

COMMONWEALTH-STATE FINANCIAL RELATIONS

The States will receive GST revenue and payments from the Australian Government totalling an estimated \$64.6 billion in 2005-06 (Table 1) and \$67.5 billion in 2006-07 (Table 2).

All GST revenue is paid to the States in accordance with the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the IGA). The GST revenue pool is distributed among the States on the basis of relativities recommended by the independent and expert arbiter, the Commonwealth Grants Commission (CGC). The CGC's recommendations are based on the principle of Horizontal Fiscal Equalisation (HFE).

In 2005-06, the States are estimated to receive \$1.2 billion more revenue from GST than they would have received from Australian Government Financial Assistance Grants (FAGs) and their own inefficient taxes abolished under tax reform. Only New South Wales will require Budget Balancing Assistance (BBA) in 2005-06. In 2006-07, all States and Territories are estimated to receive a GST windfall. This windfall is estimated to be \$1.9 billion in 2006-07.

The Australian Government has now reached agreement with all States on a schedule for the abolition of most taxes listed for review in the IGA. Inefficient state taxes such as stamp duty on mortgages, leases, and credit and rental arrangements will be abolished, as was originally intended under the IGA. The abolition of these taxes is expected to save taxpayers approximately \$4.4 billion over the four years from 1 July 2006.

The Australian Government will also extend the transitional period from 30 June 2006 to 30 June 2009. This is a guarantee by the Australian Government that ensures that no State is worse off as a result of tax reform. Given current estimates, this is a sufficient timeframe to ensure the States will no longer require transitional assistance even after the abolition of the IGA taxes.

The Australian Government will provide payments to the States under the *Agreement to Implement the National Competition Policy and Related Reforms* of an estimated \$820.4 million in 2005-06. The 2005-06 National Competition Policy Payments are the final payments under the current National Competition Policy arrangements. At its 10 February 2006 meeting, the Council of Australian Governments (COAG) agreed to a new National Reform Agenda comprising human capital, competition and regulatory reform streams. COAG agreed that, if funding is needed to ensure a fair sharing of the costs and benefits of reform, the Australian Government will provide funding to the States on a case-by-case basis once specific implementation plans have been developed.

Budget Paper No. 3

The Australian Government will also provide the States with payments to compensate for GST revenue deferred as a result of allowing certain small businesses and non-profit organisations to pay their GST on an annual basis, as well as Specific Purpose Payments, including FAGs to local government, to contribute towards meeting the costs of State and local government responsibilities.

Other features of Commonwealth-State financial relations include the First Home Owners Scheme, which provides compensation to first home buyers for the one-off increase in housing prices associated with indirect tax reform, and mirror tax arrangements, which provide for the collection of certain state taxes on activities in or on Commonwealth places, to ensure competitive neutrality for businesses operating from Commonwealth places.

Table 1: GST revenue provision and total Australian Government payments to the State/local sector in 2005-06 (estimated)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---|----------|----------|----------|---------|---------|---------|---------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| (1) Provision of GST revenue to the States(a) | 10,258.2 | 7,750.7 | 7,612.9 | 3,764.7 | 3,408.5 | 1,480.8 | 715.0 | 1,821.7 | 36,812.6 |
| (2) Budget Balancing Assistance | 43.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 43.8 |
| (3) Compensation for GST deferral(b) | 36.6 | 27.5 | 25.9 | 12.9 | 11.6 | 4.7 | 2.3 | 5.5 | 127.0 |
| (4) Residual adjustment amounts | -13.9 | 11.1 | 38.8 | -0.5 | 1.4 | 2.9 | 0.7 | 11.0 | 51.4 |
| (5) National Competition Policy Payments | 291.9 | 187.7 | 178.8 | 70.9 | 51.3 | 19.0 | 12.8 | 8.0 | 820.4 |
| (6) Total Specific Purpose Payments (6.1)+(6.2)+(6.3) | 8,592.3 | 6,229.4 | 5,118.0 | 3,177.0 | 2,092.2 | 659.5 | 413.7 | 418.9 | 26,701.0 |
| (6.1) Specific Purpose Payments to the States | 6,250.8 | 4,403.7 | 3,719.2 | 2,429.0 | 1,506.7 | 482.1 | 269.1 | 338.5 | 19,399.1 |
| (6.2) Specific Purpose Payments through the States | 2,232.5 | 1,733.7 | 1,313.2 | 699.3 | 542.4 | 161.7 | 138.3 | 70.2 | 6,891.3 |
| (6.3) Specific Purpose Payments direct to local government | 109.0 | 92.0 | 85.6 | 48.7 | 43.1 | 15.7 | 6.3 | 10.2 | 410.6 |
| (7) Total Australian Government payments to the State/local sector (2)+(3)+(4)+(5)+(6) | 8,950.7 | 6,455.7 | 5,361.5 | 3,260.3 | 2,156.5 | 686.1 | 429.5 | 443.4 | 27,743.7 |
| (8) GST revenue and total Australian Government payments (1)+(7) | 19,208.8 | 14,206.4 | 12,974.4 | 7,025.0 | 5,565.0 | 2,167.0 | 1,144.5 | 2,265.1 | 64,556.3 |

5

(a) The GST estimate has been adjusted to account for the final 2004-05 outcome, reflecting that payments in 2004-05 exceeded final collections in that year. (Further details are provided on page 17.)

(b) Consistent with the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*, \$219.4 million in compensation paid to the States in 2004-05 as an advance from their 2005-06 GST entitlement will be deducted from GST payments to the States in 2005-06. This amount will be repaid to the States in 2005-06 in addition to the \$127 million it is estimated the States will require to compensate for lower GST revenue in 2005-06 as a result of allowing certain taxpayers to pay GST annually.

Table 2: GST revenue provision and total Australian Government payments to the State/local sector in 2006-07 (estimated)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|--|----------|----------|----------|---------|---------|---------|---------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| (1) Provision of GST revenue to the States | 10,941.4 | 8,465.4 | 7,968.9 | 3,921.8 | 3,543.5 | 1,556.7 | 758.0 | 1,974.4 | 39,130.0 |
| (2) Budget Balancing Assistance | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| (3) Compensation for GST deferral | 5.0 | 3.8 | 3.5 | 1.7 | 1.5 | 0.6 | 0.3 | 0.7 | 17.2 |
| (4) Total Specific Purpose Payments (4.1)+(4.2)+(4.3) | 9,112.9 | 6,531.2 | 5,423.1 | 3,485.2 | 2,197.1 | 698.3 | 443.5 | 431.8 | 28,324.4 |
| (4.1) Specific Purpose Payments to the States(a) | 6,591.6 | 4,578.2 | 3,897.8 | 2,675.6 | 1,586.0 | 503.2 | 288.0 | 342.5 | 20,464.3 |
| (4.2) Specific Purpose Payments through the States | 2,374.5 | 1,846.3 | 1,421.7 | 747.6 | 576.9 | 172.1 | 148.1 | 75.8 | 7,363.0 |
| (4.3) Specific Purpose Payments direct to local government | 146.8 | 106.7 | 103.5 | 61.9 | 34.2 | 23.0 | 7.5 | 13.5 | 497.1 |
| (5) Total Australian Government payments to the State/local sector (2)+(3)+(4) | 9,117.9 | 6,535.0 | 5,426.5 | 3,486.9 | 2,198.6 | 698.9 | 443.8 | 432.6 | 28,341.6 |
| (6) GST revenue and total Australian Government payments (1)+(5) | 20,059.3 | 15,000.4 | 13,395.4 | 7,408.7 | 5,742.1 | 2,255.6 | 1,201.8 | 2,407.0 | 67,471.6 |

(a) For one SPP agreement, individual State splits cannot be specifically identified (see footnote (d) in Table B3). Therefore, the sum of the individual State splits which include 'Specific Purpose Payments to the States' as a component will not match the total.

GST REVENUE PROVISION TO THE STATES

All GST revenue collected is received by the States. Consequently, they have a secure, growing and broad-based revenue source. Subject to the IGA, States can spend their GST revenue according to their own budgetary priorities. The States' GST revenue has grown significantly since its introduction in 2000-01 (Table 3).

Table 3: GST revenue provision to the States since 2000-01

| | 2000-01 | 2005-06 | 2006-07 | Increase from 2000-01 to 2006-07 | Increase | Average annual increase |
|--------------|-----------------|-----------------|-----------------|--|-------------|-------------------------------|
| | \$m | (a) \$m | (a) \$m | \$m | % | % |
| NSW | 7,257.6 | 10,258.2 | 10,941.4 | 3,683.8 | 50.8 | 7.1 |
| VIC | 5,099.3 | 7,750.7 | 8,465.4 | 3,366.1 | 66.0 | 8.9 |
| QLD | 4,658.2 | 7,612.9 | 7,968.9 | 3,310.7 | 71.1 | 9.5 |
| WA | 2,374.6 | 3,764.7 | 3,921.8 | 1,547.2 | 65.2 | 8.8 |
| SA | 2,278.9 | 3,408.5 | 3,543.5 | 1,264.6 | 55.5 | 7.7 |
| TAS | 988.1 | 1,480.8 | 1,556.7 | 568.6 | 57.5 | 8.0 |
| ACT | 472.6 | 715.0 | 758.0 | 285.4 | 60.4 | 8.3 |
| NT | 1,225.6 | 1,821.7 | 1,974.4 | 748.8 | 61.1 | 8.4 |
| Total | 24,354.9 | 36,812.6 | 39,130.0 | 14,775.1 | 60.7 | 8.3 |

(a) Estimates.

GST revenue

Estimates of GST revenue in accrual terms for the years 2005-06 to 2008-09 are shown in Table 4. These estimates have been revised since the 2005-06 Budget and the *Mid-Year Economic and Fiscal Outlook 2005-06* (MYEFO) to account for policy decisions and parameter variations.

Table 4: Reconciliation of GST revenue (accrual), 2005-06 to 2008-09 (estimated)

| | 2005-06 \$m | 2006-07 \$m | 2007-08 \$m | 2008-09 \$m |
|---|----------------|----------------|----------------|----------------|
| GST revenue at 2005-06 Budget | 38,000 | 40,060 | 42,270 | 44,520 |
| <i>Changes from 2005-06 Budget to MYEFO</i> | | | | |
| Effect of policy decisions | -57 | -9 | -20 | -10 |
| Effect of parameter and other variations | -23 | 189 | 160 | 120 |
| Total variations | -80 | 180 | 140 | 110 |
| GST revenue at 2005-06 MYEFO | 37,920 | 40,240 | 42,410 | 44,630 |
| <i>Changes from MYEFO to 2006-07 Budget</i> | | | | |
| Effect of policy decisions | 0 | 51 | 88 | 87 |
| Effect of parameter and other variations | -60 | -291 | -288 | -277 |
| Total variations | -60 | -240 | -200 | -190 |
| GST revenue at 2006-07 Budget | 37,860 | 40,000 | 42,210 | 44,440 |

Despite cash collections being up, estimated GST revenue in 2005-06 has been revised down by \$60 million since MYEFO as a result of moderation in expected receivables. The GST revenue estimate for 2006-07 has been revised down since MYEFO by

\$240 million, reflecting the impact of downward revisions to consumption and dwelling investment forecasts and the expected impact of moderation in receivables in 2006-07. Estimates of GST receipts in cash terms are shown in Table 5.

Table 5: GST receipts (cash), 2006-07 to 2009-10 (estimated)

| | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|--------------|---------|---------|---------|---------|
| | \$m | \$m | \$m | \$m |
| GST receipts | 39,130 | 41,300 | 43,480 | 45,670 |

GST revenue measures

Policy decisions affecting GST revenue estimates include: providing funding for additional compliance activities for GST; aligning the import entry level threshold for postal and courier imports; allowing a broader range of personal aquatic survival skills to be GST-free; simplifying and improving alignment of various small business concessions contained in the tax laws; and amending the GST law to ensure it applies appropriately to non-resident enterprises.

The estimated revenue effect of GST measures introduced since the 2005-06 Budget is shown in Table 6. Detailed information on each measure is in Appendix A.

Table 6: GST revenue (accrual) measures since the 2005-06 Budget (estimated)

| | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|--|-------------|-------------|-------------|--------------|
| | \$m | \$m | \$m | \$m |
| Additional free supplies provided by telecommunications suppliers not subject to GST | - | - | - | - |
| Additional GST compliance funding | 50.6 | 93.0 | 93.0 | - |
| Alignment of import entry thresholds for courier and postal imports - GST component | -8.0 | -8.0 | -8.0 | -9.0 |
| Change in GST treatment of certain public ancillary and prescribed private funds | .. | .. | .. | .. |
| GST and representatives of incapacitated entities | .. | .. | .. | .. |
| GST and the sale of real property - deferral of integrity measure | * | * | * | * |
| GST and the sale of real property - margin scheme | * | * | * | * |
| GST concessions for diplomatic and consular missions | .. | .. | .. | .. |
| GST concession for the Melbourne 2006 Commonwealth Games | - | - | - | - |
| GST - simplified accounting arrangement for vouchers | .. | .. | .. | .. |
| GST - treatment of residential premises | - | - | - | - |
| Personal aquatic survival skills courses - change in GST treatment | -1.1 | -1.5 | -1.6 | -1.8 |
| Small business - aligning definitions in the tax laws | - | -5.0 | -6.0 | -1.5 |
| Supplies of options and rights offshore - deregistration and change to start date | - | -10.0 | - | - |
| Total impact of GST revenue measures | 41.5 | 68.5 | 77.4 | -12.3 |

GST revenue provision

As agreed by all States, the Australian Government distributes GST revenue among the States in accordance with the recommendations of the CGC, which are based on the principle of HFE.

The CGC recommends relativities to calculate each State's share of GST so that, if each State made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each State would have the capacity to provide services at the same standard. However, as previously noted, States can spend their GST revenue according to their own budgetary priorities.

The CGC takes into account differences in the States' capacities to raise revenues and differences in the costs the States would incur in providing an average standard of government services. GST relativities for 2005-06 and 2006-07 are shown in Table 7.

The CGC also recommends Financial Assistance Grants forgone relativities (Table 7), which are used for the calculation of each State's Guaranteed Minimum Amounts (Tables 12 and 13).

Table 7: GST relativities and Financial Assistance Grants forgone relativities, 2005-06 and 2006-07

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|-------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| GST relativities | | | | | | | | |
| 2005-06 | 0.86846 | 0.87552 | 1.04389 | 1.02500 | 1.20325 | 1.55299 | 1.14300 | 4.26682 |
| 2006-07(a) | 0.87332 | 0.89559 | 1.02387 | 1.00480 | 1.18862 | 1.54931 | 1.14575 | 4.32755 |
| FAGs relativities | | | | | | | | |
| 2005-06 | 0.80494 | 0.84699 | 1.08397 | 0.99807 | 1.30342 | 1.75127 | 1.17714 | 5.30427 |
| 2006-07(a) | 0.80893 | 0.87406 | 1.05636 | 0.96845 | 1.28415 | 1.75660 | 1.17823 | 5.47833 |

(a) These relativities take account of amended data provided by South Australia after the release of the CGC's 2006 Update report.

The GST relativities are applied to State populations to determine a weighted population for each State. The Australian Government uses the weighted populations to distribute the GST revenue pool. Each State receives a share of the GST revenue pool equal to its weighted population share of a combined pool of GST revenue and unquarantined Health Care Grants, less its unquarantined Health Care Grants. The calculations underpinning the estimated distribution of GST revenue in 2005-06 and 2006-07 are shown in Tables 8 and 9.

Table 8: Distribution of GST revenue in 2005-06 (estimated)

| Projected population as at 31 December 2005 | Per capita relativities | Weighted population(a) (1)x(2) | Share of weighted population (4) | Share of GST revenue/ HCGs pool \$m (5) | Unquarantined HCGs \$m (6) | GST revenue (5)-(6) \$m (7) |
|---|-------------------------|-----------------------------------|-------------------------------------|--|----------------------------------|--------------------------------------|
| | | | | | | |
| NSW | 0.86846 | 5,911,739 | 28.9 | 12,912.4 | 2,654.2 | 10,258.2 |
| VIC | 0.87552 | 4,424,073 | 21.6 | 9,663.0 | 1,912.3 | 7,750.7 |
| QLD | 1.04389 | 4,177,748 | 20.4 | 9,125.0 | 1,512.1 | 7,612.9 |
| WA | 1.02500 | 2,079,455 | 10.2 | 4,541.9 | 777.3 | 3,764.7 |
| SA | 1.20325 | 1,861,440 | 9.1 | 4,065.7 | 657.2 | 3,408.5 |
| TAS | 1.55299 | 755,991 | 3.7 | 1,651.2 | 170.4 | 1,480.8 |
| ACT | 1.14300 | 373,084 | 1.8 | 814.9 | 99.9 | 715.0 |
| NT | 4.26682 | 874,391 | 4.3 | 1,909.8 | 88.1 | 1,821.7 |
| Total | na | 20,457,921 | 100.0 | 44,684.1 | 7,871.5 | 36,812.6 |

Table 9: Distribution of GST revenue in 2006-07 (estimated)

| Projected population as at 31 December 2006 | Per capita relativities | Weighted population(a) (1)x(2) | Share of weighted population (4) | Share of GST revenue/ HCGs pool \$m (5) | Unquarantined HCGs \$m (6) | GST revenue (5)-(6) \$m (7) |
|---|-------------------------|-----------------------------------|-------------------------------------|--|----------------------------------|--------------------------------------|
| | | | | | | |
| NSW | 0.87332 | 5,996,121 | 28.9 | 13,728.8 | 2,787.4 | 10,941.4 |
| VIC | 0.89559 | 4,576,012 | 22.1 | 10,477.3 | 2,011.9 | 8,465.4 |
| QLD | 1.02387 | 4,181,470 | 20.2 | 9,573.9 | 1,605.1 | 7,968.9 |
| WA | 1.00480 | 2,072,430 | 10.0 | 4,745.1 | 823.3 | 3,921.8 |
| SA | 1.18862 | 1,848,180 | 8.9 | 4,231.6 | 688.1 | 3,543.5 |
| TAS | 1.54931 | 757,927 | 3.7 | 1,735.4 | 178.7 | 1,556.7 |
| ACT | 1.14575 | 377,050 | 1.8 | 863.3 | 105.3 | 758.0 |
| NT | 4.32755 | 903,077 | 4.4 | 2,067.7 | 93.3 | 1,974.4 |
| Total | na | 20,712,268 | 100.0 | 47,423.0 | 8,293.0 | 39,130.0 |

(a) The total weighted populations differ from the total populations in column (1) as the CGC calculates the per capita relativities using historical population numbers.

The effect of Horizontal Fiscal Equalisation

One way to view the effect of the CGC's application of HFE is to compare each State's distribution of the GST revenue/Health Care Grants pool using the CGC's relativities with a notional distribution on an equal per capita basis. In 2006-07, approximately \$3.2 billion (or 6.8 per cent) of the total GST revenue/Health Care Grants pool will be redistributed amongst the States, compared with an equal per capita distribution (Table 10).

Table 10: Effect of Horizontal Fiscal Equalisation in 2006-07

| | GST/HCG pool distributed under HFE \$m | Equal per capita distribution of GST/HCG pool \$m | Difference \$m | Population million | Per capita redistribution \$ |
|-------|---|--|-------------------|-----------------------|------------------------------------|
| NSW | 13,728.8 | 15,726.7 | -1,997.9 | 6.9 | -291.0 |
| VIC | 10,477.3 | 11,703.6 | -1,226.3 | 5.1 | -240.0 |
| QLD | 9,573.9 | 9,354.6 | 219.4 | 4.1 | 53.7 |
| WA | 4,745.1 | 4,724.3 | 20.7 | 2.1 | 10.1 |
| SA | 4,231.6 | 3,561.6 | 670.0 | 1.6 | 430.9 |
| TAS | 1,735.4 | 1,120.5 | 614.8 | 0.5 | 1,256.8 |
| ACT | 863.3 | 753.8 | 109.5 | 0.3 | 332.8 |
| NT | 2,067.7 | 478.0 | 1,589.7 | 0.2 | 7,617.9 |
| Total | 47,423.0 | 47,423.0 | 0.0 | 20.7 | na |

HCG means Health Care Grants.

Review of Horizontal Fiscal Equalisation methodology

As agreed between the Australian Government and all the States at the 2005 meeting of the Ministerial Council for Commonwealth-State Financial Relations, the CGC was provided with terms of reference to guide it in simplifying its methodology by 2010 and developing a continuous programme for the improvement of its assessments. The work programme is intended to place HFE on a sounder and more sustainable basis.

The CGC reported to the Ministerial Council in March 2006 on its progress with the 2010 Review, and the CGC report was endorsed by the Ministerial Council. The CGC will report again to the Ministerial Council in 2007 on its progress, ahead of its final reporting date of 2010. The CGC's 2006 progress report is available on its website at www.cgc.gov.au.

COMPENSATION PAYMENTS FOR GST REVENUE DEFERRED

The Australian Government is compensating the States for the deferral of GST revenue as a result of the Australian Government's decision to allow certain small businesses and non-profit organisations to pay GST annually. As part of these arrangements, the States will be paid \$127 million in 2005-06 and \$17.2 million in 2006-07.

This will ensure that the full financial impact of the decision is borne by the Australian Government and that there will be no impact on state budgets. Compensation payments for each year will be subject to an ex-post adjustment once final tax return data becomes available and the impact of the measure on GST revenue is known.

Table 11 shows estimates of each State's compensation payments for 2005-06 and 2006-07.

Table 11: Compensation for GST deferral (estimated)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---------|------|------|------|------|------|-----|-----|-----|-------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| 2005-06 | 36.6 | 27.5 | 25.9 | 12.9 | 11.6 | 4.7 | 2.3 | 5.5 | 127.0 |
| 2006-07 | 5.0 | 3.8 | 3.5 | 1.7 | 1.5 | 0.6 | 0.3 | 0.7 | 17.2 |

DELIVERING MORE FUNDING TO THE STATES

In 2006-07, all States will receive a GST windfall over the Guaranteed Minimum Amount (GMA). The GMA is an estimate of the funding each State would have had available to it had the Australian Government not implemented tax reform. The States will receive a total gain from tax reform in 2006-07 of approximately \$1.9 billion more than the GMA (Table 14).

Components of the GMA comprise estimates of Australian Government Financial Assistance Grants forgone, state taxes abolished by tax reform and other items. Narrow and inefficient state taxes that have already been abolished under tax reform include financial institutions duty, stamp duty on quoted marketable securities, accommodation taxes (bed taxes) and bank account debits tax. Agreement has been reached with the States to abolish most of the state taxes listed for review under the IGA. Estimates of the revenue forgone from each of these taxes will be included in the GMA once a tax is completely abolished in all States.

The States' gains from tax reform are estimated to grow to nearly \$4.1 billion by 2009-10 (Table 14).

Under the IGA, the Australian Government guaranteed that, in the transitional years after the introduction of *The New Tax System* in July 2000, each State's budgetary position would be no worse off than had the reforms to Commonwealth-State financial relations not been implemented. To meet this guarantee, the Australian Government has paid BBA to any State whose GMA exceeds its GST revenue entitlement.

In 2005-06, each State, except New South Wales, will receive a windfall over the GMA. The States will be collectively better off from tax reform by approximately \$1.2 billion in 2005-06. The Australian Government will provide BBA to New South Wales to ensure that it receives its GMA and is, hence, no worse off in 2005-06 due to tax reform.

As part of the agreement with the States to abolish most of the state taxes listed for review under the IGA, the Australian Government will extend the transitional period to 30 June 2009. Given current estimates, this is a sufficient timeframe to ensure the States will no longer require BBA even after the abolition of the IGA taxes.

Tables 12 and 13 show the estimated GMA components, GST revenue entitlement and the BBA calculation for each State in 2005-06 and 2006-07. Table 14 shows the estimated GMA, GST revenue entitlement, BBA and gains from tax reform for each State from 2005-06 to 2009-10.

Table 12: Guaranteed Minimum Amount components, GST revenue provision and Budget Balancing Assistance in 2005-06 (estimated)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---|----------|---------|---------|---------|---------|---------|-------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| State revenues forgone | | | | | | | | | |
| Financial Assistance Grants | 5,372.2 | 4,357.1 | 4,842.6 | 2,188.8 | 2,296.5 | 1,078.4 | 462.9 | 1,504.2 | 22,102.7 |
| Revenue Replacement Payments | 2,708.0 | 1,811.7 | 1,639.9 | 1,124.3 | 703.3 | 238.5 | 120.5 | 152.3 | 8,498.7 |
| Financial Institutions Duty | 772.0 | 422.6 | na | 161.0 | 107.4 | 25.4 | 21.0 | 19.8 | 1,529.2 |
| Debits tax | 323.6 | 257.8 | 330.2 | 114.0 | 57.7 | 21.7 | 17.7 | 7.7 | 1,130.3 |
| Marketable Securities Duty | 513.0 | 265.8 | 29.0 | 32.9 | 17.5 | 0.8 | 26.0 | 1.2 | 886.2 |
| Marketable Securities Duty Needs | -28.2 | 14.3 | 13.9 | 2.6 | 3.1 | 2.9 | -9.4 | 0.9 | 0.0 |
| Accommodation taxes | 96.0 | na | na | na | na | na | na | 10.0 | 106.0 |
| plus Reduced revenues | | | | | | | | | |
| Gambling taxes | 637.7 | 422.4 | 287.0 | 74.8 | 104.9 | 28.7 | 23.5 | 22.5 | 1,601.5 |
| plus Interest costs | | | | | | | | | |
| Interest costs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| plus Additional expenditures | | | | | | | | | |
| First Home Owners Scheme | 288.5 | 293.9 | 181.1 | 128.3 | 66.8 | 18.3 | 16.0 | 10.3 | 1,003.4 |
| GST administration costs | 200.8 | 149.1 | 118.1 | 59.9 | 45.6 | 14.4 | 9.6 | 6.0 | 603.5 |
| plus Other items | | | | | | | | | |
| WST payments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| minus Reduced expenditures | | | | | | | | | |
| Off-road diesel subsidies | 143.4 | 60.2 | 143.5 | 183.7 | 38.1 | 2.3 | 0.0 | 4.1 | 575.5 |
| Savings from tax reform | 203.9 | 140.5 | 115.6 | 68.9 | 50.2 | 16.9 | 11.3 | 16.6 | 624.0 |
| Low alcohol beer subsidies | 26.6 | 18.4 | 5.2 | 8.4 | 5.0 | 1.8 | 1.1 | 1.3 | 67.8 |
| minus Growth dividend | | | | | | | | | |
| Remaining state taxes | 149.1 | 96.2 | 50.4 | 30.0 | 24.2 | 6.1 | 4.7 | 3.3 | 364.0 |
| minus Compensation payments | | | | | | | | | |
| Compensation for GST deferral | 36.6 | 27.5 | 25.9 | 12.9 | 11.6 | 4.7 | 2.3 | 5.5 | 127.0 |
| plus Adjustments | | | | | | | | | |
| 2004-05 GMA adjustment | -22.0 | -3.7 | -13.4 | -2.8 | -5.1 | -2.7 | -0.3 | 0.6 | -49.5 |
| Total Guaranteed Minimum Amount (1) | 10,302.0 | 7,648.1 | 7,087.8 | 3,579.8 | 3,268.7 | 1,394.5 | 668.3 | 1,704.5 | 35,653.7 |
| GST revenue provision (2) | 10,258.2 | 7,750.7 | 7,612.9 | 3,764.7 | 3,408.5 | 1,480.8 | 715.0 | 1,821.7 | 36,812.6 |
| Budget Balancing Assistance (1)-(2)(a) | 43.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 43.8 |

(a) Where the difference between the GMA and GST revenue is less than zero, the amount is zero.

Table 13: Guaranteed Minimum Amount components, GST revenue provision and Budget Balancing Assistance in 2006-07 (estimated)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---|----------|---------|---------|---------|---------|---------|-------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| State revenues forgone | | | | | | | | | |
| Financial Assistance Grants | 5,611.2 | 4,741.4 | 4,918.6 | 2,197.2 | 2,331.2 | 1,120.8 | 481.0 | 1,635.4 | 23,036.8 |
| Revenue Replacement Payments | 2,788.7 | 1,865.5 | 1,687.3 | 1,153.3 | 724.1 | 245.5 | 124.2 | 156.6 | 8,745.3 |
| Financial Institutions Duty | 808.7 | 435.4 | na | 166.4 | 111.2 | 26.0 | 21.5 | 21.5 | 1,590.7 |
| Debits tax | 357.0 | 283.9 | 385.0 | 126.5 | 63.6 | 24.2 | 19.8 | 8.6 | 1,268.7 |
| Marketable Securities Duty | 544.9 | 281.8 | 30.1 | 34.8 | 18.6 | 0.8 | 26.6 | 1.2 | 938.8 |
| Marketable Securities Duty Needs | -24.7 | 12.5 | 13.2 | 2.4 | 1.0 | 2.9 | -8.2 | 0.8 | 0.0 |
| Accommodation taxes | 104.7 | na | na | na | na | na | na | 10.5 | 115.3 |
| Cheque Duty | na | na | na | 5.5 | 3.2 | na | na | 2.8 | 11.4 |
| plus Reduced revenues | | | | | | | | | |
| Gambling taxes | 662.1 | 446.4 | 301.0 | 77.7 | 109.5 | 31.0 | 24.1 | 23.6 | 1,675.4 |
| plus Interest costs | | | | | | | | | |
| Interest costs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| plus Additional expenditures | | | | | | | | | |
| First Home Owners Scheme | 292.0 | 297.4 | 183.2 | 129.8 | 67.6 | 18.6 | 16.2 | 10.4 | 1,015.3 |
| GST administration costs | 205.3 | 152.8 | 122.1 | 61.7 | 46.5 | 14.6 | 9.8 | 6.2 | 619.1 |
| plus Other items | | | | | | | | | |
| WST payments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| minus Reduced expenditures | | | | | | | | | |
| Off-road diesel subsidies | 144.2 | 60.7 | 146.0 | 186.2 | 38.2 | 2.3 | 0.0 | 4.2 | 581.9 |
| Savings from tax reform | 218.0 | 154.2 | 123.0 | 72.1 | 53.3 | 18.2 | 10.9 | 15.9 | 665.6 |
| Low alcohol beer subsidies | 27.4 | 19.0 | 5.3 | 8.7 | 5.1 | 1.9 | 1.1 | 1.3 | 69.9 |
| minus Growth dividend | | | | | | | | | |
| Remaining state taxes | 174.0 | 112.3 | 58.8 | 35.0 | 28.2 | 7.2 | 5.5 | 3.9 | 424.8 |
| minus Compensation payments | | | | | | | | | |
| Compensation for GST deferral | 5.0 | 3.8 | 3.5 | 1.7 | 1.5 | 0.6 | 0.3 | 0.7 | 17.2 |
| Total Guaranteed Minimum Amount (1) | 10,781.3 | 8,167.1 | 7,304.0 | 3,651.5 | 3,350.2 | 1,454.3 | 697.4 | 1,851.6 | 37,257.4 |
| GST revenue provision (2) | 10,941.4 | 8,465.4 | 7,968.9 | 3,921.8 | 3,543.5 | 1,566.7 | 758.0 | 1,974.4 | 39,130.0 |
| Budget Balancing Assistance (1)-(2)(a) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

(a) Where the difference between the GMA and GST revenue is less than zero, the amount is zero.

Table 14: Forward estimates of Budget Balancing Assistance and State and Territory gains from tax reform^(a)

| 2005-06 (\$m)(b) | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|--|----------|---------|---------|---------|---------|---------|-------|---------|----------|
| (1) Guaranteed Minimum Amount(c) | 10,302.0 | 7,648.1 | 7,087.8 | 3,579.8 | 3,268.7 | 1,394.5 | 668.3 | 1,704.5 | 35,653.7 |
| (2) GST revenue | 10,258.2 | 7,750.7 | 7,612.9 | 3,764.7 | 3,408.5 | 1,480.8 | 715.0 | 1,821.7 | 36,812.6 |
| (3) Budget Balancing Assistance(d) | 43.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 43.8 |
| (4) State and Territory gains from tax reform (2)-(1)(d) | 0.0 | 102.6 | 525.2 | 184.8 | 139.8 | 86.3 | 46.7 | 117.3 | 1,202.7 |
| 2006-07 (\$m) | | | | | | | | | |
| (1) Guaranteed Minimum Amount(e) | 10,781.3 | 8,167.1 | 7,304.0 | 3,651.5 | 3,350.2 | 1,454.3 | 697.4 | 1,851.6 | 37,257.4 |
| (2) GST revenue | 10,941.4 | 8,465.4 | 7,968.9 | 3,921.8 | 3,543.5 | 1,556.7 | 758.0 | 1,974.4 | 39,130.0 |
| (3) Budget Balancing Assistance(d) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| (4) State and Territory gains from tax reform (2)-(1)(d) | 160.1 | 298.2 | 664.9 | 270.2 | 193.4 | 102.4 | 60.6 | 122.8 | 1,872.6 |
| 2007-08 (\$m) | | | | | | | | | |
| (1) Guaranteed Minimum Amount | 11,230.0 | 8,420.6 | 7,459.8 | 3,694.2 | 3,462.3 | 1,491.9 | 720.7 | 1,965.7 | 38,445.1 |
| (2) GST revenue | 11,728.3 | 8,993.4 | 8,288.6 | 4,080.3 | 3,719.9 | 1,605.4 | 799.2 | 2,084.9 | 41,300.0 |
| (3) Budget Balancing Assistance(d) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| (4) State and Territory gains from tax reform (2)-(1)(d) | 498.3 | 572.8 | 828.8 | 386.1 | 257.6 | 113.5 | 78.5 | 119.2 | 2,854.9 |
| 2008-09 (\$m) | | | | | | | | | |
| (1) Guaranteed Minimum Amount | 11,807.3 | 8,721.1 | 7,614.3 | 3,741.8 | 3,552.1 | 1,526.0 | 743.8 | 2,063.4 | 39,769.9 |
| (2) GST revenue | 12,614.0 | 9,536.7 | 8,564.0 | 4,224.3 | 3,871.2 | 1,650.8 | 836.2 | 2,182.8 | 43,480.0 |
| (3) Budget Balancing Assistance(d) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| (4) State and Territory gains from tax reform (2)-(1)(d) | 806.7 | 815.7 | 949.7 | 482.5 | 319.1 | 124.8 | 92.4 | 119.4 | 3,710.1 |
| 2009-10 (\$m) | | | | | | | | | |
| (1) Guaranteed Minimum Amount(f) | 12,586.9 | 9,049.9 | 7,917.0 | 3,869.8 | 3,676.3 | 1,563.4 | 779.0 | 2,165.9 | 41,608.1 |
| (2) GST revenue | 13,533.2 | 9,949.6 | 8,888.6 | 4,391.5 | 4,029.2 | 1,697.3 | 879.6 | 2,301.1 | 45,670.0 |
| (3) State and Territory gains from tax reform (2)-(1)(d) | 946.2 | 899.6 | 971.6 | 521.8 | 352.9 | 133.9 | 100.6 | 135.2 | 4,061.9 |

(a) Projections from 2005-06 will be affected by variations in Guaranteed Minimum Amount (GMA) components and GST revenue. In addition to these factors, projections from 2007-08 will be affected by recommendations by the Commonwealth Grants Commission on the distribution of GST to each of the States.

(b) As part of the agreement with the States to abolish most of the state taxes listed for review under the IGA, the Australian Government will extend the transitional period from 30 June 2006 to 30 June 2009.

(c) As agreed at the 26 March 2004 meeting of the Ministerial Council for Commonwealth-State Financial Relations, bank account debits tax was abolished by 1 July 2005. The revenue forgone by the States is included in their GMAs from 2005-06.

(d) Where the difference between the GMA and GST revenue (and vice versa) is less than zero, the amount is zero.

(e) As part of the agreement with the States to abolish most of the state taxes listed for review under the IGA, stamp duties on cheques, bills of exchange and promissory notes have been abolished in all States. The revenue forgone by the States is included in their GMAs from 2006-07.

(f) As part of the agreement with the States to abolish most of the state taxes listed for review under the IGA, all States will have abolished stamp duties on credit arrangements, instalment purchase arrangements and rental arrangements, and stamp duties on leases by 1 July 2009. The revenue forgone by the States from these taxes is included in their GMAs from 2009-10.

GST adjustment in 2005-06

GST revenue provision to the States in 2005-06 has been adjusted to account for the final 2004-05 outcome. In 2004-05, the final GST cash collections outcome was \$287.4 million lower than the amount determined by the Commissioner of Taxation in June 2005 and provided to the States in 2004-05 under the terms of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (the Act).

Consistent with the provisions of the Act, the amount of GST revenue determined by the Commissioner and provided to the States in 2005-06 will take account of the difference between the final GST cash collections outcome for 2004-05 and the amount paid to the States in 2004-05. The residual adjustment amount for New South Wales for 2005-06 has been calculated to account for this variation (Table 15).

Residual adjustments

The Australian Government introduced residual adjustments to ensure that all States receive their appropriate payments under the Act as they move on or off BBA. Residual adjustments offset any underestimate or overestimate of payments that cannot be paid or recovered using other mechanisms under the Act.

Current estimates show that New South Wales will require a negative residual adjustment amount of \$43.8 million in 2005-06 to enable the 2004-05 GST overpayment to be recovered from New South Wales.

As final payments for 2005-06 will not be known until the June 2006 determinations of GST provision and payments to the States, final residual adjustment amounts for 2005-06 will not be known until that time.

Table 15 shows final residual adjustment amounts for 2002-03, 2003-04 and 2004-05, and the estimate of New South Wales' 2005-06 residual adjustment amount.

Table 15: Residual adjustment amounts, from 2002-03 to 2005-06^(a)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|------------|-------|------|------|------|-----|-----|-----|------|-------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| 2002-03 | 0.0 | 0.0 | 38.8 | 0.0 | 0.0 | 0.0 | 0.0 | 11.0 | 49.8 |
| 2003-04 | 0.0 | 11.1 | 0.0 | -0.5 | 1.4 | 2.9 | 0.7 | 0.0 | 15.5 |
| 2004-05 | 29.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 29.9 |
| 2005-06(b) | -43.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -43.8 |
| Total | -13.9 | 11.1 | 38.8 | -0.5 | 1.4 | 2.9 | 0.7 | 11.0 | 51.4 |

(a) Residual adjustment amounts for 2002-03, 2003-04 and 2004-05 were paid or recovered in 2005-06 as the Australian Government and the States had to agree on the methodology for the calculation of the adjustments before they could be made.

(b) Estimates.

Excess Budget Balancing Assistance advances

Consistent with the provisions of the IGA, the Australian Government has advanced BBA to New South Wales, the only State estimated to require BBA in 2005-06. These advances were based on the estimated BBA entitlement for New South Wales at the time of each advance. The upward revision to GST in 2005-06 in the Budget has resulted in a lower than previously estimated BBA entitlement for New South Wales. Based on current estimates, the advances to New South Wales in the year to date exceed its entitlement to BBA in 2005-06 by \$30.8 million (Table 16).

Consistent with the provisions of the Act, the Australian Government will deduct the amount of excess BBA paid in 2005-06 from payments to be made to New South Wales under the Act in 2006-07. The final amount to be deducted from New South Wales' payments in 2006-07 will be known when the final determination of each State's BBA entitlement is made under the Act in June 2006.

Table 16: Excess Budget Balancing Assistance advanced in 2005-06 (estimated)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---------------------|------|-----|-----|-----|-----|-----|-----|-----|-------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Payments to date | 74.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 74.6 |
| BBA entitlement | 43.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 43.8 |
| Excess BBA advanced | 30.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 30.8 |

DELIVERING FURTHER TAX REFORM

One of the objectives of the IGA, signed by the Australian Government and all States in 1999, was the achievement of a new national tax system, including the elimination of a number of existing inefficient taxes which were impeding economic activity. As part of this objective, the GST was intended to replace a group of inefficient indirect taxes, one Commonwealth and nine state taxes. The state taxes included in the IGA were identified by the States themselves as undesirable on efficiency and equity grounds.

The clear intent of the IGA was that if GST revenue proved to be sufficient, the States would agree to abolish these inefficient taxes.

At the March 2006 meeting of the Ministerial Council for Commonwealth-State Financial Relations, the Australian Government agreed with seven of the States on schedules for the abolition of most of the taxes listed for review under the IGA. The Australian Government has since agreed on an abolition schedule with New South Wales as well.

Timetables are now in place for the abolition of mortgage duty, rental duty, lease duty, cheque duty, non-real non-residential conveyance duty, and unlisted marketable securities duty. The abolition of these taxes is expected to save taxpayers approximately \$4.4 billion over the four years from 1 July 2006.

The Australian Government will also continue to pursue the abolition of stamp duty on business conveyances of real property, at a date to be determined by the Ministerial Council on the basis that no State will be worse off in any year. This is the last remaining tax listed for review under the IGA.

The abolition of these taxes is in addition to the taxes already abolished under the IGA: wholesale sales tax, accommodation tax, financial institutions duty, stamp duty on quoted marketable securities and bank account debits tax.

To ensure no financial disadvantage to any State as a result of their agreement to abolish state taxes, the Australian Government has agreed to extend the period for transitional assistance to 30 June 2009. This will provide compensation through BBA to any State which has a shortfall between its GST revenue and its GMA after the implementation of further tax reform under the IGA. However, current estimates indicate payment of BBA will not be required.

First Home Owners Scheme

Eligible home buyers have received over \$6.2 billion through the First Home Owners Scheme since July 2000.

The First Home Owners Scheme provides eligible first home buyers with a \$7,000 grant. Since its introduction on 1 July 2000, the scheme has provided over 828,000 grants to families and individuals to assist in purchasing their first home. The scheme is administered by the States. The Australian Government guarantees the funding for the scheme through Budget Balancing Assistance by including the cost to the States in the Guaranteed Minimum Amount (Tables 12 and 13).

In March 2001, the Australian Government made an additional \$7,000 grant available to first home buyers building or purchasing new homes before 31 December 2001. The Australian Government fully funds the additional First Home Owners Scheme with a Specific Purpose Payment through the States to meet the cost of grants. The Australian Government extended the additional First Home Owners Scheme at a rate of \$3,000 for new homes built or purchased between 1 January 2002 and 30 June 2002. To date, the additional First Home Owners Scheme has provided over 69,000 grants to eligible home buyers.

Although the additional First Home Owners Scheme has ended, grants continue to be paid to eligible applicants due to the time needed to complete construction and the period allowed to lodge an application once construction is complete. Estimates of payments are shown in the Specific Purpose Payments tables (Appendix B).

NATIONAL COMPETITION POLICY PAYMENTS

The Australian Government makes National Competition Policy Payments (NCPPs) to the States for implementing National Competition Policy (NCP) and related reforms. These reforms include a commitment to review legislation that restricts competition, apply competitive neutrality to government business activities and introduce specific reforms in electricity, gas, water and road transport.

NCPPs commenced in July 1997 with the first of three tranches of payments. The third tranche commenced in July 2001 at an annual level of \$600 million in 1994-95 prices. The NCP agreements, signed by the Australian Government and all State governments in 1995, provide for the Australian Government to make NCPPs to State governments up to and including 2005-06.

Each State's NCPPs are subject to that State making satisfactory progress with the implementation of reform commitments. Previously, prior to the scheduled payment of NCPPs in each year, the National Competition Council (NCC) assessed whether each State had met the specified conditions and provided recommendations for consideration by the Australian Government.

However, in 2005-06, for the first time, the Australian Government also considered recommendations from the National Water Commission (NWC) in relation to States' progress on water reform.

The estimated maximum level of payments in 2005-06 is \$799.9 million. The Australian Government decided to permanently deduct \$40.7 million and suspend \$39.2 million of the 2005-06 NCPP maximum entitlement and reimburse \$100.5 million of 2004-05 suspensions. These figures do not include the NWC recommended suspension of \$4 million to Western Australia's NCP payments as the Australian Government has not yet taken a decision due to the delay in the NWC completing its assessment of Western Australia's water reform obligations. These figures are currently estimates and will be finalised in accordance with updated Consumer Price Index and population data.

In relation to the 2005-06 suspensions, the NWC has indicated that it will recommend that suspensions be lifted or reduced subject to the satisfactory assessment by the NWC in 2007.

Table 17 shows estimates of NCPPs for 2005-06. Each State's amount for 2005-06 reflects reimbursements for 2004-05 suspensions, permanent deductions for 2005-06 and suspensions for 2005-06, as outlined above.

Table 17: National Competition Policy Payments

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---------|-------|-------|-------|------|------|------|------|-----|-------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| 2005-06 | 291.9 | 187.7 | 178.8 | 70.9 | 51.3 | 19.0 | 12.8 | 8.0 | 820.4 |

The 2005-06 NCPPs are the final payments under the current NCP arrangements. At its 10 February 2006 meeting, COAG agreed to a new National Reform Agenda comprising human capital, competition and regulatory reform streams.

COAG agreed that, if funding is needed to ensure a fair sharing of the costs and benefits of reform, the Australian Government will provide funding to the States on a case-by-case basis once specific implementation plans have been developed. Payments to the States, and where appropriate, to local government, would be linked to achieving agreed actions or progress measures and demonstrable economic benefits.

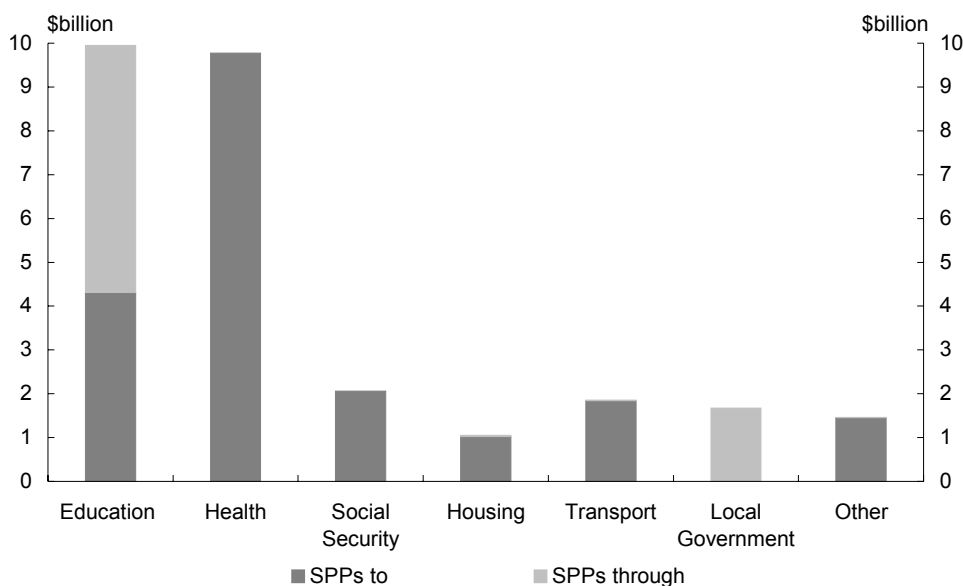
SPECIFIC PURPOSE PAYMENTS

Specific Purpose Payments (SPPs) constitute a significant amount of Australian Government expenditure. In 2006-07, SPPs to and through the States are estimated to total \$27.8 billion. In addition, the Australian Government will provide SPPs direct to local government totalling \$497.1 million in 2006-07. In total, SPPs are estimated to represent around 12.9 per cent of total Australian Government expenditure in 2006-07.

The Australian Government makes SPPs to the States and local government as a financial contribution to important areas of State responsibility in pursuit of its own specified objectives. The Australian Government makes SPPs in a large number of functional areas, including education, health, social security, housing and transport (Chart 3).

In 2006-07, SPPs for health, education and transport are estimated to account for 77.5 per cent of SPP expenditure. These categories encompass SPPs for public hospitals, schools, vocational education and training and the development, construction and maintenance of the National Land Transport Network under *AusLink*.

Chart 3: Composition of Specific Purpose Payments to and through the States in 2006-07 (estimated)



More detailed information, including payments on a State-by-State basis for 2005-06 and 2006-07, is in Appendix B.

SPPs can be classified into three groups:

- those paid directly to the States – payments direct to State governments, totalling an estimated \$20.5 billion in 2006-07;
- those paid through the States – payments to State governments to be passed on to local governments (for example, FAGs to local government) and to others (for example, to non-government schools). This category is estimated to total \$7.4 billion in 2006-07; and
- those paid direct to local government to help fund local government programmes, such as roads. These payments are estimated to total \$497.1 million in 2006-07.

SPP agreements often include agreed national objectives. However, in making these payments, the Australian Government does not seek to take over responsibility for State functions. The majority of SPPs are 'tied' meaning that they are subject to conditions designed to ensure that national objectives are achieved. These include:

- general policy conditions (for example, the provision of free public hospital access for Medicare patients in return for funding under the Health Care Agreements);
- requirements that payments be expended for a specific purpose only (for example, SPPs for schools may be spent on teacher salaries and curriculum development);
- State maintenance of effort and matching funding arrangements (whereby States are required to maintain funding levels and/or match the Australian Government's funding contribution in a specified programme area); and
- reporting of financial and performance information.

SPPs also include some payments that are not subject to conditions. These typically relate to revenue sharing arrangements or compensation (either for the transfer of responsibilities or for other Australian Government action that affects the States). For example, compensation payments are made to the States under the Extension of Fringe Benefits SPP for the extra costs resulting from the liberalisation of access to the Australian Government's Pensioner Concession Card in 1993. In return, the States agree to provide a core group of concessions to all cardholders.

FINANCIAL ASSISTANCE GRANTS TO LOCAL GOVERNMENT

The Australian Government provides financial assistance to local government for roads and other local government services. Assistance is paid in the form of general purpose assistance and untied local road funding. Local governments can spend both forms of funding according to their own priorities.

The Australian Government is providing a total of \$1.6 billion in Financial Assistance Grants to local government in 2005-06 and an estimated \$1.7 billion in 2006-07 (Table 18). The annual increase in funding is based on an escalation factor, which the Treasurer determines with reference to population growth and the Consumer Price Index.

This financial assistance is paid to the States as an SPP, on condition that all the funds are passed on to local government. In 2006-07, as in previous years, the general purpose component of local government assistance will be distributed between the States on an equal per capita basis and untied local road funding will be distributed on the basis of historical shares. State grants commissions determine the intra-State distribution of the grants to local governments.

In addition to Financial Assistance Grants, the Australian Government provides a number of SPPs direct to local government authorities to help fund roads, child care programmes, disability and other services administered by local governments. These payments are estimated to total \$410.6 million in 2005-06 and expected to increase to \$497.1 million in 2006-07.

Table 18: Financial Assistance Grants to local government in 2005-06 and 2006-07 (estimated)^(a)

| | NSW \$m | VIC \$m | QLD \$m | WA \$m | SA \$m | TAS \$m | ACT \$m | NT \$m | Total \$m |
|---|--------------|--------------|--------------|--------------|--------------|-------------|-------------|-------------|----------------|
| 2005-06 | | | | | | | | | |
| General Purpose Assistance | 375.9 | 278.0 | 218.3 | 111.1 | 85.5 | 26.9 | 18.1 | 11.2 | 1,125.1 |
| Untied local road funding | 144.8 | 102.9 | 93.5 | 76.3 | 27.4 | 26.5 | 16.0 | 11.7 | 499.2 |
| Total Financial Assistance Grants(b) | 520.7 | 381.0 | 311.9 | 187.4 | 113.0 | 53.4 | 34.1 | 22.9 | 1,624.3 |
| 2006-07 | | | | | | | | | |
| General Purpose Assistance | 386.3 | 286.6 | 227.8 | 115.0 | 87.8 | 27.7 | 18.5 | 11.6 | 1,161.4 |
| Untied local road funding | 149.5 | 106.2 | 96.6 | 78.8 | 28.3 | 27.3 | 16.5 | 12.1 | 515.4 |
| Total Financial Assistance Grants(c) | 535.8 | 392.9 | 324.4 | 193.8 | 116.2 | 55.0 | 35.1 | 23.7 | 1,676.8 |

(a) Total Financial Assistance Grants are the cash payments that the State receives on behalf of local government. They are equal to the estimated entitlement for a given year adjusted for any overpayment or underpayment from the previous year.

(b) The 2005-06 figure takes into account an underpayment of \$7.5 million in 2004-05. The Treasurer will determine the final 2005-06 escalation factor in June 2006; currently the 2005-06 escalation factor is estimated to be 1.0401.

(c) The 2006-07 figure includes an estimate of the amount necessary to adjust for the difference between the 2005-06 escalation factor estimated in June 2005 and used to calculate payments in 2005-06 and the final factor for 2005-06 to be determined in June 2006. On the basis of the current estimate of the 2005-06 escalation factor, this adjustment is estimated to be an increase of \$0.6 million. The 2006-07 escalation factor is currently estimated to be 1.0363. Financial Assistance Grants in 2006-07 will be paid on the basis of the escalation factor that the Treasurer will estimate in June 2006. The Treasurer will determine the final escalation factor for 2006-07 in June 2007.

MIRROR TAX ARRANGEMENTS

The Australian Government introduced mirror tax arrangements in 1998 to ensure the States were not financially disadvantaged by the High Court decision in *Allders International Pty Ltd v Commissioner of State Revenue (Victoria)*, which invalidated state taxes on Commonwealth places.

These arrangements mirror certain state taxes including payroll taxes, land taxes and stamp duties with respect to Commonwealth places.

The States collect these mirror taxes on behalf of the Australian Government and bear the administrative costs of collection. All mirror tax revenues are automatically credited to the Australian Government and automatically appropriated to the States at the same time. Hence, mirror taxes are recorded as both Australian Government revenue and negative revenue, with no net impact on the Budget.

Table 19 shows estimates of mirror taxes from 2005-06 to 2009-10.

Table 19: Accrued mirror taxes on behalf of the States, 2005-06 to 2009-10 (estimated)

| | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|--------------|---------|---------|---------|---------|---------|
| | \$m | \$m | \$m | \$m | \$m |
| Mirror taxes | 371.6 | 389.5 | 406.9 | 427.7 | 449.8 |

