Northern Territory Submission to the Productivity Commission on Remote Area Tax Concessions and Payments

October 2019

NORTHERN TERRITORY GOVERNMENT

Northern Territory Submission

This submission outlines the Northern Territory's positions on the draft findings and recommendations of the Productivity Commission's (PC's) draft report on Remote Area Tax Concessions and Payments (Draft Report).

Despite the PC's draft findings and recommendations, the Territory does not stray from its firm belief that the key policy objectives of the zone tax offset (ZTO) should be to:

- promote regional economic development through population growth and by incentivising labour and capital to locate to areas where there are identified hardship issues and cost disadvantages
- compensate people in regional and remote areas for the disadvantages of geographic isolation, high costs of living and harsh climates not experienced by residents in other regions
- in the current context – and aligned with the Commonwealth's *Planning for Australia's Future Population* strategy – incentivise people to move to regional and remote areas to reduce population pressures in Australia's major east coast cities.

For the Regional Area Allowance (RAA) the Territory considers the policy objective to be equity, and for the Fringe Benefits Tax Remote Area Concessions to be regional economic development.

The Territory strongly objects to the PC's draft recommendations to abolish or substantially diminish the concessions and payments available to individuals and businesses in regional and remote areas. In the absence of any compensating policy initiatives, if the PC's draft recommendations are adopted, the disadvantage faced by those individuals and businesses living and operating in regional and remote areas will be further entrenched, and would be inconsistent with initiatives across different levels of government to develop the north for the benefit of all Australians.

The Northern Territory considers that incentivising regional development is a relevant justification to retain and increase remote concessions. Investments in regional and remote areas can have benefits in lifting Australia's economic output and productivity and enhancing national security. The Commonwealth's 2015 *Our North, Our Future* White Paper highlighted the importance of northern Australia to Australia's future prosperity and security. Northern Australia contributed 10.7 per cent ($187 billion) of Australia's GDP in 2016-17 and has the potential for significant growth based on abundant natural resources and proximity to key trading markets. To unlock this potential requires access to labour (preferably resident rather than fly-in fly-out) and capital, and policy initiatives that support sustainable jobs and population growth.

From a national security perspective the Territory is strategically positioned as a regional hub for defence, border protection, and humanitarian assistance, interoperability training and ensuring critical trade routes remain open. Supporting these activities requires a long term commitment to develop the infrastructure (both 'soft' and 'hard') to create sustainable communities, and this can be encouraged through targeted incentives to attract labour and capital.

The PC acknowledges that adopting the draft recommendations will have economic and social impacts. In its submission, and in discussions with the PC, the Territory strongly advocated for the PC to investigate how regional and remote areas would have been impacted in the absence of remote area concessions and payments (e.g. what would population, economic and employment growth and distribution otherwise be) and conversely, how these regions may have developed had the ZTO and RAA been indexed to maintain the original policy intent. The Territory strongly recommends that this important analysis is undertaken and reported before the PC finalises its report. The Territory remains concerned about the impacts, at the margin, of the removal of, or reduction to, any of the current suite of remote area incentives.

Alternative measures of support for regional and remote areas that are more targeted, and which could be cost neutral to the Commonwealth, would be highly preferred to the PC's recommendation to abolish ZTO and significantly reduce fringe benefits tax (FBT) remote allowance.

The Zone Tax Offset

Productivity Commission Draft Findings

- The remoteness areas published by the Australian Bureau of Statistics (ABS) would be a more suitable basis for defining zone tax offset boundaries. They are widely used, and are updated after each census using a transparent and well-understood methodology.
- The zone tax offset (ZTO) is flawed and outdated.
  - Eligibility has not kept up with change in remote Australia, and nearly half of ZTO claimants live in large coastal regional centres.
  - Inflation and growth in wages have substantially eroded the value of the ZTO. The economic and employment impacts of the concession are likely to be small, and there is no evidence to suggest that the ZTO currently affects where people choose to live and work.
- There is no compelling justification for the ZTO in contemporary Australia. Higher living costs or other aspects of life in remote areas do not warrant compensation from other taxpayers. Australians face a range of advantages and disadvantages in where they live, and will typically locate in the area they value most highly. Communities likewise grow or shrink based on their advantages and disadvantages. Attempts by governments to artificially create an advantage for a remote community, or attract people to live in high cost areas through tax concessions, typically result in net losses to the broader Australian community.
- There is no case for the government to provide company tax offsets specifically to businesses in remote areas. Governments should focus on creating successful business environments regardless of their location.

Productivity Commission Draft Recommendations

- The Australian Government should abolish the zone tax offset and the overseas forces tax offset.

Northern Territory Recommendations

- The ZTO should be retained and its value increased by an amount sufficient that it will impact relocation decisions at the margins, and marketed to increase knowledge of the incentive.
- Acknowledging that people reside in areas they value most highly supports the use of remote area tax concessions and allowances to incentivise decision making and encourages people to relocate to areas they may not otherwise consider. Many of these areas experience labour shortages and difficulties recruiting. And while it may be true that ‘long-term’ Australians (or multi-generational Australian families) have strong ties to particular locations, this is less likely to be the case for new immigrants to Australia.
- The updated ZTO values should be indexed annually, using a relevant cost of living indicator, such that it retains its real value.
- Further changes are required to update the ZTO’s outdated eligibility boundaries in line with the ABS remoteness area classifications, with individuals in “Very Remote”, “Remote” and “Outer Regional” areas in scope to receive the ZTO.
- If the recommendation to abolish the ZTO is retained, that the PC identifies alternative measures of support for regional and remote areas that are more targeted, and which could be cost neutral to the Commonwealth.

The Draft Report recommends that the Commonwealth abolish the ZTO and the overseas forces tax offset on the basis they are ineffective, poorly targeted and that there is no compelling, contemporary justification for them to continue. The Territory strongly objects to this recommendation and related findings.

The ZTO is currently an ineffective instrument. This was not always the case.

The Territory concurs that the ZTO in its current form is unlikely to be an effective policy tool, both for the purposes of compensating for the disadvantages of living in remote areas and to influence regional development, given its significantly eroded value, having not been increased since 1993-94.

However, the effectiveness of the ZTO should not be disregarded on this basis. It is recommended that the PC make a clear distinction between the effectiveness of the ZTO in its current eroded form, and the potential of the ZTO had its real value been retained over time.

The Draft Report acknowledges the data limitations in assessing the impact and effectiveness of the ZTO and primarily relies on "first principles" as the basis for its analysis. However, the modelling that the PC has managed to secure contradicts its position, with evidence that the ZTO, when first introduced, was shown to have a positive impact on population retention in Zone B areas (page 143) and that sufficiently large and targeted financial incentives can be effective relocation policy tools (Box 4.3). The Territory maintains that there is a need for the PC to undertake modelling of the counterfactual scenario to better understand the impact of the concessions in attracting and retaining labour in regional and remote areas, and also in assessing what the impact may have been if they were set (and indexed) at levels equivalent to those when originally introduced.

As such, the PC should reconsider its recommendation to abolish the ZTO pending the results of this modelling and consider the benefits of a revised ZTO with an increased value. Furthermore, given the PC's finding that people outside the ZTO boundaries are generally unaware of the ZTO, the Territory recommends that a revised ZTO be promoted to increase its effectiveness in influencing relocation decisions.

The ZTO boundaries should be updated, with "Outer Regional", "Remote" and "Very Remote" areas in scope

In addition to increasing its value, the Territory considers that revising the current outdated ZTO boundaries in line with the ABS' Remoteness Areas Classifications is a reasonable approach, and that individuals in "Very Remote", "Remote" and "Outer Regional" areas should be in scope. In particular, regional centres should continue to be in scope given they are far from being equivalent to urban areas and major cities in terms of the quality, costs and choice of goods and services available and general amenity.

For example, the Territory's economy is highly cyclical, influenced by major projects. Currently, Darwin is experiencing a declining population (characterised by a highly transient population), high vacancy rates and low staff retention. It is strongly recommended that eligibility for any updated ZTO regions include the ABS "Outer Regional" areas and, at a minimum the "Very Remote" and "Remote" areas that face the most severe hardships should be in scope.

The Territory questions the finding that "the cost of living in Darwin is broadly comparable with that in other Australian capital cities" (page 284). The use of Numbeo as a data source to compare prices of goods and services in different capital cities across Australia is flawed given this data source is crowd sourced, consists of a relatively small sample size and is potentially out of date. The lack of "rigour" of Numbeo is acknowledged in the Draft Report. Also, the capital city cost of living comparison by Phillips et al (2012) is based on an experimental ABS publication which notes significant data gaps and advised that the publication should not be used for policy purposes at such time until the dataset is an official publication.

The PC should detail what it considers to be better alternatives to the ZTO

Notwithstanding these issues, the Draft Report notes that the ZTO, as administered through the tax system, is a broad and blunt instrument and that more targeted interventions would be preferable to achieving regional development policy objectives. The PC's view is that *"(Commonwealth) Government efforts are better directed toward improving the planning and delivery of infrastructure and public services in particular areas, taking local circumstances into account."*

Should the PC's recommendation to abolish the ZTO be maintained, the Territory recommends that the PC provide greater guidance on alternative measures that could be considered to support regional development. This could include targeted support for economic development initiatives and projects (e.g. infrastructure to support the development of significant new industries such as unconventional gas and a ship lift to support a new marine maintenance industry). Alternative measures of support to the Territory which are more targeted, and could be cost neutral to the Commonwealth, would be highly preferred to the PC's recommendation to abolish the ZTO.

The Commonwealth acknowledges it has a key role in regional development

The PC's view that the Commonwealth has a limited role to play in supporting regional development or incentivising relocation decisions is subjective and is not supported in practice. The current Federal Government (and many former administrations) have acknowledged the need for investing in regional development as evidenced through the creation of regional development portfolios and associated policies and initiatives. The fact that successive Commonwealth governments have elected to retain (and occasionally expand and strengthen) the ZTO over the past 74 years is evidence that the ZTO remains a relevant policy priority in contemporary Australia.

More recently, the Commonwealth has signalled that it will support investment to unlock the potential of remote areas through its Developing the North agenda and the National Population Policy, as well as its ongoing commitment to the Northern Australia Infrastructure Facility. These regional development objectives have broad national benefits with the Commonwealth's White Paper highlighting the importance of northern Australia to Australia's future prosperity and security.

From a national output perspective northern Australia contributed 10.7 per cent ($187 billion) of Australia's GDP in 2016-17 and there is potential for significant growth based on abundant natural resources and proximity to key trading markets.

An expanded ZTO would complement efforts to unlock the potential of the north and increase Australia's national competitiveness through ensuring industries have the labour and skills to support economic development.

Remote Area Allowance

Productivity Commission Draft Findings

- Notable characteristics of the profile of remote area allowance recipients include that:
  - most reside in very remote and remote areas of Australia (as defined by the Australian Bureau of Statistics)
  - the majority are located in the Northern Territory, with one in five Northern Territorians over the age of 15 years in receipt of the payment
  - half are located within areas of the highest socio economic disadvantage
  - almost 65 per cent of recipients are Indigenous Australians
  - just over half have been in receipt of an income support payment for over five years.
- There is a rationale for a remote area allowance to address cost of living differences affecting income support recipients in remote Australia.

Productivity Commission Draft Recommendations

- The Australian Government should revise section 14 of the *Social Security Act 1991* (Cth) to align the remote area allowance geographical boundaries with the Australian Bureau of Statistics remoteness classification for *very remote* and *remote* areas.
- The Australian Government should revise payment rates for the remote area allowance (RAA) following the completion of this study. Thereafter, the Department of Social Services should review the RAA periodically. These reviews should be made public and:
  - revise RAA payment rates, taking into account changes in living-cost differentials between remote and non-remote areas
  - report on RAA annual outlays and recipient numbers
  - consider any issues associated with administering the RAA.

Northern Territory Recommendations

- The RAA payment rates should be increased, reviewed periodically and boundaries updated in line with the ABS' Remoteness Categories classifications. Individuals in "Outer Regional" areas should continue to be in scope to receive the RAA as well those in "Very Remote" and "Remote" areas.

The Territory largely supports the Draft Report findings and recommendations pertaining to the RAA with the exception of the PC's view to substantially reducing the geographic scope of eligibility.

Individuals residing in "Outer Regional" areas should be in scope for the RAA

Redrawing the currently outdated RAA geographical boundaries in line with the ABS' Remoteness Areas categories is a reasonable approach. However, individuals in "Outer Regional" areas should continue to be in scope for the RAA. This is consistent with the Territory's position regarding revising the geographical boundaries of eligibility for an updated ZTO, discussed above.

RAA payment rates should be increased and reviewed periodically

The RAA has only been increased twice since its inception and there has been a freeze on its dollar value for almost 20 years. As such, increasing the RAA rates to reflect inflation and the differences in prices between remote and non-remote areas is a reasonable approach. The recommendation to conduct periodic reviews to ensure the RAA continues to provide adequate compensation for recipients is similarly supported. It should be noted that a possible unintended consequence of increasing the RAA would be decreasing the incentive to enter the workforce.

Fringe Benefits Tax Remote Area Concessions

Productivity Commission Draft Findings

- The use and economic effects of FBT remote area concessions vary.
  - The exemption for employer-provided housing (used as a usual place of residence) can provide significant value at the employee level, particularly for higher-income employees, and could cost as much as $430 million per year in forgone FBT revenue. Usage is concentrated in the Pilbara in Western Australia, and the Central Highlands and Bowen Basin in Queensland, and in industries such as mining, agriculture, and public services.
  - The partial concessions on employee-sourced housing are narrowly used. The 50 per cent concession is much less generous than the full exemption on employer-provided housing, and the compliance burdens are higher.
  - Use of other FBT remote area concessions (on residential fuel, meals for primary production employees and holiday transport) is minimal, in part because they provide limited tax savings and are overly complex with high compliance costs.
  - FBT concessions for fly-in fly-out workers, while widely used, are likely to have only a minor influence on decisions to maintain a fly-in fly-out workforce.
- Fringe benefits tax remote area concessions help to address inequities inherent in the FBT regime, but they are not fit for purpose. The current concessions are overly generous and complex, thereby creating other inequities.

Productivity Commission Draft Recommendations

- The PC recommends that FBT remote area concessions for employer-provided housing, and residential fuel, meals and holiday transport provided by employers in remote areas should be reduced, and that the employee-sourced housing concession should be removed.

Northern Territory Recommendations

- The exemption and concessions should be retained or, at a minimum, where there is no alternative private sector housing, the exemption for employer provided housing should be retained for all employers delivering key community services such as health, education, community safety and public administration.

<u>The impacts of the PC's draft recommendations should be modelled</u>

As identified in the introduction to this submission, the Territory strongly advocates that the PC models the impact of its draft FBT-related recommendations on regional and remote conditions to understand the impacts on variables, such as population, economic and employment growth (including distributional impacts) as well as indicators of community wellbeing. The Territory anticipates the impacts by industry and region would vary significantly, and that this analysis could assist to inform policy development and may lead to a more bespoke approach than that which is currently proposed.

<u>Proposed changes are likely to have significant negative implications for remote service delivery</u>

The Territory agrees with the PC that halving the concession for employer-provided housing to be the most significant of its FBT-related draft recommendations, noting that it will impact a few key industry sectors, each of which are significant in the Territory, including the delivery of public services.

The impact of any cost increase on high productivity industries is likely to be more readily absorbed than in less productive industries and public services. For public service delivery, any cost increases would need to be managed within usual budget constraints, and in the context that a large proportion of the housing stock is in regional and remote areas and on Aboriginal land. These areas often have low socio-economic profiles, with relatively low health and education outcomes (i.e. there is a high need for quality public service provision), and a requirement to deliver services in a culturally appropriate way.

The PC reports the first-hand experience of businesses and governments that highlight the importance of this concession in attracting and retaining skilled and other labour, and discounts this experience in making its recommendation on the basis that only a low overall proportion of dwellings in FBT remote areas (about 5 per cent) are employer provided. The Territory contends that this does not adequately consider the impact of this draft recommendation on the delivery of public services in regional and remote areas, and on the social impacts this could have, and that the PC is particularly concerned with economic issues, and less concerned with understanding the personal and social impacts of this draft recommendation.

The PC contends the concessions are overly generous (as they are likely to confer a private benefit) and complex. As the PC notes, the complexity and compliance burden of administering the partial concessions are key factors limiting uptake by entities that are aware of and eligible for these FBT concessions. That is, although the concession is available to an entity, the complexity of accessing the concession means there is no net benefit to warrant the administrative burden.

This appears to be a poor outcome in terms of the concessions meeting their policy objectives. In contrast, the exemption is far easier to administer, notwithstanding that reporting is “insufficiently detailed” as excluded benefits are not reportable. Improving the reporting of FBT exempt concessions could be a first step to better understanding the impact and extent of the exemptions, and it is recommended that in its final report the PC considers making recommendations to improve the accuracy of FBT exemption data as a first step towards understanding the true extent and impact of the concession. Better data would then allow for more accurate information to inform any future tax design considerations.

The PC notes that halving the concession for employer-provided housing will increase the cost to deliver critical public services, such as health; education; community safety; and public administration. These additional costs will have two sources, through both the increased cost to operationally deliver the services as a result of the halving of the concession, and the additional corporate costs associated with increased compliance burden.

The PC asks what impacts this may have on the provision of public services. The Territory currently provides over 2200 dwellings in regional and remote areas to support the delivery of key public services. Many of these dwellings are in Aboriginal communities where there is no private sector housing market, and others are in regional centres with ‘thin’ private sector housing markets. Halving the concession and the associated additional compliance costs will substantially increase the cost to the Northern Territory Government to deliver public services, with costs to also be borne by local governments and the many non-government organisations that operate in the Territory.

In the Territory there is low, but increasing use of fly-in fly-out arrangements for the delivery of public services. For example, even where local, full time positions are on offer in regional and remote locations, an inability to attract skilled labour to relocate can mean positions are ‘split’ between two or more persons who are engaged on a fly-in fly-out basis from urban centres outside of the Territory. This arrangement allows an employer to access the FBT employer-provided housing exemption, but the impact of these types of arrangements on health (and other public service) outcomes is not clear and warrants further investigation.

What is clear though, is that differential FBT tax concession treatment would have negative impacts on regional population growth and skills development and development more generally, and also with respect to the social fabric of these communities. These outcomes are in direct contrast to goals in the Commonwealth’s *Planning for Australia’s Future Population* strategy to incentivise people to move to regional and remote areas to reduce the population pressures in Australia’s major east coast cities, and will not support regional economic development.

The Territory strongly recommends that the PC considers retaining the exemption for employer-provided housing for the delivery of key community services such as health, education, community safety and public administration, including for non-government organisation and private sector service providers, for areas where there is no alternative private sector housing.