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Submission to Joint Standing Committee on

Secretary: ..... *John* .....

The National Capital and External Territories ('JSC')

1. My name is Michael (Mike) Hehir, I am a resident of Norfolk Island, having arrived here from Canberra in December 1999 and since that date have conducted an accommodation business known as Shiralee Executive Cottages. Prior to that I practiced as a barrister and solicitor, first in Victoria and then in Canberra. I am the President of the Norfolk Island Accommodation and Tourist Association (ATA), and am a member of the Norfolk Island Government Tourist Bureau ('NIGTB')
2. The submissions which I make are personal to myself and do not necessarily reflect the view of either of the entities referred to in paragraph 1 or their members. However, I would be remiss if I did not acknowledge that some of my submissions and recommendations result from discussion with ATA members, and other members of the public and I am grateful for their input.
3. The focus of the JSC is the good Governance of Norfolk Island. Many matters have been referred to in the two reports published by the JSC, but in this submission I wish to focus on what I perceive to be critical issues and, on which, I believe I am qualified to comment. I now address these issues.

### Financial Sustainability

#### **A. Background**

4. Norfolk Island since the advent of the Norfolk Island Act 1979 has, up to more recent years, been able to financially sustain itself. However, this has been achieved by some essential services not receiving the financial input so as to maintain those essential services to a standard similar to the Australian mainland. Examples of such services are roads, hospital, power generation and water supply. The expenditure necessary to redress these deficiencies in essential services, has not been addressed nor does any financial provision appear to have been made by the Legislative Assembly ('Assembly').
5. The Commonwealth Grants Commission published its "Report on Norfolk Island" in 1997 and although now eight years old, is referred to in this Submission, on a number of occasions. Reference is also made to the Joint Standing Committee on the National Capital and External Territories Report on Norfolk Island published in July 2004.
6. In June 2002 the Hon Administrator Mr AJ Mesner and the then Finance Minister caused to be put into effect "Focus 2002" being a review of the Island's physical and economic sustainability. This led to the investigation by The Treasury of the Australian Government and the promulgation in 2003 of the Discussion Paper "Taxation Options for Norfolk Island". This is frequently referred to in this submission.

**B. Financial Options**

7. It has recently been announced that the Norfolk Island Government intends to introduce a Goods and Services Tax Norfolk Sustainability Levy "NSL" although little detail of how the tax will be imposed has been released to the general public.

8. At the outset, I must express my concern that the imposition of a GST does not appear to have resulted from any public consultation but is, rather, a "knee jerk" reaction to the financial problems of the Government of Norfolk Island. Without in any way criticizing the Government it appears to me that it has been aware, or should have been aware for some years that there was a financial crisis imminent, so far as the funding of services on Norfolk Island. As to why nothing was done in the interim to address the problems of the Island is a matter of both concern and conjecture. One can only assume that the members of the Assembly did not address this extremely important matter or if they did address it, could not come to any agreement as to what had to be done to rectify the situation. The result of this state of affairs is the proposal to implement a GST with undue haste to rectify the financial plight of the Island. One suspects a GST has recommended itself on the basis that it will be a simple tax to collect and will provide the additional revenue required to enable the Island with its existing infrastructure, equivalent to both state and local governments, to subsist financially. I suggest, with all due respect, that the imposition of a GST and particularly the collection of revenue thereunder may prove less than simple.

9. In the Discussion Paper there is a considered and analytical approach to the collection of sufficient revenue in order that Islander's may enjoy the same benefits and standard of living as their compatriots in Australia. The Discussion Paper is useful as a tool on which to comment on the various options addressed in it.

10. The Discussion Paper correctly sets out the constitutional powers of the Government under the Norfolk Island Act, to raise revenue, stating that there are “Wide Powers for the raising of revenue”. It refers to the 2001 census and which indicates that 1229 persons were working in a job or business; 199 were retired, and it is not unreasonable to assume that all person in these two categories derive an income.
11. It correctly refers to the reliance and high dependency of Norfolk Island’s GDP on tourism. The 1997 Grants Commission Reports indicates that the percentage of persons directly involved in tourism is 60 percent and those indirectly involved is 24 percent. The Discussion Paper under the heading “Exemption from Australian Taxes” refers to section 122 of the Constitution and notes that Norfolk Island residents, companies and trusts are exempt from Australian tax on income derived from foreign sources and sources within Norfolk Island. Under the subheading heading “Cultural and Political Issues” (‘page 6’) it reports on consultations with the public and refers to the strong opposition to the levying of personal income tax on Island residents and goes on to state that “taxes on individual’s wealth, such as land, would be abhorrent”. Reference is then made to those of Pitcairn decent and the special relationship they have with the Island. There appears at page 7 the statement “additional Taxation directly targeted at Tourism is likely to discourage tourist – the life blood of Norfolk Island”.
12. The Discussion Paper under the heading “Designing a Tax System” sets out the various taxation principles and including the application of those principles to Norfolk Island. I believe those principles to be correct and virtually unarguable.

The Discussion Paper sets out the Options for tax reform and there are 6 such options, some of which I refer to in this Submission.

**B. Financial Non Sustainability**

13. Accounts of the Norfolk Island Government for the Year ended 30 June 2004 disclose total income of \$24,134,850 and total expenditure after depreciation of \$22,660,277. Commonwealth External Territories of Cocus Island and Christmas Island (both under the Australian Tax System) and having a combined population comparable to Norfolk Island have a budget of approximately \$70 million.
14. I submit that the present number of working persons has substantially decreased since 2001. More recent information as to population has been obtained by me and reveals the following:-

30 June 2005	
Residents	1375
TEP holders	357
GEP holders	<u>236</u>
	1968

30 June 2004	
Residents	1402
TEP holders	403
GEP holders	<u>215</u>
	2030

There has therefore been a net decline in population of 62 for this period and I have been informed that approximately 40 TEP holders have left the Island in the period 1 July to date, further reducing the Island's total population to 1928. There are approximately 320 students at the Norfolk Island Central School, and 94

persons are in receipt of pensions on Norfolk Island with a further 26 persons receiving health care assistance. I assume that there are approximately 40 children not yet of school age.

It necessarily follows that the number of persons on Norfolk Island who could contribute to the public purse (whether by way of levies, direct or indirect taxation or otherwise) approximates 1400.

15. If one were to be realistic, the Administration Budget of Norfolk Island, at present needs to be in the range of \$30 million - \$35,000 for the following reasons:

- (a) Norfolk Island infrastructure such as roads, telecom needs urgent upgrading;
- (b) The hospital should preferably be rebuilt, or at least upgraded;
- (c) School accommodation and facilities require improvement;
- (d) Repayment of Australian Government loans need to be budgeted for;
- (e) preliminary viability studies need to be effected with respect to power (eg examination of alternative sources involving solar and wind power generation);
- (f) substantial advertising expenditure is required to reduce the fall off of tourism and encourage an increase in tourism to the Island;

16. Leaving aside for the moment income derived by the Administration from sources other than residents, I submit that the number of persons resident on the Island and in receipt of income is approximately 1,400. If those persons were to generate government receipts of \$30 million this equates to a contribution of \$21,500 by each such person. Under the present Australian Income Tax rates a person would pay tax of this order on net income (after allowable deductions) of \$76,000. The situation worsens when one considers that Norfolk Island is rated as Zone A under the Income Tax Assessment Act 1936, and to be liable for

income tax payable of \$23,000, a net income of approximately \$80,000 would need to be derived (assumes no "relevant rebate amount")

17. If one were to adopt an administration budget of \$35 million, which I believe to be more realistic, then the revenue raising consequently needs to increase.

Adopting the basis set out in paragraph 16, the contribution of income receiving residents on the Island increases to \$25,000. This equates to an Australian resident having a net taxable income of \$83,500. Adopting a Zone A allowance, the relevant net income to support net tax payable of \$25,000 would be \$7,000 (assumes "no relevant rebate amount").

18. Under the proposed NSL, an unknown percentage tax is to be applied to goods and services provided on the Island. It has been stated that once this percentage has been finalized, some levies presently proposed such as customs duty on goods for resale and, accommodation levy will be abolished. Income generated from these sources as evidenced by the Approved Budget total \$4,250,000. If they were to be removed, the revenue falls to \$8,534,500 leaving a sum of \$21,465,700 to be raised, assuming a requirement of \$30 million. The government contributed \$11.5 million to the Norfolk Island economy in 1995/96.

19. The Norfolk Island Government, unlike other governments has only two sources of income, namely the revenue it derives from taxes and levies on its residents, and the income derived from tourists.

20. In the last week the Minister for Finance has suggested as an alternative to the NSL, the possible introduction of income tax and rates. I welcome the suggestion for the imposition of an income tax as it is less regressive and gives greater relief to low income earners, who would otherwise suffer under a goods and services tax.
21. Notwithstanding this, I remain of the opinion that Norfolk Island cannot generate sufficient income with its present population to provide revenue to the extent that the Island will be self sufficient. The calculations set out in paragraphs 16 and 17 remain pertinent.
22. The part answer to the problem is the income that can be and has in the past been the Islands main source of income, namely that derived from Tourism. However, it has been stressed that the passing on of taxes to tourists could adversely affect the tourist trade to Norfolk Island. The imposition of the proposed NSL would certainly have had such an effect.
23. Unfortunately the economy is reliant to a very large degree on income generated from tourism, and there is presently no foreseeable alternative. It has recently been stated by a senior member of the Administration that current statistics do not indicate that tourism generates additional income for the Island. I dispute this and point out that departure fees and landing fees generate \$83 per person. At least



80% of all fees paid for accommodation are received by accommodation proprietors on the Island, and the majority of these fees are expended on the Island. Tourist participate in tours, shop and eat and drink while on the Island. Furthermore, the Grants Commission Report 1997 indicates that \$2 million was generated from departure tax, landing fees and accommodation levy. Tourism to the Island has fallen from a high of 40,000 persons in 2001 to probably less than 30,000 persons in the current calendar year.

24. I submit that every effort be made to increase tourism to the Island to 50,000 persons per year. There are 65 registered accommodation properties on the Island, comprising 590 units and containing 1464 beds. The average stay on the Island is 7.1 days. If one were to adopt the number of bed nights available per annum 534,360 (ie  $1464 \times 365$ ) and divide it by the average stay, then the existing infrasture can accommodate 75,262 persons. A more realistic calculation of visitor accommodation would be the number of units 590, multiplied by 2 multiplied by the number of days 365 divided by the average length of stay of 7.1 nights. This gives an accommodation capacity of 60,660, but which is subject to seasonal fluctuations. Special tourism packages could encourage more tourism during the winter months as the Island climate is still quite mild.

25. There are two critical elements, I believe, to the financial sustainability of Norfolk Island. I have in paragraph 24 addressed the need for increased tourism and in paragraphs 16 and 17 have referred to the inability of the present population to

fund necessary expenditure. I now wish to address the question of the Island's population.

26. In 1985 a Report was prepared for the Norfolk Island Government being Norfolk Island Development Plan (a Conservation Strategy). That Report contained a population projection and in particular contained two tables one showing permanent residents and the other including permanent residents and permit holders. The projections are reproduced as follows.

Year		1983 (base) (estimate)	1986	1991	2001
% increase	1.5	1870*	1960	2110	2440
	2	1870	1980	2190	2670
	3	1870	2040	2370	3180

\*Permanent residents and Permit holders (estimate)

Year		1981 (base) (actual)	1986	1991	2001
% increase	1.5	1289*	1387	1494	1732
	2	1289	1422	1569	1901
	3	1289	1493	1729	2317

\*Permanent residents only

27. Given the nature of the Report and its environmental considerations one could reasonably accept that these population figures are sustainable. Obviously the population should be increased to a more sustainable level. I understand that the government has adopted a 2% per year growth in population and extrapolating the above figures to 2005, total population should be 2833. Referring back to paragraph 26 the Report also refers to tourist number policy of 24,000 visitors stopping an average of 9-10 days, the equivalent of almost 34,000 visitors staying 7 days. It is interesting to contrast these figures with these set out in paragraph 22 of this submission, and in the context that some 20 years have passed!

#### Recommendations as to Financial Sustainability

28. Having regard to the preceding paragraphs I make the following recommendations.

1. That there be put in place a policy to increase the Islands population to a maximum 3,000 and taking into account the following:-
  - (a) the quota of GEP's in the present year was 35 plus those falling into the special relationship category.
  - (b) of the number of persons approved as GEP's only 20% to 25% actually become residents.
  - (c) an increase in tourism numbers would justify the increase in population
  - (d) a population of 3,000 person should not adversely affect our unique

environment and lifestyle, both of which must be preserved.

(e) that increase in population be monitored in each year to assess any impact on the environment.

2. As a part alternative to 1, Norfolk Island encourage up to 100 families of wealth to reside on Norfolk Island as residents, and adopting a similar policy as to what, I understand, is adopted in New Zealand but applying the following criteria:-

(a) that each family or couple contribute \$2 million to a fund administered by the Commonwealth of Australia and for the benefit of Norfolk Island.

The fund would therefore be \$200 million and would be used to obtain a spread of investments hopefully returning approximately 7.5%

(b) The contribution to the fund would be interest free for the first three years, allowing some \$45 million to be amassed for the benefit of the Island.

(c) After 3 years the Fund would pay interest on the \$2 million at the rate of 5% pa, and which would be subject to tax. This should leave the Fund with a net income of approximately \$50,000 per annum per contributor ie \$5 million.

(d) There be a 5 year moratorium on repayment of contributions to the fund, the exceptions being death or persons having to leave the Island for health reasons.

Comment:

- (a) The New Zealand policy is attracting people of wealth, seeking a different environment and safe from world tensions including the threat of terrorism. In my view, Norfolk Island with its climate, beauty and easy life style has all the attributes necessary to attract residents of this type.
- (b) More likely than not, persons seeking residency would be of a mature age and would not necessarily bring with them dependents. This would impose less stress on the present infrastructure eg schooling. It could impose an extra demand on health services, but this would be funded by the additional income to the Island.
- (c) My suggestion is that a mixture of Recommendations 1 and 2 be adopted. Recommendation 1 without the implementation of Recommendation 2 could have a short term negative effect on the economy, despite its long term benefit.
- (d) Considerable care would need to be excised as to the suitability of persons seeking residency under Recommendation 2. One would need to examine the source of their wealth, and their family background. Ethnic origins should be ignored.

Recommendation 3

That Norfolk Island adopt a personal income tax system somewhat similar to Australia and on the following terms and conditions:-

- (a) that the tax free threshold be significantly higher than Australia, say \$10,000 to offset high living costs, which would be otherwise covered by a Zone allowance.
- (b) That the tax rate be progressive, but have a top marginal rate not exceeding 40%.
- (c) That the tax be administered by the Australian Tax Office, but exclusively for the benefit of Norfolk Island and not be integrated into the Australian Tax System.
- (d) That all businesses on Norfolk Island including banks and other Australian based enterprises be subject to tax on Norfolk Island but receive a deduction for any tax so paid, against Australian income.

#### Recommendation 4

That rates not be imposed on land, but with the possible exception of commercial properties.

#### Recommendation 5

That in lieu of rates, Land Tax be payable on land on Norfolk Island but with the usual exemption as to primary production AND a further exemption for land continuously held by Pitcairn descendants.

#### Recommendation 6

That capital gains tax be introduced but that it differ from the Australian regime in the following respects:

- (a) the rate of tax not be referable to income in the year it is levied, but be at a flat rate eg 20%
- (b) the capital gain cannot be offset against past or present trading losses.
- (c) The usual exemption as to place of residence should apply.
- (d) The base period be retrospective to 1 July 2003.
- (e) Non Norfolk Island assets be excluded

**Comment:**

I believe that some speculation in properties does take place on Norfolk Island and with consequent profits on sale, flowing offshore.

There is a need to exclude non Norfolk Island assets so that persons of wealth would not be discouraged from taking up residence on Norfolk Island

Recommendation 7

That consideration be given to privatizing the Liquor Bond and possibly Telecom. Experience in Australia and New Zealand suggests that private enterprise is more effective.

#### Recommendation 8

That customs duty be retained at its present level.

#### Recommendation 9

That the Accommodation Levy be removed. This, in effect, is a cold bed tax and is inequitable, particularly so when accommodation units presently, on average, have an occupation of less than 50%. It has been stated that this fee is passed on to tourists. In fact, this is not so. Accommodation unit holders are required to advise wholesalers in September of the preceeding year, occupation rates for the period commencing 1 April in the subsequent year. The occupation and vacancy factors for the subsequent year cannot be accurately forecast. This means that a large part of the fee is covered by owners.

The liability to pay income tax on profits is a much fairer way of determining the appropriate contribution by the accommodation sector.

#### Recommendation 10



That the possibility of establishing a Technology Park on Norfolk Island with an emphasis on IT technology be explored. The intent being to encourage non Australian companies to establish a base on the Island.

Comment

A small technology park of say 3 hectares could be established on Norfolk Island. If we are to establish our own taxation system, there will be a requirement to amend the Income Tax Assessment Act 1936 and possibly the 1997 Act also.

I am aware that the Australian Treasury has concerns that Norfolk Island not become a "Tax haven" as it had been in the past and the present, somewhat draconian provisions ensure that this will not be so.

I see no reason why a non Australian overseas company should not be allowed to establish a business on Norfolk Island and receive some initial tax concessions as this would not affect Australian revenue.

At present, many children on Norfolk Island obtain tertiary education in Australia, but have to remain in Australia in order to exploit qualifications gained. A technology park may reduce some of this imbalance.

The establishment of a Technology Park would also be consistent with the increase in population I have suggested.

Recommendation 11

That there be an independent investigation of the Administration of Norfolk Island and dependent upon such review, consideration be given to the appointment of an Administrator for whatever period of time is necessary.

Comment

There appears to be an undue proportion of the work force employed by the Administration and it equates to over 16% of the workforce. Further, the workforce seems to predominately be persons of Island origin and who may lack necessary qualifications.

Recommendation 12

That the Norfolk Island Act be reviewed.

Comment

Some 26 years have now passed since the coming into operation of the Act. There have been substantial changes to the economy, life has become more sophisticated.

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30 September 2005

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1. Taxation Options for Norfolk Island	pp3 and 5
2. ibid	p4
3. Grants Commission Report 1997	p34
4. Taxation Options for Norfolk Island	p5
5. ibid	p6
6. ibid	p6
7. ibid	pp12-14
8. ibid	p15
9. Norfolk Island Annual Report	p67
10. Norfolk Island Budget Paper	pp2-4
11. Grants Commission 1997 Report	p32
12. Taxation Options for Norfolk Island	p7
13. Grants Commission Report 1997	p35
14. NIGTB Statistics	
15. Harrison Grierson Consultants Ltd Report 1985	p27
16. Harrison Grierson Consultants Ltd Report 1985	p23