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Institute of Chartered Accountants Australia

28 February 2014

Committee Secretary
Joint Select Committee on Northern Australia
GPO Box 1428
Canberra ACT 2601

By email: jscna@aph.gov.au

Dear Sir/Madam,

Inquiry into the development of Northern Australia

The Institute of Chartered Accountants of Australia (Institute) welcomes the opportunity to make a submission to the Joint Select Committee's inquiry into the development of Northern Australia (the Inquiry).

The Institute represents accounting and business professionals in Australia and around the globe. Members strive to uphold financial integrity through a commitment to ethics and acting in the public interest.

We focus on educating candidates through the Chartered Accountants Program and engage in advocacy and thought leadership underpinned by our members' knowledge and experience. We influence a range of policy areas impacting the Australian economy and domestic and international capital markets.

A watershed member vote in 2013 set the course for the Institute to amalgamate with the New Zealand Institute of Chartered Accountants (subject to obtaining formal government approvals and effecting amendments to constituent documents), with the vision of becoming the trusted leaders in business and finance.

The proposed new institute – Chartered Accountants Australia and New Zealand – is expected to have more than 90,000 members in total with 17,000-plus candidates, giving us greater scale and influence on the world stage.

We are on the Board of the International Federation of Accountants, and are connected globally through the 800,000-strong GAA and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

General Comments

The Institute supports initiatives to develop Northern Australia. A recent report by the Regional Australia Institute identifies three distinct types of regions in Northern Australia:

- Large regional cities such as Darwin, Townsville, Cairns and Mackay;
- Mid-size towns with diverse industries and locations such as mining towns, agricultural towns and towns close to the large regional cities.
- Remote pastoral areas and remote Indigenous communities.

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Each of these regions have differing needs. It is important that any initiatives to develop the area recognise the diverse nature of the region.

A vibrant Northern Australia benefits not only its existing population but also the wider Australian community, particularly if enhanced economic activity creates employment opportunities for the local population and entices workers to relocate from those southern states which have experienced recent declines in manufacturing activity.

However, any strategy to develop Northern Australia must enable the region to be self-sufficient and sustainable in the longer term. The goal of the federal government and the governments of Queensland, Northern Territory and Western Australia should be to create the right business environment for entrepreneurial activity.

Strategic initiatives for Northern Australia should also work towards assisting the local indigenous population to share in the benefits of a dynamic economy through employment, education, training and other opportunities.

Specific Comments

We note that the Resolution of Appointment for the Joint Select Committee on Northern Australia asked that recommendations be made to 'establish a conducive regulatory, taxation and economic environment' for developing the parts of Australia which lie north of the Tropic of Capricorn.

Our specific comments below relate to the tax aspects of the Resolution.

Regional tax incentives for Northern Australia?

In the current budget climate the Institute's stance is that tax expenditures (tax concessions) are not the preferred means of providing incentives for a particular part of the economy.
This is because targeted tax expenditures:

- must be paid for in the sense that tax collections elsewhere need to be higher in order to fund the concession;
- may miss their intended target;
- may distort decision-making as taxpayers position their arrangements simply to satisfy the eligibility criteria for the tax concession;
- can create 'winners and losers', and / or
- often add complexity to the tax law and the tax administration process.

In a business context, the use of tax incentives to create 'economic zones' in one part of the country creates tax competition within our national income tax system (with attendant constitutional concerns) and leads to similar requests elsewhere from those outside the eligibility boundary.

For example, The Brotherhood of St Lawrence estimates that parts of Tasmania have the worst levels of youth unemployment in Australia (17 per cent in Tasmania compared to a national youth unemployment average of 12.2 per cent, with even higher levels in the west and north-west of the state).

In the current economic climate the Institute's preference would be that instead of tax expenditures, targeted government spending measures be used to provide transparent, measurable government support to Northern Australia.

The key government focus areas should relate to:

- Improving key public infrastructure in the region which would contribute to the establishment or re-location of business activity. For example, water management infrastructure has been identified by the Coalition as a key issue in Northern Australia (refer *Coalition's Dams and Water Management Discussion Paper).*

- Transferring suitable government departments, agencies or functions to Northern Australia. In a society where technology is rapidly reducing the tyranny of distance, a government service centre operated out of Broome would have little impact on service delivery standards nationwide.

- Addressing critical housing shortages in some key centres such as Darwin with a government assisted housing program and local measures to increase the stock of available building sites.

- Working with relevant state governments to provide a benign regulatory environment for private sector business operators, particularly in those sectors where (apart from mining and gas) Northern Australia has an acknowledged competitive edge such as agribusiness, international education, tourism and advanced manufacturing).

    - We note here that many businesses in Northern Australia are trade exposed, so initiatives such as the recent free trade agreement signed between Australia and the Republic of Korea are of particular benefit. More trade agreements with Asian countries would be similarly beneficial.

- Enhancing the existing higher education facilities in the region to help stem the migration of young people raised in Northern Australia and attract more students from Asia.

- 'Skill gap' research to identify whether skilled migration programs (from within or outside Australia) specifically for Northern Australia are effective. If incentives are required, they should take the form of fast-tracked, locally-tied immigration arrangements and direct incentives paid once the recipient has satisfied eligibility criteria which include length of stay in the region.

With the right policy settings, we believe that market forces have the greatest potential to help develop Northern Australia for the long term.

The Institute's approach reflects the pre-election views of the Coalition government in its *2030 Vision for Developing Northern Australia* (June 2013):

> *'...the main task for government should be, largely, to create the right climate and environment to encourage the establishment of viable enterprises, not to direct or be the principal financier of development. In doing so, it must follow strict requirements and key performance indicators to deliver strong outcomes.'*

On a broader, national level, the Institute believes that a lowering of the company tax rate (which even at the proposed 28.5 per cent is high by OECD standards) would provide stimulus for growth and jobs in all sectors of the economy, in all parts of Australia.

Zone tax offset

The income tax law currently provides for a zone tax offset. The original policy thinking behind the offset was to recognise the disadvantages which individual taxpayers endure because of the uncongenial climatic conditions, isolation and high cost of living in remote areas.

In early years, the offset also acknowledged the difficulty employers experienced in attracting workers to remote areas of Australia. As noted below, the introduction of Fringe Benefits Tax (FBT) has impacted this policy rationale.

The zone tax offset goes to the individual, not to business owners, and its value has declined over recent years due to non-indexation.

Eligible remote areas are classed as either Zone A or Zone B, and there are special areas within these zones. The tax entitlements for Zone A (which covers more inhospitable climatic areas with higher costs of living) exceed those for Zone B.

The Institute supports the policy behind the zone tax offset, but recommends a review of the design which could include replacement of the offset with a transfer (cash) payment mechanism. The switch to a direct payment acknowledges the tax simplification process already underway as part of the government's plans to reduce red tape, and the ATO's project to relieve most individual taxpayers of the obligation to lodge an annual income tax return.

This review of the current zone tax offset should consider:

- Whether the offset (or equivalent payment) provides reasonable acknowledgement of the additional cost of living in remote Australia;
- The introduction of indexation arrangements;
- Whether the offset (or equivalent payment) should be structured to support more permanent migration, with greater benefits obtained by those who physically reside in the remote location for longer periods (as distinct from the current 183 days in the income year test);
- The measurement of zones to ensure they are based on a contemporary measure of remoteness (this would include a regular review of population data). *Australia's Future Tax System Review* (the Henry Review) found that:

  > *'The zones were established in 1945 and the boundaries have remained broadly unchanged since 1956. Given changes in population and the distribution of industry and transport infrastructure since 1956, many areas in the zones are not disadvantaged or isolated. On the other hand some remote areas fall outside the zones. For example while Darwin is in Zone A and Townsville and Cairns are in Zone B, Ivanhoe, in western New South Wales, with a population of around 250 and more than 200 kilometres from the nearest town with over 2 500 people, lies outside the zones'.*

  The current definition of 'remote' would encompass many regional centres that are not remote by modern standards. Some towns that are genuinely remote are not included in any zone area. In addition, as well as the zones having been defined in 1956, the special areas are based on 1981 census figures and so do not reflect Australia's current population profile.
- ATO and taxpayer compliance costs (refer Taxation Ruling 94/27 for an illustration of the problems in applying the current law relating to the zone tax offset)

Living away from home allowance and zone tax offset

The introduction of zone tax offset arrangements into the income tax law pre-date the introduction of FBT.

Assuming an employee's circumstances satisfy the eligibility criteria, the more generous living away from home allowance (LAFHA) provisions of the FBT law rules now provide the main tax policy response to the difficulties associated with recruiting skilled labour for remote area employment opportunities.

Given the LAFHA arrangements under the FBT law, particularly for 'fly-in fly-out' workers, it is timely to re-consider the policy justification for any overlap that continues to occur between entitlements under the FBT and income tax laws (i.e. workers in receipt of a LAFHA who are also eligible for the zone tax offset).

FBT review of remote area and employee relocation benefits to reduce employer compliance costs

In its 2014-15 pre-Budget submission, the Institute identified FBT as a tax which should be re-designed to reduce the red tape encountered by employers in complying with the law.

FBT is a 'drag net' tax: it catches nearly every type of employee benefit and employers spend most of their time ensuring that they qualify for the many FBT exemptions that are available in the law.

This is particularly true of the exemptions which apply to fringe benefits provided to employees in remote locations, or in moving employees about the country. It is our understanding that, because of the remote area and employee relocation fringe benefit exemptions in the law, only a very small proportion of FBT collected relates to such benefits.

In our view, FBT should only apply to a small range of commonly provided fringe benefits (e.g. company cars, low-interest loans, discounted goods and services) to radically reduce the red tape burden. In particular, remote area and employee relocation benefits should be outside the net, with appropriate anti-avoidance safeguards to protect the revenue from those who abuse the concessions.

Yours faithfully,

Rob Ward
Head of Leadership and Advocacy