Discussion Paper

Revenue Measure Options for the Norfolk Island Government

This Discussion Paper is prepared by the Norfolk Island Government consistent with the Specified Improvement required under Clause 15 (a) of the Funding Agreement signed on the 22nd of September 2011.

Discussion Paper

Revenue Measure Options for the Norfolk Island Government

Background

This paper canvasses options for the Norfolk Island Government to consider for raising revenue. The Funding agreement requirement is that these options need to be more closely aligned to those revenue raising measures used in other Australian jurisdictions. The paper considers the findings of the *Public Service Review*[1],*Update on the Financial Capacity of Norfolk Island*[2]and the *Norfolk Island Development Report*[3](EDR)along with other referenced material relevant to the issue.

The Roadmap for reform agreed between the Chief Minister and Minister Crean has the goal of providing a mutually acceptable and appropriate form of modified self-government that is consistent with contemporary models for state, territory and local government –modified to take account of the unique circumstances of Norfolk Island.

The Road map requires consultation with the Norfolk Island community on the preferred model of self-government[4]. The Norfolk Island Government released publicly the preferred model of self-government on the 7th of July 2011[5]. The preferred model has the following features:-

- Norfolk Island Government to transfer to the Commonwealth any federal functions in accordance with the process outlined in the Road Map.
- Norfolk Island Government to retain State and Local Government type functions.
- Funding for Norfolk Island Government's delivery of public infrastructure and State and Local Government type functions to be shared with the Commonwealth, similar to other self-governing jurisdictions within the federal taxation system.
- Retention of the existing Territory Institutions

Therefore any discussion on revenue raising options for the Norfolk Island Government cannot be made in isolation –there is a requirement to define the expenditure responsibilities of the Territory

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[1]Australian Continuous Improvement Group; *Norfolk Island Public Service Review –Prepared for the Department of Regional Australia Regional Development and Local Government; 25 October 2011.*

[2]Commonwealth Grants Commission; *Update on the Financial Capacity of Norfolk Island 2011 –Staff findings; 2nd December 2011.*

[3]ACIL Tasman; *Norfolk Island Development Report –Reform of the Norfolk Island Economy; Prepared for the Department of Regional Australia, Regional Development and Local Government; March 2012*

[4]Roadmap Reform 1 (d) for action in 2011/12

[5]Press Release of 7th July 2011

Government into the future. With these defined the adequacy of the combination of potential revenue measures can be assessed in respect to their ability to provide a sustainable fiscal footing for the territory into the future.

The EDR highlights the necessity for some form of regular fiscal equalisation payments to occur between the Commonwealth and Norfolk Island governments. This may be through full integration of the island into the Australian Tax system or alternatively reform of the Norfolk Island Tax system, access to Commonwealth infrastructure grant programs, health funding and *ad hoc* funding provided by the Commonwealth[6]. The consultant however believes the proposals for taxation as outlined in the Roadmap is the preferable approach[7].

This paper discusses the options for funding the preferred model through the three tiers of Government revenues available to the Norfolk Island Government (Federal revenues; State Revenues and Local Government revenues). The paper has also discussed those revenue areas outlined in the CGC report as being potentially significant for the Norfolk Island Government to consider (Table 1). It has an expanded discussion in relation to those revenue areas that are considered for reform in the EDR.

Whilst the quantum of funds is important for the island to consider, under each of the potential revenue measures, so is the security and predictability of them. For self-government to be sustainable under the preferred governance model it is essential for the Norfolk Island Territory Government to have reasonable surety over future revenues. This paper discusses the significant measures and the security of the revenue flows.

Table 1 Norfolk Island Revenue Sources and assessed revenue capacity[8] ($,000)

Revenue Source	NI Actual Revenues	Comparable Revenue	Comment
<u>Federal Revenue Measures</u>			
Income Tax			Not currently applied discussed as an option
GST	7,298	Seen as a Federal tax and deductable from transfers	Discussed
Customs Duty	401	Not taken into account in the CGC update	Discussed
Healthcare/Medivac Levy	917	Not taken into account in the CGC update	Discussed
Fuel Levy	8		Not significant
<u>State Type taxes</u>			
Payroll tax	0	0[9]	This revenue source is

[6] EDR…*Op.cit.*p. viii
[7] *Pers. Comm.* Meeting with the Norfolk Island Government April 23rd 2012
[8] Source CGC *Update..Op.cit.* p. 116
[9] The CGC assessment was $26K based on the Administration retaining the operation of Norfolk Air without this the assessed revenue is nil.

Revenue Source	NI Actual Revenues	Comparable Revenue	Comment
			not considered
Land tax	170	942	This revenue source is significant but over-estimated, Discussed
Stamp duty on conveyances	461	640	Discussed
Financial transaction taxes and stamp duties on marketable securities	11	0	Not significant and not considered
Gambling taxes	1,424	468	Significant and above comparisons, not discussed
Insurance tax	0	545	Discussed
Motor taxes and charges	503	774	Discussed
Other tax revenue	386	89	Significant and above comparisons, not discussed
Mining royalty revenue	0	0	Not Discussed
Contributions by trading enterprises	476	308	Exceeds the comparative assessment and not discussed.
Interest revenue	91	283	Not significant and not discussed.
Fees and fines	69	77	Not significant and not discussed
Local Government Revenue			
Municipal Rates	0	1,393	Discussed
User charges	773	1,040	Discussed
Interest and other income	2,401	821	Discussed
'State' Grant and subsidies	0	132	Discussed

The CGC report acknowledges that it does not take into account the effect of introducing new taxes or increasing the rate of existing taxes on the Norfolk Island economy. This is however addressed in the EDR and it proposes that the resolution of the long term tax arrangements for the island should occur in the third phase of the economic development strategy. It recommends that regardless of any evidence of growth in the economy, company and income tax should not be considered for extension within the next five years[10].

This paper identifies the issues that the Norfolk Island Government considers significant in considering the revenue measures further.

[10]EDR…Op.cit. p.96

Revenue Measures

Federal Revenue Raising Measures

Income Tax

The introduction of a local income tax has been discussed in the report *Tax Options for Norfolk Island*[11] and identifies that consistent with schedule 2 of the *Norfolk Island Act* that it could be possible for the Norfolk Island Government to introduce its own income tax -however a whole of government approach would be required to do this. Since no other State or Territory imposes its own income tax, Norfolk Island moving to do so would pose potential problems for the Australian Government.

An income tax has the advantage of broadening the local tax base away from indirect taxes. However to be effective locally it was recommended that:-

- The tax should be at a progressive rate structure with a tax-free threshold to protect low income earners and higher rates cutting in to those exceeding average incomes.
- To simplify the tax it could be made to apply at low rates and denying deductions, exemptions and concessions

Therefore the report was not recommending the introduction of the Australian Income tax system – collected by the Norfolk Island Government, but rather a unique direct income taxation system designed for the island. The specific revenue impact derived from the introduction of a local income tax would be dependent upon the design of the tax and the rates that it was applied at. Therefore no estimate of the potential revenue is possible. A two year lead time was estimated as being required to have a local income tax system up and running from the time a decision (and presumably a design) was made.

The option of the introduction of a local income tax system was not part of the taxation reform options recommended in the EDR[12]

Issues

- The adoption of the Australian Income taxation system, but implemented and collected by the Norfolk Island Government would require some form of contracting of compliance services as the local cost of setting up a compliance system would be prohibitive. This cost would reduce the overall revenue yield.
- Introduction of local income tax would mean that the Norfolk Island Government would be responsible for designing and implementing a unique direct taxation arrangement for the island. This would be a unique solution that will require a legislative and administrative framework. The framework will need to be developed and operated on the island by the Administration.
- The provision of personal income information to Administration taxation officials will not be supported by the community.

[11] Discussion Paper; *Taxation Options for Norfolk Island; 2003?;* The Treasury; Australian Government
[12] *Ibid.* p. 105

- Since this tax is also in the sphere of authority normally reserved for the Commonwealth Government there are potentially problems with the interaction of the local income tax régime and that of the Australian Government.

Norfolk Island Government position

Either the establishment of a unique income tax system for the island or the adoption of the Australian Income Tax System, implemented and collected by the NIG would be both complex and require considerable local costs associated with setting up a legislative and compliance mechanism to collect and enforce the tax. It is thought that the costs associated with this would significantly reduce the net revenue yield to the Territory. The often expressed local concern associated with divulging personal information relating to income, to local officials would only be overcome by contracting these services off-shore adding to the costs and potential complexity of running the tax system.

For these reasons the option of the NIG either adopting the Australian Income Taxation system and collecting and operating that system locally is not attractive. Similarly the option of designing a unique income taxation system for the island would again involve significant local costs and resources as well as the need to reveal personal financial information. For these reasons the NIG preferred course of action is for the Australian Income Taxation system to be extended to the island, and revenue collection be administered by the Australian Taxation Office.

GST

Norfolk Island already has its own GST and under the Roadmap for reform has the ability to retain its existing GST system, request to adopt the Australian GST system or have no GST applying to the island. GST is seen as a Federal Government tax that is distributed to the States to fund state-type services. Norfolk Island's GST is collected at a higher rate than that applying in Australia (12% compared to 10% in Australia); and is applied on all goods and most services (whereas in Australia basic foods such as bread, milk and fresh produce are exempt). This system does not allow for input credits associated with capital expenditure (the Australian system does). In the current financial year it is expected to yield $7.298 mil[13] and is the single largest source of tax revenue currently available to the Norfolk Island Government to provide essential community services.

Whilst Norfolk Island is not in the Australian GST system the difficulty that Norfolk Island residents (and businesses) have to convince Australian merchants to not charge GST on goods exported to the island means that often Australian GST is paid on goods coming to the island. The mechanism of then claiming back GST through the Australian Customs service is difficult and is mostly not pursued. Therefore some benefit to Norfolk Island consumers from being outside the system is lost as local consumers end up having to pay the Australian GST on the goods they purchase. If this occurs by the Norfolk Island retailer the local consumer is effectively being charged Australian GST and Norfolk Island GST (double taxation)–further driving up local costs.

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[13] Norfolk Island Budget Papers, Mid-Year Review 2011/12, *figures after costs.*

Should the Norfolk Island Government request to adopt the Australian GST system it would be consistent with the other self-governing Territories of the Commonwealth (ACT; Northern Territory) and similarly the entry of Norfolk Island into the Australian GST regime would allow it to be considered under the process of examining relativities according to the Australian Framework for Federal Financial Relations[14]. Under this arrangement the Territories federal funding would be provided under the system of General revenue funds (Funds that the State or Territory may use as it sees fit and representing about 45% of the transfer amounts) and Specific purpose payments (SPP) and National partnership payments (NPP). SPP are broad banded to five National SPP one of each covering:-

- Healthcare
- Schools
- Skills and Workforce Development
- Disability Services
- Affordable Housing

NPP were introduced to fund specific projects to facilitate States and Territories on nationally significant reforms and to reward States and Territories for the delivery of reforms. Collectively SPP's and NPP's represent approximately 55% of federal assistance to the States and Territories.

Importantly for all the States and Territories the respective relativities for the distribution of GST revenues (which takes into account the horizontal fiscal imbalance i.e. the differences in States and Territories revenue raising capacity) is undertaken each year by the Commonwealth Grants Commission (CGC). The CGC takes into account the average of the annual relativities for the three preceding assessment years. Each State's or Territory's share of the GST in the following year is derived by combining its per capita relativity with its estimated population as at the end of the year. This approach means that since it is an averaging process there is a reasonably high degree of predictability by the State and Territory Governments associated with the federal revenue they will receive. This would be particularly attractive for Norfolk Island and would allow longer term planning within a reasonably defined resource envelope.

In the latest Commonwealth Grants Commission findings [15] the report indicates that should the Norfolk Island Government retain its existing GST system this would be seen as equivalent to Australian Government assistance to comparable communities funded through the Australian GST. This has the effect of reducing the Commission's finding of the level of assistance required by the Norfolk Island Government down from $13.069 mil to $5.394 mil[16].

The CGC has calculated the above at approximately $13.069 mil per annum as the "Financing Gap" between comparable State revenues and expenses and the gap between comparable local revenue

[14] *Report on GST Revenue Sharing Relativities -2011 Update, Commonwealth Grants Commission;* Australian Government. P.35
[15] *Update of the Financial Capacity of Norfolk island 2011 –Staff findings*. 2 December 2011; *Commonwealth Grants Commission;* Australian Government. p.3
[16] *Ibid.* Table 2;

and expenses plus provision for loan repayments over ten years. Using the approach the CGC used in the 2011 Update on relativities for Australian GST distribution the Tasmanian per capita grant was $3,500 and the Northern Territory's $11,700 per capita. Whilst Norfolk does not have the logistical problems with service delivery that the NT has, it would have greater dis-economies of scale than Tasmania. If an averaged value between the two was used ($7,600 per capita) the grant to the island would be approximately $13.7 mil per year –consistent but slightly higher than that found by the CGC.

Therefore both estimates suggest that Norfolk should receive somewhere in the vicinity of $13 -$14 mil per year in grants for the delivery of State and local government services on the island. It is important to note that this calculated level of financial assistance would not in itself make the island fiscally sustainable[17] as it makes no allowance for investment in new assets or investment in the backlog of funds necessary for replacing old wearing out existing infrastructure.

The distribution of GST revenues to the island is as important as the quantum of funds it can expect to receive. The most equitable method of it receiving funds to provide State and local government services would be through the same process as the other self-governing territories (ACT and NT). For this to happen it would require a relatively minor inclusion of the Territory into the *Intergovernmental Agreement on Federal Financial Relations (IGA).*

Issues

- The current Norfolk Island GST is at a higher rate and applies to more goods and services and does not provide the input accreditation that the Australian system does.
- Being outside the existing Australian GST system often results in Norfolk Island residents being charged Australian GST on their purchases plus the considerable difficulty of reclaiming. Therefore the benefit of not being subjected to Australian GST is reduced since most goods and services originate from Australia.
- As a self-governing Territory Norfolk Island will need to be included in the IGA.
- It will then receive funds for the provision of State and Local Government services consistent with the rest of Australia.
- It will have a high degree of funding security allowing it to plan in the same way as other States and Territories do currently.
- It will need to improve its financial management and provide some form of Treasury function for the Government to work effectively with the Australian Government system.
- The existing Norfolk Island GST system is seen locally to be less equitable than the Australian system as it is imposed at a higher rate, taxes essential foods and does not allow input credits on major capital investment. Modification of the local scheme to align it more closely with the Australian system will significantly increase the complexity (and therefore the compliance cost) of operating the scheme.

Norfolk Island Government position

The Norfolk Island Government prefers to opt into the Australian GST system and for this to be collected through the Australian Taxation Office. For Norfolk Island to operate as a sustainable self-governing external territory consistent with the framework of the other self-governing Australian

[17] *Ibid.* p.4

Territories it should be included in the IGA and receive annual GST disbursements through the existing CGC framework for fiscal equalisation.

Customs Duty

Customs duty is a further tax that is normally reserved for the Commonwealth Government to apply and collect. The Norfolk Island Government has also been granted this authority. Prior to 1994[18] the level of duty applied by Australia and New Zealand to imported goods was high. Norfolk Island with its own lower duty levels therefore could offer imported products to tourists at lower costs than they could purchase in their own countries. It was on this basis that most of the island's retail trade was established. With both Australia and New Zealand reducing duties and tariffs according to General Agreement on Tariffs and Trade (GATT) the comparative price advantage that Norfolk Island retailers enjoyed has largely disappeared. It is unlikely that either country is likely to return to a protective tariff regime in the future.

In the current financial year the expected gross revenue from customs duties has been reduced from $1.022mil to $0.800. As a revenue source it has been showing a declining return since the introduction of Norfolk Island GST. The cost of operating the customs service is $0.399 mil providing the Norfolk Island Government with a net revenue yield of $0.401 mil.

The EDR has quantified the cost of being an international destination to the island's economy as 2,200 visitors per year which based on Tourism Spending Measures and the flow-on effect through the economy the loss to the island's economy is between $4.5 and $6.4 mil per year[19]. The existence of a separate Norfolk Island customs regime on the island has been raised as a problem to allowing flights to the island to be serviced from Australian domestic terminals.

Issues

- Maintenance of a local customs duty arrangement is a difficulty with respect to including Norfolk as a domestic destination from Australia. Advice from the DRALGS is that there a possible issue of Australian Border Protection Services being extended to the island if there is a different customs regime operating locally.
- In some cases the local customs duty is higher than that applying to goods imported into Australia since the levying of customs duties applies to imported goods which may have been imported in part or as a whole to Australia means the payment of a local customs duty by the Norfolk Island consumer is double taxation[20]. This has the effect of increasing local prices and is most likely in the non-tourist related product areas (household durables; tools and machinery).
- There is a chance that the distribution arrangements of a small number of local retailers could be affected by the removal of a local customs duty regime.

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[18]General Agreement on Tariffs and Trade (GATT 1994) which placed new obligations to reduce tarrifs on its signatories.

[19]. The EDR has estimated the loss in tourists to be 2,200 per year and based on 2004/5 Tourism Spending measures this represents $3.6 mil in lost local spending per year. An economic cost of between $4.5 mil - $6.4 mil each year.

[20]This would apply to some goods where the Norfolk Island importer is not the direct overseas importer of the product and has no arrangement with the Australian importer for the goods to be re-exported to the island duty-free.

Norfolk Island Government position

The local economic loss from the island being accessed through an international terminal in respect to decreased tourism and the flow-on spending impacts is between $4.5 mil and $6.4 mil per year. The Norfolk Island Government believes that this benefit outweighs the current net revenue stream it obtains from maintaining its own Customs regime. If the removal of a local Customs regime was required to enable access to the island through domestic terminals the government would prefer to adopt Australian Customs and to have this collected and administered on the Island by the Australian Customs and Border Protection Service. In moving to this system it would suggest that at least a two year transition period be provided to enable any local retailers affected by the change to restructure according to any changed distribution arrangements.

Healthcare/Medivac levy

The Norfolk Island Healthcare/Medivac levy is a form of direct taxation normally reserved for the Federal government. This tax is used to fund the provision of healthcare services to the Norfolk Island community. It is somewhat analogous to the Australian Medicare Levy differing in that it is not progressive (i.e. everybody pays the same rate irrespective of income) and families are still required to spend more than the threshold (currently $2,500 per year) before they obtain any direct benefit.

The Healthcare/Medivac levy is not part of the Revenue Fund budget however it is estimated[21] that it provides $0.917 mil in revenue against total health expenditures of $2.893 mil[22]. On this basis the levy recovers 32% of healthcare expenses. The increasing cost of providing healthcare on the Island to the standard expected in the rest of Australia is prohibitive for the Norfolk Island Government. In both the Public Sector Review report and in the Economic Development Report it has been recommended that the responsibility for funding Health services on the island be transferred to the Australian Government. If this was undertaken funding of healthcare services in the long term would then take place through the Medicare levy system.

As an immediate action to promote community welfare the Economic Development Report suggests that an extension of medical and associated services be made to the island, pending the introduction of the taxation system[23].

Issues

- Because the Australian Medicare levy is progressive and paid through the Australian Income tax system the provision of Medicare benefits has been linked to the introduction of Australian income tax. Unless there is a mechanism to overcome this link the recommended introduction of the Australian Taxation system over a five year time-frame will mean that those disadvantaged citizens in the Island's community will be without medical cover for a considerable time.
- There are significant diseconomies associated with the small scale and isolation in providing health services to the Island that are not taken up in a *per capita* approach to healthcare funding

[21] Source CGC *Update..Op.cit*p.55
[22]Net of user charges
[23]Source EDR *Op. cit.* Table 25, p.97

as used in the CGC distribution estimates. It is unlikely that funding provided through the SPP for Healthcare would be sufficient to cover the provision of healthcare costs on the Island.

- The local Healthcare system does not require co-contribution for medical costs once the threshold has been reached in a year therefore there is no "cost-gap" for families associated with treatment above the annual threshold. Without the ability for local families to obtain "gap insurance" under the Australian Health Insurance arrangements potentially there could be a gap in providing full health cover.

Norfolk Island Government position

The Government sees the provision of healthcare on the island as a very high community priority and believes that the extension of the Australian Medicare and PBS to the island should be fast-tracked. The time period for the introduction of the Australian Taxation system represents an unacceptable period of vulnerability for the economically disadvantaged in the community. It supports the actions proposed in the EDR to continue the collection of the existing healthcare levy and pass this revenue to the Commonwealth as a co-contribution, thereby allowing an extension of Medicare benefits to the community that pre-empts the Australian Taxation Scheme. It agrees with the recommendations in both the Public Service Review and the Economic Development study that Healthcare services should be funded by the Commonwealth.

Fuel Levy

The Norfolk Island fuel levy is a further Federal type tax providing $8,000 per year in budgeted revenue. At this level of return, as a revenue source, it is of insignificant value.

State revenue measures

Land Taxes

Land taxes differ from Municipal rates in that they are normally applied by States and Territory governments. In the States and Territories, there is considerable variation in the arrangements for land tax. The Northern Territory does not levy it at all. In other States, principal residential property and productive rural land are generally exempt, but hobby farms are not. Leasehold land is variously treated. Tax scales and tax free thresholds vary between States[24].

Since it is part of the tax mix that State and Territory governments may apply to raise revenues it is included in CGC estimates of State revenue raising ability. The CGC uses the following approach to estimate the revenue on

- the value of total commercial and industrial land, with a value distribution adjustment which reflects the progressivity of the tax structure
- the value of non-principal residential (NPR) land, estimated as the total value of residential land adjusted by the proportion of residential properties rented privately.
- The commission assumes that, based on average State practice, States have no capacity to raise land tax from rural land or owner-occupied residential properties.

In the recent *Update* the CGC has revisited the estimate made by the Commission in 2006 of $3.05 mil being available to the Norfolk Island Government from Land tax down to $0.942 in the 2011

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[24]CGC *Update..Op.cit.* p.99

report. The major differences in the estimate results from better land valuation data and a revised estimate of the value of commercial land on the island from $2.0 mil per ha. being reduced to $1.0 mil per ha. The tax stream was then assessed on the basis of average state tax rates according to land value. The taxing rate ranged from 0.360% to 1.543% per annum. Based on this approach, land tax revenue raising capacity was estimated at $942 000, comprising $910 000 from land zoned on Norfolk[25] for mixed use/business/industrial land and $32 000 from NPR land.

We have sub sequentially looked at how the CGC estimated the amount of mixed use/business/Industrial land and the valuations for each. It appears that the estimate used for this land to be valued at $1.0 mil per ha exceeds the actual area of land with this value on the island. Our analysis indicates that the only zone that was valued at an average value of 1 mil/ha was that zoned "business" and in total, the area of the island zoned for this use is 13.3ha –considerably less than that estimated by the CGC. The other three zones had average values of $442.5K; $206K and $308K per ha respectively. It was therefore not possible to verify the estimate of land that could attract the value provided in the CGC report and this issue has been sent back to the CGC to consider. This difference would significantly reduce the assessed revenue stream from land tax on commercial land down below the $0.910 mil estimate possibly by as much as a half to two thirds.

Since this is one of the major new revenue measures which the Commonwealth will be expect the Norfolk Island Government to consider it is important that further detailed assessment of land values according to planning and tenure be undertaken. This would need to then be considered in relation to the wider policy associated with the Islands population, particularly if planning measures are being proposed to manage the Island's resident population.

Issues

- The major source of land tax revenue is from land zoned for "business" purposes and this is significantly over estimated in the CGC report.
- Since this tax is not applicable to rural land and owner occupied residential properties the effect on large tracts of rural land and islanders living on large parcels of land should be negligible.
- The tax will apply to land and properties which are rented and commercial property held for speculative purposes. The tax cost could be passed on in higher rents and there will be an incentive to develop rather than hold commercially zoned land.

Norfolk Island Government position

The Norfolk Island Government is prepared to consider the introduction of a land tax. Before it can consider the option further it will require a more detailed examination of the land values and land tenure. It does not believe that the quantum of revenue from this source will be as large as that estimated by the CGC. Since the introduction of a land tax will create an incentive for suitably zoned land to be developed – particularly for rental accommodation it believes the introduction of a land tax should be considered in relation to overall planning measures for the permanent and transient population of the island.

[25] Based on the *Norfolk Island Plan*

Stamp duty on conveyances

The existing stamp duty on conveyance is a flat rate of 4%. This differs in the arrangements used in the other States and Territories in that:-

- It is not progressive and does not vary with the value of the land
- There is a flat fee of $825 registration charged when the conveyance is without a monetary consideration[26] whereas in most State and Territories exemptions are given for first home buyers.

Norfolk is currently obtaining less per capita ($254) than the average of all states ($541), however it is not very significantly different from that obtained from Tasmania ($323) which has the same maximum rate (4%) as the flat rate that applies on Norfolk.

The CGC report suggests that Norfolk's revenue raising capacity from this revenue stream is $640K per year, significantly greater than the current year revised estimate of $450K. This must be considered in relation to the average respective tax rates by value considerations made by the CGC[27] under which the average value of land transferred on the Island which would attract the average tax rate (i.e. 4%) which would be $0.7-$0.8 mil. This is far higher than the actual average of all property transfers since July 2006 which was $0.25 mil[28]

Issues

- Norfolk provides the exemption on conveyance stamp duty for land passed down to children and could be analogous to the exemptions provided by States and Territories for first home buyers.
- Whilst the Norfolk Island system is not based on a progressive rate the current level of tax collection should be regarded as the maximum that can be obtained from the current level of land transfers and the local land values.

Norfolk Island Government position

The Norfolk Island Government believes that it is making significant revenue raising efforts associated with the collection of stamp duties. The existing level of revenue is a reflection of the current economic climate on the island and whilst it will continue to monitor this revenue stream it does not intend to significantly change it in the near future.

Insurance Tax

Insurance tax is not a current Norfolk Island tax. However it is a tax levied by the States and Territories on insurance premiums in Australia and as such is considered a revenue raising measure available to the Island. In Australia it is levied at different rates for Compulsory Third Party (CTP) and general property insurances. In 2009-10 the CGC reported that the all-state average tax on these premiums was 11.4%. The CGC report has estimated that the CTP premium for the island is about

[26]What is referred to in the report as "natural love and affection" and gifted transfers
[27]CGC *Update..Op.cit.* Table C-7. p.104
[28]The actual average price of all transfers since July 1 2006 to 20 April 2011 was $253,154. This excluded those which were done for "natural love or affection" inclusion of which would have lowered the average price further.

$0.78 mil and the household premium insurance of approximately $4.0 mil[29],this giving a total taxable premium base of $4.78 mil and a potential revenue stream of $0.545 mil per annum.

Issues

- As acknowledged in the report the value of $4.0 mil on household premiums appears high and before consideration needs further local verification.
- A tax on insurance premiums will increase local insurance costs. Whilst the CGC analysis identifies the tax is not present it does not provide any analysis of the comparative cost of insurance on the island versus the mainland.

Norfolk Island Government position

The Government is prepared to investigate the option of introducing a tax on insurance further. It is however concerned that the local costs of insurance are already higher, due to local factors, than the comparative level of premiums charged in Australia. It will need to undertake some comparative analysis before considering this measure further.

Motor Taxes

On a per capita basis Norfolk was assessed as already applying motor vehicle taxes at close to the all-state average ($277 per capita compared to $318 per capita). In this comparison[30] it was charging more per capita than Victoria; South Australia; Tasmania and the NT. The major difference in the taxing regime on Motor vehicles is the local flat fee for vehicle transfers versus the Australian approach for a fee based on the vehicle value. The effective rate of the all-state stamp duty being 3.2%.

Issues

- Norfolk is already levying motor taxes at a comparable rate to that applied in Australia
- The flat-fee that applies to vehicle transfers even if changed would be unlikely to significantly increase revenues as vehicles on the island are of lower value than the mainland and are transferred less frequently between owners.
- The levy rate is tied to the RPI and therefore is automatically indexed to inflation.

Norfolk Island Government position

The Government believes that it is already accessing the level of possible revenue from this source and whilst it will keep the area under review does not intend to make significant changes over the near term.

Local Government Revenue Measures

Municipal Rates

Municipal rates are charged by local governments in Australia on most ratable land based on valuation[31].

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[29]The CGC estimate based on discussions with the two insurance agents.

[30]CGC *Update..Op.cit.* Table C-12; p. 109

[31] The valuation measure differs between states but the most frequent value is based on unimproved capital value.

The EDR has referred to this as a universal land tax and the core action to improve the revenue raising capacity of the Norfolk Island Government[32]. It has proposed that this be introduced in phase two of the economic development strategy (i.e. within 2-8 years) and that consideration be given to extending the current absentee landholders levy to cover all land at a recurrent rate of between one and two percent. No estimate has been provided on the revenue stream on this and it will require valuation of all the remaining land on the island[33].

In the 2006 CGC report they compared the Norfolk Island situation with three local Governments; King Island, Shoalhaven City Council (NSW) and that of Byron Shire Council(NSW). In the 2011 update the report has assumed that the land valuation on Norfolk would be comparable to that of King Island.

On this basis the CGC has assessed that the Norfolk Island Government would be able to collect $1.4 mil from the levying of Municipal rates. This revenue target would require rates to be levied at $789 per capita[34] which is higher than the all-state per capita level ($526) and at this level would have the highest State or Territory municipal rates in Australia[35].

Unfortunately the report does not give any indication that the actual land valuation was compared for King Island and if it was whether the same over-estimate of the quantity of commercial land on Norfolk[36] has also been used in making the comparison. Of further relevance in making the comparison is the quality of local Government services that are being delivered to the King Island community and whether those are applicable to the Norfolk Island context.

Issues

- Since this is the single largest new tax to be considered on the island the quality of the revenue estimates provided in the CGC update report require considerable further examination particularly in comparing Norfolk with an individual local government community such as King Island instead of against the all-state average. Similarly if the approach proposed in the EDR is to be followed valuation of the remaining land on the island will be required.
- There is a strong sense that Municipal rates pay for local infrastructure (kerbing; street lighting; garbage collection) and the level of these services on the island is below that in the comparable communities.
- Norfolk Island, even after introducing municipal rates, would not be in a financial position to bring the local infrastructure up to a comparable standard without significant immediate investment and on-going access to the range of financing mechanisms (including debt) available to local government in Australia.

[32]EDR *Op.cit.*p.105
[33]Currently only absentee land is valued, it is estimated that it will cost $100K to obtain valuation on the island's remaining land.
[34]The same rate as levied by King Island
[35]CGC *Update..Op.cit*Table E-1; p.152
[36]As identified in the discussion on Land tax

Norfolk Island Government position

The Norfolk Island Government believes that whilst the estimate provided by the GCG of revenue yield is distorted by the previous assumptions made with respect to land valuation it will examine the introduction of a Municipal rating system. Likewise in respect of the EDR approach it will undertake to have the remaining land on the island valued. It believes that a co-commitment will need to be provided by the Commonwealth to allow immediate investment in sub-standard local government infrastructure on the island. This will initially need to be provided by specific-purpose grants[37] and thereafter by access to the normal local-government financing mechanisms available to local governments elsewhere in Australia.

User Charges

User charges reflect the fees that Local government in Australia charge for building application fees, development fees, subdivision fees, water, sewerage, septic and waste levies, license fees and fines, hall hire charges, landing charges and dog registration fees. The CGC update assessed that Norfolk was already collecting the all-state per capita average from this revenue source ($425)[38].

However similar to the approach taken with respect to Municipal rates the CGC believes the comparable revenue raising capacity for this item is that applying on a per capita basis for King Island. The King Island community pays an equivalent of $507 per capita for the provision of water; sewerage rates; a fire levy commission and waste management fees. The CGC then, based on the ratio of tourists to residents, multiplied this rate by 113% (giving an effective rate of $573 per capita) to determine that Norfolk should be able to raise $1.04 mil from this source each year.

Issues

- The comparison between the King Island situation and that of Norfolk Island needs further examination in relation to the different services provided by local government (such as water) and economic conditions (such development issues) that would impact on Norfolk's ability to raise revenue to the level assessed in the CGC report.
- There is no assessment of the effect on the local economy in increasing these fees to reflect the rates envisaged in the CGC report.

Norfolk Island Government position

The Norfolk Island Government does not agree with the approach used by the CGC in comparing Norfolk Island to the community of King Island with respect to effort and yield associated with this revenue measure. At the current level of $425 *per capita* the island's government is already yielding revenue at the all-state average. Furthermore whereas the CGC report believes it is justified in making the comparison, (and increasing it due to tourism) to King Island no rationale is provided to explain the similarity between fees and user charges between Norfolk Island and King Island. Similarly to motor vehicle charges the Norfolk Island

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[37]As acknowledged in the JSC report on….. which reported that the standard of infrastructure was below standard when self-government was granted in 1979
[38]CGC *Update..Op.cit*Table E-2; p. 153

Government believes these charges are already at an acceptable level and are also pegged to inflation through the RPI fee-unit adjustment mechanism.

Non-Tax Revenues

Trading Enterprises

Norfolk Island Government non-tax revenue from the operation of government trading enterprises (based on the current year projections[39]) are presented in Table 2. As can be seen from the table most trading enterprises return a surplus over expenses to the Revenue Fund. In total this represents $4.811 mil in transfers and in a cumulative sense is the next largest current source of government revenue after GST revenues.

Table 2 Norfolk Island Government Trading Enterprises and Revenues

Trading Enterprise	Income	Expenditure	Surplus	Comment	Cum. Revenue
Liquor Bond	3,500,000	2,794,300	705,700	PSR and EDR suggests private sector operation	705,700
Norfolk Energy	5,790,200	5,016,900	773,300	EDR proposes privatisation	1,479,000
Philatelic Bureau	209,000	207,000	2,000	PSR has retained; EDR says to review and may privatise	1,481,000
Post Office	390,900	387,000	3,900	PSR has retained	1,484,900
Electricity	3,690,000	2,968,610	721,390	PSR has retained; EDR says to review and may privatise	2,206,290
Telecom	3,206,600	2,311,940	894,660	PSR has retained. EDR proposes privatisation	3,100,950
Lighterage	510,000	305,970	204,030	PSR has retained. EDR proposes privatisation	3,304,980
Airport	1,824,800	573,950	1,250,850	PSR has retained; EDR	4,555,830

[39] Based on current Mid-year budget predictions for both revenue and expenditure for the fy 2011/12. From which the operation of Norfolk Air has been excluded since it will cease to operate from the end of February.

				says to review and may privatise	
Water Assurance	433,200	146,100	287,100	PSR has retained; EDR says to review and may privatise	4,842,930
Waste management	501,200	457,100	44,100	PSR suggests private sector operation; EDR says to review and may privatise	4,887,030
Museums	280,300	368,660	-88,360	PSR suggests Cth. and Private sector; EDR says to review and may privatise	4,798,670
Sale of Rock	100,100	87,700	12,400	Not discussed	4,811,070

On a *per capita* basis this represents approximately $2,700 per annum –greatly in excess of the estimate provided in the CGC[40] and that provided by other States and Territories.

The EDR sees the extent of the Government involvement in commercial activities as a fundamental constraint on economic development[41]. It proposes the adoption of the *Competition Principles Agreement 1995* leading to possible privatisation of GBE's and price setting of utilities by an Economic Regulator as required microeconomic reforms. The PSR has a similar set of recommendations associated with the GBE's however some are suggested for retention in public ownership. The EDR proposes that taxation reform from the introduction of rates[42] (the recurrent land tax), along with regular Commonwealth fiscal equalisation payments will mitigate the recurrent revenue loss from GBE divestment. In the short term it will require financing from the Commonwealth.

The EDR recommends that the possible sale of the Liquor Bond be commenced in the 2012/13 financial year (phase one), with the objective of maximizing any sale price through generous competition protections at the point of sale that are reduced over a three to five year period. Transfer of the Liquor Bond operation to the private sector would result in an estimated current

[40]Which only considered revenues from Electricity and gas, Water supply and sewerage; Freight; Non-urban passenger transport and Forestry operations.
[41]EDR *Op.cit.*p.48.
[42]EDR *Op.cit.*p.xi

year revenue loss of approximately $0.700 mil. This tight timeframe would require the Commonwealth to assist in the reform process and through the provision of compensatory financing for example using a mechanism of *National Competition Policy Payments*. Upon sale the only mechanism[43] available to the Norfolk Island Government to retain an income stream from the use of alcohol on the island would be through a licensing fee for establishments such as hotels and restaurants, as it the case for other States and Territories. The magnitude of the licensing revenue stream would be significantly less than the current dividend[44].

The PSR also suggests that the Government divest itself from Waste Management and this be undertaken by the private sector. Waste management by the Administration is accounted for as a trading enterprise but in effect it is the collection of a tax on imported goods (the waste management levy) and the expense associated with the operation of the Waste Management Centre. In a commercial sense it is therefore not a fee-for-service operation that can be easily privatized. The most likely approach for private sector operation would be the continued collection of the tax by the Administration and the operation of the Waste Management Centre undertaken by the private sector under contract to the Administration.

The EDR proposes that in phase two (which is expected to last at least six years) the reform of most of the remaining GBE's will take place with corporatization and following this possible privatisation. The report also notes that the situation facing Norfolk is different to that faced in Australian regional economic development strategies and that it is more relevant to the economic development strategies that emerged in transition economies following the collapse of communism[45]. The important aspect missing from the Norfolk Island environment being a social safety net to provide on-island support to those affected and to enable them to possibly undertake retraining during the transition period.

Issues

- Income from Government Trading enterprises is the second-most important current source of revenue for the Norfolk Island Government. Divestment from these revenue streams without alternate revenue sources to provide for the continuing provision of local services during the transition phase is not possible.
- The recommended divestment in the Liquor Bond operation will require immediate assistance to facilitate any process during the 2012/13 financial year. It will result in a revenue loss that will be difficult to recoup from any licensing arrangement.
- The reform of remaining GBE's during phase two will require the provision of Commonwealth transition payments (for example National Competition Policy Payments) until the provision of a full system of transfer payments from the Commonwealth is in place and local taxation reform is introduced (rates).
- The proposed privatization of waste management would involve the privatization of the waste management operations by the private sector under contract with the Administration.

[43] Assuming it relinquishes Customs duty and the Norfolk Island GST

[44] In 2010/11 there were3 Hotels;1 Tavern; 7 clubs; 12 restaurants and 1 manufacturing licence issued. If the NSW maximum licence fee of $2,500 was applied the total revenue would be $60K per annum.

[45] EDR *Op.cit.* p. 95

Norfolk Island Government position

The Norfolk island Government is open to proceeding with the possible divestment of the Liquor Bond in phase one and the corporatisation of the remaining GBE's in phase two on the basis that:-

1. That the service provision to the community be improved in terms of cost or quality by the government divestment of the operation.
2. A financing mechanism is negotiated with the Commonwealth that provides transitional financing to the Norfolk Island Government during the divestment process.
3. The Commonwealth and the NIG engage in a process to provide an on-island social safety net to provide support and training to employees affected by the GBE reform process.
4. The Commonwealth assists the NIG in negotiating a service delivery agreement with existing business enterprise centre to provide business advisory services and skills training to enable them to participate in the divestment process on the island.
5. That expertise is engaged by the Commonwealth to assist in the corporatisation/privatisation process.
6. That an enduring fiscal framework of transfer payments to the Norfolk Island Government is negotiated and provides an adequate revenue stream that is reliable and can be predicted with reasonable surety into the future