

# Chapter 1: The New System of Federal Financial Relations

This chapter provides an overview of the progress on the reforms to Commonwealth-State financial relations to commence in 2000-01 as part of *The New Tax System*.

## REFORMS TO COMMONWEALTH-STATE FINANCIAL RELATIONS

On 13 August 1998, the Commonwealth Government announced its plan to reform the Australian taxation system. A key element of *A New Tax System* was a landmark reform of Commonwealth-State financial relations. At the 9 April 1999 Premiers' Conference, Heads of Governments signed the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (Intergovernmental Agreement), which settled the key aspects of the reforms. A copy of the original Intergovernmental Agreement was included in the 1999-2000 *Budget Paper No. 3*.

In essence, the Intergovernmental Agreement:

- removes State reliance on financial assistance grants and revenue replacement payments from the Commonwealth;
- provides all goods and services tax (GST) revenue to the States, to be spent according to their own budgetary priorities;
  - this provides the States with access to a more robust tax base which will grow over time thus ensuring that State budgets will be substantially better off over the medium term;
- gives the States a direct role in determining the GST base and rate and related operational matters;
- establishes a timetable for the abolition of a range of inefficient State taxes; and
- establishes a Ministerial Council for Commonwealth-State Financial Relations (the Ministerial Council).

On 28 May 1999, following negotiations with the Australian Democrats, the Prime Minister announced changes to the *A New Tax System* package. The changes to the GST, in particular the exclusion of basic food from its base, produced a significant reduction in estimates of GST revenue collections. As all GST revenue is being provided to the States, the changes adversely impacted on the States' budgetary positions. This necessitated modifications to the Intergovernmental Agreement, culminating in the endorsement by Heads of Government of a revised Intergovernmental Agreement in June 1999.

The key changes to the Intergovernmental Agreement were as follows:

- The abolition of Financial Institutions Duty was deferred from 1 January 2001 to 1 July 2001.
- The abolition of debits tax was deferred from 1 January 2001 until up to 1 July 2005 (subject to review by the Ministerial Council).
- The Ministerial Council will by 2005 review the need for retention of a range of business stamp duties, specifically, stamp duties on non-residential conveyances; unquoted marketable securities; leases; mortgages, debentures, bonds and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; and on cheques, bills of exchange, and promissory notes. These stamp duties were originally to be abolished from 1 July 2001.
- The Commonwealth will retain responsibility for the payment of financial assistance to local government, rather than transfer this responsibility to the States.
- The States will ensure that the increase in pensions and allowances as part of the revised tax reform package will not flow through to increased public housing rents where rent is linked to the level of pension.

The Commonwealth made a commitment in the Intergovernmental Agreement to provide financial assistance to the States to cover any temporary shortfall in their budgets resulting from the implementation of tax reform. Consistent with this, the Commonwealth undertook to provide increased assistance to balance State budgets in the transitional years.

The reforms to Commonwealth-State financial arrangements required the passage of legislation by both the Commonwealth and the States. Legislation to give effect to the Commonwealth's commitments in the Intergovernmental Agreement — *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* and *A New Tax System (Commonwealth-State Financial Arrangements — Consequential Provisions) Act 1999* — received royal assent on 10 September 1999.

The States have agreed to enact legislation to fulfil their commitments, including the abolition of certain State taxes and the introduction of a First Home Owners Scheme.

## **MINISTERIAL COUNCIL FOR COMMONWEALTH-STATE FINANCIAL RELATIONS**

The Intergovernmental Agreement provides for the establishment of a Ministerial Council for Commonwealth-State Financial Relations, comprising Commonwealth and State Treasurers, to oversight the implementation and operation of the Intergovernmental Agreement. The inaugural Ministerial Council meeting on 17 March 2000 considered expected revenue payments to the States in 2000-01, as well as a range of tax reform-related issues.

The Ministerial Council noted estimates of GST revenue collections, Budget Balancing Assistance, Specific Purpose Payments, National Competition Payments and Special Revenue Assistance to be received by the States in 2000-01.

Also considered by the Ministerial Council were a range of other matters consistent with its role of monitoring the implementation of the Intergovernmental Agreement. These included:

- considering progress on the development of a range of Ministerial determinations affecting the tax base for the GST;
  - the Division 81 determination that establishes a list of Commonwealth, State and local government taxes, fees and charges that will not be subject to the GST, has been approved by the Ministerial Council and was gazetted on 1 March 2000;
- reviewing progress with implementing the First Home Owners Scheme;
  - all States anticipate the passage of necessary legislation prior to the scheme's commencement date of 1 July 2000, and promotional activities have commenced to alert first home buyers to the existence of the \$7,000 grant for home purchases after 1 July 2000;
- noting the Commonwealth's intention to legislate to require the States to withhold from any local government authority that does not register and pay GST a sum equivalent to the payments that ought to have been made. The Ministerial Council also noted States' intention to implement laws or procedures that will allow them to detect any non-compliance by local government bodies and to determine the level of local government financial assistance grants to be withheld in such cases; and
- endorsing a target date of 1 July 2001 for implementing the national tax equivalent regime for income tax for State government business enterprises.

