Northern Territory Supplementary Submission on Remote Area Tax Concessions and Payments Draft Report

November 2019

NORTHERN TERRITORY GOVERNMENT

Northern Territory Supplementary Submission

On 10 October 2019, the Northern Territory made a submission to the Productivity Commission (PC) in response to its Draft Report on Remote Area Tax Concessions and Payments (the Draft Report). This paper supports the Territory's initial submission and expands on three main issues:

1. cost of living data and analysis for Darwin
2. the proposed remote area geographical classification
3. proposed fringe benefit tax treatment.

1 Cost of Living in Darwin

The Northern Territory recommends that:

- the higher costs of living in Darwin be recognised, and taken into account when making recommendations to changes to remote area tax concessions and payments.

The Northern Territory contends the cost of living in Darwin is higher than other capital cities and other regional northern cities, and offers additional information that responds to the PC's finding that "the cost of living in Darwin is broadly comparable with that of other Australian capital cities" (Draft Report, p. 284).

Cost of living pressures are an ongoing concern for all Australian households. Unfortunately though, there are limited datasets that track price movements by capital cities and regions over time. Datasets tend to relate to expenditure rather than prices so there is also an element of household preferences in term of the goods and services that are included in a 'basket'. Price indices tend to relate to a standard basket of goods, but report price movements, rather than prices themselves, and so are of limited use in assessing the actual cost of living in a location.

That said, any analysis requires data, and the following analysis uses household expenditure on housing-related costs and food as proxies for broader prices in Darwin, the other capital cities, and other regional centres that the ABS Remoteness Structure classifies as Outer Regional. Housing and food are major non-discretionary household expenditures which typically account for over one-third of weekly household expenditure. Consistently higher costs for these non-discretionary items can impact the attractiveness of a destination as a place to live.

The cost of housing is higher in Darwin than most Australian capital cities

The PC notes that housing costs in Darwin are volatile. The Territory acknowledges this, and notes that the reporting period in Figure B.11 (p.286) includes the period when rental and mortgage costs were high as a result of the Ichthys liquefied natural gas project. Similarly, average incomes were significantly higher during this period – also a result of the Ichthys project. Figure B.11 also shows that while the housing expenditure gap between Darwin and the rest of the capital cities does vary over time, it is consistently more expensive to rent in Darwin, and that mortgages are more expensive in Darwin the majority of the time. Even at the lowest point on Figure B.11, the average renter in Darwin is paying over $500 per year extra than the median renter in Australia's capital cities.

A similar comparison using the ABS's household expenditure survey also consistently shows that Darwin is the most expensive capital city, in terms of both housing and overall expenditure, as shown in Figure 1.

Figure 1: Darwin weekly household expenditure minus eight capital cities weekly household expenditure – total, and housing costs only

Source: ABS Household Expenditure Survey

The cost of living is higher in Darwin than in other Outer Regional areas

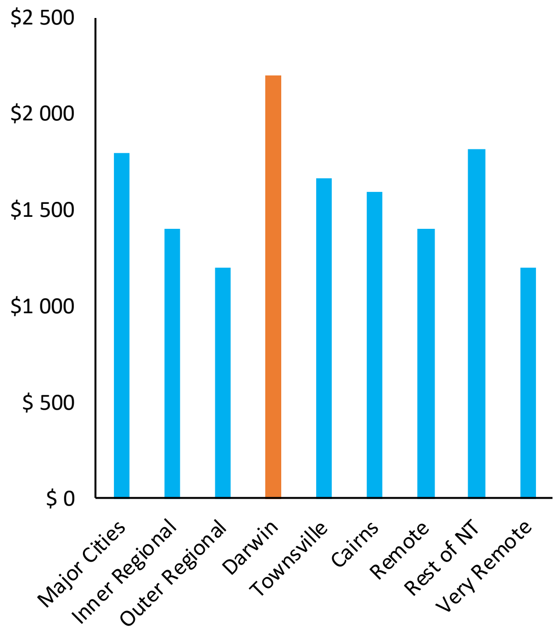
In the Draft Report, charts B.4 and B.5 (p. 277) indicate that housing costs (rent and mortgage payments) decline with increasing remoteness. While this may be correct for each remoteness classification in aggregate, households within a remoteness classification category are not homogenous. The Territory suggests there is significant variation between areas within the same remoteness classification, and this heterogeneity must be taken into consideration when developing policy options and/or recommendations regarding the zone tax offset and remote area allowance.

Figures 2 and 3 use the PC's charts B.4 and B.5 as a base, and overlays additional Census 2016 data to show the risk of treating each remoteness classification as a homogenous grouping. For example, nationally the median Outer Regional weekly rent was $225-$249 in 2016, yet in the Darwin Outer Regional area it was $420. Taking the midpoint of the range would make the national median Outer Regional rent $237, and mean that Darwin's median rent was $183 per week more than the national median, or 77 per cent higher. This equates to over $9500 a year of additional expenditure on rent in Darwin, relative to the national Outer Regional median. In Cairns and Townsville the median rent was $280 per week, still $43 more than the Outer Regional median (18 per cent) per week, or $2250 per annum. These are not insignificant amounts, and these factors should be taken into consideration when developing recommendations, and ensuring the use of medians or averages does not unduly distort the analysis findings.

It is a similar story with median monthly mortgage repayments, where the national midpoint median Outer Regional mortgage repayment in 2016 was $1300 per month, while it was $2200 per month in Darwin – an additional $900 per month (69 per cent) or $10 800 per annum. The median monthly mortgage repayment was $1668 in Townsville and $1597 in Cairns.

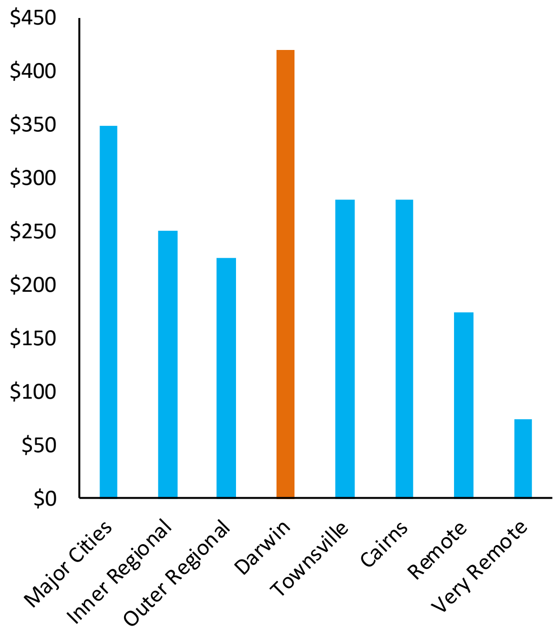
This point is highlighted in Figure B.11 of the Draft Report (p. 288). Notwithstanding that strong housing demand in the 2013-14 and 2015-16 periods drove rent and property prices up, the other time periods – in what could be called more 'normal' markets – consistently report higher rents and mortgage payments. That is, over the economic and property market cycles Darwin tends to have higher median weekly rents, and typically has higher median mortgage repayments.

Figure 2: Median mortgage costs by remoteness



Source: Productivity Commission, ABS Census 2016

Figure 3: Median rental costs by remoteness



Source: Productivity Commission, ABS Census 2016

The Draft Report notes that Darwin renters tend to commit a smaller proportion of their income on rent. It should be noted the ABS data the PC refers to does not refer to renters, but to households, and there are demographic and labour force characteristics that will contribute to 'the average' Darwin household spending a smaller proportion of gross household income on rent. The Northern Territory (and Darwin) has a young age profile relative to the rest of Australia, the highest labour force participation rate in Australia, and typically the lowest unemployment rate in Australia. Many people move to the Northern Territory temporarily to work, and the population 'churn' is significant, with up to eight per cent of the population leaving each year. The ABS reports (ABS Cat. No. 4130.0) that the average Darwin household has 2.9 residents (compared with 2.6 persons for the capital cities) and that 86.6 per cent of households have at least one working person living there (compared with 76.2 per cent for the capital cities). Additionally, the average Darwin dwelling has 3.1 bedrooms compared with 3.2 bedrooms for the capital cities.

That is, a number of factors contribute to relatively high weekly household income in Darwin, and it is not surprising that, on average, Darwin households spend a lesser proportion of their income on rent compared with other capital and regional cities. These factors include a younger demographic, larger households, more group households (ABS Census 2006, 2011, 2016), and more working persons per household.

The PC also suggests that higher average household income for renters in Darwin may translate to higher willingness to pay. This may be true, but it is also true that it costs more to build a dwelling in Darwin than in other capital cities. Notwithstanding the significance of supply and demand factors in determining prices at any particular point in time, data from a range of sources suggests that construction costs will be 10-35 per cent higher in Darwin than in Sydney[1]. This reflects different building codes and higher transport and building costs. Assuming that investors in Darwin property

[1] BMT Quantity Surveyors, 2019, Average Building Costs in Australia. https://www.bmtqs.com.au/construction-cost-table
Rider Levett Bucknall, 2017, Riders Digest Darwin. hnttps://s28259.pcdn.co/wp-content/uploads/2017/02/download.pdf

expect a ‘normal’ rate of return on their investment, this will translate to Darwin having higher rent than locations where these costs are lower.

In addition to housing, the Territory contends that the cost of a standard basket of goods in Darwin, and the Territory more broadly, is more expensive than in similarly sized centres in other jurisdictions. As discussed in the Territory’s first submission to this Inquiry, the grocery price survey undertaken by the Department of Treasury and Finance consistently reported that the cost of a standard basket of grocery items was five to ten per cent more expensive in Darwin than in Cairns. The most recent *Index of Retail Prices in Queensland Regional Centres* reports that grocery items in Cairns were 13 per cent higher than in Brisbane in 2015. By extrapolation, this suggests the cost of a standard basket of goods is around 21 per cent more expensive in Darwin than it is in Brisbane. This is broadly consistent with NATSEM’s reporting that in December 2011 the cost of a basket of food items was 14 per cent higher in Darwin than in Brisbane.

Areas within the same remoteness classification are not all the same

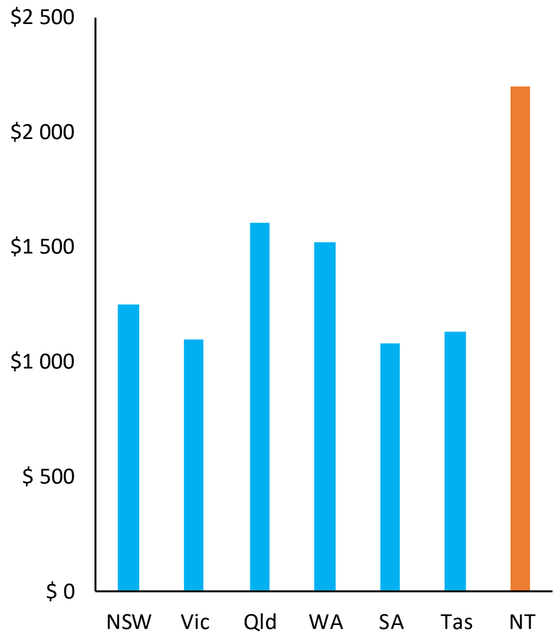
Darwin is the only capital city that the ABS Remoteness Structure classifies as Outer Regional. With the exception of Hobart, which is classified as Inner Regional, all other capital cities are Major Cities. Although classified a capital city, Darwin’s population is less than that of Townsville and Cairns, and slightly larger than Mackay’s. Implicitly the PC’s Draft Report suggests that each of these regional centres is essentially the same based on each being classified by the ABS as Outer Regional. As discussed earlier, the Territory contends the ABS remoteness structure is not fit for purpose for the terms of the PC’s inquiry as the ABS Remoteness Structure is based on access to services, not the cost to access services. While access to services may be useful as an indicator of remoteness, it says nothing about the costs. The Territory contends the cost of goods and services is considerably higher in Darwin relative to other Outer Regional areas and that using the ABS Remoteness Structure to determine eligibility for specific benefits does not adequately acknowledge this reality.

That is, while it may be convenient to use an off the shelf remoteness structure – such as the ABS Remoteness Structure – it is critical that it is fit for purpose for the task at hand. It is the Territory’s position that all areas of the Northern Territory, including Darwin, are sufficiently atypical to warrant that the Northern Territory – in its entirety – is recognised as being in scope to receive any remote area tax concessions and payments.

Census 2016 data in Figures 4 and 5 report that mortgage repayments and rents in Darwin (Darwin is the only Outer Region in the Territory) are substantially higher than Outer Regional areas in other jurisdictions. In a northern context, this is supported by rental data for Darwin, Mackay, Townsville and Cairns which report that for a three bedroom house and two bedroom unit, Darwin is consistently more expensive (see Figure 6).

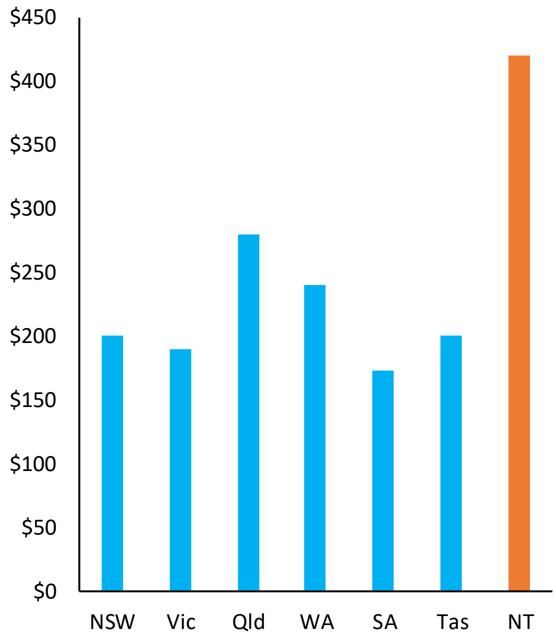
The ABS Household Expenditure Survey also reports that the proportion of Darwin household expenditure that is allocated to housing is higher than in other capital cities (see Figure 7). In the latest survey Darwin reported both the highest dollar value in expenditure for housing, and the greatest proportion of household expenditure going to housing. That is, the Darwin region is not only expensive relative to other Outer Regional areas, it is also expensive compared with other Australian capital cities.

Figure 4: Median mortgage repayments for areas classed as Outer Regional



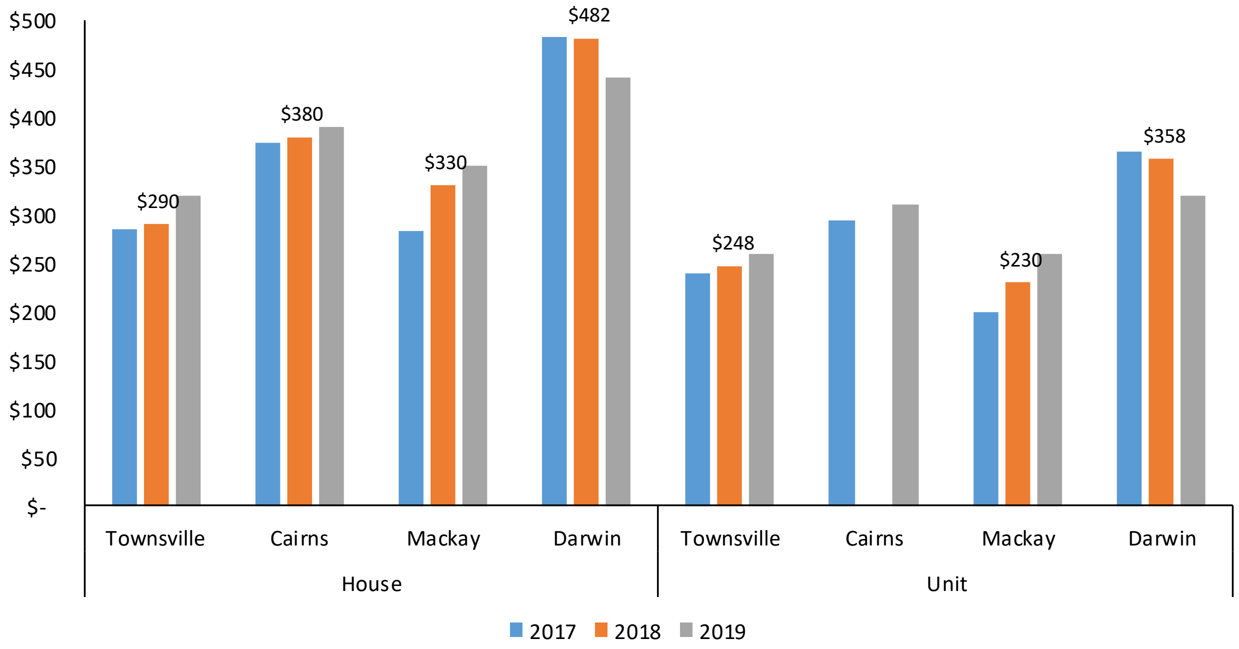
Source: ABS Census 2016

Figure 5: Median rental payments for areas classed as Outer Regional



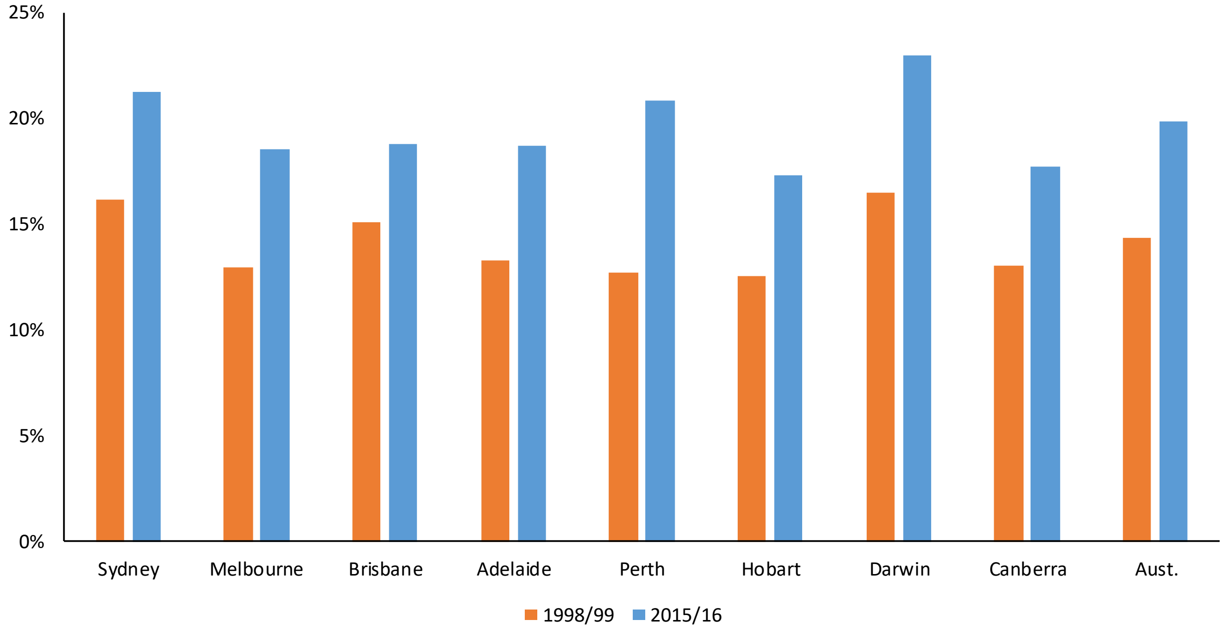
Source: ABS Census 2016

Figure 6: Median weekly rent for a 3 bedroom house and a 2 bedroom unit



Source: Queensland Residential Tenancies Authority, Real Estate Institute of the Northern Territory

Figure 7: Proportion of household expenditure that goes towards housing



Source: ABS Household Expenditure Survey, 1998-99 and 2015-16

The Draft Report suggests that part of the reason for the higher cost of housing in the Territory is consumer preferences leading to more households opting for more expensive housing. However, CommSec's *Home Size Trends* report that in 2017-18 the average size of new houses in the Territory was the smallest in Australia, with high construction costs likely to be a factor contributing to this outcome.

Higher incomes do not offset the high cost of living for all

The Draft Report suggests that Darwin's higher than average incomes offsets the higher than average cost of living. It is acknowledged that incomes in the Territory for people engaged in the workforce tend to be higher than national averages across a broad range of industries and occupations. The Territory contends though that this has always been the case – including when the ZTO was originally introduced – and should have little bearing on the PC's recommendations in the absence of any data to suggest that above average incomes is a recent phenomenon. It is reasonable to argue the Territory's economy has been, and still is, relatively heavily weighted towards agriculture, mining and manufacturing activities, and that these highly productive industries tend to pay above average wages, and individuals tend to work above average hours. On this basis, what does the PC consider has changed since the time the ZTO was initially introduced to warrant reconsidering its merit?

As the PC notes, the issue of cost of living is especially pertinent for people receiving the RAA as people living on income support payments, or who are earning award level wages, have their incomes set at a national level that does not consider variations in the cost of living between urban, regional and remote areas. In Darwin, higher than average living costs have the greatest impact on people on low and fixed incomes. It is a well-known that people have a high propensity to leave the Territory on retirement, with the cost of living being a key factor in that decision[2]. Removing support payments for retirees and other low income earners will only exacerbated this trend.

[2] Unpublished research. Dyrting S (2019). We're Still Here! Territory seniors population trends and futures. Northern Institute, Charles Darwin University.

Furthermore, the Draft Report mentions that recent economic data for Darwin is distorted by the Ichthys LNG project, particularly in relation to wages and housing costs. However the ABS, in its estimates of personal income 2011-2016, showed that this increase was largely confined to machinery operators and drivers, and technicians and trades worker, with strong increases in income seen in some years for labourers. These increases were reported most strongly in the Darwin City and Litchfield areas, which were the main residences of newly-arrived workers on the Ichthys project.

2 The Proposed Remote Area Geographical Classification

The Northern Territory recommends that:

- a flexible approach to applying the ABS Remoteness Structure for the RAA and ZTO be adopted which includes certain Outer Regional zones within the scope for eligibility if cost and isolation factors warrant their inclusion
- Darwin should remain in scope for all remote area tax concessions and payments given evidence of higher costs of living and significant isolation, relative to other regional centres considered equivalent in terms of remoteness
- the PC liaise with relevant Commonwealth and NT Government agencies to clarify the extent to which RAA recipients residing in remote areas use Darwin as a postal address prior to finalising its report.

The PC's draft recommendation for the ZTO is that it be repealed. The Draft Report then goes on to suggest that, if it were to be retained, only individuals living in Very Remote zones should be eligible to receive it (p. 152). For the RAA, the PC recommends that only individuals living in Very Remote and Remote zones should be eligible. The Draft Report suggests this would exclude around 25 000 current RAA recipients identified as living in Darwin.

The Northern Territory is strongly of the view that the ZTO should be retained and that all regions of the Territory should be in scope for the RAA. Revising the boundaries for these incentives to reflect contemporary definitions of remoteness is reasonable, however it is important that an appropriate classification framework is adopted.

The Territory argues the ABS Remoteness Structure has many characteristics that make it a suitable classification structure for most regions, and that there is simplicity in adopting an off-the-shelf remoteness index such as the ABS Remoteness Structure. However, it is critical that any remoteness structure is also fit-for-purpose. The ABS Remoteness Structure does not consider factors such as cost and isolation, and recognising the economic and social impacts of these two factors are key objectives of the ZTO and RAA.

If the PC proposes to use the ABS Remoteness Structure as the basis for any recommendations, the Territory contends that the PC should consider a flexible model, whereby certain Outer Regional zones could be in the scope for eligibility of remote area tax concessions and payments if costs and isolation factors warrant their inclusion.

The Territory is firmly of the view that Darwin and the Northern Territory are atypical of a 'standard' Outer Regional, Remote or Very Remote context. A small Aboriginal community cannot be compared with a small outback town and, similarly, Darwin cannot be compared – in economic or social contexts – with Cairns or Townsville. As previously noted, across a broad range of measures, the cost of living is higher in Darwin and the Northern Territory.

The Territory maintains that Darwin should remain in scope for all remote area tax concessions and payments given it faces unique circumstances compared with other regional centres. Darwin is a small, expensive, very remote capital city. Any map will highlight Darwin's geographic isolation. It could be argued that Perth is equally isolated, but it has a significantly larger population (2.15 million residents is 15 times larger than Darwin at 140 000) and far greater amenity in terms of the number and choice of service providers, access to services and connectivity to the rest of Australia and the world. Darwin does not have access to the full suite of service providers across a broad range of industries, particularly medical specialties and education, professional and entertainment services.

The Territory contends that removing Darwin from eligibility for the RAA could further entrench the extreme disadvantage faced by people living in the most remote areas of Australia and the Northern Territory. The Draft Report suggests that defining Outer Regional areas as out of scope for the RAA would impact around 25 000 Darwin residents. The majority of these recipients are on Newstart, the age pension, disability support pension and parenting payments. The Territory contends that the high cost of living in Darwin – detailed in the previous section – has a greater impact on the welfare of households on low, fixed incomes compared with the 'average' household.

Removing Darwin from the scope of the RAA would only serve to increase the level of disadvantage experienced by these households, purely on the basis that they are in an Outer Regional area, and on the basis that all Outer Regional areas are the same.

Given these issues, the Territory strongly recommends that the PC reconsiders how it applies remoteness classifications, and adopts changes that retains Darwin within the scope of eligibility for all remote area concessions and payments.

3 Proposed Fringe Benefit Tax Treatment

The Northern Territory recommends that:

- the current exemption on employer provided housing is retained, noting there are genuine operational requirements to provide housing for the provision of public services in the Territory
- the PC acknowledge the significant new operating and compliance costs associated with moving to a partial concession for employer provided housing, and that these additional costs may impact service provision
- should the PC retain its draft recommendation to move to a partial concession, it should recommend that the Australian Tax Office provide additional guidance on acceptable methodologies for valuing market rent for properties where there are thin or no markets
- all FBT remote area concessions remain non-reportable
- Darwin is considered remote for the purpose of FBT remote area concessions, and any changes to FBT remoteness boundaries should remain stable for significant periods of time.

The Northern Territory maintains that the current exemption on employer provided housing should be retained, particularly for the provision of public services as there is a genuine operational requirement for the provision of housing. The Northern Territory Government currently provides over 2200 dwellings in regional and remote areas to support the delivery of essential public services. The PC's draft recommendations, if implemented, will result in substantial new operating and compliance costs for the delivery of these essential public services.

The PC's draft recommendation that the housing exemption be removed and replaced with a partial concession will also require valuations of market rent which has not historically been required. The absence of functioning rental and property markets in many regions of the Territory is a significant issue, and creates practical issues regarding how to realistically and accurately estimate rent. Costs associated with valuations could be significant, particularly where external expertise is required to undertake and review valuations. These compliance costs are likely to be significant as valuation firms would be required to travel vast distances to geographically dispersed communities and population centres.

In the Draft Report the PC acknowledges the challenges of valuing market rent for some properties, but states that such instances are likely to be rare (p. 240). The Territory is of the view that such circumstances are more common than estimated by the PC, given a large proportion of the Territory's housing stock is in regional and remote communities, many on land held under the unique tenure arrangements of the *Aboriginal Land Rights (Northern Territory) Act 1976 (Cwth)*.

Clear guidance notes would need to be developed to price housing, notably in Aboriginal communities. Without this additional detail, implementing the draft recommendation will result in substantial uncertainty for employers and employees. If the PC maintains its draft recommendation it should also recommend that the Australian Tax Office provides additional guidance on acceptable methodologies for valuing market rents.

If the exemption was to be replaced with a concession it would necessitate significant investment in new internal systems and hardware to facilitate FBT reporting. Administratively this will complex. For example, reporting of police officer postings would be complex due to both the significant number of police officers posted and the high mobility of police officers due to the trend toward shorter remote tenures to facilitate better work life balance. Managing and accurately monitoring, reconciling and reporting the movement of officers via several different administration systems will be complex. That is, upfront and ongoing FBT compliance costs would be significant, and the PC must consider the net impact of any changes to the current exemption in making its final recommendations.

If the PC's recommendations are implemented, the costs to deliver essential public services such as law enforcement, health and education will increase substantially and immediately. Given employer provided housing is often provided to employees as set by relevant awards and industrial agreements, it is likely the new FBT liability would need to be met by government. The Territory contends that the option of factoring any additional costs into employee salaries would be administratively complex to implement on a case-by-case basis for a highly transient workforce. It would also incur potentially significant superannuation liabilities for the Territory, and would exacerbate the already significant challenges the faced in attracting skilled staff to regional and remote locations.

The FBT liability for the Territory, if the exemption is removed and replaced with a concession, will likely be in the tens of millions of dollars, and it is unclear whether current levels of service provision, particularly in remote areas, could be maintained.

The remote area concessions should remain as excluded (non-reportable) benefits. There are likely to be substantial new compliance costs to employers to track benefits per employee if the concessions were made to be reportable. Changes would also adversely impact employees as it may result in additional means tested liabilities (such as the Medicare Levy Surcharge).

In terms of the FBT remoteness areas, the Draft Report does not make any firm recommendations but invites feedback on a range of options to update the boundaries for FBT remote area concessions. The PC leans towards adopting a minimalist approach, involving updating the list of eligible areas in line with contemporary population data – which would result in the exclusion of Darwin from eligibility. For any options, the Territory is of the firm view that Darwin should be treated as a remote area for the purposes of FBT remote area concessions, in line with discussion in the previous section. Additionally, the FBT remoteness areas should be stable for a significant period of time (for example 20 years or more) to ensure certainty for businesses, not-for-profits and governments.