Revitalising the Australian Shipping Industry through Tax Reform: Alchemy or Piracy?

Kerrie Sadiq
Professor, School of Accountancy, QUT Business School
Queensland University of Technology
and
Adjunct Senior Research Fellow, Faculty of Business and Economics
Monash University
Overview of Shipping Reforms

• Aimed at removing barriers to investment in Australian shipping, fostering global competitiveness and securing a stable maritime skills base.

• A two pronged approach designed to achieve its stated goals by providing both a ‘stick’ and ‘carrot’ to industry participants.
  – the ‘stick’ is delivered via the provision of tighter regulation of coastal trading operations through a new licencing system, along with the introduction of a civil penalty regime and an increase in existing penalties.
  – the ‘carrot’ is delivered via taxation incentives available to vessels registered in Australia where the registrant meets certain specified criteria.

• These incentives, introduced through amendments to the *Income Tax Assessment Act 1997* and the *Income Tax Assessment Act 1936* and contained in the *Tax Laws Amendment (Shipping Reform) Act 2012*, provide five key tax incentives to the shipping industry.
Tax Reforms

• From 1 July 2012, amendments give effect to:

  – an income tax exemption for qualifying ship operators;
  
  – accelerated depreciation of vessels;
  
  – roll-over relief from income tax on the sale of a vessel;
  
  – an employer refundable tax offset; and

  – an exemption from royalty withholding tax for payments made for the lease of certain shipping vessels.
Alchemy or Piracy? (A Tax Expenditure Analysis)

- Tax reforms targeting specific industries which generally provide concessions, credits or exemptions, are broadly categorised as tax expenditures, with a resulting reduction in tax collected from qualifying taxpayers within that industry.

- These types of tax expenditures are normally introduced for the stated purposes of broader economic policy with the aim of economic steering of taxpayers towards or away from particular activities.

- Consequently, when tax expenditures are targeted at a particular industry or market sector, the policy intent is to provide a reduction in tax to in turn deliver broader domestic economic advantages.
Alchemy or Piracy? (A Tax Expenditure Analysis)

• Tax expenditures are arguably the tax alchemist’s tool for providing the ‘elixir of life’ to a flailing industry.

• However, tax expenditures also result in an erosion of the tax base and result in subsidies received by concessionary taxpayers being funded by non-concessionary taxpayers. That is, the search for wealth, like the main force behind piracy, may be achieved by certain taxpayers through their campaigns for tax concessions.

• While the shipping reforms have the potential to impact positively on shipping operators who will benefit from the tax incentives, there is a broader financial impact of these concessions, estimated to be $254.5 million over the next four financial years.
The “Girt by Sea’ Contention

“Australia is a vast island nation with the majority of its population and industry located near the sea. It is of no surprise then that the Australian economy is dependent upon sea trade. Almost all of our export trade is moved by ship and shipping plays a significant role in fulfilling Australia’s domestic freight task— carrying 24 per cent of the total freight task in 2004-05. While this is a significant contribution by the shipping industry to the national freight task, it is not a substantial one. There is room for growth in Australia’s coastal shipping industry.”
Fear of Missing Out

Government Policy Spectrum for Coastal Shipping

NZ    AUS    EU    US    JAPAN
Non-Supportive    Supportive

A Paradigm Shift – The Budgetary Option

• Is the [proposed] tax expenditure serving a valid government objective and does it reflect a government spending priority;

• Assuming the [proposed] expenditure serves a valid government purpose, and using budgetary criteria:
  – Are the benefits distributed fairly;
  – Is the program target efficient (for example, does it reach intended beneficiaries);
  – Does the program avoid causing any unintended distorting effects;
  – Are the administrative and compliance costs of the program reasonable;
  – Does the government have control over the spending program and is it politically accountable for it;
  – Is the program [to be] appropriately implemented;

• What is the best government policy instrument for the [proposed] expenditure; and

• If the spending program is [to be] delivered through the tax system, what is the most appropriate design?
Further Options for Analysis

- How the tax expenditure interacts with other government assistance;

- The expected impact of the tax expenditure upon market decisions and the basis upon which this impact has been determined, including an assessment of the limitations of that modelling in the particular context of the tax expenditure;

- Information regarding the efficacy of delivery through the taxation system, where several factors might affect the efficacy of the spending program (for example, behavioural responses);

- The distributional effect of the tax expenditure, including at least some consideration of the likely second order effects of the measure; and

- Specification of the performance outcomes.
October 2008 Parliamentary Committee on Infrastructure, Transport, Regional Development and Local Government

• Fourteen recommendations:
  – three specifically related to tax reform;
    • the introduction of an optional tonnage tax regime linked to mandatory training requirements;
    • the reintroduction of accelerated depreciation provisions; and
    • a review of s23AG of the ITAA36 to include Australian seafarers in the exemption from Australian income tax.

• These recommendations were the result of six months of Committee consultations, with 68 submissions and eight public hearings.
Targeted concessions implemented through the taxation system tend to institutionalise inequities between individuals and businesses, enhancing their potential for inefficient resource allocation. They also tend to increase compliance costs as a result of legislative complexity and enhanced administrative obligations; reduce public transparency; and, lower the likelihood of regular review of the effectiveness of such arrangements in meeting their policy intent.

Treasury would generally recommend the provision of concessionary outcomes through well-targeted expenditure programs.
Australian shipping companies are subject to the standard corporate tax arrangement, which puts them at a competitive disadvantage with ships registered in countries like Singapore, Hong Kong and Canada that offer zero tax or very low rates for shipping businesses.

Traditional maritime nations, mainly from Europe, have for some time now successfully introduced differential corporate tax arrangements and created new international registers to retain national tonnage.

Australian ships face severe competitive disadvantage in competing with foreign ships. While stakeholder views do not reflect concerns over capital costs, they do with regard to costs from higher crew wages and maintenance.

There exist differences amongst stakeholders on productivity and efficiency gains but there is general agreement on the range of fiscal and regulatory measures required, including an optional tonnage tax, withdrawal of royal withholding tax, accelerated depreciation, seafarer taxation and changes to the cabotage regime with a view to an increased Australian presence in the coasting trade.
Submissions

46 submissions were received from across the maritime and related industries and from members of the public, including:

- Industry/representative groups – 11 submissions;
- Shipping / shippers – 16 submissions;
- Land-based maritime industry – 2 submissions; and
- Cruise shipping – 3 submissions.

Generally, the submissions showed broad support for the intent of the policy to develop an efficient, sustainable and internationally competitive Australian shipping industry. There was not, however, a consistent view across industry on how this could or should be achieved.

The key issues focussed around the three main areas of reform and are summarised as:

1. [not included]
2. Taxation: There is clear support for the taxation incentives, with some questioning of the extent and the threshold criteria of their application.
3. [not included]
Cost of Tax Concessions

- The cost of the tax concessions to Commonwealth revenue is estimated at $62 million a year from 2012-13. However if the domestic industry continued to decline, revenue from this source may gradually decline in any case, although the impact would depend on whether full employment is maintained in the economy as a whole. On the other hand revitalisation could see a partial offset over time as more shipping businesses domicile in Australia and there is growth in the supporting cluster of ancillary services, such as ship financing, crewing and commercial support.

- The key complementary components to these concessions are the training requirement that will be prescribed in regulation as part of the regulatory reforms, and the proposed Compact to be negotiated between industry and the unions. While the Compact is an industry rather than a government responsibility it will be important to the overall success of the reforms.
Conclusion of the Regulation Impact Statement

• The proposed tax measures reflect the global nature of shipping. An exemption from Australian income tax is the preferred option and an income tax exemption will match Singapore (a shipping regime considered to be the premier operating base by many shipping companies) while the approach taken to seafarer taxation is consistent with international approaches.

• The abolition of royalty withholding tax is not only consistent with international approaches but it is in tune with Australia’s approach since 2001 to remove payments for the lease of equipment across a range of sectors.

• The taxation measures will also provide flexibility in the operation of vessels; the tax exemption measure will allow qualifying ships to conduct a mix of international and coastal voyages without affecting their tax status.

• They will also provide more certainty to Australian companies regarding their tax liabilities: rather than calculating actual income and deductions applicable, any tax payable will be greatly reduced compared with normal income tax rules.
20 February 2012: Exposure Draft Legislation and Associated Explanatory Material Released

• Incentives:
  • an income tax exemption for ship operators;
  • provision for accelerated depreciation of vessels via a cap of 10 years to the effective life of those vessels;
  • roll-over relief from income tax on the sale of a vessel;
  • an employer refundable tax offset; and
  • an exemption from royalty withholding tax for payments made for the lease of shipping vessels.

• 6 submissions received all arguing for further/larger tax concessions
21 June 2012: Assent of Legislation

- **S51-100**: An entity's ordinary income derived during the year or statutory income from the present year, is exempt from income tax to the extent that it is from certain shipping activities.

- **Subdiv 61-N**
  - A company may get a refundable tax offset (30%) for withholding payments made to Australian seafarers for overseas voyages if:
    (a) the voyage is made by a vessel for which the company, or another entity, has a certificate under the *Shipping Reform (Tax Incentives) Act 2012*; and
    (b) the company employs or engages the seafarer on such voyages for at least 91 days in the income year.
Revisiting the Paradigm Shift

• Is the [proposed] tax expenditure serving a valid government objective and does it reflect a government spending priority;

• Assuming the [proposed] expenditure serves a valid government purpose, and using budgetary criteria:
  – Are the benefits distributed fairly;
  – Is the program target efficient (for example, does it reach intended beneficiaries);
  – Does the program avoid causing any unintended distorting effects;
  – Are the administrative and compliance costs of the program reasonable;
  – Does the government have control over the spending program and is it politically accountable for it;
  – Is the program [to be] appropriately implemented;

• What is the best government policy instrument for the [proposed] expenditure; and

• If the spending program is [to be] delivered through the tax system, what is the most appropriate design?
Conclusion

• Controversies mean that there can never be a last word on tax expenditure management to determine whether a particular tax expenditure is alchemy or piracy.

• But, the scale and significance of tax expenditures make them too important to ignore, even if there is no ‘right’ way to identify, analyse and actively manage them.

• Without proper analysis there may be an empty treasure chest.