



Western Australian Local Government Association

WALGA submission to the Tax Discussion Paper – JUNE 2015

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Executive summary

This submission presents the views of the Western Australian Local Government Association (WALGA or 'the Association') on the Australian Government's 'Tax Discussion Paper.'

The Association agrees with the proposition that the tax system needs to be reformed to face contemporary challenges such as globalisation and the ageing population. There is also a need to use more efficient taxes so that Governments can raise the revenue they require with minimal disruption to the economy. Local Governments are already delivering in this respect – there is widespread acknowledgement that rates are a particularly efficient tax.

Nonetheless, rating efficiency could be further improved if the tax base was broadened by reforming the following State imposed exemptions from Local Government rating: Independent Living Units, State Government trading entities and State Agreement Acts.

The WA State Government could substantially improve the efficiency of its own property tax regime by phasing out stamp duty and replacing it with a broad land tax. However, the Association would only support this reform if Local Governments were assured that they would maintain their sovereignty over the rate setting process.

While Local Government rates are an appropriate source of revenue for the sector, most individual Local Governments are also dependent on a share of taxes from the other levels of Government. As Local Governments' share of Commonwealth taxation has decreased this has resulted in inequitable outcomes for communities with a low fiscal capacity since they suffer disproportionately as the support from grants decreases.

The prospect of reciprocal taxation within the Federation remains an area of interest for the Association. However, the numerous implications of a reciprocal taxation regime would need detailed investigation before this reform could be seriously considered.

The Association applauds recent changes in the 2015-16 Federal Budget that will better target the Zone Tax Offset (ZTO) to permanent residents of the relevant zones. The Association suggests that the savings from this measure should be used to increase the ZTO, which has not been increased since 1993. The Association also recommends removing the fringe benefits tax exemption for FIFO work camps located in or near communities where existing dwellings are available to house workers. Both of these reforms would assist regional development by enabling more workers to relocate to remote communities.

1 Introduction

The Western Australian Local Government Association (WALGA or ‘the Association’) is the united voice of Local Government in Western Australia. The Association is an independent, membership-based group representing and supporting the work and interests of all 138 mainland Local Governments in Western Australia, plus the Indian Ocean territories of Christmas Island and Cocos (Keeling) Islands.

The Association provides an essential voice for 1,249 elected members and approximately 24,900 Local Government employees as well as over 2 million constituents of Local Governments in Western Australia. The Association also provides professional advice and offers services that provide financial benefits to the Local Governments and the communities they serve.

The Association is grateful to the Tax White Paper Task Force for the opportunity to provide a submission in response to ‘Re:think’, the Australian Government’s Tax Discussion Paper. The Western Australian Local Government sector has an interest in the Australian tax system, both as a taxing authority and as the recipient of tax revenue collected by other levels of Government.

This submission represents the Association’s current views on aspects of the Australian taxation system and identifies a number of priority areas for reform. The Association looks forward to further opportunities to contribute as the Tax White Paper process continues and the options for reform become clearer.

The Association agrees with the Tax Discussion Paper that tax reform offers the opportunity to improve investment, productivity and standards of living. Additionally, the Association believes that changes to Australia’s tax system are necessary to face challenges such as globalisation and an aging population. The Association also agrees with the Tax Discussion Paper that rates are a particularly efficient tax and believes that rates are an appropriate source of revenue for the Local Government sector. Section 2 of this submission discusses the advantages of Local Government rates and their benefits relative to the property taxes used by the State Government.

Section 3 highlights the State Government restrictions that prevent Local Governments from achieving further efficiency gains in rating property in their district. Section 4 presents the Association’s views on the frequently raised suggestion that stamp duty should be abolished and replaced by a broad land tax. The Association expresses cautious and qualified support for such a proposal. Section 5 of this submission discusses tax sharing arrangements in the Federation with a focus on Commonwealth grants to Local Government. Section 6 raises the issue of reciprocal taxation and the implications of such arrangements. Finally, section 7 suggests potential reforms to the Zone Tax Offset and Fringe Benefits Tax that would assist in the development of regional Western Australia.

Due to meeting schedules this submission has not yet been endorsed by the Association’s State Council. The Tax White Paper Task Force will be informed of any changes to the Association’s submission following consideration by the Council.

2 The advantages of Local Government rates

Taxes are said to work best when they are broad based and applied with low rates. Local Government rates perform well against both of these criteria.

The Local Government rates base is particularly broad since it applies to most types of property, including the principal place of residence. Although there are a few exemptions from the rates base, these are: consistent with the tax exemptions applied by other levels of Government, justified by a sound rationale and generally well supported by the community. For example, charitable organisations are exempt from rates as well as Federal company tax and State land tax. These tax exemptions are justified on the basis that charitable organisations provide social services that would otherwise need to be provided by Governments.

Compared to the State Government's property taxes, Local Government's property tax regime is applied at low rates and has a relatively small impact on the economy. In 2013-14, WA Local Government rate revenue was \$1,835 million, which represented 0.7 percent of Gross State Product (GSP). In comparison, over the same period, WA State Government property tax revenue was \$3,113 million, or 1.2 percent of GSP.

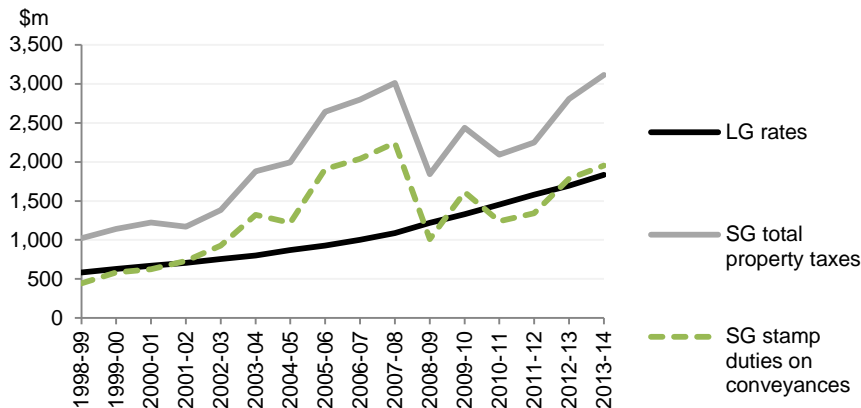
Local Government rates also compare favourably to State Government property taxes on efficiency grounds. In WA, rates are levied on improved property values in urban areas (using Gross Rental Valuation or 'GRV' rating) and unimproved property values in rural areas ('UV' rating). Taxes based on property values are very efficient because the tax base is said to be immobile, which means there is little one can do to avoid or minimise the tax liability. Indeed, the Tax Discussion Paper identifies municipal rates and land taxes as the most efficient taxes used in Australia.

In contrast, most of the WA State Government's property tax revenue comes from stamp duty on conveyances – a tax that is widely criticised for its inefficiency. As a transaction based tax, stamp duties can be quite easily avoided, simply by not conducting the transactions that attract the tax. This causes a number of problems:

- Inefficient use of the housing stock, since older couples are discouraged from downsizing and young purchasers tend to buy bigger homes than they immediately need to avoid paying stamp duty in the future.
- Workers are discouraged from moving closer to their jobs, which contributes to longer daily commutes.
- Workers are discouraged from moving from areas with high unemployment to regions with labour shortages.

A further disadvantage of stamp duty is that it is based on both the volume and value of transactions, and is therefore a volatile source of revenue. Rates, on the other hand, provide a relatively reliable and steady income stream:

Figure 2.1 WA Local Government and State Government property taxes



Source: ABS, 5506.0 - Taxation Revenue, Australia, 2013-14

The stable nature of rates promotes sound decision making and assists in Councils' long term planning. This means that Local Governments have generally avoided the 'boom or bust' scenarios that have affected the Federal and State Budgets recently – considered as an aggregate sector, WA Local Governments have consistently achieved a healthy budget surplus.

A further advantage of Local Government rates is that Councils are particularly accountable to their communities for the use of the funds raised:

Policymakers make better decisions when they also bear the cost and quality of their decisions. Moreover, clear links between tax revenue and expenditure create fewer opportunities for waste and maladministration.

Local government decisions have both these characteristics. Local councillors are affected by the quality of their council's services, and local taxes are used for local ends.¹

This level of accountability ensures Local Governments' spending commitments determine the revenue required and the subsequent level of tax rates. As a consequence, Local Governments typically lower the 'rate in the dollar' when property values increase. Again, this contrasts with other levels of Government. The State Government usually retains the same property tax rates and thresholds when property values increase, resulting in 'windfall' revenue gains. Similarly, the Federal Government often relies on income tax 'bracket creep' as a means of improving its revenue outcomes.

Nonetheless, despite these advantages of rates, there will always be some Local Governments that have little capacity to raise rates revenue, such as those with low populations or in remote locations. It is therefore very important that Local Governments with low fiscal capacities have access to tax sharing programs from the other levels of Government.

¹ Creighton, A. and Hartwich, O. M. (2011), 'Australia's Angry Mayors: How Population Growth Frustrates Local Councils', *Policy Monograph (Population and Growth series)*, PM120.

3 Restrictions on Local Government rates

The previous section demonstrated that rates are an efficient and appropriate source of revenue for Local Governments. However, rates could be an even more efficient tax if State Government imposed restrictions on Local Government rates were removed.

Independent Living Units

A number of legislated exemptions from the rates base constrain Local Government revenue in WA. Section 6.26(2)(g) of the *Local Government Act 1995* provides that 'land used exclusively for charitable purposes' is exempt from Local Government rates. Exemptions under this section of the Act have extended beyond the original intention and provide rating exemptions for land used by not-for profit organisations for profitable purposes. The most prominent example of this is the exemption provided to Independent Living Units (ILUs).

ILUs are separate dwellings, usually in retirement villages, and residents often manage their own affairs without any health, nursing, personal or other forms of support provided by the owner of the village. The not-for-profit sector is an important, although not the only, developer of such accommodation. As the population ages the revenue forgone from conversion of existing rate paying land to ILU accommodation operated by the not-for-profit sector is expected to grow and place an increasing burden on the smaller proportion of the population who do pay rates.

State Government Trading Entities

State Government trading entities do not pay rates to Local Governments, but instead pay a 'rate equivalent' payment to the State Government to comply with the 'competitive neutrality' principle of National Competition Policy. This matter is of serious concern to Local Governments with substantial State owned trading entities in their district. The shortfall in rates is effectively paid by other ratepayers, which means ratepayers have to pay increased rates because trading entities have a presence in the district.

The State Government trading entities covered by this arrangement include Port Authorities and a number of utility corporations. Most of these entities place significant demands on Local Government infrastructure, especially roads. The rate revenue foregone from these trading entities is substantial – about \$19 million in 2013-14.² The Association therefore believes it would be appropriate for Government Trading Entities' rate equivalency payments to be made to the relevant Local Governments instead of the State Government.

State Agreement Acts

Local Governments in WA are often restricted in rating major resources projects, largely as a legacy of a pre-FIFO era where mining firms constructed 'company towns' located in the vicinity of project sites. These arrangements were prescribed in State Agreement Acts, which are essentially contracts between the State Government and proponents of major resources projects that are ratified by the State Parliament.

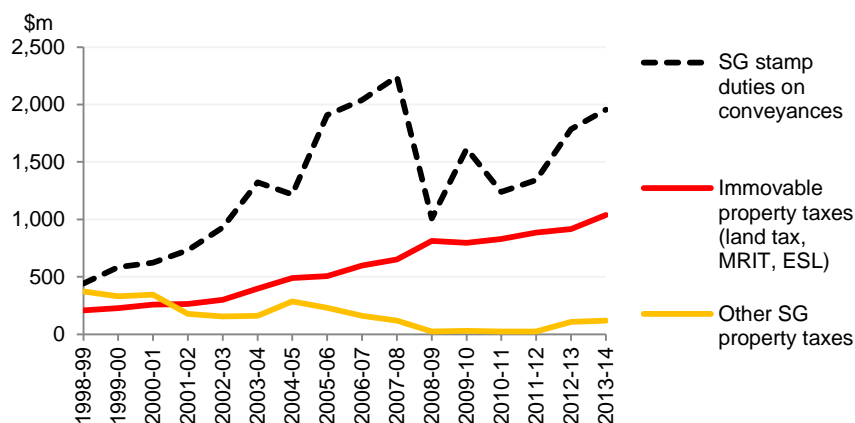
² Source: WA State Budget Papers 2014-15

Most mining company towns have long been ‘normalised’ as Local Governments and State Government utility providers have assumed responsibility for services and infrastructure. However, despite the Association and Local Governments repeatedly advocating for change in this area, the rating restrictions remain. This causes inequity between proponents of older projects, who benefit from substantial rates concessions, and newer projects which are generally liable for standard Local Government rates.

4 State property taxes and implications for Local Government

The WA State Government uses a number of property taxes, including: stamp duty on conveyances, land tax, the Metropolitan Region Improvement Tax (MRIT) and the Emergency Services Levy (ESL). Other types of property taxes such as ‘financial institutions transactions taxes’ and miscellaneous minor stamp duties have mostly been phased out by the State Government over time. Immovable property taxes (land tax, MRIT and the ESL) have become increasingly important over time:

Figure 4.1 WA State Government property taxes



Source: ABS, 5506.0 - Taxation Revenue, Australia, 2013-14

The above graph shows that the State Government is increasingly relying on its ‘immovable property’ tax base as a source of revenue. This is somewhat understandable given the inherent stability and efficiency of taxing property values – for example, land taxes and Local Government rates share many of the benefits discussed in section 2. However, most State Governments in Australia apply land tax in an inefficient way, with a number of exemptions from the tax base, including the primary place of residence.

When land taxes are applied to a comprehensive base, they have a number of benefits:

- They can be used as a fair and efficient method of taxing and funding infrastructure (since any uplift in land values caused by new infrastructure will be partly captured by the government via increased land tax revenue).
- Because land taxes are based on the unimproved value of land, they encourage development and for land to be put to its most productive use. They therefore also tend to discourage land banking, speculation and urban sprawl.
- They provide a stable source of revenue for the State Government – particularly compared to other revenue sources such as mining royalties and stamp duty.
- Progressive land tax rates can be used to ensure owners of higher valued land pay a higher proportion of tax (just as progressive income tax rates increase the rate of tax paid by higher income earners).
- In contrast to stamp duty, broad land taxes spread the tax burden among the community, rather than the small group of people that move house in a given period.

- If land tax replaced stamp duty this would have positive effects on labour productivity and congestion, since this would remove the disincentive for people to relocate for work purposes.
- If land tax replaced stamp duty this would have a positive impact on housing affordability, since the upfront costs of home ownership would be reduced. Additionally, the supply and turnover of housing stock would probably increase, further improving affordability.

A number of reviews have recognised these benefits and have recommended that State Governments make greater use of broad land value taxes and phase out inefficient stamp duties. This included the ‘Henry review’³ of Australia’s taxation system and a recent Economic Regulation Authority inquiry into microeconomic reform in WA.⁴ In the ACT, significant tax reform is already taking place – stamp duties are being phased out over the next 20 years and municipal rates are being increased in their place.⁵

The efficiency arguments notwithstanding, the prospect of a broadened land tax is a concern for the Local Government sector. Relative to other taxes, rates are a highly visible tax and sometimes a sensitive issue in the community. An annual land tax bill for householders will also be a highly visible tax and the similarities between land tax and rates may cause confusion in the community.

Consequently, the Association believes that if State Governments begin to make greater use of land tax, this should be accompanied by measures that clearly define which level of Government is using which taxes. Furthermore, it should be clear to the community what their property taxes pay for, i.e., a distinction should be made between the services and infrastructure of Local Government and those of the State Government.

The Association therefore believes that Local Government should not be the ‘tax collector’ for the State. Each level of Government should be ‘sovereign in their own sphere’; including being accountable to the community for the tax revenue they raise and having the discretion to set their own tax rates.

This view disagrees with the Henry Review, which suggested significant administrative savings would result from Local and State Governments sharing the same tax base:

A redesigned land tax system could be simply administered by aligning local government rates with the land tax. Ideally, landowners should receive just one bill per year covering both and have a single point of contact for enquires, debt management and compliance. More significant simplification could be achieved if all local government rates had the same base as State land tax. This would reduce administration and compliance costs for individuals and businesses that pay rates across different councils in the same State and lower the cost of valuation, which is a significant part of the cost of collecting land tax and rates.

³ Treasury (2010), *Australia’s Future Tax System: Report to the Treasurer, Part Two: Detailed Analysis*, Vol. 2.

⁴ Economic Regulation Authority (2014). *Inquiry into Microeconomic Reform in Western Australia*.

⁵ Because there are no Local Governments in the ACT, municipal rates are effectively a combination of a land tax for the Territory Government and traditional Local Government rates.

The Association agrees that it may be possible to achieve savings in the valuation process by using the same valuation base across rates and land tax, and this may be an idea worthy of further investigation. However, the Association disputes the administrative savings claimed by sending 'just one bill per year'. These savings may come with a heavy cost for Local Governments. Shared administrative arrangements would increase the incentive for the State Government to become involved in the rate setting process. In effect, this has already happened in those States where rate capping has been introduced. Shared administrative arrangements may also cause confusion for rate payers – this has already been Local Government's experience in collecting the ESL on behalf of the State Government.

As well as the State Government needing to collect its own land tax (and other property taxes such as the ESL), the Association would also require the following conditions to be met before it could support a broadening of the land tax base:

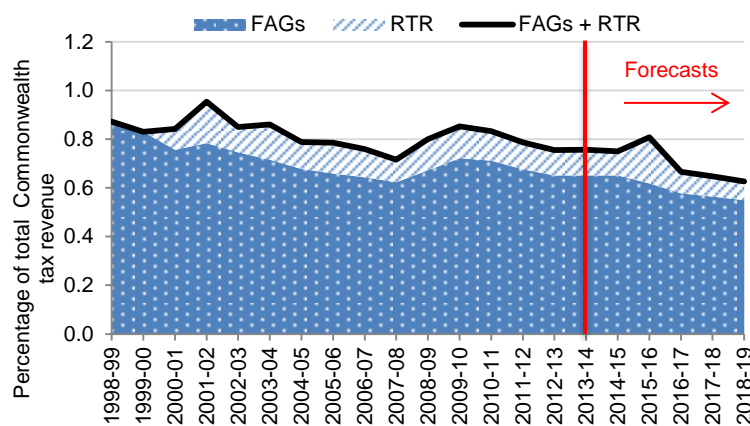
- That land tax should only be expanded to the extent that it replaces stamp duty revenue; the overall State Government property tax burden should remain the same.
- That appropriate transitional arrangements are in place. This should include phasing in the land tax over time and exemptions or concessions for households and other entities that have recently paid transfer duty.
- That appropriate arrangements are made for 'asset-rich, income-poor' households. This could include allowing pensioners to defer their land tax payments until the property is sold, as currently occurs with Local Government rates.
- That most agricultural land should be exempt for land tax, through the application of a per square metre value threshold as suggested by the Henry Review.

5 Tax sharing arrangements in the Federation

While a detailed discussion of tax sharing arrangements is best explored in the Federation White Paper process, there are, nonetheless, implications for own source revenue at lower levels of Government when inefficient tax sharing arrangements are used.

Local Governments currently receive ongoing financial assistance from the Commonwealth under two programs: Financial Assistance Grants (FAGs) and Roads to Recovery (RTR).⁶ Over time Local Governments have become increasingly concerned as the significance of these grant payments (as a share of Commonwealth taxation) has decreased:

Figure 5.1 FAGs and RTR as a proportion of Commonwealth Government taxation



Source: ABS 5506.0 - Taxation Revenue; Federal Budget 2015-16

Continued Commonwealth support for Local Governments is justified because Local Governments only have one source of their own tax revenue (rates) and it is not feasible for most Councils to provide a sufficient level of services from rates revenue alone. Because it would be administratively costly to establish income or consumption taxes at the local level, Local Governments should be entitled to a share of taxation revenue from other levels of Government.

This was well recognised when FAGs were established – the funding pool was set as a proportion of income tax revenue. However, since 1995, FAGs have been set with an indexation methodology that only considers the CPI and population growth. Additionally, indexation of the FAGs pool is subject to the discretion of the Federal Treasurer. Currently, the FAGs pool is frozen at its 2014-15 level because the 2014-15 Budget suspended indexation for three years.

RTR payments, when first introduced in 2000-01, somewhat offset the impact of the decreasing significance of FAGs. However, there is no formal process for setting or escalating the RTR pool. Therefore, from 2002-03, the overall decline in payments to Local Government as a proportion of tax revenue continued.

⁶ FAG payments are made 'through' the State Governments according to a set of principles set by the Commonwealth. RTR payments are made directly from the Federal Government to Local Governments.

As their share of Commonwealth taxation decreases, Local Governments must either cut services or increasingly rely on their rates base. But large rate increases are not a feasible option for many Local Governments. While rates are overall a small taxation burden for the WA economy, this does not necessarily apply to all regions and communities in the State:

Table 5.1 Gross Regional Product and rates revenue in WA regions, 2012-13

	Gross Regional Product (GRP) (\$m)	Rates revenue (\$m)	Rates as a proportion of GRP (%)
Perth	177,991	1,098	0.6
Gascoyne Goldfields	14,555	133	0.9
Peel South West	19,232	216	1.1
Pilbara Kimberley	22,873	108	0.5
Wheatbelt Great Southern	8,190	147	1.8
Western Australia	242,841	1,702	0.7

Source: National Economics, State of the Regions 2013-14; WA Local Government Grants Commission data; author calculations

The above table suggests that rates already have a greater impact on the regional economy in the Peel-South West and Wheatbelt-Great Southern areas of WA. This is unsurprising because rural Local Governments often have a small rates base due to low populations and significant expenditure commitments such as large road networks. It is also consistent with a 2008 Productivity Commission study that found rural and remote Local Governments were already drawing heavily on their fiscal capacities and had little potential to increase their own-source revenue.⁷

The declining significance of operating grants to Local Government will lead to inequitable outcomes in Australia, as some communities have little capacity to absorb the impact of decreasing Commonwealth assistance. The Association therefore believes an effective tax sharing regime, such as the arrangement that was in place when the FAGs program began, has the potential to greatly assist Australia's rural and remote Local Governments.

⁷ Productivity Commission (2008), *Assessing Local Government Revenue Raising Capacity*.

6 Reciprocal taxation arrangements

Generally, the different levels of Government in Australia do not tax each other. One exception to this arrangement occurs in Tasmania, where the State and Local Governments are liable for each other's taxes. There may be some benefits to such arrangements, particularly where property based taxes are used. For example, when constructing facilities such as schools, hospitals and office buildings, the State Government might choose a smaller land footprint (by building up rather than out) to minimise their rates bill.⁸

Reciprocal taxation arrangements are an area of interest for the Association and their introduction at the State level could potentially provide overall benefits to the sector. However, the impact of reciprocal taxation on Local Governments would vary according to the State Government presence in their district, i.e., the additional rates revenue raised compared to the State taxes incurred.

When Tasmania introduced reciprocal taxation in 2003, it was estimated that only three out of 29 Local Governments would be worse off in net terms as a result of the changes⁹. But reciprocal taxation in WA is likely to be very different as there is a high proportion of small rural and remote Councils that would be worse since they have little or no State Government presence in their Local Government Area. The prospect of reciprocal taxation would need to be accompanied by compensatory arrangements for such Local Governments before it could be supported by the sector.

⁸ Note that the incentive to do this will be greater when UV, rather than GRV or other capital improved valuation methodology, is used.

⁹ State Government of Tasmania & the Local Government Association of Tasmania (2003), *Statewide Partnership Agreement between Government of Tasmania and Tasmanian Councils on Financial Reform*.

7 Personal Income tax and Fringe benefits tax reforms

Zone Tax Offset

The Association believes the Zone Tax Offset (ZTO) should be reformed. The ZTO is an income tax rebate available to residents of particular areas in Australia, designated Zone A, Zone B and special areas within each zone. The ZTO provides assistance to taxpayers in remote areas in recognition of the higher living costs they incur. Much of WA's vast area is within the zones where the ZTO applies.

Taxpayers are eligible for the ZTO if they reside in one of the applicable zones for at least 183 days of the year. This means that some fly-in, fly-out (FIFO) workers (and other non-resident workers using similar arrangements, such as drive-in, drive-out) are eligible for the ZTO despite their home address being elsewhere.

A recent Federal Parliamentary inquiry into the use of FIFO argued that FIFO workers generally spend money and invest in the areas where their families reside, not the areas where they work. The inquiry's final report concluded that it is a misuse of the ZTO 'to support workers and their families who incur little or none of the additional costs of living in the zones.'¹⁰ Subsequently, the inquiry recommended that 'the Commonwealth Government review the Zone Tax Offset arrangements to ensure that they are only claimable by permanent residents of a zone or special area.'¹¹

The 2015-16 Federal Budget announced changes that would tighten eligibility for the ZTO and ensure it was better targeted to permanent residents. The Association applauds this initiative from the Federal Government, but suggests the budget savings should be directed towards an increase in the ZTO.

The nominal level of the main 'fixed' component of the ZTO has not increased since 1993. The Association believes the fixed components should be increased in line with the increase in the CPI since 1993. This would recognise that the real value of the rebate has steadily eroded over time and would also assist regional development by encouraging workers to relocate to WA's more remote communities.

Fringe benefits tax

The Parliamentary FIFO inquiry mentioned above also indicated that fringe benefits tax (FBT) could be reformed with potential benefits for communities in WA's mining regions.¹² Under current arrangements, employers' use of work camps is exempt from FBT, but using housing in existing towns is subject to FBT. This means FBT has encouraged employers to use FIFO rather than locating workers and their families in regional communities.

The Association acknowledges that the FBT exemption for work camps is reasonable for particularly remote project sites or for the construction phase of projects. However, operational workforces located near existing cities and towns should not be encouraged,

¹⁰ The Parliament of the Commonwealth of Australia (2013), *Cancer of the bush or salvation for our cities? Fly-in, fly-out and drive-in, drive-out workforce practices in Regional Australia*.

¹¹ Ibid.

¹² Ibid.

through the tax exemption, to be located in camps. Indeed, this practice is detrimental to the development of mining regions as it discourages workers from participating in community life and spending money in the local area.

8 Conclusions

The Association agrees with the proposition that the tax system needs to be reformed to face contemporary challenges such as globalisation and the ageing population. There is also a need to use more efficient taxes so that Governments can raise the revenue they require with minimal disruption to the economy. Local Governments are already delivering in this respect – there is widespread acknowledgement that rates are a particularly efficient tax.

Nonetheless, rating efficiency could be further improved if the tax base was broadened by reforming the following State imposed exemptions from Local Government rating: Independent Living Units, State Government trading entities and State Agreement Acts.

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