.1%); and that within the private sector, industries like agriculture, forestry and fishing, and accommodation and food services, in which small businesses tend to constitute a greater share of activity, account for a larger share of employment in Tasmania than they do elsewhere.

In fact, the small business share of private sector employment in Tasmania *fell* by 10.2 percentage points between June 2007 (the earliest date for which this data is available) and June 2019 – more than for Australia as a whole (9.9 percentage points), and more than in any other state except Western Australia (12.7 percentage points) and Queensland (12.9 percentage points), states in which the share of employment in mining (which is dominated by large employers) rose significantly over this period.

In fact, employment at small businesses in Tasmania has declined significantly over the past 12 years. Employment at small businesses in Tasmania *fell* by 11.6% between June 2007 and June 2019 – more than double the national average of 5.4%, and in marked contrast to the net increases of 1.2% in Victoria and 3.2% in New South Wales (Chart 8 on page 31) – despite those two states have much lower tax-free thresholds for payroll tax than Tasmania (refer back to Chart 7 on page 28).

² Note that ‘private sector’ in the context used here excludes banks and other financial intermediaries, insurance companies and superannuation funds.

Chart 8: Change in employment at 'small' businesses, states and territories, June 2007 to June 2019



Note: 'Small businesses' are those with fewer than 20 employees.

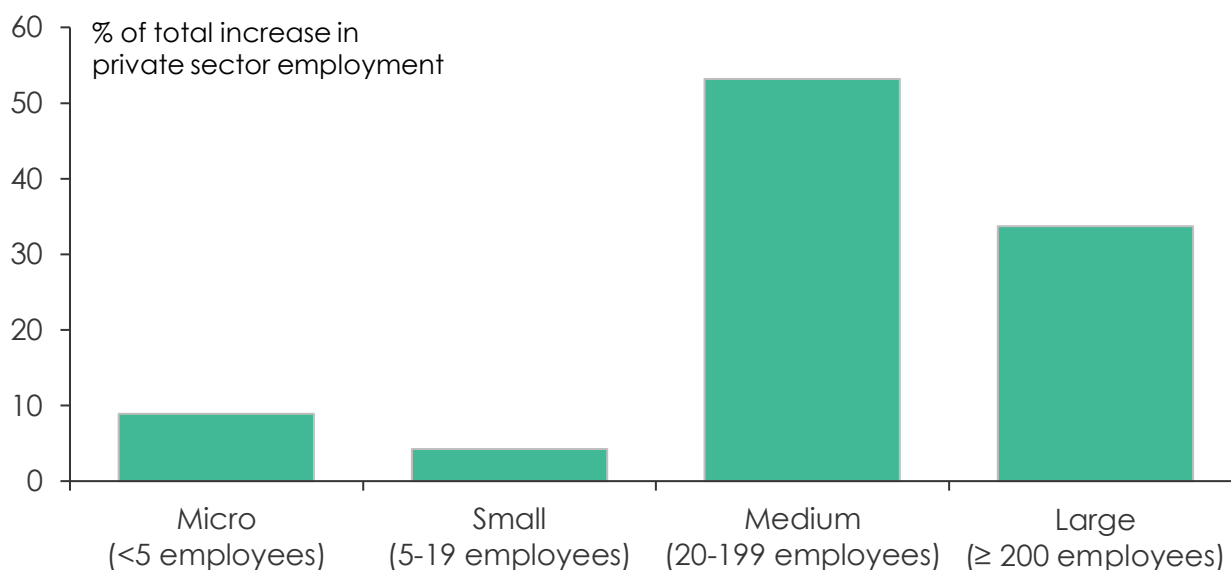
Source: ABS (2020c), additional data on employment, wages and sales and service income by business size provided on request.

By contrast, employment at medium-sized enterprises (those with between 5 and 199 employees) in Tasmania *increased* by 43.8% over the 12 years to June 2019, while employment at large enterprises (those with 200 or more employees) *increased* by 39.3% - despite these firms paying the second-highest rate of payroll tax in Australia.

Even over the most recent five years (from June 2014 to June 2019), during which employment at small businesses in Tasmania *did* rise, by 3.9%, that growth was substantially outpaced by both medium businesses (at which employment grew by 15.8%) and large businesses (at which employment grew by 7.2%) – as shown in Chart 9 on page 32.

Put differently, even during the past four years – a period during which small business confidence in Tasmania, as measured by the Sensis Business Survey (2019), has been at record highs – small businesses accounted for *only 13%* of the total increase in private sector employment, as against 52% by medium businesses (many of whom would have been subject to payroll tax) and 34% by large businesses (all of whom would have been subject to payroll tax).

Chart 9: Change in private sector employment by size of business, Tasmania June 2015 to June 2019



Source: ABS (2020c), additional data on employment, wages and sales and service income by business size provided (by ABS) to author on request.

Moreover, two-thirds of the increase in employment at small businesses in Tasmania over the four years to June 2019 was at ‘micro’ businesses – that is, those with fewer than five employees, who would have been exempt from payroll tax in any state or territory – while only one-third of it was at businesses with between five and 19 employees, who are more likely to be exempt from payroll tax in Tasmania than in any other state.

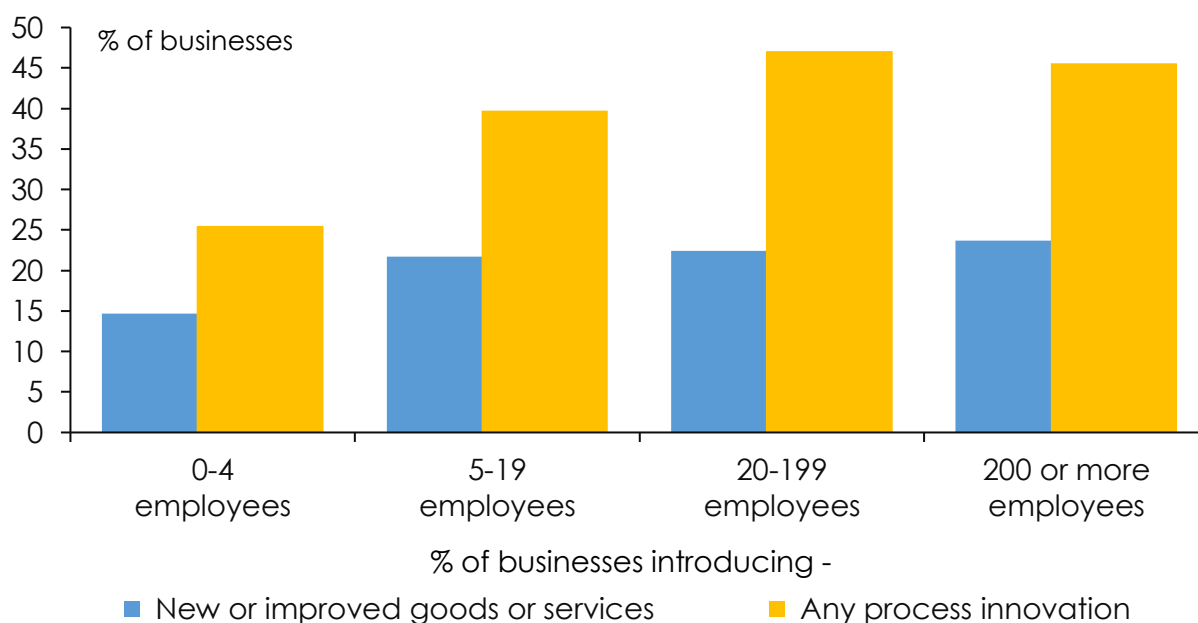
In the 2019-20 State Budget Papers, the Tasmanian Treasury estimated that the tax-free threshold for payroll tax would deprive the government of \$166.3 million in revenue that it would otherwise have collected in 2019-20 – equivalent to 44% of the revenue it predicted the government *would* collect from employers who aren’t exempt from it (Tasmanian Government 2019a: 108); or just \$3mn less than the total amount the budget provided for spending on housing and community amenities in 2019-20.

Such a large ‘tax expenditure’ (as the Budget Papers call it) might be more justifiable if it demonstrably created employment. But there is in fact *no evidence* that it does.

Nor is there *any* evidence that tax preferences for small businesses, while undoubtedly politically popular, contribute to the achievement of other economically or socially desirable objectives.

For example, contrary to what appears to be a widely-held assumption, small businesses are *not* inherently more innovative than larger ones. ABS data shows that small businesses are *less* likely to introduce new products or services, or to engage in other forms of innovation, than medium-sized or large ones (see Chart 10 on page 33).

Chart 10: Innovative activity by business size, Australia, 2018-19



Source: ABS (2020d).

The data shown in Chart 10 are for Australia as a whole: a state breakdown is not available. But there is no objective reason to think that small businesses in Tasmania are (in general) significantly more innovative than their counterparts in other states.

One thing that small businesses *are* significantly more successful at than medium-sized or large businesses is in *not* paying tax.

According to research by the Australian Taxation Office (2020), small businesses accounted for almost exactly half of the ‘tax gap’ (or difference) between the amount of (personal plus company) income tax which would notionally have been collected if there had been ‘full compliance’ with taxation laws, and the amount which was actually collected, in 2015-16 (the latest year for which such estimates are currently available). By contrast, ‘large corporate groups’ and ‘high wealth individuals and associated groups’ – the two segments most popularly thought to be not paying their ‘fair share’ of taxes – accounted for 8.8% and 3.1% respectively of the total measured income tax ‘gap’.

It is of course the case that there are many more small businesses in Australia than large ones, or high net worth individuals. But that doesn’t explain why small business accounts for such a disproportionately large share of the ‘tax gap’. The same ATO research shows that small businesses paid only 87.5% of the tax which the ATO estimates would be paid in 2015-16 if they ‘fully complied’ with the law.

By contrast, large corporate groups paid 95.3% of the tax which the ATO reckoned they 'should' have paid; and high wealth individuals and groups 92.7% of the tax which the ATO estimated they should have.³

'Non-compliance' by small businesses is estimated to have deprived the federal government of \$11 billion of revenue in 2015-16, compared with just under \$2 billion from 'non-compliance' by large corporate groups, and \$703 million from 'non-compliance' by high net worth individuals.⁴

It seems somewhat perverse, against that background, that small businesses (as a group) are 'rewarded' by being taxed (since 2015-16) at a lower rate on a given amount of income than larger businesses; and by being completely exempt from payroll tax.

However the costs of exempting such a large proportion of the potential Tasmanian tax base from paying payroll tax goes beyond merely foregoing a large amount of revenue for no gain in terms of the stated objectives of encouraging job creation, innovation and investment.

Tasmania is also foregoing the advantages of what economists generally regard as an 'efficient' tax.

This view is of course not widely shared. Nearly all businesses, and a large share of the general population, appear to regard payroll tax as a 'tax on jobs' which is therefore a Bad Thing and should be abolished – in contrast to the GST which many business groups see as a 'good tax'. Indeed some politicians and business groups argue that the abolition of payroll tax should be funded by some combination of increasing the rate and broadening the base of GST (see for example CCIQ 2015: 11; Business SA 2015; Smith 2019).

But is payroll tax *really* a disincentive to employment? And is it really such a 'bad' tax?

It's already been shown that, in Tasmania (as elsewhere), businesses which are too small to be liable for payroll tax have not (in aggregate) created *any* employment over the past twelve years, and have accounted for only about one-eighth of the increase in employment over the past five years: whereas most of the increase in private sector employment in Tasmania both over the past twelve and the past five years has occurred at firms which are liable for payroll tax.

³ Of course, large companies (and, to some extent, high net worth individuals) are more able than small businesses to influence tax laws in ways that reduce the amount of tax they are legally required to pay, through political processes or via legal challenges to the ATO's interpretation of existing tax laws. That said, large businesses have not been able to persuade Parliament that the statutory rate of company tax which they pay should be reduced; and banks (who are among the largest businesses in Australia) have not been able to prevent a specific additional tax (the Major Bank Levy) being imposed on them. By contrast, small business, *collectively*, has been highly successful at persuading all political parties that they should pay tax at a lower rate than 'big' business.

⁴ The ATO expects to publish updated 'tax gap' estimates, for the 2017-18 financial year, in October.

So the evidence that payroll tax is a disincentive to job creation is, to say the least, pretty flimsy.

More fundamentally, however, the fact that a business may be legally liable to pay a tax in the first instance does not necessarily mean that that business ultimately bears the burden of the tax.

For example, employers are legally required to remit to the ATO pay-as-you-go tax instalments deducted from their employees' wages and salaries (no matter how many employees they have, it is also worth noting): but no-one disputes that those tax payments are ultimately borne by the employees, not their employer.

Likewise, businesses whose products or services are subject to GST are legally liable for collecting it, and remitting it to the ATO (less the credits for GST paid on inputs): but it is well understood that the burden of GST falls on the customers for or purchasers of those products and services, in the form of higher prices.

Nor is it clear that the ultimate burden of company tax falls on the companies which are legally liable to pay it: some of it may be passed on to consumers in the form of higher prices; some is passed on to shareholders in the form of lower dividends; and the Treasury has argued that about two-thirds of the burden of company taxes is borne by employees in the form of lower wages (Rimmer, Smith and Wende 2014: 34).

The difference in practice between the GST (which, as noted above, many business groups regard as a 'good tax') and payroll tax (widely seen as a 'bad' tax) is worth exploring in greater depth.

As is widely understood, from the perspective of a business which is required to collect GST on its (taxable) sales and remit the proceeds to the ATO, the GST is effectively a tax on the difference between the revenue from taxable sales, and the cost of taxable goods and services used in producing the products or services which the business sells (The GST paid on 'inputs' is offset against the GST charged on 'outputs'). That's why in most other jurisdictions which have a tax like the GST it is called a 'value added tax' (Charlet and Owens 210: 944-954).

For nearly all businesses, the difference between the value of 'outputs' and the value of (material) 'inputs' is represented by the cost of the labour used to produce the 'outputs' (wages, salaries and other on-costs) and the gross profit margin.

In effect, therefore, the GST is equivalent to a 10% tax on labour costs – ie, to a 10% payroll tax – plus a 10% tax on gross margins – with an exemption for sales to non-residents (exports).

Yet no-one says that GST is a 'tax on employment' which 'costs jobs'.

And no-one seriously argues that ‘small business’ should be exempt from the GST in order to ‘create jobs’ (although small businesses are allowed to remit GST collections to the ATO at less frequent intervals than larger ones: which, by comparison with the more regular payments of GST required of larger businesses, amounts to an interest-free working capital loan from the ATO).

Alternatively, one can think of a payroll tax as being conceptually similar to a GST, except that it doesn’t tax the gross margin, and it doesn’t provide an exemption for exports.

Following this line of logic, the notion of increasing the rate or broadening the base of the GST in order to pay for reductions in, or the abolition of, payroll tax comes very close to taking money out of one pocket and putting it in another (leaving to one side the possible distributional consequences of a ‘tax switch’ along these lines – ie, that an increase in the GST would take a bigger ‘bite’ out the income of low-income households than out of that of high-income households).

It’s also worth noting that most other ‘advanced’ economies levy much higher rates of payroll tax on considerably broader bases than Australia: it’s just that most of those other ‘advanced’ economies call those levies ‘social security’ taxes, charges or contributions rather than payroll tax.

In the United States, for example, ‘Social Security’ (the age pension) is funded by a 12.4% tax on wages and salaries, and self-employment income, up to US\$132,900 (about A\$190,000) per annum, divided equally between employers and employees. ‘Medicare’ (which in America means health insurance for seniors) is funded by a similar tax of 2.9%, except there is no ceiling on the income which is subject to it (US Social Security Administration 2020; US Centers for Medicare and Medicaid Services 2020). These are, in effect, a combination of payroll tax (on the employer, at a higher rate than is payable in any Australian state or territory) and a flat-rate, hence regressive, income tax on individuals. There are no exemptions for ‘small businesses’

To take another example, in France employers pay ‘social security contributions’ of 10.45% of wages and salaries, and employees 7.30%, to fund age pensions; in addition employers pay social insurance contributions of between 7 and 13% of wages and salaries for health insurance and sickness benefits, between 3.45% and 5.25% for ‘family benefits’, 4.05% to fund unemployment benefits, and 3% to fund workers’ compensation insurance (CLEISS 2020). These are payroll taxes – and very big ones at that – by another name. There are *pas d’exemptions pour les petites entreprises*. Yet very few people in France disparage them as ‘*impôts sur les emplois*’.

In Norway, social security payments via what is in everything except name a payroll tax reach up to 14.1% of a firm’s wages and salary bill, with total collections amounting to 6% of GDP. Similar collections occur in Sweden (7% of GDP) and Finland (9%) (Scott 2019).

Returning to Tasmania, it is difficult to see how Tasmania derives *any* benefit from foregoing \$166 million of revenue annually by exempting a higher proportion of businesses from payroll tax than any other jurisdictions apart from South Australia and the ACT, whilst collecting \$340 million in revenue by imposing the second-highest tax rate in Australia on those businesses which aren't exempt from payroll tax.

It's not even as if Tasmania's generous payroll tax exemptions greatly simplify the compliance burdens for small businesses (one of the arguments commonly advanced as a reason for the exemptions), since *all* employers, regardless of how many employees they have, are required (by state law) to pay workers' compensation premiums (which are expressed as a percentage of payrolls, just like payroll tax).

They are also required by federal law to deduct PAYG tax instalments and compulsory superannuation contributions – and in some cases, student debt (HELP) repayments and child support payments.

Having to pay payroll tax as well would not greatly add to that burden – especially if the Tasmanian government 'contracted out' the collection process to the Australian Taxation Office, which could then administer the payroll tax system through its Single Touch Payroll system, which is already used by over 80% of employers with fewer than 20 employees.

Indeed, the very existence of the payroll tax threshold arguably adds to the complexity of the payroll tax system for businesses. As the Thodey Review for the NSW Government noted,

“[T]ax exemptions inevitably give rise to loopholes, which create a need for anti-avoidance provisions. In the case of payroll tax, the contractor provisions and grouping provisions, which are key points of discontent for taxpayers, are necessary to maintain the integrity of the tax by preventing firms breaking operations into smaller entities or creating artificial outsourcing arrangements to fall below the threshold” (Thodey et al 2020: 79).

The Thodey Review also drew attention to another adverse effect of tax-free thresholds for payroll tax:

“[The] payroll tax threshold ... may discourage growing and productive businesses just below the threshold from expanding due to the additional tax and compliance costs” (Thodey et al 2020: 78).

It concluded that “States simply cannot afford to continue to hollow out their largest revenue base” (Thodey et al 2020: 80). Similar advice has been proffered to state governments by some of Australia's foremost experts on state taxes, such as John Freebairn (Freebairn, Stewart and Pei 2015: 14), Robert Carling (2008: 6-7, and 2009: 10), and Neil Warren (2020).

Renowned economic modeller Chris Murphy has calculated that payroll tax has a ‘marginal excess burden’ of 37 cents for each additional dollar of revenue – making it one of the more ‘efficient’ taxes of the eight that he evaluated – but also concluded that “the efficiency of payroll tax could be improved by reducing the small business threshold to broaden the base”, a measure which he estimated would lower the ‘marginal excess burden’ of payroll tax to 24 cents per dollar of revenue raised (Murphy 2016: 43).

It would surely be more advantageous to Tasmania in attracting investment and employment from other parts of Australia (or in competition with other states and territories to attract investment and employment from other parts of the world) if we were able to say that Tasmania had the lowest payroll tax rate in the country, rather than (as at present) that we have the second-highest rate in the country, payable by the second-smallest proportion of businesses.

In particular, having a lower payroll tax rate payable by a larger proportion of businesses would make it easier to encourage medium and large businesses – which, as noted above, have accounted for almost all of the net new job creation in Tasmania over the past five and the past twelve years – to expand in, or relocate to, Tasmania.

And those who do still believe – in the face of all the evidence – that payroll tax discourages employment should be prepared to concede that reducing the rate of payroll tax on large employers (which lowering the rate and broadening the base of payroll tax would do) would result in a net increase in jobs, either directly or via the relatively large number of small businesses which larger businesses use as contractors.

If there is to be *any* preferential tax treatment for particular types of businesses at all, it should be for *new* businesses, rather than small ones.

There are four advantages of this approach:

- first, new businesses are more likely to be established in ‘growing’ sectors of the economy, or in sectors which are better-placed to cope with emerging structural and other changes in the broader economic, political, social or physical environment, than small businesses which are often in the sector which they’re in because that’s where they started one or more generations of proprietors ago, rather than as the result of any conscious choice to remain in that sector;
- second, new businesses are much more likely to be innovative (indeed, the desire to introduce a new product, or a new process, is often a major reason for the establishment of a new business) – so that preferencing new businesses is more likely to foster faster productivity growth than preferencing small businesses, simply because they are small and for no other reason;

- third, there will always be far fewer new businesses than small ones, so that providing preferential tax treatment for new businesses will entail a much smaller cost in terms of revenue foregone than providing preferential treatment for small businesses – and, moreover, the preferential treatment can be made more generous for a smaller number of beneficiaries; and
- fourth, there is no way that a new business can prevent itself from becoming a more mature business – and hence no longer qualifying for tax preferences for new businesses – other than by going out of business (in which case it no longer qualifies for preferential tax treatment)⁵ – so that the problem of ‘perverse incentives’, where by businesses choose to stop expanding their payrolls at a level just below the tax-free threshold no longer exists.

Of course, most *new* businesses will also be small: but under a regime which gave preferential payroll tax treatment to new businesses rather than small ones, it would also be possible to offer preferential tax treatment to a large business which established operations in Tasmania for the first time (whether as the result of an expansion of its overall operations to include Tasmania, or by transferring an existing operation to Tasmania from another part of Australia or from overseas) without the need for ‘secret deals’.

This would also reduce the risk to Tasmania of (ever again) getting sucked into an ultimately counter-productive ‘race to the bottom’ in competition with other states to entice a large company to establish a presence in the state – something which the Productivity Commission (1996) condemned as having “little or no positive effect on the welfare of Australians”, usually entailing “secrecy ... which creates a potential conflict of interest for publicly accountable officials”, is “often supported by [the] misuse of evaluation techniques” and “at best shuffles jobs between regions and at worst reduces economic activity”.

Broadening the base and lowering the rate of payroll tax – most sensibly by reducing the tax-free threshold to \$300,000 per annum, which would exempt all businesses employing the equivalent of five employees paid average weekly total earnings, and using the proceeds to lower the current rate, with an exemption for businesses in the first three years of their existence in Tasmania, and possibly with a lower ‘intermediate’ rate for businesses with, say, five to twenty-five employees – would be a growth-, employment- and welfare-enhancing reform which should be embraced by the Tasmanian government as part of a longer-term vision for the post-Covid economy.

⁵ It would of course be necessary to have adequate safeguards against ‘phoenixing’ – that is, when a new company is created to continue the business of an existing one that has been deliberately liquidated in order to avoid paying taxes, employee entitlements or other creditors, or in this case to continue to access preferential tax treatment. But both the ATO and ASIC already have strong mechanisms in place to guard against those risks: and they will be further strengthened by the introduction of director ID numbers next year.

4. Inheritance or estate taxes

Taxes on deceased estates – variously known as ‘death duties’, ‘estate duties’, ‘probate duties’, ‘inheritance taxes’, ‘bequest taxes’ or (less commonly) ‘succession taxes’ – had a long history in Australia prior to their abolition in the late 1970s and early 1980s.

The first tax of this type was introduced in New South Wales in 1851, as part of the movement to self-government (Smith 1993: 26): it was abolished in 1874 and then re-introduced in 1880. Tasmania was the second colony to introduce a tax on deceased estates, in 1865: it initially only applied to ‘personal’ property, and didn’t touch landholdings until 1894 (following a similar change in Britain). By 1895, all the Australian colonies had some form of ‘death duty’; and by 1910, estate duties accounted for more than 30% of total state government revenues (Mathews and Jay 1972: 83). The Commonwealth Government introduced its own estate duty (on top of state duties) in 1914, to finance the ‘war effort’ in circumstances where the collapse in international trade due to the onset of World War I meant a sharp decline in the customs revenue which provided most of the Commonwealth’s revenues during the first 14 years after Federation (a national land tax was also introduced in that year, and the first national income tax a year later).

By the late 1960s, the failure of state and federal governments to adjust the thresholds at which estate duties became payable since the 1940s meant that individuals with quite modest levels of wealth (as little as \$5,000 for estates passing to beneficiaries other than a surviving spouse, children or grandchildren) were becoming subject to duties that were originally only meant to tax very large inheritances or bequests, while wealthy individuals became increasingly willing and able to avoid death duties using discretionary trusts and other instruments of ‘estate planning’ (Reinhardt and Steel 2006: 9).

In 1971, Western Australia elected an independent, Syd Negus, to the Senate, on a platform of abolishing death duties. Groups representing farmers became particularly active in calling for the abolition of death duties, arguing that they were causing the ‘break-up of family farms’. Meanwhile death duties were becoming less important as a source of revenue to state governments, after they were given control of payroll tax in 1971: in 1973 they accounted for only 9% of total state tax revenues, down from almost 17% in 1968-69 (Mathews and Jay 1972: 247; Duff 2005: 50).

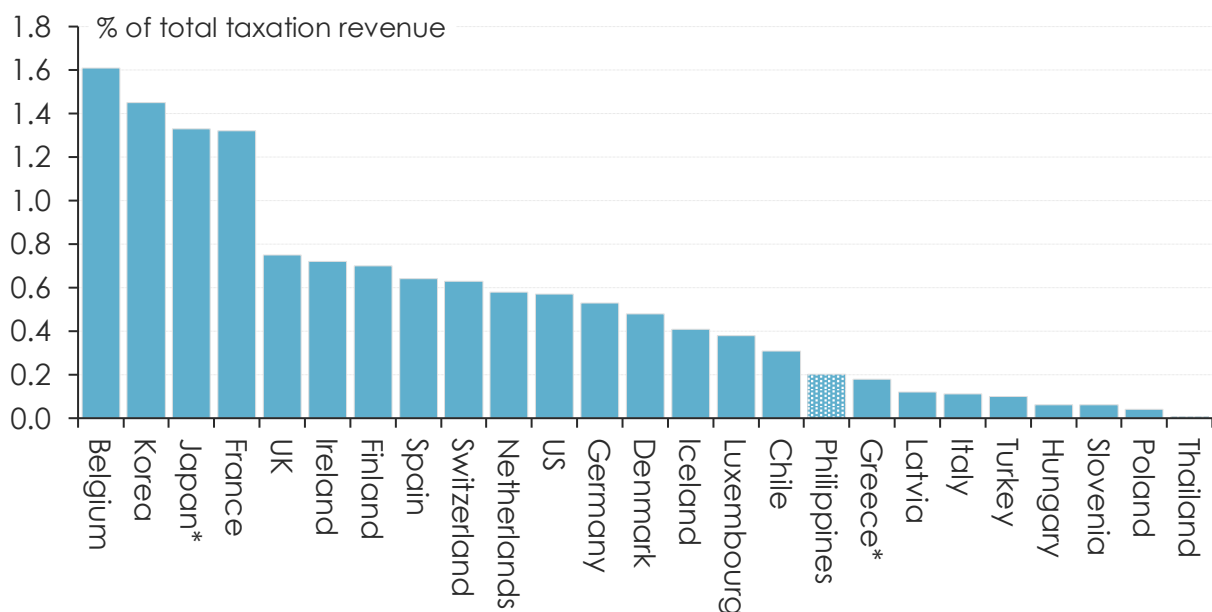
The Queensland Government of Premier Joh Bjelke-Petersen abolished that state’s death duties with effect from 1st January 1977. Other states then hurried to abolish their own death duties, fearing the emigration of wealthy older people or the transfer of assets to Queensland (both of which the Queensland Government actively encouraged).

Meanwhile, during the 1977 federal election campaign, Gough Whitlam as Labor leader promised to abolish Commonwealth death duties if Labor were returned to government: whereupon Malcolm Fraser promised to do the same if re-elected, and subsequently fulfilled that promise with effect from 1st July 1979.

Thus Australia became one of the first ‘advanced’ economies to have no taxes on the transfer of wealth at death, followed by Canada (where the last province to abolish death duties, Quebec, did so in 1985), New Zealand (in 1992), Israel (in 2001), Portugal and Sweden (in 2004), Hong Kong (in 2006), Singapore and Austria (in 2008), and Norway and Estonia (in 2014). Among other economies, India abolished estate duties in 1985, and Russia in 2006.

However, the majority of ‘advanced’ economies continue to levy some form of tax upon the transfer of assets after death, even though they make a relatively small contribution to total revenue (Chart 11).

Chart 11: Revenue from estate, inheritance, death, succession and gift duties as a pc of total tax revenues of all levels of government, OECD member countries, 2018



* 2017 The Philippines and Thailand are not members of the OECD.

Source: OECD (2020).

In particular, it is notable that the UK and the US have continued to impose estate duties (despite periodic attempts to abolish them), as have the two Asian OECD members (Japan and Korea), and two OECD countries that are generally seen as ‘low tax’ countries (Switzerland and Luxembourg) which attract migrants from ‘high tax’ countries.

The Henry Review did not recommend the (re-)introduction of what it termed ‘bequest taxes’ “at this time”, although it did conclude that such a tax would be “a relatively efficient means to taxing savings”, that it would “fit well with Australia’s demographic circumstances over the coming decades” and that it could “increase labour supply and savings by recipients and prospective recipients [of inheritances]”. It also noted that a bequest tax would be “complex” and would require some “anti-avoidance provisions, including a tax on gifts”, which would entail “significant administration and compliance costs” (Henry et al 2010, Volume I: 137).

The Australian National University’s Tax and Transfer Institute also argues that a “well-designed estate tax could complement taxes on the income from savings”, though it notes that deferred payment for government services (or of other taxes, such as municipal rates or, as advocated in the earlier section on land taxes) out of deceased estates would have “many of the positive features of estate taxes with less potential for avoidance and estate planning” (Varela, Breunig and Sobeck 2020: 34).

The idea of taxing inheritances or bequests is not something confined to socialists or others of a left-leaning or ‘progressive’ disposition. On the contrary, it has been supported by economists and others from across the entire spectrum of political perspectives and inclinations.

Adam Smith, in *The Wealth of Nations*, decried

“the most absurd of all suppositions, the supposition that every successive generation of men [sic] have not an equal right to the earth, and to all that it possesses; but that the property of the present generation should be restrained and regulated according to the fancy of those who died perhaps five hundred years ago” (Smith 1776: 486).

Likewise, John Stuart Mill, one of the most revered liberal (in the European sense of that phrase) thinkers, wrote that:

“a succession duty is the most unobjectionable mode of ... redistributing wealth ... because in that way it is confined to hereditary wealth. I think you must allow people to retain the full advantage for their lives of what they have acquired; but the State may deal with it on the occasion of succession. I certainly think it fair and reasonable that the general policy of the State should favour the diffusion rather than the concentration of wealth” (Mill 1852 in Ekelund and Walker 1996: 559).

The Economist magazine, which takes an unashamedly liberal (again, in the European sense) perspective on most issues, says:

“people who are against tax in general ought to be less hostile to inheritance taxes than other sorts. However disliked they are, they are some of the least distorting.

Unlike income taxes, they do not destroy the incentive to work - whereas research suggests that a single person who inherits an amount above \$150,000 is four times more likely to leave the labour force than one who inherits less than \$25,000. Unlike capital-gains taxes, heavier estate taxes do not seem to dissuade saving or investment. Unlike sales taxes, they are progressive. To the extent that a higher inheritance tax can fund cuts to all other taxes, the system can be more efficient ... A fair and efficient tax system would seek to include inheritance taxes, not eliminate them" (2017).

A year later, *The Economist* was blunter, stating that "all countries should tax property and inheritance more", because "in a world where property ownership brings windfalls that persist across generations, such taxes are desirable" (2018).

It's perhaps worth re-iterating that *The Economist* is no 'socialist rag': on the contrary, according to its [Wikipedia entry](#), it "typically champions "neoliberalism, particularly free markets, free trade, free immigration, deregulation, and globalisation".

In much the same vein, it's worth noting that support for inheritance or estate duties among politicians hasn't been confined to those of the left-of-centre variety.

Winston Churchill, in his first Budget as Chancellor of the Exchequer in 1926, increased rates of death duty in order to fund a reduction in personal income tax, arguing that

"the process of creation of new wealth is beneficial to the whole community [while] the process of squatting on old wealth though valuable is a far less lively agent ... A premium on effort is my aim and a penalty on inertia may be its companion" (Daunton 1997: 1072).

Theodore Roosevelt, a Republican who was President of the United States between 1901 and 1909, in 1906 proposed a "graduated inheritance tax by which a steadily increasing rate of duty should be put upon all moneys or other valuables coming by gift, bequest, or devise to any individual or corporation", for which "the prime object should be to put a constantly increasing burden on the inheritance of those swollen fortunes which it is certainly of no benefit to this country to perpetuate" (Roosevelt 1906).

Herbert Hoover, Commerce Secretary during Republican President Calvin Coolidge's Administration and subsequently President himself, an unabashed conservative whom history typically condemns for his unwillingness to ameliorate the Great Depression which began during his term, nonetheless favoured "a steeply graduated tax on legacies and gifts ... for the deliberate purpose of disintegrating large fortunes" (Leuchtenberg 2009: 59).

Sir Robert Menzies could readily have abolished federal estate duties if he had wanted, but never once sought to do so during his eighteen years as Prime Minister of Australia.

Neither did Sir Thomas Playford make any move to abolish state death duties during his 27 years as Liberal Premier of South Australia; nor did Sir Henry Bolte during his 17 years as Liberal Premier of Victoria, or his successor Dick Hamer who was Premier for nine years; and nor did Sir David Brand during his twelve years as Liberal Premier of Western Australia – although any one, or all, of them could have done so had they wished to during their long terms in office.

And John Howard, one of whose first acts as Treasurer in Malcolm Fraser's Government was, as he records in his memoirs, to "take legislation through federal parliament abolishing all federal death duties", acknowledges that although "this was a big and popular reform, [it] further narrowed the tax base" (Howard 2010: 303).

It's also striking that – at least in the United States – death duties or inheritance taxes enjoy surprisingly wide support from people who would have to pay quite a lot of them (or whose children would).

The American industrialist Andrew Carnegie, who in the early 1900s was reputed to have been the richest man in the world, wrote in 1899:

"The growing disposition to tax more and more heavily large estates left at death is a cheering indication of the growth of a salutary change in public opinion.... Of all forms of taxation, this seems the wisest. Men who continue hoarding great sums all their lives, the proper use of which for public ends would work good to the community, should be made to feel that the community, in the form of the state, cannot thus be deprived of its proper share" (Carnegie 1889: 653).

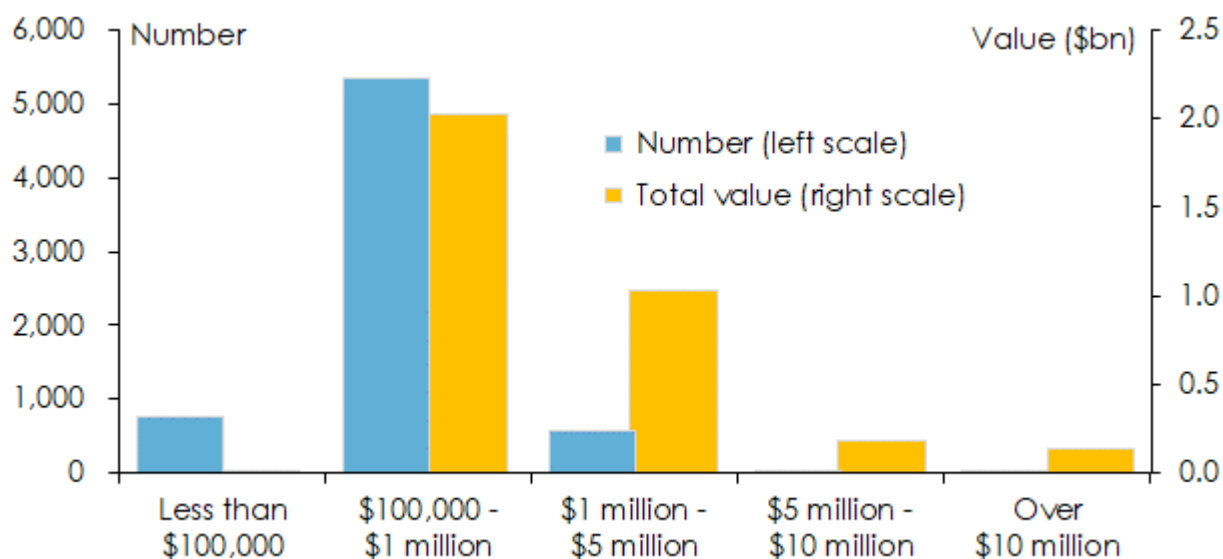
Ray Dalio, the founder of New York-based hedge fund Bridgewater Associates and, according to *Forbes* magazine (2020) the 69th richest person in the world this year, supports the retention of death duties (Dalio 2019): as does Abigail Disney, granddaughter of Roy Disney, who with his more famous brother Walt founded the Disney Corporation (Kolhatkar 2019). Warren Buffet (founder of Berkshire Hathaway, who ranks 8th on Bloomberg's Billionaires Index), Bill Gates (co-founder of Microsoft), the late John Bogle (founder of the Vanguard Group which pioneered index funds, and Robert Rubin (former co-Chairman of Goldman Sachs and of Citigroup) have all supported the retention of estate taxes in the US (Reilly 2012; Coudriet 2019).

There are, of course, many more rich people who are opposed to any form of taxation of estates or inheritances: but the point is that this opposition is neither monolithic nor uniform: far from everyone who would be subject to such a tax think that it is a Bad Thing. In particular, rich people who have generated their wealth themselves, appear more inclined to favour some form of taxation of estates or inheritances than those who have inherited much or all of their wealth.

During the three financial years 2017-18 through 2019-20, the Supreme Court of Tasmania granted probate on 6,747 estates with a total gross value of \$3.4 billion (Supreme Court of Tasmania 2020).

91% of these estates had a gross value of less than \$1 million – and they accounted for 60% of the total value of estates granted probate in the three years to June 2020 (see Chart 12).

Chart 12: Number and value of estates granted probate by the Supreme Court of Tasmania, 2017-18 to 2019-20



Source: Supreme Court of Tasmania (2020).

Of the remaining 9% of estates, just over 8½% (of all estates) were valued at between \$1 million and \$5 million, and they accounted for just over 30% of the value of all estates granted probate during this period; 29 (or less than half of one percent of the total number) were valued at between \$5 million and \$10 million, and they accounted for 5½% of the total value of estates granted probate; while 10 estates (0.1% of the total number) were worth \$10 million or more, and they accounted for 4.1% of the total value of estates granted probate during the three years to June 2020.

Although, as a general principle, taxes should ideally be levied across as broad a base as possible (so as to enable rates of tax to be lower, and to avoid the distortions and perverse incentives associated with exemptions and thresholds), there are sound reasons for departing from this principle in the case of an estate or inheritance tax.

First, because (as noted by the Henry Review), such a tax is “inherently complex” and can entail “significant administration and compliance costs”, there is no point in seeking to impose it on small estates or inheritances: the costs of doing so would likely exceed the revenue raised.

Second, seeking to tax relatively small bequests or inheritances would likely generate widespread (and understandable) opposition to the whole concept of taxing bequests or inheritances (as indeed it did when the failure to index thresholds for inflation resulted in modest estates becoming subject to a tax that was originally intended only to tax large estates, ultimately creating a groundswell which led to the abolition of estate taxes in Australia in the late 1970s as noted earlier).

An estate tax which exempted all estates valued at less than \$1 million, but taxed estates valued at (for example) \$1 million or more at (for example) 5%, that part of those valued at \$5 million or more at 10% on the value in excess of \$5 million, and those valued at \$10 million or more at 20% on the value in excess of \$10 million, would in theory have generated revenue totalling \$95 million over the three years to 2019-20 – or just under \$32 million per annum – equivalent to 27% of the amount collected by payroll tax, or 35% of the amount collected by conveyance duties.

Only 619 estates would have been subject to such a tax (only 9% of the total). The 580 estates valued at between \$1 million and \$5 million would have paid an average of \$88,843; while the 29 estates valued at between \$5 million and \$10 million would have paid an average of \$586,809, and the 10 estates valued at over \$10 million would have paid an average of \$2,618,433 in tax.

In practice, the amounts collected, both in total and from individual estates, would be less than set out in the preceding paragraphs, because it would be sensible and reasonable to exempt the family home and superannuation savings where they passed to a surviving spouse or partner (although there is no valid reason why those assets should be exempt when passing from a deceased parent to any other relative).

It may also be deemed expedient to exempt family farms from taxation in circumstances where there are no significant off-farm real or financial assets in the estate.

And it would be important for the thresholds, wherever they are set, to be indexed annually against movements in consumer prices, so that the intention to confine liability to the most valuable estates is not undermined by inflation, as it was between the 1950s and the late 1970s.

Another desirable variation may be to allow, either as a deduction from the taxable value of an estate, or as a credit against the tax otherwise payable, the value of bequests or gifts made (either out of the estate or during a prescribed period prior to death) to Tasmanian charities or other institutions which have Deductible Gift Recipient status from the Australian Charities and Not-for-Profits Commission.

This would provide a powerful incentive for affluent Tasmanians to make donations to charities and eligible not-for-profits, in much the same way as similar provisions have done in the United States.

Over the four years following the introduction (by the Wilson Administration) in the United States of estate duties in 1917, the gross value of estates increased by 25%, but the value of charitable bequests increased by 3,419% – from 0.12% of the value of estates to 3.04% of the value of estates in 1921. Between 1918 and 1945, charitable bequests averaged 4.82% of the gross value of estates; comparable figures are not available for the years from 1946 to 1988, but between 1988 and 2000, charitable bequests averaged 7.28% of the gross value of estates (Doti 2003).

If the value of gifts or bequests to eligible Tasmanian DGRs were to be credited against the tax otherwise payable on estates (as opposed to being made deductible from the gross value of an estate in order to determine its taxable value), it would be possible for every person whose estate would be subject to such a tax to avoid it *entirely*, by making gifts or bequests equal to or greater than the amount of tax that would be otherwise payable.

In effect, such a system would offer a choice to (the relatively small number of) wealthy Tasmanians: leave a relatively small part of your estate (less than one-fifth, for the largest estates) to ‘worthy causes’ in Tasmania, or pay an equivalent amount in estate duties. Most if not all Tasmanians would likely choose the former option: and a large proportion of the Tasmanian community would thereby indirectly benefit through the work that the recipients undertake. But to the extent that they didn’t, the community would benefit through the provision of additional public services, the opportunity to collect less in other forms of taxation, or a stronger budget ‘bottom line’.

And to the extent that some wealthy Tasmanians chose to avoid that choice by moving to another state, there would probably be some small intangible benefit from having fewer mean-spirited citizens in our midst; and some (very) marginal tangible benefit in reduced demand on Tasmania’s hard-pressed health care system.

5. Conclusion

This report proposes reforms in three areas of Tasmania's state taxation system:

- first, replacing stamp duties on the transfer of land (conveyance duty) with a broadly-based land tax, levied at progressive rates on the per-square-meter value of individual land holdings, with no exemption for owner-occupied housing but with transitional provisions to avoid 'double taxation' and deferral provisions to cater for people who may be 'asset rich but income poor' (such as retirees and pensioners);
- second, lowering the rate and broadening the base of payroll tax, by substantially reducing the threshold at which employers become liable to payroll tax, and providing exemptions for new businesses; and
- third, re-introducing estate duties which were abolished in Tasmania in the late 1970s, but structuring them so that less than 10% of all estates would be liable to pay them, and giving those who would be liable to pay them the option of reducing or eliminating entirely their liability by making gifts or bequests to Tasmanian charities and not-for-profit institutions.

The first of these has been recommended by every official inquiry that has considered state tax systems, as well as by numerous academic studies.

The second recommendation has been supported by some, though not all, official inquiries, and also enjoys widespread support among economists, but would be opposed by many (though not all) business groups and employers' representatives, especially those advocating for small business.

The third enjoys some support among economists (and, perhaps surprisingly, from a number of individuals who would be liable to pay estate duties), but has never been endorsed by any official inquiries, at least not in Australia. It would be vigorously opposed by many (including some who would be completely unaffected by what is proposed here); it could easily be an object of 'scare campaigns', especially by those who are willing to overlook the specifics of what is proposed in order to inveigle against what they would excoriate as a 'death tax' (Boyce 2020). But it can be embraced by those who believe that equity, as well as efficiency, is a legitimate objective of any taxation system.

This report does *not* seek to make a case that any of these reforms should be implemented *now*, or in next year's state budget. Rather, it aims to start an informed and reasoned public 'conversation' about Tasmania's state tax system, in the hope that parties seeking to form government after the next election might seek a mandate for reform from the Tasmanian people at the next election, with a view to implementing it in the next term of the Tasmanian Parliament.

This report has intentionally *not* sought to argue that the overall level of Tasmanian state taxation should be either higher or lower than it is at present.

That is an inherently *political* choice, not one about which economics has much to say (with any great authority) on either theoretical grounds or on the basis of accumulated empirical evidence. It is a choice which should not be considered independently of an evaluation of the public goods and services which are funded by the revenue raised by state taxes (among other sources of revenue).

Rather, the fundamental objective of the reforms which are proposed in this report is to reduce Tasmania's reliance on 'bad taxes' and increase its use of 'good taxes' to raise whatever level of taxation revenue the Tasmanian community thinks should be collected by its state government.

In so doing, the recommendations in this report, and the arguments which are presented in support of them, are intended to help build a more prosperous and fairer Tasmania, one of which the people of Tasmania can be proud; one of which other people will want to become a part; and one which can be an inspiration to those seeking to build more prosperous and fairer societies elsewhere in Australia and around the world.

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