Australian Government
Productivity Commission

Remote Area Tax Concessions and Payments

Productivity Commission
Study Report
Overview

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).

Foreword

Tax concessions for remote areas date back to the end of World War II when an income tax concession was introduced in recognition of the high living costs, isolation and uncongenial climate in much of remote Australia.

Australia has evolved considerably since then. Some places that were undeniably remote in 1945 have become urbanised, with good connections to the rest of the country and the world. Over that time, technological and economic developments have cushioned many of the difficulties of living in remote Australia.

This study is a timely review of three longstanding tax concessions and payments targeted to residents and businesses in remote and regional areas: the zone tax offset, the remote area allowance, and the fringe benefits tax remote area concessions. The study examines the operation and effectiveness of the measures, and their role and relevance in contemporary Australia, as part of a broader tax and transfer system.

The Commission has benefited from engaging with residents, business owners and community leaders in remote and regional Australia. We are grateful to everyone who has been involved in this study. We particularly thank those who provided written submissions, met with us, or provided assistance in organising our extensive program of visits around the country.

This study would not have been possible without the assistance of the Australian Taxation Office and the Department of Social Services, which provided timely access to administrative data.

We would also like to express our appreciation to Jane Melanie, who led the study, and the team: Paul Loke, Tom Nankivell, Brent Carney, Matthew Hyde, Daniel McDonald, Bronwyn Fisher, Arseni Matveev, Manpreet Singh, Cathal Leslie and Annika Powers. Our thanks also go to Ralph Lattimore, Henry McMillan, Marco Hatt, Ingrid Ottaway and Pragya Giri for their assistance.

Jonathan Coppel
Presiding Commissioner

Paul Lindwall
Commissioner

February 2020

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The full report is available at www.pc.gov.au

OVERVIEW

Key points

- Remote area tax concessions and payments are outdated, inequitable and poorly designed. They should be rationalised and reconfigured to reflect contemporary Australia.
- Remote Australia has changed considerably since the introduction of the first of these concessions in 1945. Many areas once considered isolated are no longer so, and improvements in technology have reduced the difficulties of life in remote Australia, although to a lesser extent in very remote places.
- About half a million Australians live in remote areas far from cities and regional centres. The tyranny of distance makes living and doing business challenging, with many things taken for granted by most Australians unavailable or difficult to get. Yet for those in remote Australia there is frequently a strong personal or cultural connection to a place and community as well as to the way of life it offers. Others are attracted by job opportunities.
- The zone tax offset (ZTO), remote area allowance (RAA), and fringe benefits tax (FBT) remote area concessions are designed to redress some of the inherent challenges of living in, or to support, parts of regional and remote Australia.
- The ZTO — a small tax concession available to residents of specified areas — is outdated. As it currently operates, it is poorly-targeted, and ineffective as a magnet for remote living.
  - It lacks a compelling contemporary rationale, and should be abolished. In many cases, higher remuneration for jobs in remote Australia compensates workers, at least to some extent, for the disadvantages of remote living.
  - If the ZTO is retained, only those people living in *very remote* areas should be eligible.
- The RAA is a supplementary payment for people on income support in remote areas. It partially compensates for higher living costs. The majority of recipients face socioeconomic disadvantage and barriers to mobility. Being out of the labour market, RAA recipients do not benefit from the remuneration premiums that apply to ZTO recipients.
  - The RAA has a legitimate role — it can serve to partly compensate people on income support for higher living costs and less ready access to services. But it needs a refresh — with boundaries set around *very remote* Australia only and payment rates reviewed.
- FBT concessions for remote areas have dual objectives: equitable tax treatment where employers have operational reasons to provide goods and services to employees; and regional assistance goals.
  - The most compelling argument for these concessions is the former. But current concessions are overly generous and complex, thereby creating other inequities. By virtue of their broad application, they are ineffective in supporting service delivery needs and regional development.
  - The concessions should be redesigned to be more tax neutral. This would reduce the scope for differential tax treatment to distort investment decisions — delivering more efficient outcomes and generating tax revenue that could be used for other priorities.
  - Most significantly, the exemption for employer-provided housing should be changed to a 50 per cent concession (as it was prior to 2000), and provisions allowing employers to claim housing exemptions solely because it is ‘customary’ should be removed.
- In looking at alternative mechanisms to support regions, governments should be cautious of top-down approaches. While there are few one-size-fits-all solutions, harnessing existing capabilities and locational advantages should be at the core of any such strategy.

Overview

As one of the least densely populated countries in the world, large swathes of the Australian continent are ‘remote’: sparsely populated and distant from major cities. Many parts of remote Australia offer their residents a unique lifestyle, or a different set of employment opportunities to other parts of Australia. Living and doing business in remote places, however, can be challenging and demands resilience.

Australian governments at all levels have a long history of supporting people and businesses in remote Australia. As communities have continued to transition over time in response to economic, social and technological changes, there has been continued pressure to help sustain their long-term viability and prosperity.

The nature and scope of this support has evolved — mirroring the evolution of remote Australia itself. Some places that were undeniably remote in 1945 (when tax concessions for ‘isolated areas’ were introduced) have since become highly developed, with connections to the rest of the country and the world. Further, technological and economic developments have cushioned many of the difficulties stemming from distance, isolation, and a harsh climate.

Against this backdrop, the Commission has been asked to review three longstanding tax concessions and payments for residents and businesses in remote and certain regional areas: the zone tax offset (ZTO); the remote area allowance (RAA); and the fringe benefits tax (FBT) remote area concessions. These constitute small and discrete measures that sit within an existing, and much larger, tax and transfer system.

The concessions date back to the end of World War II, when the Australian Government introduced income tax deductions for residents of designated zones in recognition of the hardship that they faced. Governments further expanded the arrangements over the following decades.

- In 1984, the RAA was introduced as a supplementary payment for income support recipients, extending the benefits of the ZTO to non-taxpayers residing in remote Australia.
- In 1986, FBT remote area concessions were introduced to lessen the impact of the then-new FBT. These concessions were subsequently expanded, most notably in 1997 (for primary producers) and 2000 (for other employers), with a change from a 50 per cent FBT concession to a full exemption for employer-provided housing in remote areas.

Apart from a 2015 amendment to the ZTO to exclude fly-in fly-out (FIFO) workers who reside outside the zones, there has been no substantive change to the ZTO and the RAA for more than thirty years. This inertia has kindled concerns that these measures have failed to keep pace with change in remote Australia, and may now be outdated.

The Commission's approach

The Australian Government asked the Commission to assess the effects and policy merits of the three remote area measures, whether they meet their objectives, and the relevance of these objectives in contemporary Australia. It also asked the Commission to make recommendations for their future operation, including the levels of assistance provided, indexation and boundaries.

As required by the *Productivity Commission Act 1998* (Cth), the Commission has taken a community-wide perspective while also considering ways of promoting regional development. This involved taking into account not only the economic and employment effects of the measures at a local level but also their ramifications at a national level in terms of forgone tax revenue, increased government outlays, and displaced economic activity.

The Commission has taken the broad architecture of the tax, expenditure and welfare system as given in assessing the design and desirability of the three measures. In determining whether the measures are warranted, the Commission has considered:

- whether there is a significant market or government distortion impairing economic efficiency (and hence aggregate welfare), or an explicit 'social equity' objective
- whether the benefits of an intervention outweigh its costs, and whether the measure in question is the best available means to address the policy issue.

Community input

As a first step, the Commission sought to understand the demands of life in remote Australia. This involved an extensive program of visits to meet with residents, business owners and community leaders. The Commission received 98 submissions from a wide cross-section of stakeholders before the draft report. Following the release of the draft report, the Commission engaged further with stakeholders across all key affected jurisdictions, and received a further 101 submissions. Most submissions were from people and groups who favoured retaining, extending and increasing the level of support.

The submissions also highlighted the issues remote communities face on a daily basis. Some people keenly felt the absence of the things they believe most Australians take for granted — for example, having access to nearby schools. Others held deep concerns over the social and economic decline in their community, the loss of social fabric, and the prospects of their towns.

In some cases, the challenges raised diverged sharply from one town to the next. Some people questioned the value of a transient FIFO workforce for their communities, while those in 'source' regions saw FIFO as generating beneficial income and employment opportunities for their residents.

In other cases, the same issues resonated with people from opposite ends of the country. One prominent issue was the high cost of living in remote Australia. It was also clear that expectations about the accessibility and quality of services have risen significantly over the years, just as they have elsewhere in Australia.

The Commission also visited communities that were optimistic about their future, typically due to access to a large natural asset base (amenable to mining or tourism) and to a pool of workers with the necessary skills. The Commission came across many individuals with a strong sense of purpose and determination who enjoy living where they do, although some also felt somewhat 'stuck' in remote Australia.

The broader policy context

In undertaking this study, the Commission has considered other government measures designed to provide support for regional and remote Australia — as well as measures that are broader in scope and intent but interact with the tax concessions and payments, such as those responding to the needs of Indigenous communities. An understanding of these broader measures helps put into context the relative importance of the remote area tax concessions and payments for regional and remote Australia.

State and Territory governments, with support from local governments, have primary responsibility for service delivery within their jurisdictions. The measures include: remote area (district) allowances to attract police, teachers and other professionals; support for patients needing to travel long distances to access specialist medical services; and distance education. In addition, initiatives extend to the funding of regional projects — the Western Australian Government's Royalties for Regions program is but one example.

The Australian Government also assists people, businesses and communities in regional and remote areas, including through payments to doctors to work in remote areas, subsidies for the supply of some utility services like telecommunications, assistance for industries prominent in regional and remote areas, specific funds such as the Building Better Regions Fund and significant infrastructure investments (including regional airports). This is on top of Australia's system of horizontal fiscal equalisation, which aims to give each jurisdiction the fiscal capacity to provide a similar level of public services, and notably considers the higher per capita expenditure on service delivery in remote areas.

All governments have extensive involvement in the relief, recovery and reconstruction of communities devastated by natural disasters, such as the recent bushfires. Their responsibilities include building resilience to future natural disasters — through mitigation and prevention strategies — as well as the initial response and recovery from a natural disaster. The crux of this support is that it is targeted to the communities affected, wherever they are located.

In this broader context, the ZTO, the RAA and the FBT concessions are a very small subset of the measures that assist individuals, businesses and communities in regional and remote Australia, and which facilitate their development.

The empirical challenge

A challenge for this study has been the dearth of data. Even where data are available, gauging the effects of the measures is problematic. The value of the ZTO and RAA is small in relation to incomes, making it difficult to disentangle their effects from other factors and to assess their local impacts. Equally, the impacts of the FBT remote area concessions on particular industries are confounded by factors that have a much greater influence on the performance of these industries, such as commodity price cycles in the case of the mining sector.

Given this, the Commission has undertaken several empirical exercises, drawing largely on unpublished data sources, and conducted a survey of the use of FBT remote area concessions in the mining, agricultural and local government administration sectors. This final report has benefited from participants' responses to the information requests in the draft report, which have contributed to narrowing some of the data gaps. Drawing from other data sources, the Commission has also revisited its analysis of wage and cost of living differentials.

Constitutional issues

There has been persistent debate about the constitutionality of remote area tax concessions. Section 51(ii) of the Constitution confers on the Commonwealth the power to make laws with respect to 'taxation; but so as not to discriminate between States or parts of States'. Section 99 further states that 'The Commonwealth shall not, by any law or regulation of … revenue, give preference to one State or any part thereof over another State or any part thereof'. The arrangements, however, have never been directly tested by the High Court.

After seeking the advice of the Attorney-General's Department on the constitutional validity of the ZTO, the Cox Review (1981, p. 5) noted that:

> … there was doubt about the issue and that [the members of the Cox Review] could have no assurance that the provision was constitutionally sound, notwithstanding that the arrangements had been in existence since 1945.

The Commission has also sought and received legal advice and has considered the associated constitutional risk when examining different reform options.

Life in remote Australia

Remote Australia accounts for more than 85 per cent of Australia's landmass but just 2 per cent of Australia's population. It encompasses outback stations, small country towns, outback and coastal Indigenous communities, mining towns, offshore islands — and the vast and barely populated spaces between. The diversity of people, cultures, natural environments and settlements makes it impossible to tell a single story of life in remote Australia.

When income tax concessions were introduced in the mid-1940s, life in remote Australia was often arduous, with less access to the amenities available in cities (figure 1, panel A). These difficulties were particularly acute when compounded by a high cost of living and a harsh climate.

Since then, economic, social and technological change has altered where and how Australians live. Over a long period, the Australian economy has grown from its agrarian (and rural) roots to become a service economy. With a greater share of economic activity and employment now centred in our major cities, regional centres and coastal areas, some previously isolated towns have developed into large, connected economic centres in their own right and are no longer remote (figure 1, panel B). For example, in 1947, Cairns had a population of 16 600 (now 152 700) while Darwin had just 2500 residents (now 134 500). At the same time, improved communication and (air and road) transport infrastructure, more affordable air-conditioning and other advances have helped lessen the difficulties of life in many remote places.

Of course, the tide of economic progress does not lift all boats equally, and nor has the story been one of universal, continuous growth — some places grow steadily, while others experience booms and busts. Accordingly, some remote areas have not benefited from economic development as much as others, and some others have had a declining population.

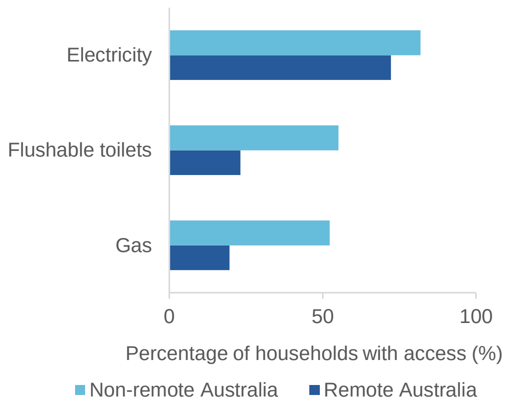
More generally, in much of very remote Australia, the difficulties of remote living have, at best, been only partly overcome; as one former resident of remote Western Australia put it:

> Long hours in cars to get anywhere; high airfares; fuel prices; food prices; costly housing; high insurance costs; liquor restrictions in some of the very remote regions; poor roads that bash their cars to pieces; high education costs of kids having to be sent away to schools; medical services where the Flying Doctor works day and night; lack of entertainment and access to major events such as concerts, grand finals and the like.
>
> Things may have improved from the days of telegraph lines and the weekly mail truck but the difference between city, town and bush remains – and the cyclones, droughts and floods keep coming. (Malcolm Ainsworth, sub. 10, p. 1)

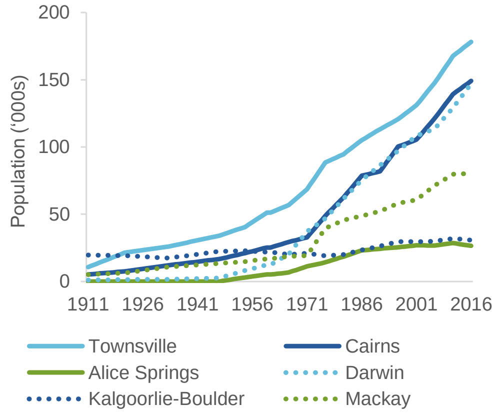
Isolation can make it hard for people in remote areas to attain a comparable standard of living to city residents or to those living in regional towns. Access to key services such as education, healthcare and transport is a major concern, especially for those living in *very remote* areas (as defined by the ABS). The cost of living is generally higher, and businesses face higher costs: for example, in paying higher 'compensating' wages to attract and retain skilled labour.

Figure 1 A snapshot of remote Australia and its evolution

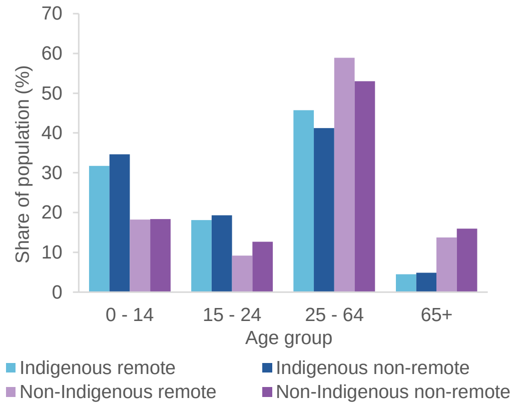
A. In 1947, remote residents had fewer comforts



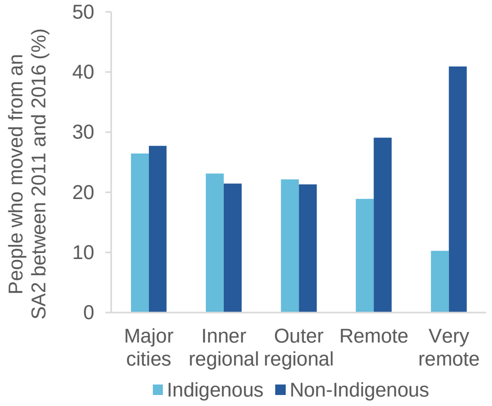
B. Some remote towns have grown into cities, while others have not



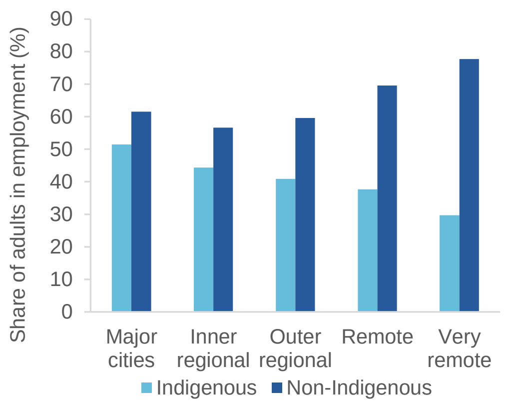
C. Much of the non-Indigenous population are in their prime working years …



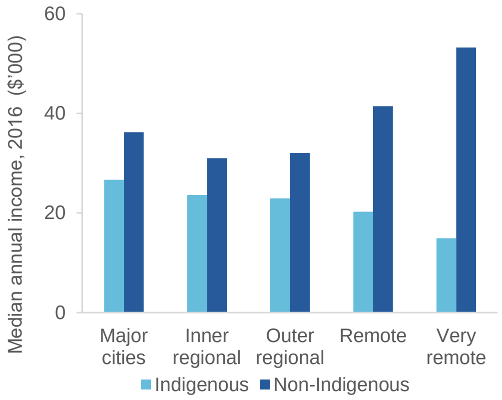
D. … and they are generally more mobile than their Indigenous counterparts



E. There are divergent employment rates across and within areas …



F. … as well as divergent income patterns



In spite of these challenges, many Australians choose to live in remote locations because they have compensating benefits. Some hold a strong cultural or personal attachment to a particular place and the way of life it offers, while others obtain higher remuneration or job opportunities that make living there more attractive. The Commission was also struck by the community spirit in many remote areas, which enhances people's quality of life.

However, other people are less mobile, which affects their ability to seize economic and educational opportunities elsewhere. This contributes to diverging socioeconomic outcomes among those who are mobile and those who are not.

Indigenous Australians, representing about a quarter of remote area residents, are far less likely to have moved in the previous five years than their non-Indigenous counterparts (figure 1, panel D). Further, the patterns of movement are different. Non-Indigenous residents typically move between remote Australia and large urban areas, suggesting that they might be moving temporarily for work purposes. For Indigenous Australians, there is little movement between large urban areas and remote areas, with movement overwhelmingly *within* remote Australia and largely motivated by familial and cultural ties.

There are also marked divergences in income and employment outcomes between Indigenous and non-Indigenous Australians. These differences are particularly stark in *very remote* areas (figure 1, panels E and F).

A closer look at the cost of living

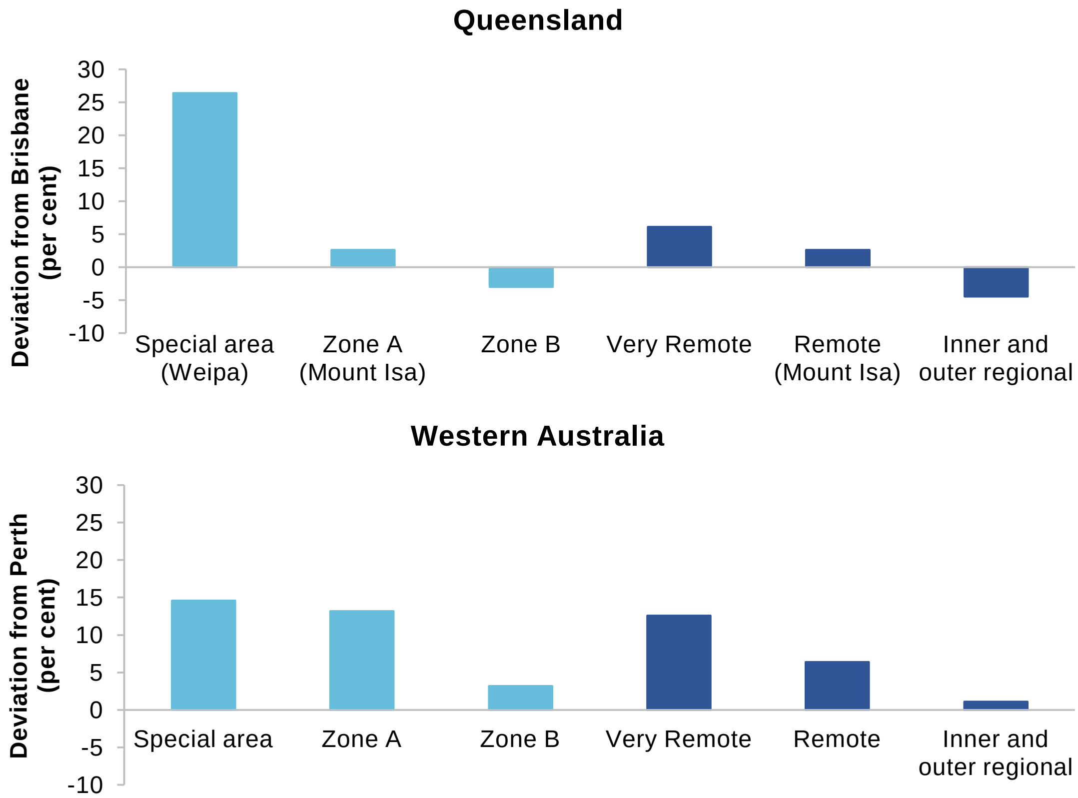
Many goods and services are more expensive in remote Australia. Study participants gave specific examples, which were useful in their own right although they do not provide a comprehensive basis for enumerating the geographic differences in the cost of living. The Commission has had to draw on a wider range of sources — including data from the ABS, the Australian Competition and Consumer Commission, CoreLogic and the consumer advocacy body CHOICE, as well as State-based price surveys — to help paint a picture on how the cost of living varies across Australia.

Regional price indexes for Queensland and Western Australia, which cover the places where 75 per cent of ZTO recipients and 40 per cent of RAA recipients live, suggest that a typical household basket of goods costs more in special areas and Zone A communities than in the less remote Zone B, where price levels are on average close to those in the relevant capital city (figure 2). That said, there is some variation within the zones. A similar pattern holds for the ABS remoteness areas (figure 2).

There is clearer and more consistent evidence that food and grocery prices increase with remoteness. For example, in 2017, the Northern Territory Market Basket Survey found that the average cost of a food basket based on the average diet of Indigenous Australians in remote stores was 45 per cent higher than in a Darwin supermarket.

Figure 2 **Price levels are higher in remote areas**

Cost of overall basket of goods and services by zone and ABS remoteness areas, Queensland and WA regional price indexes[a,b,c,d]



[a] Queensland and Western Australia price index values are not directly comparable. They use different baskets of goods and services and apply different weightings; Queensland prices were surveyed in 2015 and Western Australia prices were surveyed in 2019; the indexes measure deviation of price levels from different cities (Brisbane and Perth, respectively). [b] Unweighted averages of observations are shown. In Queensland, there were three observations in the *very remote* category, two of which were also in Zone B and were of lower price levels than in Brisbane. [c] In Queensland, only one community was surveyed in each of the following categories: special area (Weipa), Zone A (Mount Isa) and *remote* (Mount Isa). [d] The light blue bars refer to the zones as defined for the purposes of the ZTO. The darker blue bars refer to remoteness categories as defined by the ABS.

The pattern of food and grocery prices in part reflects the presence of major supermarkets that typically apply broadly uniform pricing across Australia. More than four in five residents of *outer regional* areas live within a 50 km radius of a Coles or Woolworths store, falling to about half in *remote* areas and one in five in *very remote* areas — with areas in italics referring to ABS classifications of remoteness.

More generally, prices of items that can be bought online are the same across Australia. However, freight costs can add significantly to the final cost of delivered goods, especially in *very remote* areas.

Residents of remote areas also face additional car maintenance and fuel costs. A resident of Useless Loop in Western Australia observed that:

> Essentially to do almost anything, that the general public take for granted, necessitates a 350km trip by road, to the nearest towns of Carnarvon or Geraldton. Some 120km of that road journey is unsealed, and often impassable, roadway. (Katherine Trigg, sub. 17, p. 1)

For housing, the issues are more complex.

On the one hand, comprehensive data from CoreLogic indicate that median house prices and rents are significantly lower in *remote* and *very remote* areas than in *major cities* for a given number of bedrooms. Further, in many remote communities there is a high reliance on subsidised social housing.

On the other, regional price index data from Queensland and Western Australia indicate that *total* housing costs, including utilities, maintenance and insurance, are higher in *remote* and *very remote* areas than in *major cities* and in *inner* and *outer regional* areas. This is particularly the case in small communities lacking resident tradespeople and where materials need to be transported over long distances or across water. These price data do not control for the quality of housing, making firm conclusions difficult.

Overall, living costs in some *remote* areas may not be significantly different from those in their respective capital cities. However, it is clear that *very remote* areas face higher living costs on average, and that some communities in those areas experience prices for many goods and services that are substantially greater than those elsewhere in Australia.

A closer look at the accessibility of services

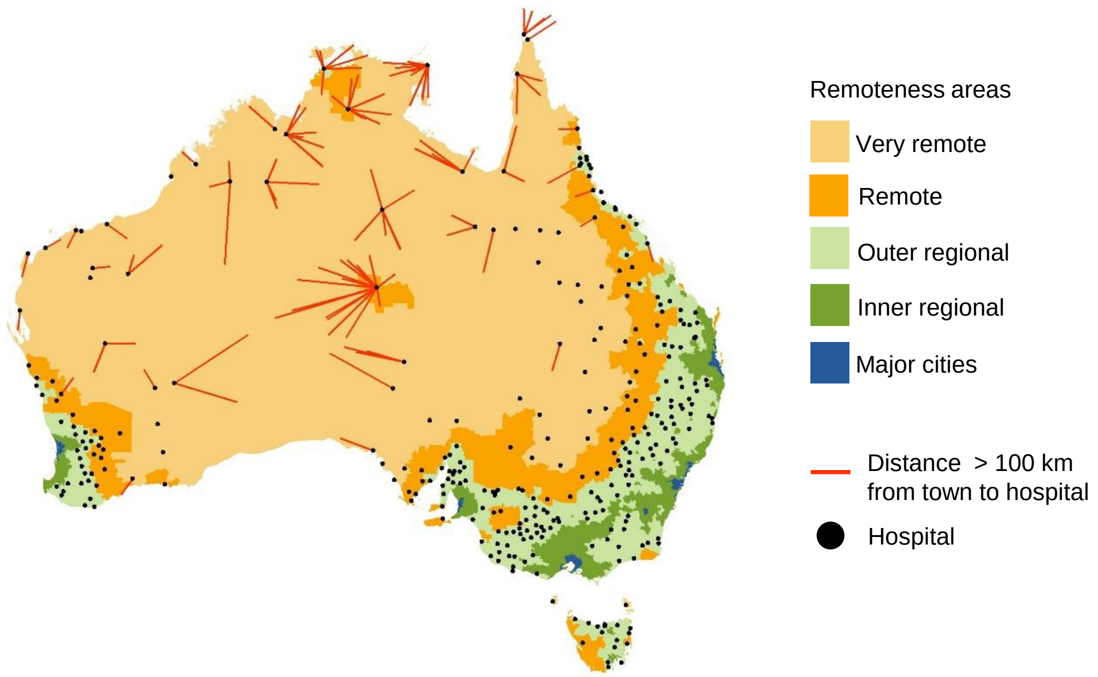
The availability and cost of accessing key services, such as healthcare, is a major concern for many Australians living in remote areas. In many cases, residents must travel long distances for face-to-face treatment — and even further to access specialists. About 40 per cent of *very remote* Australians are more than 100 kilometres from the nearest hospital, compared with only 3 per cent of *remote* area Australians (figure 3). Further, response times for emergency services can be several times higher in *remote* areas than in *major cities*, and higher still in *very remote* areas.

Similarly, while primary education is relatively accessible for most remote area residents, access becomes more difficult as students progress through high school and on to university or vocational education. Even though there are alternatives to traditional class-based learning, including distance education, it is still common for many remote area families to enrol their children in boarding schools, and for tertiary students to relocate to regional centres or cities to continue their studies.

These challenges vary from place to place, but can be significant — especially in *very remote* areas.

Figure 3 **Access to public hospitals is limited in *very remote* areas**[a]

Towns more than 100 km from an emergency department



[a] The map shows the distribution of public hospitals across the remoteness areas, and distances of more than 100 km between towns of over 200 people and public hospitals. The overwhelming majority of these towns are in *very remote* areas.

The zone tax offset

The ZTO is a concession targeted at residents of specified parts of Australia (the zones). While more modest in value than when first introduced, today's ZTO still applies to taxpayers across more than three-quarters of Australia's landmass. It is a small part of the tax and transfer system, claimed by just 3 per cent of taxpayers (around 480 000 people).

Table 1 and figure 4 provide a snapshot of the measure.

- Base rates differ by zone, with higher tax offsets available to residents of areas considered to be more remote (table 1). The highest rates are available for residents of 'special areas', covering particularly remote parts of Zones A and B and some adjacent and offshore islands (figure 4). Taxpayers can claim a larger offset if they maintain dependants.

- About 95 per cent of claimants reside in Queensland, Western Australia or the Northern Territory, and nearly half live in the four largest cities in the zones (Townsville, Cairns, Darwin and Mackay). The average per-person claim was $319 per year, although nearly half of all claims were less than $100.
- In aggregate, the offset amount claimed is estimated at $153 million in 2016-17 — a relatively small concession compared with other tax offsets (including the Seniors and Pensioners Tax Offset and the Australian Super Income Stream Offset, jointly worth about $1.4 billion annually).

Table 1 **Summary of the zone tax offset**[a]

	Base offset	*Dependant loading*	*Claimants*	*Total claims*[b]	*Average claim*
Ordinary Zone B	$57	20%	291 000	$39 million	$133
Ordinary Zone A	$338	50%	123 000	$63 million	$511
Special Areas	$1 173	50%	28 000	$32 million	$1 146[c]
Other[d]	**na**	**na**	38 000	$19 million	$496
Total	**na**	**na**	**480 000**	**$153 million**	**$319**

[a] Based on Commission estimates of zone boundaries. [b] Refers to self-assessed amount of ZTO claimed by taxpayers, which may exceed the amount actually received. [c] Average claim is less than the base rate because some taxpayers did not reside in a special area for the entire financial year. [d] Includes claimants who recorded out-of-zone addresses, overseas addresses, and postcodes not linked to a geographical area. **na** Not available.

Operation of the ZTO

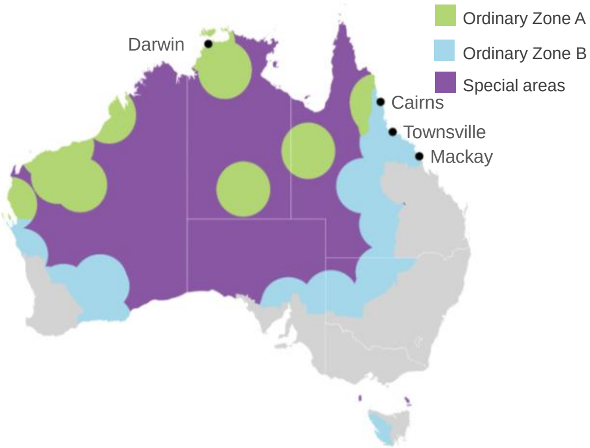
As currently configured, the ZTO is largely ineffective and does not deliver on its original objective (nor against any others that have been ascribed to it), and the zones are outdated.

The measure has little effect

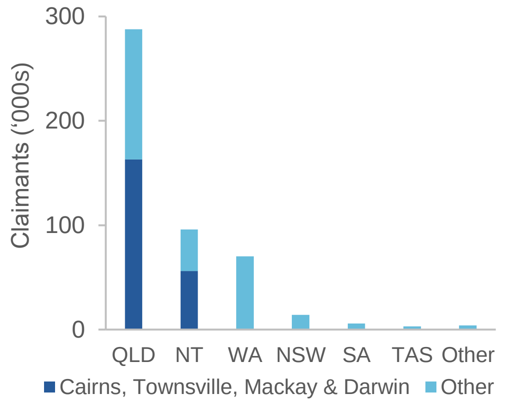
Since the last increase in the level of the ZTO in 1993-94, its value has declined markedly in real terms and as a share of after-tax earnings. Today, for a taxpayer on an average income, the base Zone A offset represents less than 1 per cent of after-tax income — compared with 3.7 per cent when the ZTO's predecessor was first introduced in 1945. If the offset had been adjusted to keep pace with inflation, it would be more than double the current base rate of $338. The offset available to those living in one of the special areas created in 1982 is more substantial, but its real value has also fallen (figure 4, panel C).

Figure 4 A snapshot of the ZTO

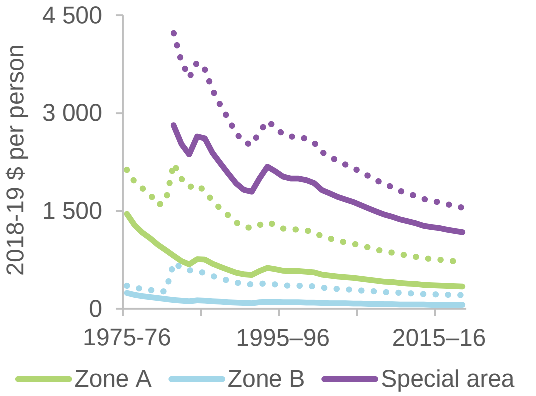
A. The ZTO zones cover more than 3/4 of Australia's landmass



B. Nearly half of claimants reside in large coastal cities

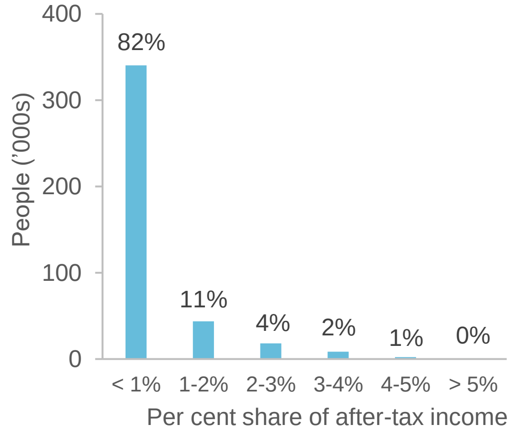


C. The ZTO has fallen significantly in real value …

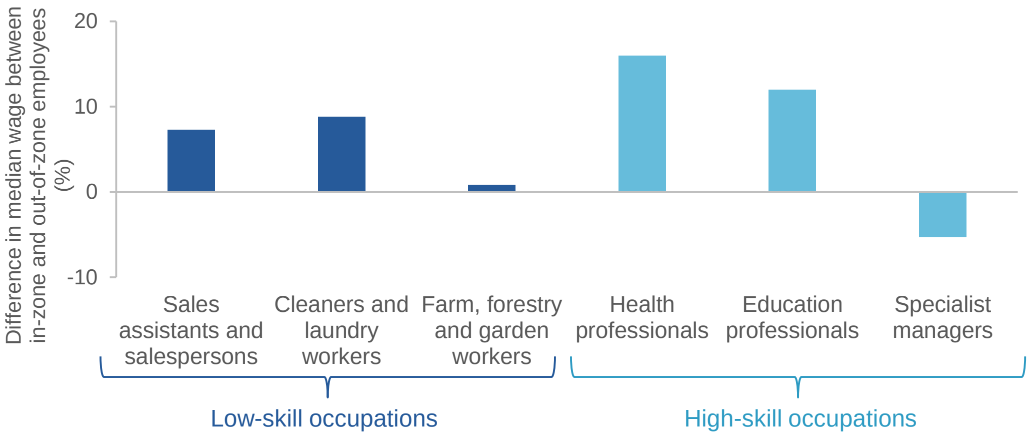


Dotted lines show rebate for taxpayer with two dependants

D. … and is a small share of income for most claimants



E. Median wages and salaries are higher in the zones for many occupations



A near-universal view in submissions was that the ZTO rates are inadequate to compensate for the disadvantages of remote living or to encourage people to move to the zones from elsewhere in Australia. The Commission likewise found no evidence to suggest that the ZTO (at its current rate) affects where people decide to live and work.

Further, it was clear from our engagement with remote communities (and a review of the literature) that decisions to move to and settle in a remote environment are not only about dollars. Many people decide where to live based on liveability (including access to services) and lifestyle. These factors cannot be addressed by a tax concession alone.

The zones are outdated

Against a backdrop of significant evolution in remote Australia, some areas covered by the ZTO are clearly no longer ‘isolated’. In particular, as noted above, coastal areas like Townsville, Cairns and Darwin have developed considerably since the 1940s.

These places, along with Mackay, are regional cities in their own right, with easy access to key services, well-developed retail markets, and good transport connections to other capital cities. A more contemporary measure of remoteness (the ABS remoteness classification) defines much of the north-east coast of Queensland, as well as Darwin, as *outer regional*, and not *remote* or *very remote*.

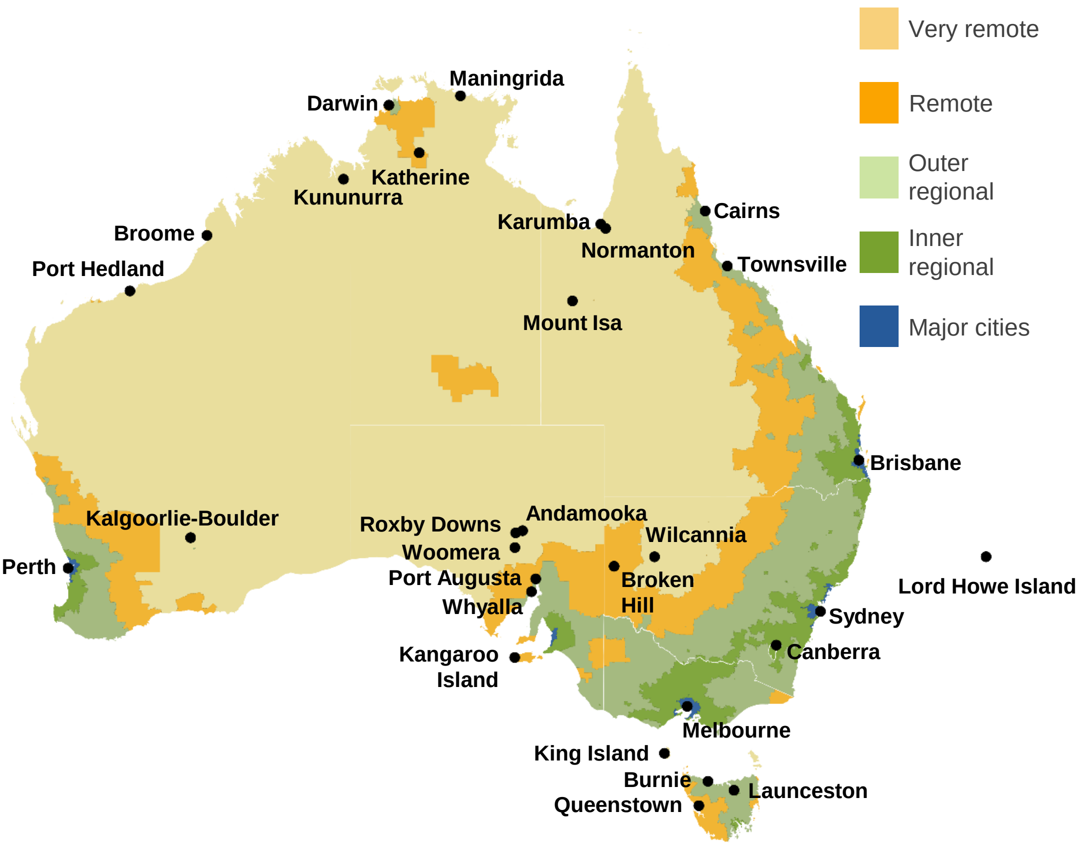
Other anomalies in the current boundaries were brought to the Commission’s attention. For example, one participant observed that towns with vastly different circumstances are eligible for the same ZTO rate, commenting that the Queensland part of Zone A includes:

> … Camooweal, Cloncurry and Mount Isa – the infrastructure, business, travel and education opportunities along with cost of living in these three towns are vastly different but all receive the same Zone Tax Offset. Mount Isa is a regional town with a population close to 22,000, a regional airport with commercial flights, several schools (both primary and secondary) and numerous businesses. Cloncurry has a population of approximately 2719. Camooweal, 200kms away from Mount Isa, has a population of 208 and is a significantly smaller town, with limited services or infrastructure in or surrounding the town. Yet these towns all fall under the same zone for the ZTO. (Isolated Children’s Parents’ Association of Australia, sub. 74, pp. 2–3)

Similarly, some *very remote* areas (based on the ABS classification) receive a small offset as part of ordinary Zone B, or lie outside the zones. For example, Wilcannia (in New South Wales), which is classified as *very remote* by the ABS, is eligible for the same tax offset as Townsville, which is classified as *outer regional* (figure 5).

Figure 5 **ABS remoteness areas**[a,b]

Based on the 2016 census



[a] The settlements marked on the map are the places where the Commission held consultative visits. Note that, although not visible due to the scale of the map, Broken Hill, Darwin and Kalgoorlie-Boulder are classified as *outer regional*; Port Hedland, Roxby Downs and Mt Isa are each classified as *remote*. [b] *Major cities* include Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra and Newcastle.

Is there a role for the ZTO in contemporary Australia?

While the flaws in the ZTO mean that at the very least it should not continue in its current form, the larger question is whether a ZTO is warranted at all.

The rationale for the ZTO has shifted over time. Originally, the concession was designed to reduce income tax paid on the higher wages needed to attract workers to isolated areas. This became less relevant as, since its introduction, marginal tax rates on high incomes have fallen significantly. Later on, the 1981 Cox Review (the most recent review) justified the concession on what it termed 'social grounds'. This effectively reframed the ZTO's objective towards equity, with a focus on addressing the hardships of remote living.

Participants in this study also posited rationales for the concession. Most fell into two broad categories:

- *compensation* — for the disadvantages of living in remote areas, such as higher living costs or impaired access to government and other services, along similar lines to the Cox Review
- *regional assistance* — particularly to encourage people to live, work and start businesses in regional and remote areas, and to reduce congestion in our major cities.

In many parts of regional and remote Australia (but not *very remote* Australia), costs are not higher than in major cities. Even where this is the case, higher living costs or other aspects of life in remote areas do not warrant compensation for two main reasons.

- First, everyone faces advantages and disadvantages in where they live and will typically locate themselves in the area they value most highly.
- Second, many employers both in private and public sectors already provide additional wages to compensate for the disadvantages of remote living (figure 4, panel E). Many State governments (as well as both the Australian Public Service and the Australian Defence Force) pay allowances and provide 'in-kind' remuneration to remote area workers, teachers, police officers and health care professionals.

There is no general role for the Australian Government to augment these dynamics. However, an exception may apply to people who live in remote areas and face significant barriers to geographic mobility, or whose income is not primarily derived from paid employment — a situation most likely to apply to RAA recipients (discussed later).

The ZTO is also difficult to justify as a way of encouraging people to relocate to particular areas. Broad tax concessions are an ineffective tool to promote migration and do little to support regional economic development. As the Commission found in its 2017 *Transitioning Regional Economies* report, the growth (or decline) of areas generally reflects their intrinsic economic advantages (or disadvantages), and their capacity to withstand economic shocks.

The ZTO should be abolished

In sum, the Commission considers that there is no compelling, contemporary justification for the ZTO and, on this basis, it should be abolished.

For most claimants, abolishing the ZTO would have small impacts. Among taxpayers in ordinary Zone B (who represent about 60 per cent of claimants), the average loss of $133 each year — about $2.50 a week — would be absorbed with little discernible impact. And for most others, the loss would be modest.

For a small number of low-income earners residing in special areas (about 12 000 taxpayers), ending the concession would represent a more substantial loss, equivalent to more than 3 per cent of their after-tax income. Moreover, in a few of these special areas (particularly remote islands, such as King Island and Lord Howe Island), the cumulative impact from the abolition of the ZTO would be larger. Over time, wages may adjust (at least partially) in response to the change, limiting these direct impacts.

Repealing the ZTO would also bear on the overseas forces tax offset (OFTO). This gives a tax concession to defence force employees and civilians on particular overseas assignments — although currently fewer than 50 people claim it. As with the ZTO, there is not a good case for retaining the OFTO — defence employees should be compensated directly through normal remuneration arrangements, not the tax system. Accordingly, the OFTO should similarly be abolished.

Abolishing the ZTO and OFTO would increase Australian Government revenue by around $150 million per year.

If retained, the ZTO should be reconditioned

The terms of reference ask the Commission to determine what an appropriate ongoing form and function of the ZTO might be — a Gordian knot, given that the Commission considers that the ZTO lacks a compelling or contemporary policy rationale.

If the ZTO is nevertheless retained, it should remain a minimalist financial support measure to reduce its adverse impacts. A pragmatic approach would be to limit it to *very remote* areas, where the cost of living most clearly exceeds living costs in the rest of Australia, and where access to services is most difficult and barriers to mobility are most acute. This would at least make the measure's eligibility criteria more compatible with its claimed objectives, a good design principle for any program.

The ZTO should be provided as a fixed offset at the current special area rate ($1173 a year) for all *very remote* areas. The concession should be streamlined further by abolishing the current complex system of dependant rebates. And the boundaries for eligibility should be redrawn accordingly, using the remoteness classifications published by the ABS.

A ZTO only for *very remote* areas, provided at the special area rate, would reduce the number of concession rates from three to one and trim the number of income taxpayers eligible for the offset to about 60 000 (down from 480 000 who claimed the ZTO in 2016-17). These changes to the operation of the ZTO would see its annual budget cost reduced by half to about $70 million.

Remote area income tax concessions for businesses?

The study's terms of reference also ask the Commission to consider whether businesses in remote areas should be provided with support similar to the ZTO.

Place-based business tax concessions (for example, lower payroll tax for businesses in regional areas) are often predicated on encouraging businesses to relocate to support regional development, or to reduce congestion in cities.

There is no credible case for the Australian Government to provide company tax offsets to businesses in remote areas. In general, attempts by governments to create a sustainable advantage for a community that it does not already possess, or to divert economic activity from one place to another, impose economy-wide costs that outweigh any local benefits.

The Australian Government's White Paper on Developing Northern Australia acknowledged the net economic costs of concessional tax arrangements. The paper steered away from proposing these across northern Australia, primarily because of the risk of 'misallocation or distorted investment decisions' stemming from preferential taxation or regulatory arrangements.

Centralised decision-making has a poor track record of spurring successful regional economic development, both in Australia and overseas. The diversity of regional areas, the issues they face, and their different strengths and weaknesses, all mean that top-down policy initiatives, such as tax concessions, are rarely effective.

Such concessions lack transparency and add complexity to the tax system. Moreover, their legality at the Commonwealth level could be tested, and if so, they risk falling foul of the Australian Constitution.

There are more effective and less distortionary ways for governments to support businesses in remote areas. These include, for example, removing unnecessary regulatory impediments to business development *regardless* of location.

The remote area allowance

The RAA is a supplementary payment for income support recipients (such as age and disability support pensioners and recipients of Newstart allowance and parenting payment) living in eligible remote zones. It was introduced in 1984 in response to the Cox Review, which found that:

> … the zone allowance [ZTO] is not a good form of assistance for all people living in isolated areas. Individuals whose income is insufficient for whatever reasons are unable to take advantage of the tax rebate. Persons whose main source of income is a social security benefit are excluded from any benefit. (Cox et al. 1981, p. 29)

The objective of the RAA is to compensate for the higher cost of living in remote regions. It is paid each fortnight as a flat payment across all eligible remote areas and income groups. For a single individual, the fortnightly rate translates to a payment of about $470 a year; for a couple with two children, it translates to $1190 a year. Recipients of the RAA may also be eligible for the ZTO, but receipt of the RAA reduces the ZTO claimable on a dollar-for-dollar basis.

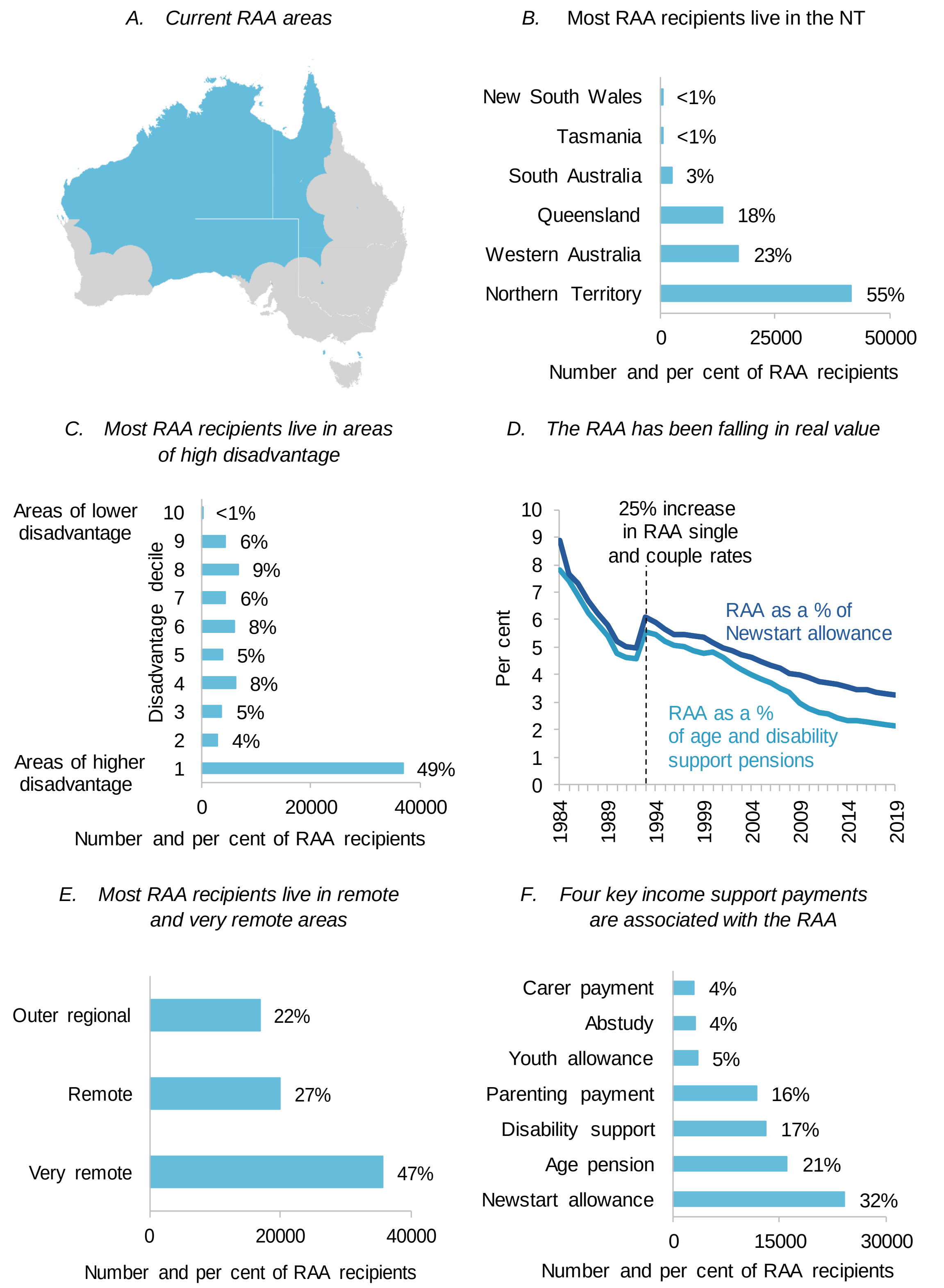
The Australian Government spends around $44 million on the RAA each year, reaching over 113 000 income support recipients in eligible areas. Zones eligible for the RAA are a subset of those eligible for the ZTO and exclude ordinary Zone B (figure 6, panel A).

The RAA is unusual in that its beneficiaries are concentrated: geographically; by socioeconomic status; and by ethnicity. The majority of recipients are located in the Northern Territory, with one in five Territorians over the age of 15 years in receipt of the payment (figure 6, panel B). Half of all RAA recipients fall within areas of the highest socioeconomic disadvantage (figure 6, panel C) and two thirds of recipients are Indigenous Australians. This means that even small changes to the RAA could have a significant cumulative impact on some communities.

Other notable characteristics of RAA recipients include:

- the majority are in receipt of either the Newstart allowance, age pension, disability support pension or parenting payment
- just over half have been in receipt of an income support payment for over five years
- fewer than one in ten had employment earnings in the fortnight prior to being surveyed
- beneficiaries are predominantly in the 25 to 34 years and the 65 years and over age groups.

Figure 6 A snapshot of the RAA



Is there a contemporary rationale for the RAA?

The RAA is premised on income support recipients in remote areas being disadvantaged by relatively high living costs. While the evidence is not definitive, the Commission has found that living costs tend to increase with remoteness, with the special areas and ordinary Zone A having higher living costs, on average, than adjacent regional areas and state capital cities.

There are features other than higher costs of living that also demarcate the difficulties of living in remote Australia from those of living in non-remote Australia. Access to key services is particularly challenging, for reasons of both availability and cost (in money and time), for communities in *very remote* areas that are far from major population centres.

As with the ZTO, higher living costs (and less ready access to services) per se do not justify government compensation. However, there are two important differences between the ZTO and the RAA, and between their recipients, that sway the balance towards retaining a RAA in some form while abolishing the ZTO.

First, whereas employers can provide higher remuneration to attract and retain workers in remote locations, there is no equivalent market mechanism to compensate income support recipients, who are predominantly not in the workforce. Second, RAA recipients in remote areas are generally more likely to face impediments to moving locations than those in jobs. The latter reflects that:

- social and cultural connections and personal circumstances can ‘anchor’ people to places. This is particularly relevant for Indigenous Australians in remote areas, who constitute nearly two thirds of all RAA recipients. Indigenous Australians in *very remote* areas are much less mobile than non-Indigenous Australians, largely as a result of familial and cultural ties (figure 1)
- people on a very low income in remote areas, which would include some RAA recipients, tend to be less mobile than those on a higher income. The older age distribution of RAA recipients (one third are 55 years old or over) may also make them less mobile than ZTO beneficiaries who are typically of working age
- in some particularly remote places, land and housing markets can be highly illiquid, geographically tying home-owning residents to the area. And RAA recipients with a continuing need for social housing and who wish to relocate to a new area may face the challenge of losing their accommodation and entering the queue in another area. This means that disadvantaged people in remote areas are likely, on average, to have fewer options than otherwise similarly disadvantaged people in non-remote areas.

These limits on the mobility of many RAA recipients restrict their effective choice of where to live relative to most ZTO beneficiaries. This, together with the absence of a market mechanism of recompense for higher living costs and lower access to services, provides a policy basis for a geographically-based supplementary income support payment like the RAA.

However, it is far from a perfect payment — some people *would* have the capacity to move, others might face relatively low costs of living due to their preferences, and others might have higher costs. But no social security payment can be finely calibrated to each person. In the case of the RAA, there are enough people in roughly similar circumstances to justify a premium.

The unique conjunction of circumstances relating to the RAA does not apply elsewhere, and the Commission does not see a broader case for geographically-based income support payments.

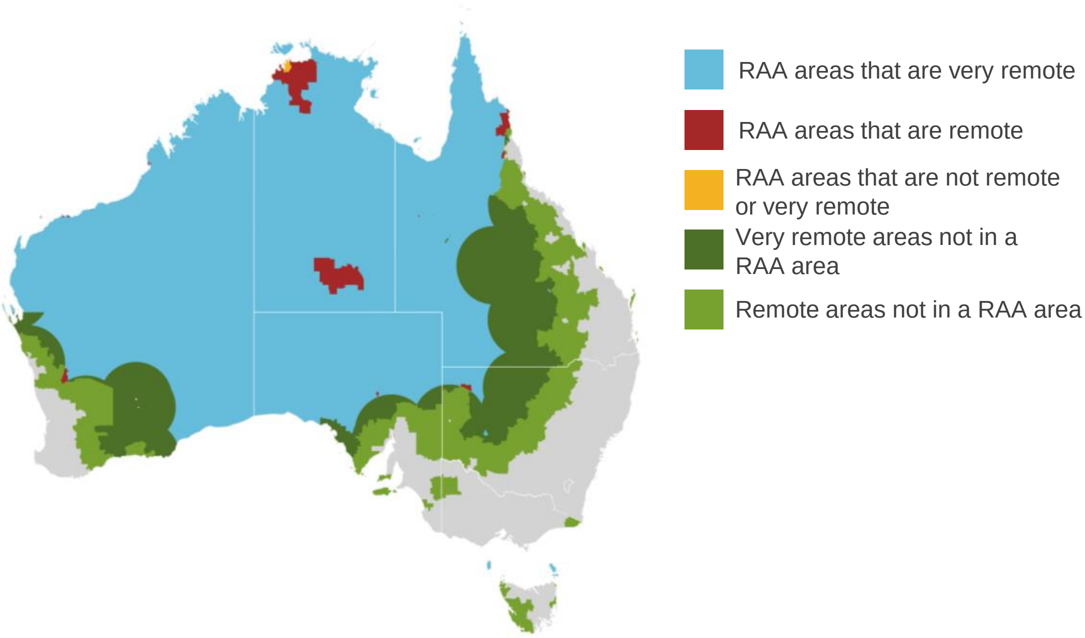
A refresh is required

The boundaries should be updated

As with the ZTO, the RAA zones do not reflect contemporary definitions of remoteness. Inevitably, this gives rise to anomalies in the boundaries.

There are significant areas of Australia that are classified as either *very remote* or *remote* by the ABS, but are not eligible for the RAA. These include expansive areas in Queensland and New South Wales, and areas in the south west of Western Australia, the south east of South Australia and the west coast of Tasmania (figure 7). On the other hand, Darwin is classified as *outer regional* rather than *remote* by the ABS, but Darwin residents are eligible for the RAA.

Figure 7 **RAA areas do not reflect contemporary definitions of remoteness**



The draft report expressed a slight preference for updating RAA boundaries to ABS *remote* and *very remote* areas. However, further analysis has prompted the Commission to recommend that RAA boundaries be aligned to ABS *very remote* areas only.

- Living costs in *very remote* areas are significantly higher than those in *remote* areas (which in some cases are not much different to those in capital cities).
- People in *very remote* areas have less ready access to hospitals, schools, retail facilities and other services.
- Recipients in *very remote* areas, particularly Indigenous Australians, tend to be less geographically mobile.
- *Very remote* areas tend to have greater levels of socioeconomic disadvantage and be less resilient to adverse economic changes than *remote* areas.

Targeting the RAA boundaries to *very remote* areas would exclude an estimated 25 000 (annual) recipients in Darwin and a further 33 000 people living in places like Alice Springs (Northern Territory), Karratha (Western Australia), Katherine (Northern Territory), Mt Isa (Queensland), Port Hedland (Western Australia) and Roxby Downs (South Australia). Overall, it would decrease the number of people eligible for the RAA by a net 46 000.

Boundaries should be adjusted when the ABS remoteness definitions are updated (currently on a five-yearly basis).

RAA payment rates need a reset

Payment rates have been increased only twice since the RAA's inception, and no adjustments have been made in almost 20 years. Because the RAA (unlike its associated income support payments) is not indexed, the payment rates of the RAA in real terms and as a share of the primary income support payment have fallen. For example, the RAA payment as a percentage of the maximum age and disability support pension for a single person has decreased from 7.8 per cent in 1984 to 2.2 per cent today (figure 6, panel D).

The Australian Government (through the Department of Social Services) should initiate a process for setting new payment rates for the RAA.

In revising the payment rates, the Government should aim for coherence between the RAA and the broader income support system. Among other things, it should take into account the availability of measures such as Commonwealth rent assistance, allowances for isolated children and the relocation scholarship that help to address the difficulties of living in remote areas. It should also consider the disincentives to work that the RAA could engender — particularly in the context where the ZTO is abolished (as recommended by the Commission).

As with other income support payments, the Government also needs to consider the appropriate trade-off between the adequacy of RAA payment rates and the forgone benefits from spending on other priorities. And it should take into account the impact of technological and economic advances that alter the nature of remote living. Australia's regions are always changing. This makes it important to periodically review not only RAA payment rates but also the administration of the RAA itself.

Fringe benefits tax remote area concessions

FBT was introduced in 1986 to tax remuneration provided to employees in a form other than wages, and as an integrity measure to prevent this 'remuneration in kind' from being used to lower personal income tax obligations.

FBT is levied at a flat rate of 47 per cent, equivalent to the top marginal individual income tax rate (plus the Medicare levy). It applies to any goods and services provided to employees, including through reimbursement of employee expenses, except those excluded in legislation. A key feature of the regime is that the high rate of tax discourages the provision of goods and services in favour of wage income, except where there is concessional treatment.

Under Australia's FBT regime, specific concessions apply to the provision of certain goods and services to employees working in designated remote areas. Although these concessions have elements in common with the ZTO and the RAA — in that they all provide assistance to people or businesses through the tax and transfer system based on their location in Australia — they also differ significantly in their objectives, operation, and impacts.

The remote area FBT concessions take two main forms:

- exemptions, whereby the good or service is not subject to any FBT
- partial concessions, where the taxable value of the good or service is reduced for FBT purposes.

Subject to eligibility criteria (box 1), which are partly linked to the ZTO boundaries, the following FBT remote area concessions apply.

- Housing owned or leased by the employer and provided to an employee as their usual place of residence (hereafter, employer-provided housing) is exempt from FBT.
- Various forms of financial assistance with employee-sourced housing, such as assistance with rent or mortgage interest payments, attract partial concessions where the taxable value is reduced, often by 50 per cent.
- Temporary accommodation, meals, and transport for FIFO and drive-in drive-out employees (hereafter referred to as FIFO arrangements) are exempt.
- The provision of residential fuel (including electricity and gas) and holiday transport attract 50 per cent concessions, while meals provided to primary production employees are exempt.

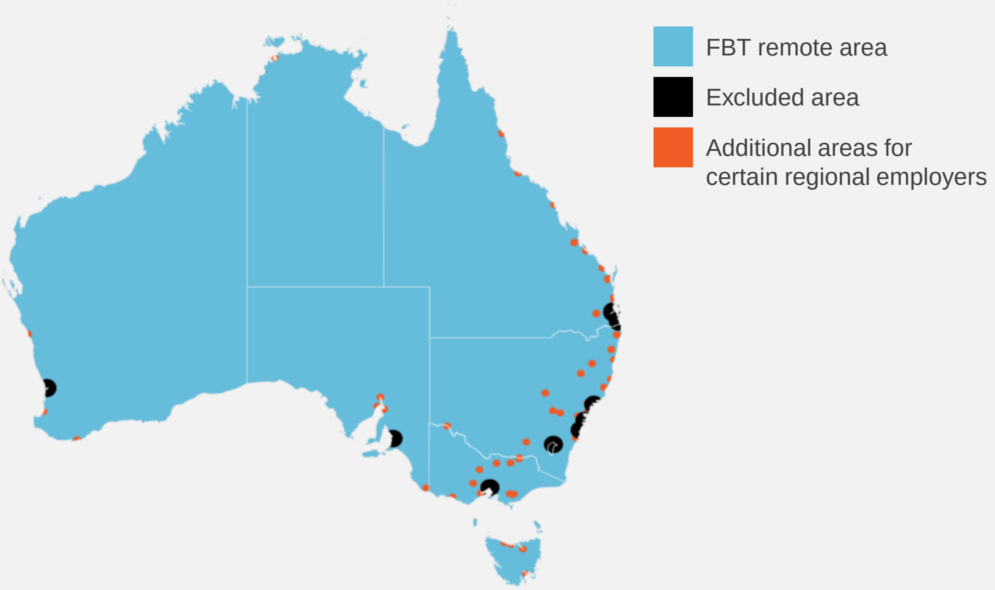
Box 1 Eligibility criteria for the FBT remote area concessions

Eligibility criteria for FBT concessions differ across the various concessions. For instance, for employer-provided housing, employers must demonstrate that they meet one of three tests to show that the provision of housing is *necessary*: i) employees may be *required to move*; or ii) there are *insufficient alternatives*; or iii) it is *'customary'* in the industry. However, in the case of assistance for employee-sourced housing, the requirement for it to be 'customary' must be met.

The geographic boundaries that define 'remote areas' for FBT purposes are based on the distance — by road, as they existed in 1986 — between the employee's location and various-sized 'eligible urban areas', defined by population figures from the 1981 census.

- In (ZTO) Zone A or B, for a location to be remote for FBT purposes it must be at least 40 km from an 'eligible urban area' of 28 000 or more people and at least 100 km from an eligible urban area with a population of 130 000 or more.
- Outside (ZTO) Zone A or B, for a location to be remote it must be at least 40 km from an eligible urban area with a population of 14 000 or more and at least 100 km from an eligible urban area with a population of 130 000 or more.
- For exempt remote area housing provided to employees of certain regional employers (essentially public hospitals, charities and police), any location at least 100 km from an eligible urban area with a population of 130 000 or more counts as remote.

These criteria lead to a definition of 'remote' for FBT purposes that covers some 97 per cent of the Australian landmass (the blue area on the map below). As this definition is based on 1981 populations, it encompasses some population centres that would now exceed the thresholds. For example, using population data from the 2016 census, Kalgoorlie (and locations within a 40 km radius) would no longer be considered remote. Around Cairns and Townsville, areas within a 100 km radius would no longer be deemed remote, and the exemption for housing would no longer be available to 'certain eligible employers' in these locations.



Although the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA) includes concessions for goods and services provided to people employed on a FIFO basis, only one of these concessions — for remote area transport — explicitly links eligibility to remoteness. Most FBT exemptions used for FIFO workers can be claimed by employers irrespective of geographic location.

The use and economic effects of FBT concessions

There is no central data source on the use and fiscal cost of FBT remote area concessions. Employers are not required to report exempt goods and services to the Australian Taxation Office (ATO), and the expense is not discernible from their other expenses. Where partial concessions are used, the reporting is insufficiently detailed to separate out the remote area concessions from other concessions that apply Australia-wide.

The Commission has therefore had to draw on a range of sources — submissions, surveys of the mining, agriculture and government administration sectors, and cameos — to fill the data gaps and shed some light on the use of these concessions, their economic impacts and potential costs to government.

The exemption for employer-provided housing is the big-ticket item

The evidence gathered by the Commission suggests that the exemption for employer-provided housing (as an employee's usual place of residence) is the big-ticket item. This exemption is uncapped and can be worth many thousands of dollars at the employee level (figure 8). Tax savings from the exemption are greater for people on higher than average incomes, reflecting the difference between their personal marginal tax rate and the effective tax rate (of zero per cent) on exempt housing. The tax savings from the exemption are also higher than those associated with a partial concession.

Figure 8 **Tax savings from the housing exemption are much greater than from the partial concessions[a,b,c,d]**

Compared with the employee paying for housing from their after-tax income

Mya's employer is offering a salary package of $80k p.a

Housing costs are $300/wk ($15.6k p.a)

Tax savings from FBT concessions

If full exemption:	$5 382
If partial concession (50%):	$851

Jack's employer is offering a salary package of $250k p.a

Housing costs are $300/wk ($15.6k p.a)

Tax savings from FBT concessions

If full exemption:	$7 332
If partial concession (50%):	$3 666

[a] For employer-owned property, 'housing costs' would be the equivalent market rent (less any employee contributions). [b] In these examples, a partial concession is a 50 per cent reduction in taxable value of the total housing costs. [c] For simplicity, the following have been excluded: the effect on the employer's superannuation guarantee liability, other costs associated with labour (for example, payroll taxes), and tax offsets and deductions. [d] Estimates are based on 2018-19 income tax rates.

Use of the exemption for employer-provided housing is concentrated in certain areas — such as the Pilbara in Western Australia, and the Bowen Basin and Central Highlands in Queensland — and in industries such as mining, agriculture, and public services (including hospitals, police and local government) (figure 9).

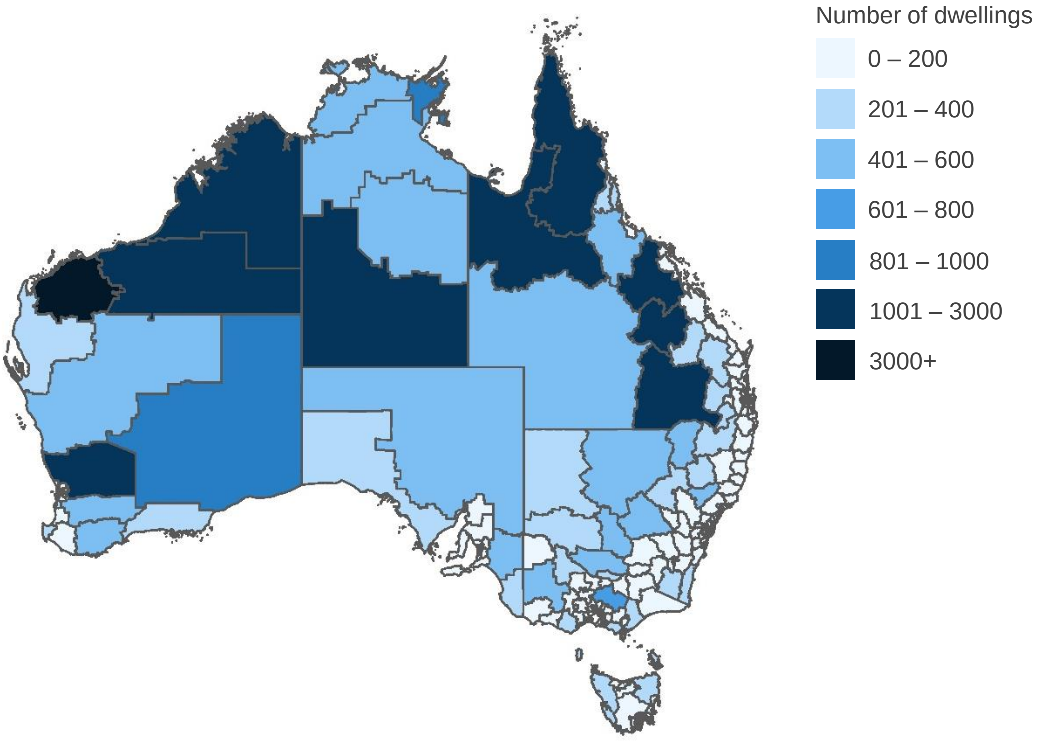
The Commission estimates that there are about 42 000 employer-provided dwellings used as an employee's usual place of residence in the FBT remote areas, with the cost of the exemptions (in terms of forgone tax revenue) ranging between $300 million and $390 million per year.

Concessions tend to increase employment by reducing labour costs, particularly in regions where these concessions are heavily used. They also tend to draw resources away from other regions or industries in the same region that cannot access them.

Many larger employers consider the exemption an important tool for attracting staff to remote areas. Smaller businesses are less likely to provide housing. This (in part) reflects the financial risk associated with owning properties if an employee vacates the property.

While the use of employee-sourced housing concessions is more difficult to estimate, these are likely to be concentrated in the same industries and areas as employer-provided housing. The total fiscal cost of these concessions is expected to be much lower than the cost of the exemption for employer-provided housing, given their lower usage and smaller tax savings to employees.

Figure 9 **Employer-provided housing is concentrated in certain more remote areas**



The FIFO conundrum

The use of FIFO work practices elicits strong, but mixed, views.

Many study participants argued that the sustainability of townships is threatened by large-scale FIFO practices, and that FBT concessions for FIFO workers contribute to this effect. Regional authorities said they often struggle to maintain infrastructure and a sense of community with a transient and non-rate-paying population.

People from source communities and industry take a more positive view of FIFO operations. They contend that businesses use FIFO workers simply because it is difficult to source and retain the necessary skilled labour in remote areas.

It is difficult to determine the extent to which FBT concessions for FIFO workers affect any one employer's decision between employing a local or FIFO workforce or the mix between the two — although, in general, it is unlikely that the concessions would be the main motivator.

FIFO is generally the preferred approach to managing the construction phase of projects in remote areas because of the temporary spike in employment and the difficulty of sourcing skilled construction workers locally. It is generally too expensive (and unreasonable) to require employees to change their residence for a short period.

During the operational phase, other economic and social factors are at play. Typically, businesses (particularly in mining) will only establish a residentially-based operation where there is already a community nearby with at least basic services and a degree of liveability. To the extent that FIFO options are a part of businesses' broader strategies for staff attraction and retention, FBT concessions are unlikely to be a determining factor.

Other concessions are much less significant

The use of other FBT remote area concessions (such as those on residential fuel, meals for primary production employees, and holiday transport) is relatively limited. Their collective fiscal cost is estimated to range between $30-$130 million per year.

Assessment of the FBT tax concessions

Views differ on whether the policy intent of the FBT remote area concessions is to provide equitable tax treatment where employers have operational requirements to provide particular goods and services to employees, or to provide regional assistance by giving employers greater financial capacity to attract and retain employees, or both.

The different views on the intent of remote area tax concessions among study participants give rise to different perceptions of their effectiveness.

For those who see the role of the concessions as a regional assistance measure (by promoting regional economic development or supporting service delivery), the concessions are too difficult to access (particularly for small business) and fail to attract people and investment to remote areas. For others who see the concessions as a way of correcting for inequities in the FBT regime, there is staunch opposition to any tightening of the current concessions, especially for FIFO.

Tax concessions in general have inherent drawbacks, regardless of the objective they are intended to advance. They are less transparent than direct government outlays, subject to little public scrutiny and review, and introduce complexity into the tax system. These significant drawbacks led the Henry Tax Review to recommend that programs should not be delivered as tax concessions 'unless there is a clear countervailing benefit in terms of efficiency, equity, complexity, sustainability and policy consistency'. The Commission concurs with this view.

Some concessions are justified

The most compelling argument for FBT remote area concessions is that they address inequities inherent in the FBT regime. In some cases, employers have operational requirements to provide goods and services (such as housing) to employees, and it would be inequitable to apply the full rate of the FBT. The full rate discourages the provision of remuneration in kind, but where this is unavoidable it creates a larger tax obligation (in most cases) than if the employee was paid the equivalent in wages. Differences in costs for businesses created by discriminatory tax treatment also encourage inefficient investment decisions.

In the absence of broader changes to the FBT regime (such as taxing fringe benefits in the hands of employees rather than employers), remote area concessions are the most direct and practical way to address equity concerns with the FBT. These concerns hinge on the likelihood that there is an operational reason for an employer to provide the good or service and on whether it privately benefits the employee.

- Where there is an operational reason to provide a good or service to an employee, but that good or service does not privately benefit the employee, there is a strong basis for it to be exempt from FBT. Exemptions could also extend to cases where the private benefit (and forgone tax revenue) is sufficiently small relative to other factors, such as the compliance burden that would be imposed by subjecting it to FBT.
- Where there is an operational reason to provide a good or service that also privately benefits the employee, a partial concession may be warranted. While the FBT regime generally penalises the provision of goods and services to discourage non-wage remuneration, a full exemption achieves the opposite. A partial concession can achieve a better balance, reducing incentives to provide goods or services instead of wage income without overly penalising employers in instances where these goods or services must be provided.
- Where there is no operational reason to provide a particular good or service — where it is not required to perform employment duties, and can be readily purchased by the employee themselves — there is no case for an FBT concession. Equitable tax treatment would require employees to purchase these goods and services themselves from their after-tax income.

In the case of FIFO arrangements, there is an operational requirement to provide temporary accommodation, meals and transport, but there is no clear benefit to employees that would warrant the imposition of FBT.

But current concessions err on the side of being overly generous …

Full exemptions for employer-provided housing (as usual place of residence) are available across much of Australia. Notwithstanding cases (such as remote farms) where the provision of housing is an operational requirement that warrants concessional treatment to avoid punitive taxation, the size and scope of current exemptions are too expansive for this purpose.

The general principle in individual income tax law is that taxpayers are entitled to claim deductions for expenses (that are not reimbursed by their employers) incurred wholly for the purpose of earning an income, as well as for the work-related portion of those expenses that are both work-related and private in nature.

The distinction between a work-related expense and an expense that is private in nature has evolved over time through case law. For accommodation expenses, a key consideration is whether an expense is dictated by work or by a personal choice about where to reside. The provision of accommodation as a 'usual place of residence', in contrast with short-term temporary accommodation, would typically be considered private in nature.

A *full exemption* for employer-provided housing is overly generous given that the provision of housing for use as an employee's usual place of residence also benefits the employee. Most people have to pay the costs associated with their usual place of residence from after-tax income, but using the exemption provides eligible employees with significant tax savings: the portion of their remuneration provided as housing is taxed at zero per cent rather than at their marginal individual income tax rate. This advantage holds even where there is no alternative to employer-owned housing, or where an employee chooses to retain their previous residence.

Additionally, current eligibility rules mean that the exemption applies in areas where housing is available on the private market — and, because the exemption is not tax-neutral, it can incentivise provision of housing in lieu of wages. Consequently, it is conceivable that individuals could be benefitting from the exemption in places like Townsville, Cairns, Darwin, or Byron Bay, and in some cases for high-end properties.

The cost advantage created by these arrangements also has economic efficiency implications. Economic output is likely to be lower, as investment decisions are distorted by artificial cost advantages. Further, there is little transparency attached to these measures, with minimal reporting of the concession and no reporting of the exemption to the ATO.

… and are poorly targeted to regional assistance goals

Using one policy instrument to address inequities in the FBT regime and to pursue regional economic development objectives inevitably leads to conflicts between these two objectives. As an illustration, FBT exemptions for FIFO workers, while warranted to address inequities in the FBT regime, can run counter to regional economic development objectives by discouraging people from settling in regional communities.

The concessions' current boundaries encompass about 97 per cent of Australia's landmass. Broad boundaries may be appropriate from a tax equity perspective, as a way of covering areas where employers may have an operational requirement to provide certain benefits to their employees. However, this also means that they are ineffective at targeting particular regions for economic development. Economic development policies are more likely to be cost-effective when they focus on harnessing the capability and locational advantages of particular communities or regions.

The Commission also does not consider that there is a clear benefit to using tax concessions rather than direct government spending to support the delivery of public services in regional and remote Australia. These concessions, by virtue of being applicable across most of Australia's landmass, make it difficult to take into account the specific service needs of regional and remote communities. They also carry the significant drawback of obscuring the cost of delivering public services in regional and remote areas.

A more targeted approach is warranted

The FBT remote area concessions, as they are currently designed and administered, do not address either of their purported objectives effectively.

Any redesign of the FBT remote area concessions needs to balance two considerations: improving tax neutrality between different kinds of remuneration, and minimising compliance and administration costs.

Improving tax neutrality for remuneration provided as goods and services in remote areas would not only strengthen the integrity of the tax system, but also foster more efficient investment decisions by reducing artificial cost advantages afforded to some businesses through FBT exemptions and concessions.

Broader reforms to the operation of FBT and other components of the income tax system — for instance, taxing fringe benefits in the hands of employees as suggested by the Henry Review — would address neutrality concerns and fundamentally alter the case for specific concessions.

In the absence of such fundamental reform, there is a need to better target access to the concessions. This involves examining the nature of each type of good or service provided by employers, determining whether a concession is warranted, and identifying what form it should take.

In doing so, compliance and administrative costs must be balanced against tax neutrality goals. For low-value items, the compliance costs associated with a partial concession may outweigh the tax neutrality benefits. As such, exemptions may be warranted. However, where the concessions are more material (as they are for housing), higher compliance burdens are justified on tax neutrality and integrity grounds and by efficiency considerations.

Exemptions for employer-provided housing should be partly wound back

Given the considerations above, the Australian Government should change the exemption for employer-provided housing (as usual place of residence) to a 50 per cent concession (as it was prior to 2000), and tighten eligibility rules. Moving to a 50 per cent concession would improve the tax neutrality between employer-provided housing and wage income — it makes the effective tax rate on employer-provided housing 30.7 per cent, which is close to the marginal income tax rate that most employees in employer-provided housing face. Such a change would reduce the incentive to use employer-provided housing in cases where it is not an operational requirement — reducing both the cost of the concession, in terms of forgone tax revenue, and the inequity between those who use the concession and those who cannot, without penalising employers in cases where it is a requirement (with rare exceptions).

In changing the remote area employer-provided housing concession, there is also a case for increasing the reporting obligations of employers that use the concessions. The relatively high value of these concessions warrants at least some additional reporting to the ATO to enhance its capability to administer the concessions and enforce compliance. At a minimum, such reporting should include brief details about the number and location of houses provided.

Eligibility rules should be tightened

Amending the eligibility rules to focus use of the concession on cases where there is an operational requirement would further limit scope for the proposed partial concession to be used in tax reduction strategies and improve the integrity of the income tax system. To this end, the Australian Government should also remove provisions that allow employers to claim the existing exemption for employer-provided housing merely because it is ‘customary’, or in less remote areas where they are ‘certain regional employers’.

- The ‘customary’ rule explicitly allows the existing exemption to be used (by some employers) in locations where there is sufficient alternative accommodation available — that is, where there is no operational reason for the employer to provide the housing.
- Equally, given that the additional areas for ‘certain regional employers’ are more populous towns, the need to provide accommodation for operational reasons is less credible.

If, after implementation of these reforms, the ATO had lingering concerns about misuse of the concessions, there would be merit in the Government considering a cap on the FBT remote area housing concessions.

Effects of changing the FBT remote housing concession rules

Changes to the FBT remote housing concession rules can be expected to have some local and broader effects.

Changing the exemption for employer-provided housing to a 50 per cent concession would substantially reduce the tax savings for individuals, although the reduction in tax savings would vary with income. For the vast majority of individuals (with income above $37 000), the partial concession would still provide tax savings relative to a no-concession scenario.

Assuming no change in the provision of employer-provided housing, the shift to a 50 per cent concession could raise about $150–195 million in FBT (appendix C).

In practice, employer behaviour could be expected to change. Some employers would continue to provide housing, and pay FBT on that housing, but might reduce employee wages in order to recoup some of the extra tax payments; this would lower income tax receipts. Other employers might cease to provide housing and instead increase employee wages. This could be an attractive option where a private housing market exists, or where the FBT concession results in a tax disadvantage for employees on incomes below $37 000.

Compliance costs

Changing from an exemption to a partial concession would increase compliance burdens. It would require employers who were previously using the housing exemption provisions to submit FBT returns. These additional compliance burdens would likely have a disproportionate effect on smaller employers — some of whom might only provide housing to a single employee. That said, it is worth noting that employers providing housing to employees are more likely to be larger businesses that can be expected to already have FBT reporting systems in place. As such, the incremental compliance costs to them are unlikely to be substantial.

Further, while it is difficult to determine the value of housing provided to employees where housing markets are absent or thin and volatile (such as on a remote station or mine site), the Australian Government could mitigate this problem by developing simplified valuation methodologies in consultation with stakeholders.

On balance, the Commission considers that the additional compliance costs associated with its recommendation are more than offset by the benefits of more equitable tax treatment and a broader improvement in the integrity of the income tax system. While compliance costs should be the minimum necessary to achieve a particular objective, minimising compliance costs should not be the primary objective of an FBT regime; this principle applies to the tax system generally.

Regional employment

To the extent that removing the exemption or reducing the value of FBT concessions has a material impact on costs and the viability of projects, any resulting decline in economic activity may have a knock-on effect on employment in some remote areas, shifting employment to other places.

These effects are generally likely to be small. In areas where employer-provided housing is most prevalent — such as the Pilbara — there may be discernible effects on local employment levels and housing markets. However, even in the Pilbara, the total tax savings associated with the current exemption for employer-provided housing (which are estimated to be in the range of $30-50 million) are small relative to the economic output of the region.

Overall, it is unlikely that changes to the existing exemption will have significant impacts on the viability of resource projects in the region. Indeed, changes in the economic and employment levels of these regions are much more significantly affected by commodity price volatility. While they may be modest, shifts in the location of employment and activity prompted by changes to FBT should not be seen through a negative lens, as these shifts will typically *promote* efficiency and overall community wellbeing.

Other types of remote area concessions could also be better targeted

In addition to changes to the exemption for employer-provided housing, the Commission also proposes changes to the other remote area concessions (table 2). In particular, the Australian Government should:

- remove the current partial concessions on employee-sourced housing (such as rent or mortgage assistance). These partial concessions do not satisfy the condition that there is an operational requirement for employers to provide the assistance. They are premised on employees having secured their own housing. If employees are able to secure their own housing, such assistance is substitutable with wage income
- retain the partial concessions on residential fuel for use in conjunction with employer-provided housing, as well as the exemption for meals for primary production employees. However, eligibility for both should be tightened to include only those cases where there is an operational requirement to provide the meals or fuel. There is scope to reduce the complexity of the exemption for meals
- remove the partial concessions on holiday transport. Holiday transport directly benefits employees, but there is no operational requirement to provide it, so it is inequitable for it to be partly funded by taxpayers.

The impacts of these proposed changes are expected to be contained, as these concessions are narrowly used and provide small tax savings.

The FBT remote area boundaries should be updated and simplified

Geographical restrictions that apply to FBT remote area concessions are a comparatively simple, objective and intuitive way of approximating those circumstances where an employer needs to provide a good or service for operational reasons (such as remote area housing). However, they are not without their drawbacks. Inevitably, lines drawn on a map are somewhat arbitrary and create inequities between those who can and cannot access the concessions when they face otherwise similar circumstances. Drawing boundaries too narrowly risks excluding cases where it is necessary to provide goods and services, such as housing, to employees (for example, on farms in less remote areas). Conversely, defining the areas too broadly makes the concessions more likely to be used in cases where they are not necessary.

Discarding boundaries altogether would have the dual advantages of mitigating constitutional validity risks and enabling access to the concessions wherever there is an operational requirement to provide the relevant goods or services. However, there is a risk that usage could expand markedly in the absence of boundaries. It is unlikely that compliance could be adequately enforced without boundaries, particularly given the limited information currently reported to the ATO on taxable fringe benefits.

On balance, in view of the risks associated with removing the boundaries, the Commission considers that boundaries should be retained. That said, the current boundaries are outdated and overly complex. They are based on measures of population from the 1981 census and road distances in 1986. Since then, population growth has meant that some areas once classified as remote for FBT purposes are no longer remote, while others with population decline have become remote. The reliance on a 1986 road map also adds to the complexity of administering and complying with the concessions.

At a minimum, the boundaries should be updated to reflect populations as of the 2016 census and contemporary road infrastructure. Subsequent updates should be preceded by sufficient notice, and could involve a ‘two strikes’ system by which eligibility is only adjusted after confirmation in two consecutive censuses. This approach would provide some stability for business planning purposes and minimise undue disruptions for employers and their employees.

Implementation issues

The Commission has proposed substantial changes to the design of FBT remote area concessions (table 2), which raise implementation and transition issues.

To enable a smooth transition, the Australian Government should introduce the Commission’s suite of recommendations with a delayed start date (for example, after two years), to provide time for current users to adjust and restructure their business affairs. Announcing the changes in advance would also give governments time to implement any measures required to ensure continuity of services, in cases where those services are adversely affected by the changes.

Table 2 **Proposed changes to FBT remote area concessions**

	Existing concessions	*Proposed changes*
Employer-provided housing	Exemption from FBT for employer-provided housing in designated remote areas. (FBTAA, s. 58ZC)	• Change the exemption to a 50 per cent concession. • Remove the provision that enables employers to claim the concession because it is 'customary' to provide housing (s. 58ZC(2)(d)(iii)). • Remove the extension of the concession to additional areas for 'certain regional employers' (s. 140(1A)). • Develop valuation methodologies for remote area housing. • Collect data on use of the concession.
Employee-sourced housing	Partial concessions on other forms of housing assistance in designated remote areas (FBTAA, s. 60 and Divisions 14A, 14B)	• Remove the partial concessions on employee-sourced housing.
Temporary accommodation, meals and transport for FIFO workers	Exemption from FBT for temporary accommodation, meals and transport for FIFO workers. (Note: remote area transport (s. 47(7)) is the only concession linked to remote area boundaries).	• No change to existing concessions for FIFO arrangements.
Residential fuel	Partial (50 per cent) concession for residential fuel used in housing that attracts an FBT remote area concession. (FBTAA, s. 59)	• Limit access to the concession for use in conjunction with employer-provided housing to instances where there is an operational requirement for the employer to provide residential fuel (s. 59(1)). • Remove the concession for use in conjunction with employee-sourced housing (s. 59(2) and (3)).
Meals for primary production employees	Exemption from FBT for meals provided to primary production employees on work days. (FBTAA, s. 58ZD)	• Limit access to instances where there is an operational requirement to provide meals. • Remove the definition limiting the exemption to meals 'ready for consumption'.
Holiday transport	Partial (50 per cent) concession on return holiday transport to specified destinations. (FBTAA, s. 60A and s. 61)	• Remove the holiday transport concession.
Boundaries for the concessions	Based on 1981 populations and 1986 road distances. Different population thresholds apply in ZTO zone and non-zone areas.	• Update the boundaries to reflect 2016 census populations and contemporary road infrastructure. • Align population thresholds at 40 km from communities with populations of 28 000 or more and 100 km from communities with populations of 130 000 or more (as they currently are in the ZTO zones). • Periodically update the boundaries using a 'two-strikes' rule to determine whether communities fall in or out of eligible areas.

Measures to mitigate adverse impacts

The case for financial compensation to mitigate adverse effects of the proposed reforms is weak. The reforms do not levy a disproportionate tax liability on businesses in remote areas — they remove an overly generous concession and, in turn, better align the tax obligations of remote area employers with those in the rest of Australia. Overall, this makes the tax system fairer.

There is a possible exception for service delivery organisations. These organisations have an obligation to deliver public services — such as health services, education, policing, and general municipal services like waste collection — to people living in the FBT remote areas. Reducing tax savings from the concession and removing the additional areas for 'certain regional employers' increases the cost of providing these services, with State, Territory and local governments left to make up the difference. If they fail to do so, this could affect the level and quality of public services that are delivered.

The Commission estimates that the 'morning after' increase in FBT on employer-provided housing (as a usual place of residence) for key affected sectors — public administration and safety, education and training, and health care and social assistance — could be between about $45 million and $60 million. In practice, employer behaviour would change in response to the new policy in ways that may lessen the financial impact on these sectors.

Larger Australian and State and Territory government agencies will have some capacity to raise revenue to replace the (implicit) funding provided by the concessions. Local governments' ability to mitigate the impacts on public service delivery could be more constrained, given their budgets and limited revenue-raising capacity.

There is a case for the Australian Government to consider providing some of the assistance it currently provides (non-transparently) through the FBT concessions in other ways. If the Australian Government adjusts the funding of service delivery agencies, general revenue assistance paid to State and Territory governments would be an effective way of doing so.

This form of assistance is untied, and therefore flexible enough for State and Territory governments to direct it to those services or local government areas that are most affected. From an administrative viewpoint, it is simpler to negotiate (relative to options such as specific purpose grants) and transparent (in contrast to carve-outs for particular agencies).

Alternative mechanisms to support remote Australians

The terms of reference for this study direct the Commission to consider if there are alternative mechanisms to better support Australians residing in specified geographic areas.

Many government programs already look to address disparities in the cost of, or access to, services or infrastructure between different parts of Australia. For example, as mentioned earlier, the Australian Government provides additional payments to doctors to work in remote areas, and subsidies for the supply of some utility services like telecommunications. These types of programs exist in addition to Australia's system of horizontal fiscal equalisation, which seeks to give each jurisdiction the fiscal capacity to provide a similar level of public services, and notably takes into account the higher per capita expenditure on service delivery in remote areas. Governments, particularly at the State and Territory and local levels, also have programs to support regional economic development.

The Commission has not sought to endorse any specific alternative use for the tax revenue that would be gained by abolishing or reconditioning the ZTO and tightening the FBT remote area concessions. Whether, and in what form, to provide support for residents of regional and remote areas will depend on governments' priorities, as well as an assessment of the relative effectiveness of different measures.

The issue of regional development involves complexities beyond the scope of this study. The diversity of regional communities, the issues they face, and their different strengths and weaknesses all mean that there are few common solutions; a program that works in one area may be counter-productive in another.

There have been many examples of parlous and ineffective programs. While these examples are not reasons to reject regional development policy per se, they provide reason for caution and furnish some 'do not do' imperatives, such as politically motivated handouts that do not draw on any natural advantages of an area.

On the positive side, policy development needs to acknowledge that local communities frequently have a superior capacity to identify their goals, issues and solutions than higher levels of government, though not necessarily the funds or collective information to make the best investments. That implies a role for State and Territory governments to lead regional development initiatives, as those governments are likely to be the stakeholders with the greatest access to local information, the ability to trade off alternative investments, and the best incentives to make good decisions. The Australian Government can play a role in the limited circumstances where a national approach is required and where cross-jurisdictional coordination is helpful.

Accordingly, while success is not guaranteed, higher level governments should look mainly to help regions harness their existing capability and locational advantages — rather than trying to relocate economic activity around the country. This requires an assessment of the regional context and the region's potential for innovation, clear governance across government and private sector institutions, the development of an overall vision, and a coherent and consistent policy mix and delivery plan. Decisions about regional assistance should also be independent of political interference, and should be made as close to the ground as possible in line with local priorities.

Recommendations and findings

The broader context

FINDING 2.1

The broader context for remote area tax concessions and payments has changed considerably since the first concession was introduced in 1945. Technological advances have helped lessen the difficulties of life in remote parts of Australia. Some communities once considered isolated — such as Cairns and Darwin, which had populations of 16 600 and 2500 (in 1947) respectively — are now well-developed, internationally-connected cities with populations near 150 000. Their residents can no longer be considered isolated.

FINDING 2.2

Remote Australia is home to 2 per cent of the national population. In general, remote Australians experience lower unemployment, higher labour force participation, and (in many cases) higher incomes than non-remote Australians. But this hides major disparities within and between *remote* and *very remote* areas.

Indigenous Australians in remote Australia (who make up 28 per cent of its population) are less likely to be employed or participate in the labour market, and tend to earn lower incomes than both non-Indigenous Australians and non-remote Indigenous Australians. They also tend to be less mobile than non-Indigenous Australians in *remote* areas, and even more so in *very remote* areas.

Further, socioeconomic disadvantage is more prevalent in remote Australia than elsewhere — especially among the Indigenous population and in *very remote* areas.

FINDING 2.3

Some inherent features of remote Australia make it difficult for residents to attain a comparable standard of living to city dwellers and people in regional areas.

- The cost of living generally increases with remoteness.
- People in remote Australia typically have less ready access to services.
- Many aspects of running a business, including attracting and retaining suitably-qualified staff, are more difficult in remote Australia.

These difficulties are most pronounced in *very remote* areas.

Many remote areas also face a harsh climate and the risk of natural disasters, although these phenomena are not unique to remote Australia.

FINDING 2.4

Although life in remote Australia has a unique set of challenges, many Australians choose to live there because of the pace and quality of remote life, or because of close personal or cultural attachments to places or to communities. Others move to remote areas in pursuit of economic opportunity. For some residents of remote areas, however, mobility may be constrained by socioeconomic and other factors.

FINDING 3.1

Remote area tax concessions and payments form just one small part of the broad suite of measures put in place by all levels of government to assist individuals, businesses and communities and to facilitate development in regional and remote Australia.

The zone tax offset

FINDING 4.1

The design of the zone tax offset (ZTO) is outdated.

- The boundaries have not kept up with changes in remote Australia, and nearly half of ZTO claimants live in large coastal regional cities.
- Inflation and growth in wages have substantially eroded the value of the ZTO.

Further, there is no evidence to suggest that the ZTO encourages people to live and work in the zones.

FINDING 5.1

There is no compelling justification for a zone tax offset in contemporary Australia.

Higher living costs or other aspects of life in remote areas do not warrant compensation through the tax system. Australians face a range of advantages and disadvantages in where they live, and can typically decide to live in the area they value most highly.

The economic development of a particular region succeeds or otherwise based on that region's advantages and disadvantages, as well as its vulnerability to economic shocks. Attempts by governments to create an artificial advantage for a remote community, or to attract people to live in high cost areas through tax concessions, are unlikely to be effective and typically result in net losses to the broader Australian community.

RECOMMENDATION 5.1 **ABOLISH THE ZONE AND OVERSEAS FORCES TAX OFFSETS**

The Australian Government should abolish the zone tax offset (ZTO) and the overseas forces tax offset.

If the ZTO is retained, the Australian Government should recondition the offset by making it:

- available to residents of *very remote* areas only, as defined by the Australian Bureau of Statistics, with the eligible area updated after each census
- a flat rate at the existing special area rate of $1173 a year.

FINDING 5.2

There is no case for the Australian Government to provide company tax offsets specifically to businesses in remote areas. Governments should focus on creating an environment for businesses to succeed without regard to location.

The remote area allowance

FINDING 6.1

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 socioeconomic disadvantage
- two thirds of recipients are Indigenous Australians
- just over half have been in receipt of an income support payment for over five years.

FINDING 6.2

The unique conjunction of higher costs of living and less ready access to services, together with the restricted geographic mobility found in parts of remote Australia, provide a justification for the remote area allowance. The Commission does not see a broader case for geographically-based income support payments.

FINDING 6.3

The remote area allowance (RAA) zones do not reflect contemporary definitions of remoteness. Zone A is largely based on boundaries drawn in 1945, and special areas are based on town sizes as measured in the 1981 census.

RAA payment rates have not been adjusted in almost 20 years. As the RAA (unlike its associated income support payments) is not indexed, the payment rates of the RAA as a share of the primary income support payment have fallen.

RECOMMENDATION 6.1 **ADJUST RAA BOUNDARIES**

The Australian Government should revise section 14 of the *Social Security Act 1991* (Cth) to align the remote area allowance geographical boundaries with *very remote* areas, as defined by the Australian Bureau of Statistics.

RECOMMENDATION 6.2 **REVISE RAA PAYMENT RATES**

The Australian Government should initiate a process to set new payment rates for the remote area allowance (RAA). Revision to payment rates should be guided by the following considerations:

- coherence between the RAA and the broader income support system
- disincentives to work that the RAA could engender
- an appropriate trade-off between the adequacy of payment rates and the forgone benefits from spending on other priorities
- the impact of technological and economic advances on life in remote Australia.

Fringe benefits tax remote area concessions

FINDING 7.1

The use of fringe benefits tax (FBT) remote area concessions varies.

- The exemption for employer-provided housing (used as a usual place of residence) can provide significant tax savings at the employee level, particularly for higher-income employees, and could cost as much as $390 million per year in forgone FBT revenue nationally. Usage is concentrated in certain areas — such as the Pilbara in Western Australia, and the Bowen Basin and Central Highlands in Queensland — and in industries such as mining, agriculture, and public services (including hospitals, police, and local government).
- The partial concessions on employee-sourced housing are narrowly used. The partial concessions are 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.

FINDING 7.2

Fringe benefits tax (FBT) remote area concessions help to address inequities inherent in the FBT regime, but the current concessions are not fit for purpose — they are overly generous and complex. This creates other inequities, including artificial cost advantages for some businesses which, in turn, encourage inefficient investment.

Simultaneously trying to address inequities in the FBT regime and pursuing regional assistance goals has meant that the concessions have been poorly targeted to both objectives, which are better addressed separately.

RECOMMENDATION 8.1 **TIGHTEN TAX TREATMENT OF EMPLOYER-PROVIDED HOUSING**

The Australian Government should amend the *Fringe Benefits Tax Assessment Act 1986* (Cth) to change the tax treatment of employer-provided housing. Specifically, it should:

- replace the exemption for employer-provided housing (section 58ZC) with a 50 per cent concession (as it was prior to 2000)
- remove the provision that enables employers to claim the concession because it is ‘customary’ to provide housing (section 58ZC(2)(d)(iii))
- remove the provision that extends the concession to additional areas for ‘certain regional employers’ (section 140(1A)).

The Australian Government should direct the Australian Taxation Office to collect data on use of the concession. To limit compliance burdens, the Australian Government should develop simplified valuation methodologies for employer-provided housing.

RECOMMENDATION 8.2 **REMOVE THE CONCESSIONS FOR EMPLOYEE-SOURCED HOUSING**

The Australian Government should amend the *Fringe Benefits Tax Assessment Act 1986* (Cth) to remove the concessions on employee-sourced housing (section 60 and Divisions 14A and 14B).

RECOMMENDATION 8.3 **TIGHTEN TAX TREATMENT OF OTHER GOODS AND SERVICES**

The Australian Government should amend the *Fringe Benefits Tax Assessment Act 1986* (Cth) to change the tax treatment of residential fuel, meals for primary production employees, and holiday transport provided by employers in remote areas. Specifically, it should:

- limit access to the residential fuel concession for use in conjunction with employer-provided housing (section 59(1)) to instances where there is an operational requirement for the employer to provide residential fuel
- remove the residential fuel concession for use in conjunction with employee-sourced housing (section 59(2) and (3))
- limit access to the exemption that currently applies to meals for primary production employees (section 58ZD) to instances where there is an operational requirement for the employer to provide these meals
- remove the definition limiting the exemption to meals 'ready for consumption', as it leads to ambiguity and difficulty in implementation
- remove the holiday transport concession (section 60A and section 61).

RECOMMENDATION 8.4 **REVISE BOUNDARIES FOR FBT REMOTE AREA CONCESSIONS**

The Australian Government should revise the geographic boundaries for the fringe benefits tax remote area concessions by:

- updating the boundaries to reflect populations as at the 2016 census and contemporary road infrastructure
- aligning population thresholds at 40 km from communities with populations of 28 000 or more and 100 km from communities with populations of 130 000 or more.

It should periodically update boundaries to reflect changing populations, giving sufficient notice to minimise disruption for affected employers.

RECOMMENDATION 8.5 **ANNOUNCE CHANGES IN ADVANCE**

The Australian Government should introduce legislative changes to the fringe benefits tax remote area concessions with a delayed start date (for example, two years from when they are legislated).

FINDING 8.1

The Commission’s proposed reforms to the fringe benefits tax remote area concessions would shift some of the cost of funding public services in remote areas from the Australian Government to State, Territory and local governments. This could affect the level and quality of public services that are delivered.

General revenue assistance paid to State and Territory governments would be an effective way for the Australian Government to adjust the funding of service delivery agencies. Such assistance can be made simple and transparent while granting State and Territory governments the flexibility to direct funds to those services or local government areas that are most affected.