RE:THINK

Principles for taxation reform

JUNE 2015

TTF AUSTRALIA
Tourism & Transport Forum

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Tourism & Transport Forum (TTF) is a national, member-funded CEO forum, advocating the public policy interests of the most prestigious corporations and institutions in the Australian tourism, transport, aviation and investment sectors.

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Introduction

Tourism & Transport Forum (TTF) welcomes the opportunity to make a submission to the Federal Government's *Re:Think* discussion paper on taxation. The submission below discusses a range of high-level principles based on TTF's advocacy agenda to inform the government's approach to the subsequent Green and White Papers.

Australia's taxation reform project should be an ongoing process. While the biggest and most contentious debates are reserved for the most complex structural reform, there are also a raft of micro-reforms that can and should be addressed by government to improve productivity and the living standards of Australians. This requires a constant dialogue with industry and the community and the political will to enact change.

TTF has long advocated for a range of reforms that can help stimulate investment, grow jobs and drive economic growth.

For the visitor economy – the cohort of businesses that are directly and indirectly involved in attracting and servicing visitors, both domestic and international – taxation can have an enormous impact. Indirect taxes like the GST and the Passenger Movement Charge can inject negative price signals into the Australian product offering, making us a less competitive destination for international visitors. Likewise, any erosion in disposable income through high marginal tax rates or 'bracket creep' can impact on the discretionary spending habits of Australians and subsequently on sectors like retail and tourism.

The taxation system can also play a role in facilitating investment and improving the productivity of existing assets. There are opportunities for the government to examine how it can structure taxation to better:

- reflect the economic value of assets;
- promote the efficient functioning of markets for goods and services, including the needs of the capital markets; and
- the impact on infrastructure development on the value of property.

As the *Re:Think* process continues, TTF will be make further detailed submissions on specific options for reform.

Priorities for growing the Visitor Economy

Tourism as an economic driver

Tourism is a service export and an important driver of growth and jobs for the Australian economy. Against the backdrop of a transitioning economy, with a declining manufacturing sector and a waning mining investment boom, tourism offers strong employment opportunities, a rapidly expanding base of potential customers and a strong competitive advantage. Tourism is already Australia's largest service export, generating expenditure of over $100 billion every year – more than all our primary industries combined. As a labour-rich industry, the visitor economy supports almost a million jobs and directly employs almost twice as many people as the mining industry.

The potential of Australia's tourism industry was highlighted in the recent Deloitte Access Economics report *Positioning for Prosperity*. The report identified tourism as one of Australia's five super growth industries capable of collectively delivering an additional $250 billion to the national economy over the next 20 years.[1]
A key component of achieving this potential is to maximise engagement and visitation from a broad range of markets. This includes traditional markets, such as Europe and North America, and newer markets such as Asia, the Middle East and South America.

Australia's position in the Asia-Pacific presents an unparalleled opportunity to respond to the growing travelling middle-class of the region who want to come to Australia for holidays, to visit friends and family, for business or for education.

Challenges ahead

The Australian government, together with the states and territories, has endorsed an aggressive tourism target as part of the Tourism 2020 strategy. Rapid growth in Asian visitor spending, the fastest growing segment of Australia's visitor economy, underpins the target of doubling nominal overnight visitor spending from $70 billion in 2009 to $115-140 billion by 2020.

Current trends and policy settings mean that even the lower end of the range is under threat. As at June 2014 overnight visitor spending was $84.4 billion. However, to be tracking towards the lower target, spending needed to be at $87.7 billion, or $3.3 billion higher, by June 2014. To be tracking to achieve the higher target, spending needed to be at $95.9 billion, or $11.5 billion higher.

In a highly-contested marketplace, Australia's competitor destinations are moving ahead. Key competitors for the long-haul Asian traveller match their marketing campaigns with government-wide efforts to cut red tape on business, streamline visa processes, and improve the airport welcome experience. It is clear that it will require effort across many areas of government if Australia is simply to maintain its market share of Asian outbound travellers, let alone grow market share and reach the Tourism 2020 targets.

Although the number of Chinese arrivals to Australia continue to rapidly grow, our market share against rival long-haul destinations is declining. As an indicator of the challenge, both Canada and the USA are seeing significantly faster growth in Chinese arrivals than Australia, with the US up 23 per cent in 2014 and Canada up more than 30 per cent so far this year compared to 15 per cent growth to Australia.

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[1] Deloitte Access Economics (2013) *Positioning for Prosperity? Catching the next wave*

Priorities for Improving Transport

Driving productivity

Over the last century, the transport needs of Australia have changed as we have moved from an economy typified by agriculture, then manufacturing and now mining and service industries.

Moving people and ensuring linkages between urban centres and labour markets is as vital today as rail lines were for transporting agriculture 100 years ago. In our densely developed cities, public transport is often the most effective way to do this; while at the same time reducing the costs of congestion. This is particularly important as the service sector of the economy grows. The service sector already accounts for 85 per cent of all jobs and will account for 70 per cent of Australia's economic output by 2040.

TTF has found that there are strong productivity and economic benefits that flow from an expansion of public transport infrastructure. In a report prepared for TTF by PwC[2], a case study into the impact of the opening of the Chatswood to Epping rail line on the Macquarie Park business hub in Sydney found that it resulted in additional annual economic growth of between 1.56 per cent and 2.44 per cent. These findings align with other case studies in the report, such as the impact of the opening of the City Loop in Melbourne and the Docklands Light Rail in London.

With these findings in mind, TTF strongly believes that the Federal Government must be modally-neutral in the way it funds transport projects. We welcome the commitment of the Federal Government to improve our urban motorway network. However, there is no logical reason why public transport projects, if they are properly assessed and recommended by Infrastructure Australia, should not also receive funding. Federal funding support for just one transport mode can skew infrastructure priorities and may mean that more worthy projects are not being progressed by state governments.

TTF also advocates for increased private sector involvement in the delivery of public transport through franchising models. Private operators have greater capacity and a proven track record of delivering more efficient services that are focussed on the experience and satisfaction of the customer. This can also help to promote best practice and innovation in customer service for public transport passengers, particularly the adoption of new technology.

[2] TTF, *Better Public Transport. Better Productivity*, 2014

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Addressing structural change

Digital disruption

As in many sectors of the economy, the emergence of new digital enterprises is disrupting the traditional business models of operators in the tourism and transport sectors. This is most pronounced in the growth of what has come to be termed as the 'sharing economy', where social media has empowered those who were traditionally only consumers to commercialise their own residential and vehicular assets.

Shared economy businesses take goods and services not being fully utilised by their owners – such as spare bedrooms, cars – and rent them out for use by other people. This generates an income stream for the owner of the asset and also reduces 'waste' by increasing the amount of time the asset is in use. Social media and other social technologies that connect people are a key marketplace and therefore facilitator of these business models.

Initially many of these businesses were home-based, very small and stayed outside the tax system – operating on a cash-based system.

More recently, however, these businesses have grown and, in some cases, globalised. While their scale and market coverage have seen them become direct competitors to established operators, regulators have taken time to respond to this rapid growth, meaning that many of these new sharing economy based businesses have operated outside the conventional frameworks. This has created a digital divide, where conventional businesses devote resources to comply with regulations governing concepts like safety and minimum product standards while new digital businesses have been able to largely escape these obligations because of the inadequacy of enforcement or redundancy of legislation, or a combination of both.

These new types of businesses need to be considered in any review of the tax system. Importantly, as a general principle, similar transactions and activities should face similar tax regimes. The challenge for tax policymakers is to ensure that these now substantial businesses are incorporated into the tax system.

As such, TTF welcomes the recent advice issued by the Australian Tax Office (ATO) that outlines how sharing economy businesses need to arrange their tax affairs. In particular, TTF welcomes the like-for-like approach of the ATO including the need for UberX drivers to be immediately registered in the GST system, which matches the GST obligations of the competing service of taxi drivers. In the same ruling, the ATO reiterated that income earned from other activities, including letting rooms, advertised on peer-to-peer digital platforms is assessable.

This area of the economy has particularly strong impacts for the tourism and transport sectors and TTF encourages this review to consider the likely future path of such businesses to ensure the tax system is designed to capture all competitors in the marketplace and is flexible enough to adapt to future changes in the marketplace. Likewise, where it is deemed that the current legislative framework adequately captures the economic activity in question, governments must ensure that resources are dedicated to maintaining enforcement capacity.

Personal income tax

As a predominantly discretionary spend, tourism is impacted by changes in personal income and wealth. A personal tax and welfare system that maintains disposable incomes for consumers is crucial for the sector.

Personal income tax levels have an impact on workforce participation. As a sector heavily reliant on access to labour, high effective marginal tax rates can discourage participation in the workforce, particularly at the segment of labour market most likely to engage in the tourism and hospitality industry. There are numerous examples in the tourism sector where the current tax system discourages increased workforce participation. These include the new 'backpacker tax', high effective marginal tax rates and unnecessary complexity.

Workforce participation crimped by high effective marginal tax rates

As an industry that employs a large proportion of part-time employees, the sector is conscious of the impacts that high effective marginal tax rates have on labour force participation.

Tourism directly employs 534,000 people, with 244,000 working part-time. Many of this group will be second-income earners in households or having their income supplemented with welfare payments. For these employees, as their hours worked increase the welfare payments they receive decrease. These occur at different rates, however, which can create situations where the effective marginal tax rate of earning another dollar is substantially higher than the marginal tax rate of the tax system alone. For example, a parent receiving some family tax benefits and child care support may find themselves facing effective marginal tax rates in excess of 50 per cent if they take an extra shift each week. This situation is particularly common amongst lower income groups and where the lower paid employee is a second-income earner in a household.

This interaction between the welfare system and the tax system has implications for labour-intensive industries such as tourism that rely on and provide support for part-time employees to grow and expand businesses.

Bracket creep impacts on disposable income

As a discretionary spend sector, tourism is concerned about any tax policies that reduce the amount of discretionary income available for potential customers. Recent Federal Budgets have not addressed the issue of bracket creep, which sees employees being pushed into higher tax brackets as nominal wages are increased to maintain real wages. This phenomenon reduces the disposable income available to employees as they move into higher tax brackets and reduces the progressivity of the tax system overall.

Complexity of the personal income tax system

Complexity is an issue across the tax system, including with respect to personal income tax.

One area of particular concern within the personal tax system is Fringe Benefits Tax (FBT). This tax collects just 1.2% of all Federal tax revenue but is extremely costly for companies to comply with due to the need to attribute specific costs to each employee and the large number of rules and concessions. FBT increases integrity of the tax system, by taxing both wage and non-wage employee payments, but it currently does so at great cost. Options worth exploring further include moving to a system largely used elsewhere which involves FBT benefits being dealt with by individual tax payers rather than employers.

The FBT system is also inequitably applied. The current arrangements deliver preferential treatment of salary-packaged cars while public transport is taxed at 46.5 per cent. This creates a bias in the system towards private vehicle use and a disincentive to employers encouraging public transport use.

Working holiday sector at risk from non-resident treatment

As of July 1 2016, working holiday maker visitors will be treated as non-residents for tax purposes. Currently, they are treated as residents once they have lived in Australia for 6 months.

This change has the potential to discourage workforce participation by working holiday makers – notably in areas where labour availability can be scarce during important harvest seasons – as it dramatically increases the tax they will pay. These employees are usually low-paid in minimum wage-style jobs which make them particularly sensitive to tax changes.

The change will also dramatically reduce the amount of funds available for these working holiday makers to spend on tourism-related activities while they are in Australia – which further crimps the capacity of tourism-businesses to invest, hire and grow

Business tax

As with the personal tax system, the company tax system needs to support investment and growth.
The company tax system needs to be fair, treating all companies equally. The new two-tiered system, apart from adding complexity, is creating a competitive advantage for companies that have annual turnover less than $2 million and a disincentive for larger businesses to grow.

The company tax system needs to encourage investment in assets. This means developing depreciation rules that recognise how assets are used and the investment hurdles that need to be overcome in a global capital environment.

The company tax system needs to encourage investment in labour skills and development. There are many tax benefits and rebates that companies can receive from investing in capital assets – such as the R&D tax rebate. However, there are no similar incentives for companies that invest in that other key input – labour.

Company tax cut not delivered to all businesses

In the 2015/16 Budget, the Federal Government indicated it wanted to lift business investment, especially in the non-mining sector. This is needed because of the substantial fall in mining investment expected in the next few years as the mining cycle moves from the investment to production phase.

The Government has argued that a way to do this is to provide a company tax cut and generous depreciation rules for businesses with turnover less than $2 million per year.

TTF does not oppose this policy but argues that a better way to boost investment and employment in the economy would be to also include those firms that do most of the investing and employing – large businesses. This decision has reduced fairness in the company tax system and risks distorting the competitive process as smaller competitors are treated differently and given a competitive advantage to larger ones.

Encouraging investment

Investment in public transport infrastructure can be stimulated by an appropriately-targeted taxation system. Large-scale public transport projects have the capacity to significantly lift property values in surrounding areas once completed. Value-capture financing models, which include such methods as tax increment financing, can provide a mechanism for the recouping of some of the cost of an infrastructure project by capturing the corresponding value uplift.

Similarly, investment in tourism assets should not be hampered by a poorly-calibrated taxation regime. Tourism is a global sector and many major businesses are international in nature. This means local investment projects, such as construction or refurbishment of hotels or the financing of new aircraft, are also competing with other potential projects around the world. As such, Australia needs to have a tax system that encourages this investment, including internationally comparable capital works deductions and depreciation rules.

Indirect taxation

Passenger Movement Charge

Australia currently levies a $55 Passenger Movement Charge (PMC) on all departing passengers over the age of 12. The PMC is the second-highest departure tax among the member countries of the Organisation for Economic Cooperation and Development (OECD) after the United Kingdom and the highest in the developed world for journeys under 3,220km.

Modelling by the International Air Transport Association (IATA) suggests that holiday visitors (as distinct from those travelling to visit friends or relatives) are most sensitive to departure taxes such as the PMC, with every price increase of 10 per cent estimated to generate a decline of 5 to 7 per cent in the number of leisure passengers travelling globally[3]. The price sensitivity of air travel is most pronounced on short-haul routes. This is where the PMC, as a flat tax, makes up a larger overall proportion of the fare. Analysis by TTF shows, for example, that the $55 PMC represents around 18 per cent of the cheapest low season return air fare to New Zealand[4].

Using the average return airfare paid to Australia in early 2014 of $1,628, IATA calculates the removal of the PMC would represent a decrease in total fare of 3.3 per cent. This in turn would drive an increase in passenger traffic of around 2.3 per cent annually, leading to 348,000 additional international passenger return journeys each year[5].

Many countries are moving away from departure taxes, as the impact on tourism is becoming more widely understood. Malta led the European movement away from taxing tourists, becoming the first country to repeal its departure tax in 2008. Another country to repeal its tourism tax is Ireland, which abolished its Air Travel Tax in April this year after economic modelling showed the losses to the economy of around €482 million. Ireland has had a number of new international air services introduced from the United Kingdom and long-haul routes following the zero-rating of the tax.

Even the United Kingdom government announced that from 1 May 2015, the Air Passenger Duty (APD) will not apply for young children on flights that depart from the United Kingdom. The tax costs £13 for short-haul flights, covering all of Europe, plus Turkey and North Africa. It can be as much as £97 for longer journeys. While the

3 International Air Transport Association (2013)

4 Tourism & Transport Forum (2014) - Australian Tourism Industry Submission to Joint Review of Border Fees, Charges and Taxes

5 International Air Transport Association (2014)

abolition of the tax initially only applies to under-12s, from March 2016 it will be extended to all children under 16.

The PMC is no longer a cost-recovery measure, with the proceeds simply going to consolidated revenue. While it is currently frozen at $55, the current Federal Government has given no commitment to extending this freeze beyond the current term of Parliament. The government has an opportunity to make strategic adjustments to the PMC, including a reduction for short-haul flights, to help stimulate growth in visitor numbers and expenditure. Industry will be looking to the *Re:Think* process to address the PMC and its impact on the visitor economy.

GST and state and territory tax issues

Currently, tourism is the only export subjected to GST. There are some exemptions that minimise this impact – such as international airfares to Australia. But this still leaves GST levied on many leisure tourism activities.

There is an opportunity for this review to improve the operation of the GST and other state and territory taxes by simplification including looking for ways to consolidate the number of taxes charged, harmonising multi-state taxes and reviewing the numerous exemptions within the system.

In addition, tourists can claim back some of the GST they pay through the Tourism Refund Scheme. However, this is a cumbersome scheme that is in need of reform and awareness to encourage greater take-up by tourists.

The current system, administered by the Australian Customs and Border Protection Service can be cumbersome and time consuming. It also costs the Australian taxpayer some $14 million per year to administer, funded from the Customs budget. A viable alternative is to allow private operators to administer the scheme. Economic modelling, undertaken by KPMG on behalf of the Tourism Shopping Reform Group, estimates that by 2017 such a reform could attract an extra 18,000 international visitors to Australia, increasing international visitor shopping spend by $226 million.

Harmonisation of state taxes

Payroll tax, land tax and stamp duties, as well as differing taxation and regulatory regimes for such industries as rental cars, are levied in each state but are subjected to different rules and have different rates. This creates high compliance costs and distorts investment decisions, especially for businesses that operate across state boundaries. Ideally, some of these state taxes, especially those that only collect small amounts of funds, could be abolished in the context of broader taxation reforms that favour more efficient revenue collection sources. However, at a minimum greater focus on achieving harmonisations of base definitions would reduce the compliance cost for multi-state businesses.