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**REGIONAL
INCOME TAXATION
IN
AUSTRALIA**

DISCUSSION PAPER

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EXECUTIVE SUMMARY

CURRENT AUSTRALIAN SYSTEM

- IS POORLY TARGETED
- EXCLUDES CORPORATIONS
- IS DECLINING IN REAL VALUE

COMPARISONS

- REGIONAL TAXATION MEASURES ARE WIDESPREAD IN OTHER COUNTRIES

PROPOSED SYSTEM

- IS MORE RIGOROUSLY DEFINED
- INCLUDES CORPORATIONS
- MAINTAINS VALUE OVER TIME

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REGIONAL INCOME TAXATION IN AUSTRALIA

In examining regional taxation and its possible benefits it is proposed to consider the issue on two bases,

A Definition of the areas subject to assistance.

B The type of taxpayers to which any assistance is targeted, and the amount of assistance provided.

CURRENT AUSTRALIAN INCOME TAX ZONE SYSTEM

AREA DEFINITION

The present zonal system has been in place since 1945 and is broadly divided into a Zone A for Northern Australia and Zone B for Southern Australia, with Special Zone A, and Special Zone B areas regarded as deserving greater benefits.

Special Zone A and B areas were defined as those more than 250 kilometres from the nearest urban centre with a 1981 census population of 2500 or more, or the 1976 census if more applicable.

The Commissioner of Taxation has discretion to rectify anomalies which may occur where near neighbours reside on either side of the 250 kilometres line.

The areas were obviously defined with the intention of providing taxation relief in mineral and pastoral development areas, and to encourage population growth in Northern Australia.

Zone A comprises those areas where the factors of isolation, uncongenial climate and high cost of living were considered more pronounced and Zone B comprises the less affected areas.

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AMOUNT AND TYPE OF ASSISTANCE PROVIDED

- Current Zone rebates are available to INDIVIDUAL taxpayers who in general reside for 183 days or more in a zone.
- The rebate is additional to other rebates.
- Special Zone A or Special Zone B residents
\$ 1173 + 50% of other available rebate.
- Ordinary Zone A
\$338 +50% of other available rebates.
- Ordinary Zone B
\$57 + 20% of other available rebates.

The above amounts were last revised for the 1993/1994 taxation year.

DEFICIENCIES IN THE EXISTING ZONE TAXATION SYSTEM AREA DEFINITION

- A. The current system omits significant areas of the country which, particularly with changing population densities, can only be regarded as isolated and having high costs of living.

Some of the more glaring anomalies are:

- while areas barely 70 kilometres west of Hobart are deemed isolated none of Victoria is so regarded.
- areas 600 kilometres from Melbourne, Sydney and Brisbane receive no benefits.
- the entire tourist strip from Mackay north taking in Airlie Beach, Cairns and Port Douglas falls into Zone B.
- the zone B boundary moves 200 kilometres west at the Queensland border - surely it should be *east!!* (ie. to the right)
- Darwin, with an international airport, receives Zone A benefits.

The existing Zonal boundaries have failed to keep pace with the changing demographics of rural and regional Australia, including

- the achievement of significant population centres in Northern Australia.
- declining populations and services in many rural areas once considered prosperous.

TYPE OF TAXPAYERS, AND AMOUNT OF ASSISTANCE

- A. The current system is targeted at individual taxpayers and offers no taxation relief to corporate taxpayers.
- B. The current rebate values, as previously noted, have been in effect since the 1993/94 taxation year and have therefore declined significantly in real value
- Ordinary Zone B rebate (\$57 + 20% of other rebates) is of insignificant benefit.
- C. Special Zone A&B residents receive equal rebate amounts, while Ordinary Zone A&B rebates differ.
- D. There is some doubt over the Constitutional validity of the Zone System as outlined in FCT V Clyne (1958).

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SYSTEMS IN USE IN OTHER COUNTRIES

USA - Federal Government 1.

- Has created Empowerment Zones, Enterprise Communities and Rural Development Areas.
- Special tax incentives to remain in effect for ten years or until the date designated during nomination.
- Apply to up to nine Empowerment Zones and 95 Enterprise Communities nominated by state and local governments.

Secretary of Agricultural will designate three of the Empowered Zones and 30 Enterprise Communities in eligible rural areas (IRS to provide selection regulations).

- A.** 20% tax credit for the first \$15000 paid per employee with a maximum of \$3000 per resident employee who performs a minimum 90 days service in the zone for the years 1994 - 2000, and phased out by 2004. (The deduction the employer would normally be allowed for wages is reduced by the amount of the credit for the year).
 - B.** An accelerated building allowance on expenditure similar to that applying under our own system.
 - C.** Qualified Enterprise Zone Facility Bonds which operate in a manner similar to our own Infrastructural Bonds, although targeted at commercial, rather than public infrastructure. Limits per investor vary between \$3 million per zone and \$20 million over all zones.
- Enterprises Zones are employed by over 40 US states.

1. Empowerment Zones, Enterprise Communities and Rural Development Investment Areas Jeffrey K Jones CPA The CPA Journal (US) July 1994

UK - has an enterprise zone regime intended to encourage new industries in depressed areas - commenced 1981. 2.

- Enterprise zones last for ten years from designation.
- Provides Capital Allowances in designated enterprise zones of 100% of original cost for industrial, and commercial buildings or qualifying hotels. Extends to fixed plant and machinery integral to commercial and industrial buildings; OR
- a writing-down allowance of 25% of original cost where less than the full 100% initial allowance is claimed.
- the greater allowances are restricted to expenditure incurred within 20 years of the time the site is first included in the zone (generally ten years from the expiry of the zone).
- allowances are available to purchasers as well as constructors of buildings provided they are acquired unused during the life of the zone.
- Investors in an enterprise zone property trust are entitled to the allowances rather than the trustees.

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Ireland - Designated Areas in existence since 1952

France - Aid to Decentralisation is a grant - based incentive program to relocate business outside Paris.

Norway - taxpayers in designated areas receive reductions in personal income tax.

2. *1999 CCH Editions Limited*

Tax incentives are regarded as cost effective and may merely forgive taxes that otherwise would not be collected - have a multiplier effect that increases the revenues of the other businesses that support new business and its employees. 3.

- may need to be offered to compete with other countries which already do so.

Recent US research indicates a growing consensus that taxes influence the economic growth of a region.

Safeguards

- evaluation, public disclosure, establishing standards, and sanctions
- disclosure makes the process less political and more open to public scrutiny
- standards include length of time business is requested to stay in the locality
- sanctions eg Clawback of tax benefits

3. *Use of business tax incentives Part 1 Journal of State Taxation; Greenvale; Spring 1999*

China 4.

- Special Economic Zones
 - up to 2 year tax holidays, with 50% reduction for the ensuing 2 or 3 years, depending on classification
 - 15% tax on income derived from production, business and other sources
 - 10% tax in any year where enterprises export 70% or more of value their products
 - technologically advanced enterprises
10% for another three years
- Economic and Technological development Zones
- State Hi-tech Industrial Development Zones.

4. *Australian Accountant - October 1993*

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PROPOSALS FOR A NEW ZONAL TAXATION SYSTEM FOR REGIONAL AUSTRALIA

AREAS SUBJECT TO ASSISTANCE

Through passage of time the original focus and intent of zone allowances is no longer fully applicable.

There are nevertheless large regional rural areas of the country experiencing economic stagnation and upon which the effects of;

- isolation
- interest rate variations
- fuel and associated freight costs

are having deleterious affects.

To reduce the complexity between various areas of the Income Tax Act it is suggested that the concept of Remote Area contained in the Fringe Benefits tax legislation be adopted being:

- at least 40km from a centre of 28,000 or more and at least 100km from a centre of 130,000 or more.

In doing so, it is suggested that the present distinction between Northern and Southern Australia (ie Zone A and B) be removed in favour of a single zone, as already applies for the existing (Special Zone A and B) allowances.

The suggested change would ensure that existing Special Zone A and B areas remain undisturbed, while a greater proportion of rural and regional Australia would obtain additional benefits.

Should the radii of 40 kilometres and 100 kilometres be regarded as insufficient, greater distances may be more appropriate and could be determined through epidemiological analysis.

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TYPE OF TAXPAYERS AND ASSISTANCE LEVELS

Corporate

It is clear from much of the information available that large amounts of assistance in other countries is targeted directly at the corporate sector.

To encourage greater investment in rural and regional areas, corporate employers must also be eligible for tax relief.

Such measures should in the writer's view include:

- a reduction in company tax rates by perhaps 15% to eligible companies
- bona-fide residency tests
- claw-back provisions where necessary

Individual

The present Zone Rebate values are diluted over time due to increasing income levels.

A new system should therefore

- focus on taxation rates, with a suggested 15% reduction in tax rates.
- have residency requirements of 183 days or more.

Conclusion

The existing Zone Rebate Scheme operating in Australia

- is poorly targeted regionally
- excludes corporate investors
- declines in real value over time
- is meaningless in ordinary Zone B

A better system is required to

- encourage investment in rural and regional areas
- reflect changing population trends
- compensate areas disproportionately affected by interest rate and fuel cost increases.

BECAUSE OF OUR FREE-TRADE POLICIES VERSUS THE PROTECTION RECEIVED BY BUSINESSES AND RESIDENTS IN OTHER COUNTRIES, RURAL AND REGIONAL AUSTRALIA INDIRECTLY SUBSIDISES ALL URBAN AUSTRALIANS.

A MORE TARGETED AND BROADENED REGIONAL TAXATION POLICY WOULD ALLEVIATE THIS IMBALANCE.