



Inquiry into Microeconomic Reform in Western Australia

Reforming State Taxes

ISSUE

State taxes are an important source of revenue for the Western Australian Government. These taxes accounted for around a third of the Government's revenue in 2014/15.

However, poorly designed taxes impose substantial costs on the economy, including efficiency costs, compliance costs, and administrative costs.

Inefficient taxes also distort the choices of businesses and individuals. For example, a business may send operations off-shore, or decide not to expand so as to minimise payroll tax. Similarly, individuals may choose not to move to a new area for work, or to buy a house that better suits their needs, because of the cost of residential transfer duty.

The costs arising from the inefficiency of Western Australia's three largest taxes - being payroll tax, residential transfer duty and land tax - alone are significant.

These costs have been estimated by the ERA's consultants to be in the order of \$1 billion per annum. They arise because taxes distort the decisions of taxpayers to work, save, invest, or consume.

The costs associated with taxes can be minimised by ensuring taxes are efficient (that is, taxes are applied to broad and relatively immobile bases at low rates) and are simple to administer and comply with.

Poorly designed taxes impose efficiency costs, compliance costs, and administrative costs on both taxpayers and the Government.

Inefficient payroll, residential transfer duty, land taxes cost Western Australia around a billion dollars each year.

WHAT WE RECOMMENDED

The ERA presented two main options for improving the efficiency of Western Australia's major taxes, while collecting the same amount of revenue for the State Government. These options were:

1. broadening the base and lowering the rate of all three taxes to increase their efficiency; or
2. increasing the reliance on efficient taxes (land tax and payroll tax) and reducing or abolishing the inefficient taxes (residential transfer duty).

We recommended that the Government give further consideration to both options, but consider that the second option is preferable.

WHY WE RECOMMENDED THIS

A preliminary investigation indicated that the tax reform options have the potential to add \$460 million (Option 1) to \$580 million (Option 2) to the State economy.

Reforming State taxes will also ensure that the State Government has access to a stable and growing source of revenue.

INCREASING RELIANCE ON EFFICIENT TAXES, AND REDUCING RELIANCE ON INEFFICIENT TAXES

The ERA's preferred option involves:

- removing all concessions and exemptions on land tax and raising the rate (while retaining the progressive scale) and therefore significantly increasing the amount of revenue raised by land tax; and
- removing all concessions and exemptions on payroll tax (with the exception of the exemption threshold) and lowering the rate, such that the total net revenue raised by payroll tax remains the same; and
- abolishing transfer duty on residential property.

Any reforms to the taxation system that are revenue neutral for the Government will result in winners and losers.

This is because a reduction in the taxation liability of an individual or business will have to be paid for by an increase in the liabilities of others.

IMPLEMENTING THE REFORMS

The ERA recognises that there are practical barriers to reforming State taxes.

These barriers include the difficulties of convincing the business community and the general public of the need to forgo existing exemptions and concessions in State taxes for the broader public benefit of lower tax rates applied to broader bases.

However, the immediate impact on the individuals who do not benefit from the taxation reforms can be softened by adopting a staged-approach to the implementation of any reform measures.

Saving Western Australia \$460m to \$580m a year:

Removal of transfer duty
on residential property



A lower payroll tax rate,
more broadly applied



Using land tax
to provide an efficient,
stable source of revenue



This fact sheet is part of a series on the ERA's 2014 Inquiry into Microeconomic Reform in Western Australia

The full report and additional fact sheets are available at erawa.com.au

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