

# Inquiry into Zonal Taxation

Submission to the Committee on Investment, Industry and Regional Development

June 2016

## **Introduction and overview**

The NSW Business Chamber (NSWBC) welcomes the Legislative Assembly's Committee on Investment, Industry and Regional Development (the Committee) Inquiry into Zonal Taxation.

As you may be aware, NSWBC is one of Australia's largest business support groups, with a direct membership of more than 19,000 businesses and providing services to over 30,000 businesses each year. NSWBC works with businesses ranging in size from owner operators to large corporations, and spanning all industry sectors from product-based manufacturers to service provider enterprises.

Operating throughout a network in metropolitan and regional NSW, NSWBC represents the needs of business at a local, State and Federal level, advocating on behalf of its members to create a better environment for industry. To inform the content of this submission, NSWBC consulted its regional advisory councils and regional presidents' forum to ascertain the issues that are important to members.

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## **A conceptual basis for zonal taxation**

A first step in considering the issues which form the Committee's terms of reference will be to consider the conceptual arguments in favour (or against) subjecting different geographic locations to different policy arrangements.

NSWBC takes a broadly-conceived notion of the concept of "zonal taxation". In this regard NSWBC takes zonal taxation to refer to the application of alternative policy settings (whether tax-related or otherwise) in different geographic locations (whether a specific location, or multiple locations that meet certain characteristics).

As a general principle, NSWBC considers that if a particular policy setting can be regarded as "good policy" then it should be applied state-wide rather than to specific areas based on postcode or otherwise. It follows that to limit the application of such a policy would also limit its benefits — NSWBC would not support any approach that seeks to advantage one geographic location by disadvantaging another.

The popular concept of the "Special Economic Zone" (SEZ) has received much prominence following its successful application as a tool to open-up and reform transition economies. In locations such as China, SEZs were used to predominantly achieve two objectives:

1. trial new policies (including rules, systems and institutions) for their eventual broader application outside of the SEZ; and
2. facilitate the reform and opening-up of economies that were previously closed to the outside world (through closed current and capital accounts).

SEZs have not generally been regarded as successful where they have been established to create favourable tax or policy environments with the intention of boosting economic activity in that location. This is because any benefits accrued to the SEZ are offset by disadvantages in surrounding areas. A successful SEZ is usually considered so because it can achieve other objectives such as those listed in points 1 and 2 above. That is why NSWBC urges the Committee to give thorough consideration as to what policy objectives might warrant such arrangements, rather than viewing them through the lens of incentivising economic activity in a given location.

This is not to suggest that specific policies cannot (and should not) be tailored to suit the needs of the constituents to which they apply. For example, tax policy settings recognise that some businesses face different challenges to others and that it would therefore be inappropriate to subject them to the same tax arrangements. This is the approach taken for payroll tax with NSW businesses only becoming liable for the tax after their payrolls exceed \$750,000, while land tax does not apply to land used for the purposes of primary production.

In this regard a business' geographic location may be completely arbitrary as to whether any form of relief or alternative treatment is warranted. Indeed, assigning relief by geographic location may exclude the access of many businesses outside that location for which relief could be equally justifiable.

That said, NSWBC acknowledges that geography — at least conceptually — may be an appropriate basis for applying different policy settings in some circumstances. They include (but are not necessarily limited to) policy arrangements in border regions as well as in circumstances where a targeted policy response is warranted by the economic and social impacts of a significant and rapid structural adjustment. Further, the economic and social needs of NSW's urban and regional communities are not identical and it is appropriate for governments to develop policies that are suited to their circumstances.

This submission will outline a number of areas where the Committee may wish to investigate the appropriateness of alternative policy arrangements in specific locations as well as policies that could be used to develop NSW's regions. It will also reiterate a number of areas in which NSWBC has advocated for policy changes that could deliver state-wide benefits and improve the competitiveness of NSW.

## **Treatment of border regions**

In 2012 NSWBC submitted to the Committee on Economic Development *Inquiry into the establishment of special economic zones*.

NSWBC emphasised some of the specific disadvantages faced by NSW businesses operating within close proximity (and that must compete with businesses subject to more favourable arrangements) to a neighbouring jurisdiction. It also noted that border-region businesses operating across jurisdictions may be subject to overlapping regulatory arrangements. For example, the submission noted that Albury businesses have reported that payroll tax, land tax, transport regulation, and trade training are all areas where they are at a significant competitive disadvantage when compared to their neighbours in Wodonga.

That submission emphasised NSWBC was supportive of COAG's efforts (at the time) to move towards greater harmonisation through the *National Partnership Agreement to Deliver a Seamless National Economy*, and that border region SEZs could complement these national reforms and offer a more immediate solution to cross border issues. However, it is now clear that a national approach to reform has lost momentum and that significant reform is unlikely in the foreseeable future.

It is for this reason that this submission offers a more nuanced view of the role that SEZs could play in border regions. Specifically, a strong degree of caution is required because unless there is harmonisation at the national level, favourable zonal taxation arrangements would risk shifting the problems from one NSW region to the next rather than acting as a stepping stone to broader harmonisation.

If a negative impact associated with more favourable policy settings in a neighbouring jurisdiction is concentrated in a particular geographic location then, at the first instance, consideration should be given as to whether relief or incentive schemes can be targeted based on criteria other than geography (for example, whether relief could be targeted to adjust for disadvantages faced by interstate-trade exposed businesses).

This follows the principle that relief from an identified shortcoming in NSW policy should not be isolated, but broad such that all NSW businesses can benefit. In this respect if a policy setting is more favourable in a neighbouring jurisdiction, then NSWBC would contend that the favourable policy setting should be adopted state-wide to ensure the competitiveness of NSW as a whole.

Notwithstanding the above, NSWBC retains its view that a pragmatic approach to border region issues could deliver benefits for businesses put at a competitive disadvantage due to their close proximity to businesses operating in a neighbouring jurisdiction. NSWBC welcomes further consideration into whether zonal taxation arrangements could deliver benefits for these businesses. Here the emphasis should be on identifying and correcting areas of disadvantage faced in border regions rather than applying preferential settings intended to favour those regions.

## **Structural adjustment**

A further instance in which zonal taxation arrangements may be warranted is during a rapid structural adjustment owing to changes in the viability of a major employer or industry in a given region.

While in the long-run government policy should not seek to preference one industry over another or one location over another, in the short-term this proposition may be challenged by other priorities such as the wellbeing of a community. In the event of the collapse of a major employer firm or industry, governments must balance the costs of short term assistance to facilitate a smooth process of structural adjustment and the costs of inaction which may include significant regional unemployment and stagnation.

The Committee may wish to consider the extent to which favourable policies, including zonal taxation arrangements, could form part of a response to such challenges. In this respect NSWBC offers that any relief should be temporary; should only be provided if an industry or firm will be viable over the longer term; and is sufficiently targeted that it does not significantly disadvantage other businesses (including as taxpayers). While the circumstances that warrant special arrangements are unlikely to occur frequently, NSWBC supports a pragmatic approach when considering specific challenges faced by NSW communities.

For example, NSWBC is supportive of last year's decision to defer payroll tax liabilities for BlueScope Steel as a practical measure to support the restructure of its Port Kembla operations. This, as an example, demonstrates the benefits that a pragmatic approach can deliver.

However, in other circumstances, relief may be better delivered through targeted assistance for communities. Targeted training assistance to enable workers to attain skill sets required in a process of structural adjustment and focussing on investment and infrastructure projects that have strong job creation potential may be more effective in supporting communities in these circumstances. For example, it is arguable that the Central West Jobs Action Plan (in response to the announced closure or downsizing of significant employers in the region) is a better approach to delivering longer lasting and sustainable benefits than what could have been delivered through zonal taxation arrangements. The Committee should therefore consider zonal taxation in the context of the suite of policies that could be used.

## **Policies affecting regional NSW**

While NSWBC is not supportive of the fundamental premise of the inquiry that zonal taxation is, in the main, an appropriate mechanism to support regional economic growth, the NSWBC strongly supports other regional policy initiatives to help grow jobs and investment in our regions.

### **Investment in infrastructure**

A more efficient approach to support regional economic growth can be achieved by stimulating productivity through strategic investments in regional infrastructure projects. Upgrading key infrastructure – roads, rail, air, ICT – will allow regional business to reduce costs, increase productivity, better connect to a wider customer base and reduce the tyranny of distance, enabling them to better compete with their metropolitan counterparts. NSWBC supports the NSW Government's commitments to use a significant proportion of the capital raised from the sale of 'Poles and Wires' to fund regional infrastructure projects.

In its 2016-17 pre-Budget submission, NSWBC called on the Government to demonstrate the state-wide benefits of asset recycling by announcing regional infrastructure projects as soon as possible (to demonstrate that the benefits are not simply major projects for urban centres).

## **Fuel levies**

NSWBC notes the terms of reference of the Inquiry regarding the impact of fuel levies on regional areas. NSWBC notes that fuel excise is a Commonwealth tax. NSWBC's national counterpart, the Australian Chamber of Commerce and Industry (ACCI), has previously highlighted the impacts that fuel excise has on business. ACCI's longstanding view is that fuel excise should only be applied for road transport reasons where these taxes are hypothecated to direct investment back into roads.

While NSWBC recognises the disproportionate impact of fuel levies on regional areas (for the obvious reason that people in regional areas generally drive further than their metropolitan counterparts) we are not of the view that attempts should be made to simply adjust fuel levies on a regional basis. Either they should be reduced across the board or hypothecated to specific road investment.

## **Improvements in planning arrangements**

A clear example where NSW is at a competitive disadvantage is our lack of a flexible planning framework to encourage innovative and entrepreneurial activity.

As an example of where opportunity exists to create a more competitive planning environment, the Queensland Government designates certain areas of land 'State Development Areas'<sup>1</sup> which provides defined areas of land for industry, infrastructure corridors and major public works that promote economic development. With the State Government controlling developments and approvals in these areas, we have heard anecdotally that a number of businesses, frustrated with the overly complex planning frameworks within NSW (and multiple approvals with local and state government), have relocated to Queensland to take advantage of these development areas. Opportunities to establish similar development areas within NSW, particularly in the North Coast region, should be pursued as a priority.

## **Road freight restrictions**

Upon consulting with NSWBC's regional members, concerns were raised regarding the application of truck load limits. In particular, members pointed to the higher costs associated with registering prime movers of higher capacity as well as additional charges associated with second and third trailers on road trains. As a result operators are hit twice: once for registering a higher capacity vehicle and then again for making use of that capacity.

Further, restrictions that are sensible and appropriate for higher traffic locations may not strike an appropriate balance of risks and benefits in more remote areas. This includes restrictions on oversize loads (which must be carried as a single unit) and overall truck length restrictions.

The Committee may wish to consider how potential efficiency and economic gains that come with improvements in road freight arrangements could be opened up for regional communities.

## **Backpacker tax**

A further issue of concern to NSWBC members is proposed changes to Working Holiday Maker Tax (backpacker tax) arrangements that will make it more difficult for regional businesses to meet their demand for seasonal labour. Together with the National Farmers Federation and a number of industry associations in the agricultural and tourism sectors, we have expressed our concerns that imposing a high tax rate on these workers will result in detrimental labour shortages - the brunt of which will be borne by regional communities. We continue to propose that either the changes be scrapped, or the tax rate lowered from 32.5% to 15-19% and the program expanded and promoted to encourage more workers to take it up.

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<sup>1</sup> <http://www.statedevelopment.qld.gov.au/coordinator-general/state-development-areas.html>

While these issues are response to changes by the Commonwealth Government, the Committee may wish to consider how these changes will impact on affected communities within the context of its deliberations.

## Improving the competitiveness of NSW taxes

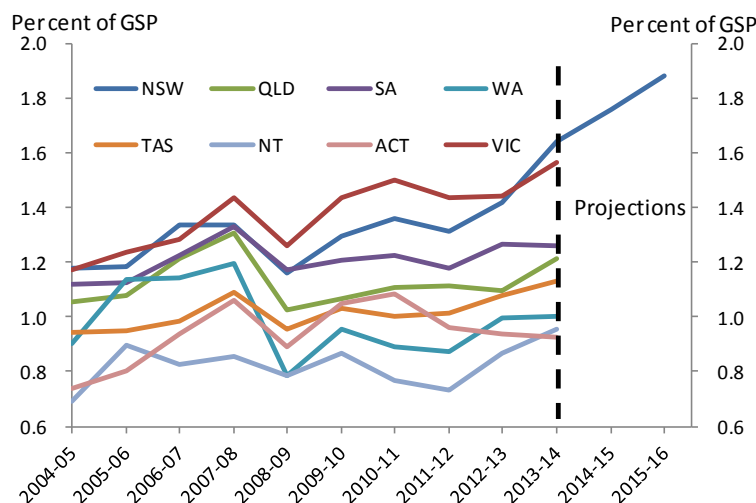
The Committee’s terms of reference ask that it consider exemptions from, or concessions in relation to, payroll tax, stamp duty and land tax.

Before considering the appropriateness of zonal taxation arrangements, NSWBC notes that the NSW tax system is becoming increasingly inefficient. Its 2016-17 pre-Budget submission, NSWBC drew attention to the State’s increasing reliance on inefficient taxes such as transfer duty. As the recent NSW Intergenerational Report confirms, transfer duty is among the most harmful taxes costing around \$800,000 to collect \$1m in revenue. This compares with virtually nothing<sup>2</sup> for efficient taxes such as broad-based land taxes (as distinct from the existing narrow-based land tax that currently applies in NSW).

NSWBC recently launched its Thinking Business Report [Taking on Tax: Reforming NSW Property Taxes](#) which highlights the economic benefits that would accrue from replacing transfer duty with a broad-based land tax. The modelling shows a boost to Gross State Product of more than 1 per cent, the creation of almost 10,000 new jobs and additional consumption of more than \$1,400 each year for the average household.

NSWBC analysis demonstrates that the NSW tax system is the least efficient in the country and that its position relative to other jurisdictions is likely to deteriorate significantly (Chart 1). A key reason for this has been the significant increase in transfer duty receipts owing to heightened activity in the property market. For example, NSWBC estimates that price-related bracket creep in the residential property market boosted transfer duty by more than \$2.3bn in 2014-15 compared with the period before July 2012. The 2015-16 half-yearly review estimates that transfer duty will be more than \$8.7bn in this financial year – by far the largest contributor to own-source revenue.

**Chart 1 - The efficiency cost of state taxes**



Source: NSWBC 2016-17 pre-Budget submission. Estimation based on ABS and NSW Government data together with KPMG estimates of the average excess burden of major Australian taxes.

Note: the Y-axis is an estimate, presented as a percentage of GSP, of the welfare losses (also known as the excess burden of taxation) associated with state-based taxes. For NSW, 69 per cent of the increase over this period is attributable to growth in transfer duty receipts.

<sup>2</sup> Or net benefits as recent Commonwealth Treasury modelling shows

When considering the impact of state taxes on NSW businesses, a key cause for concern among NSWBC members is the competitiveness of NSW payroll tax arrangements. This is because businesses operating in other jurisdictions are subject to more favourable payroll tax arrangements, directly disadvantaging NSW businesses. As noted in NSWBC's 2016-17 pre-Budget submission, NSW has the third lowest payroll tax threshold in the country and the second highest average rate of payroll tax at common payrolls (for example, payrolls of between \$3 and \$5 million). The disadvantages faced by NSW businesses will be exacerbated by recently announced increases in the payroll tax threshold in Victoria and the ACT.

It is for these reasons that NSWBC encourages the Government to raise the payroll tax threshold to \$850,000 over a four year period and to reintroduce indexation of the payroll tax threshold in subsequent years.

Clearly there is a strong case for state-wide tax reform and NSWBC recommends taking a broad approach to considering the benefits of reform. If left unaddressed, the NSW economy and NSW businesses, compared with their interstate rivals, will be at a significant disadvantage irrespective of their geographic location.

### **Zonal arrangements for payroll tax, stamp duty and land tax**

In considering whether it is appropriate for geographic-based exemptions or concessions apply to payroll tax, stamp duty and land tax, it is also worth considering how these taxes are currently designed.

Each of these state-based taxes already have exemptions and/or progressive arrangements which mean that urban and regional communities will be impacted differently by these taxes. This includes but is not limited to:

- **payroll tax** — a payroll threshold below which a business is not liable for payroll tax; tax exempt status for not-for-profit entities; and rebates associated with the Jobs Action Plan.
- **transfer duty** — progressivity which applies lower rates to lower value transactions.
- **land tax** — land used for primary production is exempt; and progressivity which applies based on aggregate holdings of land.

As an example, progressivity in these taxes means that urban communities will typically account for a higher share of receipts (relative to their share of the potential tax base) given they typically account for a greater proportion of higher value land and/or transactions. This can be justified on policy grounds given that urban communities have greater access to public amenity such as infrastructure and services. Indeed the value of land is itself directly affected by access to public amenity which forms an indirect link with the amount of tax paid in locations with greater access.

While the Committee may wish to consider whether the current balance afforded by these design features is appropriate, NSWBC recommends against the application of geographic criteria in the design of state-based taxes. Instead, NSWBC would welcome further consideration into how the efficiency of these taxes could be improved, including by moving toward a broader-based land tax and by reducing the role of transfer duty in state-finances. Any rebalancing in how these taxes apply to regional and urban communities should be achieved via the fine tuning of the taxes themselves rather than on a geographic basis. In this regard NSWBC is not aware of any compelling evidence to suggest that such a rebalancing is required (noting that other policies, as outlined above, are better suited to ensuring the needs of regional communities are met).



That said, NSWBC is aware of member concerns regarding the burden of council rates which fall more heavily on commercial entities. Unlike land tax, council rates are localised which can mean that rates are higher in isolated regional areas with a relatively small ratepayer base. The Committee may wish to consider how horizontal fiscal imbalances such as these impact on regional communities.

## **Conclusion and summary**

NSWBC would again like to thank the Committee for the opportunity to contribute to this inquiry.

While we believe there is only a limited role for different tax regimes to deal with the specific challenges faced by regional communities, NSWBC welcomes this inquiry which gives focus to the issues facing the regional economy. Some of these challenges — including the tyranny of distance, structural change, interstate-trade exposure, and concentrated industrial structures — are better dealt with by using specific and targeted measures that are able to directly address problems that government is being asked to help address.

Overall NSWBC supports a pragmatic approach to considering whether zonal taxation arrangements could benefit NSW businesses. As this submission notes, this could include circumstances where businesses are disadvantaged by NSW Government policy (such as in border regions) or where temporary arrangements are an appropriate response to a specific challenge faced by a community (such as a rapid and significant structural adjustment).

While we believe policy frameworks can be adjusted to pilot or test approaches, NSWBC does not support special arrangements intended to favour businesses located in a given location. Experiences elsewhere suggest that such arrangements are rarely successful and are merely a zero sum game.

Before considering the benefits of zonal taxation arrangements, NSWBC considers that the Committee should have a strong conceptual and policy foundation for what such arrangements are intended to achieve.

NSWBC would welcome a broader interpretation of the issues affecting the competitiveness of NSW, including by considering opportunities to improve the efficiency of the NSW tax system. To ensure the needs of NSW's regional communities are met, NSWBC would also welcome the Committee's consideration into the policies (as noted in this submission) that would unlock growth for the State's regions.