Australian Shipowners Association

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To Whom It May Concern:

Please find below the submission from the Australian Shipowners Association regarding the Business Tax Working Group Discussion Paper dated 13 August 2012 (the "Discussion Paper").

This Discussion Paper canvases consultation on a number of different options available to offset the cost of a corporate tax rate cut by broadening the business tax base.

This submission is concerned with Option B.2 (removal of the capped effective life provided to certain depreciating assets) and the potential impact of such a change on the Australian shipping industry.

Executive Summary

It is extremely disappointing for the shipping industry to discover that 44 days after much-needed changes were introduced in this area that the removal of accelerated depreciation was being considered.

These changes were introduced after an extensive, 4-year consultation period on what would deliver the best outcome for the industry. Publications like the Discussion Paper undermine business confidence in the new tax arrangements and discourage investment.

A strong shipping industry can deliver many benefits to Australia, however, given the internationally competitive climate to attract and retain shipping operations, these potential benefits will only be delivered through a consistent and focused approach to rebuilding the Australian shipping industry.

This short term uncertainty will discourage the long term investment required and, as a result, fail to meet the Government's objectives to rebuild the Australian shipping industry.

Furthermore, the economics do not justify removing the accelerated depreciation for the shipping industry. This removal is designed to identify savings to fund a future reduction in the corporate tax rate. Without the benefit of accelerated depreciation in the first place ship operators will simply base themselves overseas (as they have been doing for the last 20 years) and, therefore, no additional revenue will be raised in any case.

Rationale for shipping reforms being introduced

The Australian shipping industry has been in serious decline over the last 20 years with minimal investment in new shipping over that period.

This is partly due to an uncompetitive shipping tax regime, where, unlike most other countries, Australia has offered no tax concessions to the shipping industry. As a result, over 99% of the ships importing and exporting goods from Australia are owned by foreign shipowners.

Other countries have experienced significant economic benefits following the introduction of tax benefits for the shipping industry. As an example, it is considered that the UK shipping industry is between three and five times larger than it would otherwise have been without the introduction of shipping tax concessions in 2000. The impact of these concessions on the UK has been significant with per annum increases in GDP of around GBP 5.5 billion and GBP 1.4 billion of Exchequer revenues.[1]

This potential opportunity was recognised by Minister Albanese who has driven an exhaustive consultation process over the last 4 years in relation to the goal of revitalising the Australian shipping industry:

- Parliamentary Inquiry report released entitled *Rebuilding Australia's Coastal Shipping Industry* (October 2008)
- A Shipping Policy Advisory Group of Industry leaders formed to assist in implementation of above report (February 2009)
- Election campaign commitment to revitalise the Australian shipping industry (August 2010)
- Release of Discussion paper entitled *Reforming Australia's shipping* (December 2010)
- Submissions received on above Discussion Paper (January 2011)
- Formation of 3 industry reference groups to consult on taxation, regulatory and workplace elements of the proposed shipping reforms (February 2011)
- Regulation Impact Statement on the proposed shipping reforms was finalised and approved by the Office of Best Practice Regulation (August 2011)
- Release of specific policy details on revitalising the Australian shipping industry "Stronger shipping for a stronger economy" (September 2011)
- Meetings of General Industry Forums (November and December 2011)
- Release of exposure drafts of relevant legislation and consultation process on various drafts (late 2011 to early 2012)
- Industry wide consultation meeting to discuss the proposed reforms (March 2012)
- Review of legislation by House Standing Committee on Infrastructure and Communications (May 2012)
- Finalisation of Bluewater Shipping Reform Labour Relations Compact (May 2012)
- Review of Senate Economics Legislation Committee (June 2012)

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[1] Quoted from a report by Oxford Economics – The economic contribution of the UK shipping industry in 2007, Final Report February 2009

- Final legislation enacted and applicable from 1 July 2012 (June 2012)

The above consultation process included extensive input from the key stakeholders – shipowners, ship operators, shipping customers, trade unions, training organisations and relevant Government departments (including the Australian Taxation Office, Treasury, Department of Infrastructure and Transport).

During this extensive consultation process, Minister Albanese introduced the shipping tax changes as part of a comprehensive policy package to deliver a stronger Australian shipping industry:

"We are determined to create an environment that will encourage and sustain growth and productivity in our shipping industry."[2]

The end-result of this consultation was a comprehensive parcel of reforms, designed to offer particular, inter-related benefits. To remove one of these benefits in a piecemeal fashion would appear to negate the significant work already done in this area to design an appropriate policy package.

Importance of the taxation reforms as a holistic package

By designing an effective regime for the taxation of shipping, coupled with the other proposed reforms, it was hoped that Australia can derive significant economic advantages as other comparable countries have done. As the Minister stated:

"The tax reforms are a major component of the government's Stronger Shipping for a Stronger Economy legislative reforms to revitalise the Australian shipping industry.

The purpose of the government's tax reforms is to encourage and support capital investment.

Encouraging new investment is critical if we are to revitalise the industry.

The tax reforms I am introducing today provide a platform for this investment."[3]

The Discussion Paper itself states that "There may also be cases where departures from uniform tax treatment are justified on economic grounds, social or environmental grounds"[4]

It is our view that the accelerated depreciation recently introduced in the shipping industry is one such case. This is supported by Minister Albanese who noted in his Second Reading speech that the Australian fleet has an old fleet in comparison to international standards and saw the following key benefits from the renewal of the Australian fleet, encouraged by the introduction of accelerated depreciation:

- The economic benefits given that the cost of running a 20 year-old ship can be 40% greater than a 5 year-old ship;
- Newer vessels with newer technology are safer and more environmentally friendly;

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[2] Extract from the Minister for Infrastructure and Transport's speech "Stronger Shipping for a Stronger Economy", 9 September 2011
[3] Extract from Minister Albanese's Second Reading Speech on the Shipping Reform (Tax Incentives) Bill 2012
[4] Paragraph 84 of the Discussion Paper

- Replacement of the fleet should reinvigorate the industry and encourage employment[5].

In support of particular taxation policies being used to drive capital expenditure outcomes, the Discussion Paper notes, "in some cases, there are good reasons to favour some types of capital expenditure"[6].

As has been proven in other countries, a successful shipping industry builds a maritime cluster which can result in significant economic and tax benefits.

A maritime cluster is effectively a geographic connection of interconnected businesses, suppliers and associated institutions in the maritime industry. A maritime cluster typically comprises core sectors (i.e. shipping, ports and offshore), together with related activities (i.e. marine equipment, fisheries, Navy, maritime services, seaports, inland navigation, logistics, maritime works, recreational boating etc).

A strong maritime cluster will typically be characterised by a number of high-value support services also being located within the country.[7]

As a cluster grows and develops it becomes self-sustaining, generating significant economic benefits and continuing to attract more businesses to the cluster. A number of indirect economic benefits also arise from support services being provided to businesses operating within the cluster.

The benefits arising from a strong shipping industry and a successful maritime cluster are outlined below:

- Economic benefits – as outlined above, the introduction of the tonnage tax in the UK has resulted in significant annual increases in GDP and tax revenues due to the effect of the maritime cluster. If the Australian tonnage tax regime generated even 10% of the benefits generated by the UK regime, this could lead to approximately A$215m of additional annual tax revenues and an annual increase in GDP of A$850m for Australia.[8]
- Employment - direct benefits arise from the economic activity and jobs generated by the cluster and indirect benefits arise from the jobs and demand created up and down the supply chain and the increased consumption in the economy overall.

[5] Refer Minister Albanese's Second Reading Speech, Tax Laws Amendment (Shipping Reform) Bill 2012

[6] Refer paragraph 116 of the Discussion Paper.

[7] This could include engineers, lawyers, accountants, brokers and agents, insurers, financiers, ship valuations, ship classification expertise, dredging, charterers, pilotage, specialised media, hydrographers, cruising, education and training governance, hydrographic offices, navies and coast guards, trade unions and associations, oceanography, oceanology, consultancy, environmental agencies, ship designers, commercial dispute resolution, arbiters, research expertise at universities etc

[8] Based on an Oxford Economics Study indicating the UK tonnage tax regime generates £5.5bn of GDP annually (at A$1 = £0.65, this equals approximately A$8.5bn, of which 10% is A$850m) and results in tax revenues of £1.4bn (at A$1 = £0.65, this equals approximately A$2.15bn, of which 10% is A$215m).

- Improvement in the current account position – a 2007 study shows that the almost total reliance on foreign shipping to carry Australia's external trade results in a $7.5bn deficit in Australia's current account[9].

- Development of seafaring skills which can then be transferred to land-based jobs (e.g. harbour masters, logistics support, classification experts etc).

- Know-how and expertise - training and development of cadets enriches the industry and builds its long term future as well as supporting skilled workers in the economy.

- National security – access to an Australian merchant fleet should this be required.

- Risk Management / supply chain security – strong Australian fleet can help to ensure continuity and stability of supply.

Furthermore, these benefits can be achieved at minimal cost to the Australian economy because the existing shipping regime does not currently generate significant tax revenues given the small size of Australian controlled shipping. The accelerated depreciation regime is intended to fund economic growth in the future. It follows that removal of this recently introduced concession will only have a miniscule impact on tax collection (if any) in the immediate future so would not give rise to revenue saved in order to fund any broader corporate tax rate cut.

It is also worth nothing that the removal of accelerated depreciation for the shipping industry in lieu of a lower corporate tax rate is not a like-for-like swap. The tax exemption for the shipping industry introduced in parallel with the accelerated depreciation would likely mean that the removal of accelerated depreciation would lead shipping companies to revert to a tax-exempt regime in any case. Thus the benefit of removing the accelerated depreciation for the shipping industry is not the same as for other industries who will benefit from a lower corporate tax rate. The shipping industry already has a tax-exempt alternative to fall back on.

Internationally competitive nature of the shipping industry

Another point worth noting which is of particular relevance to the shipping industry is that the removal of the accelerated depreciation "will inevitably have implications for a sector's ability to compete for investment"[10]

The shipping industry, by its nature, is a very mobile industry. Shipping organisations can base themselves anywhere in the world as they are not constrained by location given their assets can move to where they are required. The majority of developed countries have recognised this and have deliberately introduced tax incentives to try to encourage a local shipping industry. They recognise that, without a globally competitive shipping tax regime, the activity will move elsewhere and, therefore, no tax will be raised from that industry in any case. The logic follows that by 'ring-fencing' an attractive tax regime for the shipping industry, additional economic

[9] Refer Australian Bureau of Statistics, International Trade in Goods and Services, 2009 report which noted that payments made to foreign shipping entities by Australian residents reached $8.1bn in 2007, compared with payments made to Australian shipping entities of $625m.

[10] Paragraph 81 of the Discussion Paper.

benefits and tax revenues can be achieved as the maritime cluster builds around the shipping industry.

Other countries are competing strongly for shipping companies to operate from their jurisdiction. Australia needs the accelerated depreciation benefits to remain competitive in the global context.

The implications of this global competitiveness are that the removal of the accelerated depreciation for the shipping industry will simply not result in more tax revenue for Australia as, without these benefits, the shipping industry will simply base itself elsewhere. Thus it is a misnomer that removing this benefit can fund another outcome (lower corporate tax rate) because no additional funds will likely be raised from its removal.

As a final point, as the Discussion Paper itself acknowledges[11], these shipping changes have only recently been introduced.

The shipping industry is an investment environment where decisions about new tonnage have a 15 to 20 year investment timeframe. As a result, the uncertainty created by the Discussion Paper's comments relating to accelerated depreciation will discourage the investment needed to deliver the stronger shipping industry as desired by Minister Albanese. Ship operators will simply choose an alternative jurisdiction where the tax regime is more stable and predictable, at the detriment to Australia.

Conclusion

As has already been acknowledged during the extensive consultation process, the shipping industry is deserving of the proposed tax reforms because the economic and other benefits arising from a strong shipping industry were considered to warrant the tax incentives. This continued uncertainty over the long-term availability of these reforms will simply discourage investment and reduce the likelihood of successfully rebuilding the Australian shipping in industry.

For this reason, and for the reasons discussed above, it is our view that the Business Tax Working Group should conclude that the removal of the recently introduced accelerated depreciation for the shipping industry should not be pursued.

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Should you have any questions on the above, please do not hesitate to contact me.

Kind regards

Teresa Lloyd

Teresa Lloyd
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Australian Shipowners Association

[11] Paragraph 118 of the Discussion Paper.