

# **The economic development of Northern Australia: a critical review of the taxation benefits and incentives both past and present and the potential taxation options for the future.**

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## **Abstract:**

*In 2015 the Commonwealth Government produced a White Paper on the need to realise the full potential of Northern Australia and for that region to become an economic powerhouse within Australia. The White Paper explicitly states that the Government is not declaring the North a Special Economic Zone (SEZ) where tax concessions are provided to businesses to reside and operate in the region. This paper will examine the current government's approach to developing the North and in particular the approach to attracting economic activity and foreign investment. This paper will focus on the current tax benefits for those living and working in the north such as zone rebates and in particular what more that could be done by both the Commonwealth and State and Territory governments to encourage economic activity. The paper will also examine the tax concessions that existed in the past such as an exemption for income tax pursuant to the now repealed s 23(m) of the Income Tax Assessment Act 1936 (Cth) for companies resident in the Northern Territory prior to 1947 and the Darwin Trade Development Zone (TDZ) that was abolished in 2003. The paper will then assess the merits of offering tax benefits in the form of tax credits for businesses operating in the North and greater tax deductions. The paper will explore the merits of a SEZ for the North as well as tax benefits that could be offered by the States of Queensland and Western Australia and the Northern Territory. The paper will also provide recommendations for a range of tax benefits that could be offered by the various governments to businesses and individuals in order to assist in developing the North. If not, the North may fail to fulfill its true potential.*

## **I INTRODUCTION**

The 'North' of Australia encompasses parts of the Northern Territory, Western Australia and Queensland. It is generally defined as that part of Australia that is to the north of the Tropic of Capricorn.<sup>1</sup> This is the area that is specifically examined in this paper and in particular the taxation issues that relate to the development of this part of Australia. This paper will examine the current governments' approach to developing the North and in particular the approach to attracting economic activity and local and foreign investment. The paper will focus on the current tax benefits for those living and working in the north such as zone rebates. In particular

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<sup>1</sup> ADC Forum, 'Northern Development: Creating the future Australia', Report of the ADC Forum: Northern Development Summit, June 2014, xi.

the paper will discuss what more could be done by both the Commonwealth and State and Territory governments in terms of taxation benefits. The paper will examine the tax concessions that existed in the past such as an exemption from income tax pursuant to the now repealed s 23(m) of the *Income Tax Assessment Act 1936* (Cth) for companies resident in the Northern Territory (NT) prior to 1947 and the Darwin Trade Development Zone that was abolished in 2003. The Paper will then assess the merits of offering tax benefits in order to attract investment and people to develop the north. This will include exploring the merits of a SEZ for the North. The paper will conclude with recommendations for various tax benefits to be offered otherwise the North may not succeed in fulfilling its true potential.

Prior to examining the existing taxation concessions and the past taxation concessions that applied to the north of Australia, it is important to examine the recent Commonwealth Government inquiries into recommendations for the development of the northern part of Australia. There are two main reports, the first in 2014 which comprised an inquiry and a subsequent 'Green Paper' which is in Section A, below. The Government then issued a 'White Paper' in 2015 and that is discussed in Section B, below. Both Government reports discuss the merits of a SEZ and the existing tax concessions that are relevant to the north such as the zone offset for individuals. These reports form the basis for the introduction of this paper and put the taxation issues for the development of the north into context. A recent paper by Fitzpatrick and Jian provides an excellent discussion of the literature on the problems facing the development of north Australia and the creation of a SEZ.<sup>2</sup>

### *A Pivot North – Inquiry into the Development of Northern Australia*

As the Chair of the Committee stated in their foreword to the report, '[s]ince 1937 there have been numerous reports and recommendations with the aim of developing Northern Australia which are gathering dust on shelves. It is now up to us to prove the sceptics wrong and get things moving'.<sup>3</sup> The report puts the northern part of Australia in perspective when it states that the area of land represents 40 percent of Australia's total land mass but only has one percent of the population of Australia. It is on the door step to Asia.<sup>4</sup> This green paper was the first step in promoting the development of northern Australia and it was then followed by the white paper which is discussed below. The terms of reference included an additional requirement in relation to taxation matters. The Committee was asked to make recommendations on taxation matters related to the regulatory and economic environment of Northern Australia.

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<sup>2</sup> Jeffrey Fitzpatrick and Zhang Jian, 'Using China's Experience To Speculate Upon The Future Possibility Of Special Economic Zones (SEZs) Within The Planned Development Of Northern Australia', (2016) 18 *Flinders Law Journal* 29, 35.

<sup>3</sup> Parliamentary Joint Select Committee on Northern Australia, Parliament of Australia, *Pivot North-Inquiry into the Development of Northern Australia: Final Report* (September 2014) ix.

<sup>4</sup> *Ibid.*

The Committee examined the various submissions relating to the introduction of a SEZ. One of the strongest advocates for a SEZ was made by ‘Australians for Northern Development and Economic Vision (ANDEV).<sup>5</sup> Their contention was that the whole of the Northern part of Australia should be a SEZ with reduced State, Territory and Commonwealth taxation, tax concessions for investment in infrastructure and streamlined regulatory requirements.<sup>6</sup> Other aspects of the ANDEV submission will be discussed in Part IV of this paper.

Recommendation 37 of the report stated that the Commonwealth Government should explore reforms to the taxation system in order to promote investment and development in the North. The recommendation considered that a SEZ be established.<sup>7</sup> As discussed below, the White Paper on the North categorically ruled out the establishment of a SEZ. The Committee, in its recommendation 38 contends that the Zone Tax Offset which provides very limited income tax relief for individuals working and living in remote areas should be reviewed. The basis for this recommendation was that the purpose of the offset should be to promote development and that can only be achieved by individuals employed by business in the remote areas.<sup>8</sup>

This report formed the basis for the subsequent ‘White Paper’ which was published one year later.

### *B The White Paper on Developing the North*

In 2015 the Commonwealth Government produced a White Paper on the need to realise the full potential of Northern Australia and for that region to become an economic powerhouse within Australia.<sup>9</sup>

The north has untapped promise, abundant resources and talented people. It is also Australia’s closest connection with our key trading markets and the global scale changes occurring in Asia. A strong north means a strong nation. Even though over one million people live in the north — all of the Northern Territory and those parts of Western Australia and Queensland above the Tropic of Capricorn — it accounts for over half of our sea exports (Ports Australia, 2014). Thriving and diverse exports in minerals, energy, agriculture and tourism underpin our national income. The earnings from the Pilbara alone are larger than the individual economies of 119 countries but are generated by only 60,000 people (Pilbara Development Commission, 2013).

Many previous efforts to develop the north have floundered through a lack of foresight and the absence of markets in our region for high value goods and services. Through this, the first ever White Paper on Developing Northern Australia (the White Paper), the Commonwealth

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<sup>5</sup> Australians for Northern Development and Economic Vision, Submission No. 147, Attachment 9 to the Parliamentary Joint Select Committee on Northern Australia, Parliament of Australia, *Pivot North-Inquiry into the Development of Northern Australia: Final Report* (7 April 2014).

<sup>6</sup> Parliamentary Joint Select Committee on Northern Australia, Parliament of Australia, above n 3, 39.

<sup>7</sup> *Ibid*, 191.

<sup>8</sup> *Ibid*, 192.

<sup>9</sup> Australian Government, *Our North, Our Future: White Paper on Developing Northern Australia* (2015)

Government is putting in place the right policies, at the right time, to unlock the north's vast potential. This White Paper has been developed to stand the test of time — it should be the first, and last, White Paper for the north.<sup>10</sup>

Given the optimism and encouraging assessment of the northern part of Australia you would have expected the Commonwealth Government to be engaged in a great deal of activity encouraging both people and businesses to move to the north and develop its potential. However, the only tangible sign of any activity is the announcement by the Minister for the Department of Industry, Innovation and Science that from 18 January 2017 the location of the 'Office of Northern Australia' (ONA) will be established in Darwin, NT with one full time public servant.<sup>11</sup> The Minister, Mr Frydenberg, made the following announcement in relation to the establishment of the ONA:

Further, the ONA will play a central key role in the implementation of the Government's \$5 billion Northern Australia Infrastructure Facility (NAIF), working closely with northern stakeholders and colleagues in the Department of Industry, Innovation and Science. The NAIF will provide concessional loans to major economic infrastructure to support the development of Australia's north.<sup>12</sup>

The White Paper states that the Free Trade agreements with China, Japan and the Republic of Korea will bring about foreign investment into the area.<sup>13</sup> More private investment is being encouraged by the Government in order to support its ambitious plans for developing the north.<sup>14</sup> Most of the foreign investment in the mining boom period of 2010 to 2015 was directed in the north and the Government at the time of the White Paper expected it to continue. In 2012 it was \$206 billion.<sup>15</sup> As history has now shown, the mining boom is over and investment has reduced substantially as new infrastructure and plant has been constructed. However, it is contended in this paper that private investment both domestically and foreign will not be attracted to the north without some form of taxation benefits. The current company tax rate of 30 percent is one barrier to investment. The Government also believes that as a result of its promotional activities it will attract investment to the north<sup>16</sup> and the free trade agreements with the USA, Japan, China, Republic of Korea, Singapore and Canada will support this objective.<sup>17</sup> The Commonwealth Government also believes that by reducing barriers to investment such as lengthy timeframes for regulatory approvals; high costs; and duplication of government approvals.<sup>18</sup> The Commonwealth Government introduced an Entrepreneurs' Infrastructure Programme whereby the government provides grants; an Early Stage Innovation Company tax credit for investors as well as Export Development grants. It contends that these financial and tax related benefits

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<sup>10</sup> Ibid, 1.

<sup>11</sup> Department of Industry, Innovation and Science, 'Office of Northern Australia open for business', (Press Release 18 December 2015) <[www.northernaustralia.gov.au](http://www.northernaustralia.gov.au)>

<sup>12</sup> Ibid.

<sup>13</sup> Ibid, 152.

<sup>14</sup> Ibid, 61.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid, 61.

<sup>17</sup> Ibid, 63.

<sup>18</sup> Ibid, 59.

should assist in attracting investment in developing the north. These arrangements are discussed briefly in the next section of this paper under the heading of existing tax benefits relevant for the development of the northern part of Australia.

The report specifically states that the creation of a SEZ in a particular region of Australia would contravene the Australian Constitution, as it would amount to discrimination in taxation pursuant to s 51(ii) and s 99.<sup>19</sup> The report goes on to state that any reduction of taxation and the streamlining of regulatory requirements should apply to the whole of Australia and not just a SEZ.<sup>20</sup> This aspect of the potential for a SEZ is examined in detail in Part IV of this paper.

## II THE EXISTING TAX BENEFITS RELATED TO THE NORTH

There are a number of minor tax benefits that are provided by the Commonwealth Government which are relevant to individuals working in the north. This part of the paper will briefly examine those tax benefits as they apply to individuals. This will also include a brief examination of the tax benefits provided to corporations in the form of export market grants and tax concessions for innovation development and research and development expenditure. Some State and Territory governments provide tax benefits in the form of reduced payroll tax, land tax and stamp duty. The NT does not have a land tax so that tax relief is not relevant if operating in the NT. The fact that tax or tax transfer benefits are provided to individuals and corporations operating in the North of Australia is evidence that these benefits do not contravene s 51(ii) of the Australian Constitution and that further and more extensive tax or tax transfer benefits could be applied to both individuals and corporations in the future in order to develop the north.

### *A Isolated Area Zone Tax Offset*

The Isolated Area Zone Tax Offset is available for individual taxpayers living in remote areas classified as Zone A with an offset of \$338; Zone B with an offset of \$57; Special Area within Zones A and B with an offset of \$1,173 and an Overseas Forces offset of \$338. The offset or rebate, as it was originally known as, was introduced in 1945 in recognition of individuals living in remote and harsh conditions.<sup>21</sup> The Henry Tax Review recommended that the isolated zone rebate be reviewed and this is contained in Recommendation 6 (b).

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<sup>19</sup> Ibid, 60.

<sup>20</sup> Ibid.

<sup>21</sup> Section 79A, *Income Tax Assessment Act 1936* (Cth).

The zone tax offset should be reviewed. If it is to be retained, it should be based on contemporary measures of remoteness.<sup>22</sup>

Since the Henry Tax Review which was released in December 2009, nothing has been done to review the tax offset. Fullerton provides a detailed discussion of the history of these tax offsets and contends the rebates should be increased and could be used as a means of attracting university graduates by reducing their university debt.<sup>23</sup> This would be an important incentive especially if you are trying to attract a skilled workforce to a particular area. It is an alternative to paying exorbitant wages.<sup>24</sup> As discussed below, medical practitioners are paid a cash incentive to work in isolated and remote areas. The White Paper states that the cost to revenue of this tax benefit is \$300 million per year and has been in place since 1945 to help individuals living in remote places.<sup>25</sup> The scheme has been amended to exclude the fly-in and fly-out workers who do not 'have their usual place of residence' in the remote areas.<sup>26</sup> The requirement of residing in the remote area for more than 183 days was replaced with the residence test. This measure took effect from 1 July 2015.

### *B Remote area housing exempt fringe benefit*

Employers are exempt from paying Fringe Benefits Tax (FBT) on the value of housing that is provided to individuals working in remote areas, s 58ZC, *Fringe benefits Tax Assessment Act 1986* (Cth). In order for the accommodation to be exempt from FBT it must be located at least 40 kms from a town with a census population between 14,000 and 130,000 or 100 kms from a town with a census population of 130,000 or more. If the accommodation is located within Zone A or B it must be at least 40 kms from a town with a census population between 28,000 and 130,000 or at least 100 kms from a town with a census population of 130,000 or more.

### *C Financial incentives for rural doctors*

The Commonwealth Government introduced financial incentives for individual medical practitioners operating in remote areas throughout Australia. They are a form of tax transfers designed to benefit remote communities by attracting medical practitioners to rural and remote locations.

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<sup>22</sup> Australia's Future Tax System Review Panel (Ken Henry (Chair), J Harmer, J Piggot, H Ridout and G Smith), *Australia's Future Tax System: Report to the Treasurer* (December 2009) (AFTS Report).

<sup>23</sup> Alexander Fullerton, 'Are you still here, Mr Hasse? A study of Australia's Tax Rebate for Residents in Isolated Areas', (2014) 9(1) *Journal of the Australasian Tax Teachers Association* 24.

<sup>24</sup> White Paper, 104

<sup>25</sup> White Paper, 104

<sup>26</sup> *Tax and Superannuation Laws Amendment (2015 Measures No. 5) Act 2015*.

From 1 July 2015, the General Practice Rural Incentives Program (GPRIP) moved to the new classification system, the Modified Monash Model (MMM), to more effectively target financial incentives to doctors working in areas that experience greater difficulty attracting and retaining general practitioners. Commencing on 1 July 2015, participants are now being assessed against the new eligibility criteria. The first payments under the new arrangements are expected to commence in August/September 2016.<sup>27</sup>

The Maximum Incentive Payment Amounts are shown in the following table. They show the maximum annual payment available to medical practitioners across each MM category at each year level.<sup>28</sup> The MM categories relate to the level of remoteness of the medical practice.

<b>Location (MM)</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5 plus</b>
<b>MM3</b>	\$0	\$4,500	\$7,500	\$7,500	\$12,000
<b>MM4</b>	\$0	\$8,000	\$13,000	\$13,000	\$18,000
<b>MM5</b>	\$0	\$12,000	\$17,000	\$17,000	\$23,000
<b>MM6</b>	\$16,000	\$16,000	\$25,000	\$25,000	\$35,000
<b>MM7</b>	\$25,000	\$25,000	\$35,000	\$35,000	\$60,000

These amounts are not subject to withholding but are part of the medical practitioner's assessable income. The Commonwealth government is prepared to make a tax transfer payment under this scheme in recognition of the fact that medical practitioners would prefer to live and work in the urban parts of Australia and not the remote and rural areas. This approach could easily be extended to other professional skills that are in short supply in remote areas.

#### *D Export Market Development Grants (EMDG)*

The Export Market Development Grants (EMDG) scheme provides Australian Government financial assistance for aspiring and current exporters.<sup>29</sup> Each applicant for an EMDG is only entitled to a maximum of eight grants and they need not be in consecutive years. The EMDG scheme provides a reimbursement of up to 50 percent of the total eligible expenses, less the \$5000, up to a maximum amount of \$150,000. The reimbursement is paid in the year following the incurring of the expenses. The applicant must own the goods or services that are being

<sup>27</sup> Australian Government, Department of Health, General Practice Rural Incentives Program Guidelines, effective date: 1 November 2016.

<sup>28</sup> Ibid.

<sup>29</sup> Australian Government, Austrade, Export Market Development Grants in brief.<[www.austrade.gov.au/emdg](http://www.austrade.gov.au/emdg)>

exported and the goods may even be made outside Australia. They can consist of tourism services or events held in Australia or Intellectual Property such as trademarks or patents. The type of expenses that are eligible for the scheme includes activities such as overseas representation; marketing consultants; marketing visits; communications; free samples; IP registration; trade fairs; promotional literature and advertising and the cost of bringing overseas buyers to Australia.<sup>30</sup>

### *E Innovation Tax Concession, Venture Capital and R&D Tax Concessions*

The following section of the paper briefly outlines all of the tax concessions including tax offsets for the development of innovative ideas which may ultimately be commercialised. The tax concessions include benefits for the innovator and the investor through a number of programs that have recently been introduced by the Commonwealth Government. None of these programs specifically relate to the development of the north of Australia but they could all be utilised by investors and innovators throughout Australia. They are discussed in this paper because they highlight the extent to which the Commonwealth Government provides limited tax concessions for the development of business in Australia but they also endorse the use and need for tax benefits in order to encourage investment for the development of business activity.

#### *I Early Stage Innovation Tax Concession and Venture Capital and Early Stage Venture Capital Limited Partnerships (ESVCP) tax incentives and concessions*

The Commonwealth Government introduced the *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* for the purpose of establishing a number of new arrangements to venture capital limited partnerships and early stage venture capital limited partnerships. The Treasurer, Mr Morrison made the following statement in his Second Reading Speech:<sup>31</sup>

This bill is an important step for Australia—investors, venture capital funds and innovation companies in all industries will benefit from these measures. These measures have specifically been designed to foster a shift towards a culture of innovation, whereby entrepreneurial risk-taking is encouraged and rewarded. The Act delivers upon two commitments: providing concessional tax treatment to investment in innovative, high-growth start-ups; and reforms to the arrangements for Venture Capital Limited Partnerships to improve access to capital, and make the regime more user-friendly and more internationally competitive.

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<sup>30</sup> Ibid, 4.

<sup>31</sup> Scott Morrison, The Treasurer, Second Reading Speech, Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016

The first measure, schedule 1 to this bill, amends the *Income Tax Assessment Act 1997* to improve investment into early stage innovation companies through incentivising investors with business expertise and experience to assist entrepreneurs with commercialising their concepts and ideas.

The second measure, schedule 2 to this bill, will amend the *Venture Capital Act 2002* and the *Income Tax Assessment Act 1997* to reform the arrangements for venture capital investments, which is expected to attract greater levels of investments at the growth stage of developing a concept, while improving the international competitiveness of investing in entrepreneurs at this stage of the financing life cycle.

The first measure, the Early Stage Innovation Tax Concession (ESITC) scheme was developed by the government to encourage early investment in innovation. The example provided by the National Innovation and Science Agenda illustrates the way in which the tax incentive operates:

Jessica is the founder of a startup business called PaySmart Pty Ltd that is developing a software application to automate bill payments. She is looking to raise \$200,000 in equity finance to continue developing the software.

Alex is an experienced early stage (angel) investor and believes that PaySmart has excellent growth potential. He invests \$200,000 and claims a 20 per cent non-refundable tax offset, reducing his income tax payable by \$40,000.

In addition to contributing capital, Alex uses his business skills to help PaySmart grow. He sells his shares for \$400,000 four years later. As Alex's investment in PaySmart is a qualifying investment and has been held for between 12 months and 10 years, the full capital gain of \$200,000 is exempt from capital gains tax.<sup>32</sup>

The tax incentives include a 20 per cent carry-forward non-refundable offset on investments capped at \$200,000 per year, and a 10-year exemption on capital gains tax for investments held in the form of shares in the innovation company for at least 12 months, provided that the shares held do not constitute more than a 30 per cent interest in the innovation company. The tax offset will be available upon investment, not when the funds are used by the innovation company, and any sale of the shares will be taxed on a 'deemed capital account' basis.

The second measure, the Venture capital and early stage venture capital limited partnerships (ESVCP) tax incentives and concessions scheme has been in existence for many years having replaced the Pooled Development Fund investment arrangements. The ESVCLP program provides tax incentives for investing in early stage venture capital activities. Key benefits provided under the ESVCLP program include:

- flow-through tax treatment
- an ESVCLP tax offset for the investment made by a limited partner
- income and capital gains on the disposal of EVCIs and other income earned on EVCIs not being subject to tax to

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<sup>32</sup> Australian Government, National Innovation and Science Agenda <http://www.innovation.gov.au/page/tax-incentives-investors>.

- limited partners (either foreign resident or Australian resident)
- general partners who are Australian resident or resident of a country that has a double tax agreement with Australia
- general partners' carried interests being held on capital account rather than revenue account.<sup>33</sup>

From 1 July 2016, additional tax incentives are available to ESVCLPs and their investors and some requirements have been relaxed, which include:

- 10% non-refundable carry-forward tax offset on contributions made at any time to an ESVCLP that becomes unconditionally registered on and after 7 December 2015
- increase in the maximum fund size from \$100 million to \$200 million
- removal of divestiture requirement when the value of the investee exceeds \$250 million.

## II *R&D Tax Concessions*

It provides targeted R&D tax offsets designed to encourage more companies to engage in R&D. The incentive has two core components. Entities engaged in R&D may be eligible for:

- a 43.5% refundable tax offset for eligible entities with an aggregated turnover of less than \$20 million per annum, provided they are not controlled by income tax exempt entities
- a 38.5% non-refundable tax offset for all other eligible entities (entities may be able to carry forward unused offset amounts to future income years).<sup>34</sup>

Broadly speaking, your eligibility to claim R&D tax offsets will depend on whether or not you are an R&D entity and, if you are, whether or not you have incurred notional deductions of at least \$20,000 on eligible R&D activities.<sup>35</sup>

## III *Entrepreneurs' Programme*

The Entrepreneurs' Programme is the Australian Government's flagship initiative for business competitiveness and productivity. It forms part of the Australian Government's new industry policy outlined in the National Innovation and Science Agenda.<sup>36</sup> This Agenda is the business

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<sup>33</sup> Australian Taxation Office < <https://www.ato.gov.au/business/venture-capital-and-early-stage-venture-capital-limited-partnerships/esvcp-tax-incentives-and-concessions/> >

<sup>34</sup> Australian Taxation Office < <https://www.ato.gov.au/Business/Research-and-development-tax-incentive/Eligibility/> >

<sup>35</sup> Ibid

<sup>36</sup> Australian Taxation Office < <https://www.business.gov.au/assistance/entrepreneurs-programme-summary> >

focus element of the Australian Government's broader Economic Action Strategy. The Strategy brings together and builds upon other economic reforms to make the most of Australia's strengths and business opportunities.

The programme offers support to businesses through four elements:

- Accelerating Commercialisation - helps small and medium businesses, entrepreneurs and researchers to commercialise novel products, services and processes
- Business Management - experienced Business Advisers and Facilitators review business operations, including business direction, strategy, growth opportunities and supply chain. They provide a report with strategies for business improvement and work with you to make them happen
- Incubator Support - assists New and Existing Incubators to improve the prospects of Australian start-ups achieving commercial success in international markets, through helping them to develop their business capabilities.
- Innovation Connections - experienced Innovation Facilitators work with your business to identify knowledge gaps that are preventing your business growth. The outcome is an Innovation Facilitation Report. This may include a matched funding grant that assists direct access to research capability.<sup>37</sup>

Practical support for businesses includes:

- advice from people with relevant private sector experience
- co-funded grants to commercialise new products, processes and services
- funding to take advantage of growth opportunities. This may include a matched funding grant of up to \$1 million to support commercialisation activities.<sup>38</sup>
- connection and collaboration opportunities.

The above raft of tax concessions in the form of tax offsets and accelerated tax deductions are clear examples of the Commonwealth Government using the tax system to provide incentives for investment in innovative ideas and businesses. These taxation benefits apply to any company operating throughout Australia. However, if additional taxation benefits were offered to those companies operating in the north through a SEZ then additional benefits would flow to a region that is important for the future of Australia.

### III THE FORMER TAX CONCESSIONS

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<sup>37</sup> Australian Industry Group. <<https://www.aigroup.com.au/business-services/governmentprograms/entrepreneursprogramme/>>

<sup>38</sup> Ibid.

There have been attempts to attract business and people to the Northern Territory (NT) through the use of taxation concessions. On 1 July 1978 the NT attained responsible self-government. Prior to that date the NT was administered by the Commonwealth Government, having been handed back to the Commonwealth by the State of South Australia on 1 January 1911. The people living in the territory lost their representation in the State Parliament of South Australia and the National Parliament of Australia. From the time of the first major European settlement in 1863 until 1910, the Territory was the responsibility of the Government of South Australia.<sup>39</sup> The Northern Territory has a very chequered history which has resulted in various attempts by governments to offer taxation incentives in order to encourage investment in the area. The two main schemes to provide taxation concessions for businesses in the NT are examined below.

#### *A Exemption from income tax for companies resident in the NT*

In 1923 the Commonwealth Government first granted an exemption from income tax for companies involved in primary production, mining or fisheries that operated in the NT. The exemption continued until 1 July 1947. Clause 3 of the Explanatory memorandum for the Bill stated that the exemption was introduced 'in order to assist and encourage the development of the Northern Territory of Australia'. This was achieved by inserting s 23(m) into the *Income Tax Assessment Act 1936* (Cth). This did not create a potential problem with s 51(ii) of the Australian Constitution because the NT was not part of South Australia, not an independent Territory but under the administration and control of the Commonwealth Government. The exemption from income tax encouraged development in growing cotton near Katherine but it was not very successful due to transport problems.<sup>40</sup> The income tax exemption was successful for opening up new agricultural land in the Northern Territory.<sup>41</sup>

The well-known High Court case of *North Australian Pastoral Company Limited v Federal Commissioner of Taxation* [1946] 71 CLR 623 examines the concept of residence in the NT in order for the income from primary production to be exempt from income tax.

#### *B The Darwin Trade Development Zone (TDZ)*

The Darwin Trade Development Zone (TDZ) is Australia's former attempt at establishing a form of special economic zone. It commenced on 25 September 1985 as the *Trade Development Zone Act* (NT) (TDZ Act) and was abolished on 1 July 2003. The Act was amended on 18 June 1999

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<sup>39</sup> P.F. Donovan, *At the other end of Australia*, (1984, University of Queensland Press, Brisbane, Queensland) xiii.

<sup>40</sup> *Ibid*, 62.

<sup>41</sup> *Ibid*, 63.

in order to establish Trade Development Zone Authority. The objective of the amended TDZ Act was to establish an Authority to administer, control and encourage the development of a trade development zone in the Territory and to attract industry to that zone, and for related purposes.

Each corporation wanting to operate within the TDZ was licensed by the Authority. The effect of obtaining a licence was that 'notwithstanding anything in any other Act, a licensee shall not be liable to pay a fee, tax, duty, rate or charge specified in the Regulations in relation to the business conducted by him in the Trade Zone in respect of the period during which his licence remains in force. In effect the NT government exempted the businesses within the zone from payroll tax and stamp duty.

The functions of the Authority were –

- (a) to promote and manage the Trade Zone;
- (b) to make arrangements for the provision of facilities and services to meet the requirements of persons carrying on business in the Trade Zone;
- (c) to advise persons carrying on business or proposing to carry on business in the Trade Zone on matters relating to the provision of services and facilities and privileges available, or which will be available, to them in relation to those businesses or proposed businesses and provide general assistance to facilitate the establishment and conducting of those businesses as it thinks fit;
- (d) to advise the Minister and such other persons and authorities as the Minister directs or the Authority thinks fit on –
  - (i) the development and encouragement of the use of the Trade Zone for manufacturing, entrepot and associated industries; and
  - (ii) the needs of, and the provision of government and other services to, persons carrying on business in the Trade Zone; and
- (e) such other functions as are imposed upon it by or under this or any other Act.

The TDZ was abolished in 2003 by the *Trade Development Zone Act Repeal Act 2003*. The Second reading speech provides a very brief statement of why the first ever Australian attempt at a SEZ was now being abolished:

The bill is cognate with the repeal of the Trade Development Zone Authority Act. Australia is now party to all trade agreements which restrict government subsidies and many forms of government assistance to exporting business. Australian business and government also adhere to principles of competitive neutrality onshore. To say the least, times have changed since the concept of the Northern Territory Trade Development Zone. The concept of a zone where businesses derive a benefit over other like businesses because they are in a particular zone is no longer appropriate in today's business world.

Government therefore does not intend that the corporation take on the activities of what is currently the Trade Development Zone Authority. The corporation becomes responsible for the land interest, assets and liabilities of the Trade Development Zone on its establishment. The current leasees will, at that point, become tenants of the Land Development Corporation. It is intended that there will be as little disruption to Trade Development Zone businesses in this change over as possible. A provision is made in the bill for the assignment of all rights, authorities, other than the exemption from payroll tax and stamp duty. These exemptions as a

right of the TDZ licence will cease with the repeal of the Trade Development Zone Act. A separate arrangement is being provided by Treasury to cover payroll tax concessions over licences until the licences expire. Stamp duty concessions will cease all together.

A full analysis of the successes and failures of the DTZ is the province of further research and not within the main focus of this paper. The tax concessions were limited to those being offered by the Government of the Northern Territory and not the Commonwealth Government. There are a number of successful new industries operating within the former DTZ, especially in the area of oil and gas processing.

#### IV RECOMMENDATIONS

If the Commonwealth Government is serious about developing the north then tax incentives in different forms must be considered for both individuals and businesses. The following part of the paper will examine a range of taxation benefits that might be worthy of consideration in the future.

##### *A Special Economic Zone*

In order to assess the merits or disadvantages of a SEZ, it is important to briefly examine what is a SEZ and what form would it take. Special Economic Zones (SEZ's) are all zones established by governments as a means of encouraging multinational enterprise (MNE) investment in the country. They provide an 'economic sanctuary' consisting of specially demarcated areas for businesses to carry out their operations under a set of rules different to domestic businesses. While the underlying reason for establishing such zones differs for each country they all contain these basic key features:

- seeking foreign investment into the country;
- products and services developed in these zones are required to be exported out of the country (protecting the local domestic markets);
- total exemption or a reduction of sales, income and other duties either for a specified or unlimited period of time;
- employing and up-skilling the local population;
- reducing the amount of 'red tape' and bureaucratic procedures in these zones e.g. 'single window' administrative solutions.

- free importation of raw materials, components and equipment.
- injecting Foreign Direct Investment (FDI) and Capital into the country.

There are a number of different types of zones and in order to understand what is meant by a SEZ it is useful to briefly describe the other zones:

1. Industrial Estates or Parks which are designated areas that mainly involve import substitution products and processing raw materials obtained by the domestic market.
2. Export Processing Zone (EPZ) are mainly focused on processing products or services for export.
3. Free Trade Zone (FTZ) have been developed to expand trade with neighbouring countries and they obtain reductions or exemptions from duties and other taxes.
4. Special Economic Zones (SEZ) are areas engaged in a wide variety of activities which can include research and development and manufacturing and enjoy similar tax benefits provided to FTZ's.
5. Investment Facilitation Establishment (IFE) 'entail a tract of land, with or without real estate facilities, or building development and contains certain basic infrastructure facilities such as water, electricity, road and other types of amenities for the facilitation of business or commercial activities.'

An Export Processing Zone is defined as 'a clearly demarcated industrial zone which constitutes a free trade enclave outside a country's normal customs and trading system where foreign enterprises produce principally for the export and benefit from certain tax and financial incentives.' The main difference between an EPZ and a FTZ is that a FTZ 'is an integrated township with fully developed infrastructure whereas an EPZ is just an industrial enclave.' As stated in the introduction to this paper, for ease of understanding all types of zones are referred to as free-trade zones, FTZ's.

The amount of land allocated for zones differs from country to country. 'In some cases entire countries, such as Singapore or Hong Kong, are virtually EPZs in themselves. In others, such as China's special economic zones, they are on such a vast scale that they do not seem to fit the definition...individual firms have been granted zone status, notably in Tunisia, where nearly 580 firms (1989-90 figures) in nine regions of the country fall into this category.'

Similar to worldwide trends, most currently operating zones focus on labour-intensive, assembly-orientated activities such as apparel, electronics, and electrical goods, with women making up the majority of the workforce. The World Bank surveyed three economies, Bangladesh, India and Sri Lanka and found that they largely neutralised each other, 'making it likely that non-fiscal aspects of the FTZ environment are more crucial as determinants of investment decisions. Incentives might, however, be more important factors when choosing between these and other countries with substantially different incentive packages.'

Incentives offered by SEZs encompass regulatory incentives, financial incentives and fiscal incentives. In the context of SEZs, regulatory incentives encompass the relaxation of regulations impacting targeted companies. Such relaxed regulation is generally the relaxation of direct investment regulations, may also include relaxation of visa classes to attract certain employees or relaxation of trade, shipping and manufacturing regulations. Financial incentives encompass public spending to attract companies. This may consist of direct cash payments or subsidies or through increased public funding on infrastructure. Financial incentives can be designed to specifically target desired industries through tailoring the infrastructure of the geographical area to the needs of such industries. Financial incentives through low land rental and utilities for example are offered in countries such as Egypt, Lebanon and the UAE.<sup>42</sup>

Fiscal incentives consist of easing the tax burden of targeted companies or their employees. Unlike the other incentives, they are commonly legislation based changes through the tax system. Such fiscal incentives may specifically targeted at industries through the creation of eligible categories, or may be generally applied to all such taxpayers within the region. Targeting may also be achieved through reducing certain taxes that apply to targeted industries such as indirect taxes on the importation and exportation of goods and services as desired. Fiscal incentives may apply for a limited period of time (e.g. a tax holiday).

In the context of Middle East and Northern African (MENA) countries, fiscal incentives play a large part in the policy of attracting investment in both the general economy and SEZs, with a number of SEZs providing significantly attractive tax regimes:

MENA countries rely in large measure on fiscal incentives to attract investors in the general economy, with financial and regulatory playing a less prominent role. For the most part fiscal incentives offered to investors in the general economy are available to companies in the FEZs as well. However, some zones go beyond this and offer additional fiscal concessions. Four countries offer a complete exemption from corporate and private income taxes in their free zones (Algeria, Egypt, Kuwait and United Arab Emirates), whereas companies located in SEZs (in Egypt – and likewise in Jordan) are requested to pay certain low income taxes. Jordan's free zones offer freedom from the taxation of corporate profits earned on manufacturing goods for imports or trading within the zones. Several countries (Lebanon, Morocco and Yemen) offer corporate tax holidays in their FZs that are more generous than what is available under their general investment incentive regimes. Some zones also offer reduced personal income taxes on expatriate staff. In Yemen, the income of non-Yemeni employees is completely exempt from taxation; in Jordan's free zones non-Jordanian employees enjoy a 12 year tax holiday, and in Tunisia's FZs a flat individual income tax rate of 20% is applied to the salaries of foreign staff.<sup>43</sup>

MENA countries initiated the trend for economic zones to move away from “free trade zones” and “export processing zones” towards “special economic zones” with a focus on value added services to specific industries.

The 2002 Multilateral Investment Guarantee Agency (MIGA) (a member of the World Bank Group) Foreign Direct Investment Survey provides the top 20 factors cited as the main

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<sup>42</sup> Nada Farid, *Towards Best Practice Guidelines for the Development of Economic Zones: A contribution to the Ministerial Conference by Working Group 1*, 2009, 8.

<sup>43</sup> Ibid 9.

determinants affecting the decision making process for locating overseas.<sup>44</sup> The top 3 by percentage of influence are market access (77%), stable socio-political environment (64%) and ease of doing business (54%). Despite fiscal incentives playing the largest part in the design of attracting companies and investment, national taxes and local taxes were cited as 11<sup>th</sup> and 17<sup>th</sup> most influence at 29% and 24% respectively.

According to these statistics by the MIGA Foreign Direct Investment Survey, tax is therefore only one consideration for a company in deciding whether to locate a business in a SEZ jurisdiction. The factors sighted most highly indicate that factors which may facilitate economic activity and enable a business to generate pre-tax profits are most important. This is obvious because a lower rate is not going to be beneficial if a business cannot profit in the first place. Despite tax concessions being used as the main tool by governments to attract businesses to locate to a SEZ, the tax benefits may therefore not be the primary factor considered by such businesses.

Given the fact that taxation concessions are not the main focus of SEZ's, it is quite strange that the Australian Government has dismissed the idea of establishing a SEZ in Australia. The Commonwealth Government is currently concerned about the 'Budget' and bringing it back into surplus, but their approach to a SEZ may be short sighted given the other benefits of a SEZ. The Australian Government's White Paper on developing the north specifically stated that they were not in support for the development of a SEZ in the north of Australia. They made the following comment: Why the Government is not declaring the north a Special Economic Zone:

A Special Economic Zone (SEZ) is a geographically limited region in which special taxation and/or regulatory arrangements apply such as duty concessions for manufactured exports. Since the establishment of the first modern free trade zone in Ireland in 1959, it is estimated that 3,500 such zones have been established in around 130 countries (Boyenge, 2007). SEZs have been successfully used to trial reforms before being applied more broadly. More often, SEZs have been useful in attracting investors who are particularly sensitive to taxation and/or regulatory hurdles.

The creation of SEZs must be considered carefully to ensure that they attract new investment, given their ability to potentially lead to misallocation or distorted investment decisions. The World Bank found that if a SEZ is to be successful then "the commercial case must be present" and that case "must be based on sustainable sources of competitiveness, not on fiscal incentives" (Farloe & Akinci, 2011).

In Australia, the Constitution prohibits Commonwealth taxation that discriminates between states or parts of states as well as Commonwealth laws or regulation of trade, commerce or revenue that gives preference to one state or part of a state over another.

If the policies within SEZs (for example, lower taxation or regulatory requirements) have net advantages for an economy, there is an argument for extending the logic of these policies to the nation as a whole — and not confining the benefits of SEZs to specific regions. This principle

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<sup>44</sup> The World Bank Group, Foreign Direct Investment Survey 2002: A study conducted by the Multilateral Investment Guarantee Agency with the Assistance of Deloitte & Touche LLP.

underpins many of the measures in this White Paper, which are national in scope while being of particular significance to the north.<sup>45</sup>

However, there are a number of individuals and organisations that do not accept this current view of the Commonwealth Government. For example, in August 2013, the then Prime Minister Kevin Rudd pledged to create a special economic zone in the Northern Territory with a company tax rate of 20 percent, a third lower than anywhere else in Australia. Mr Rudd then went on to say that the Constitution of Australia would allow the creation of a special taxation zone and that he was prepared to fight such a case in the High Court. The Opposition Party leader, Mr Abbott appeared to support the notion of a special tax zone on the basis that the Coalition had already recognized the potential of northern Australia and the need for taxation concessions.<sup>46</sup>

On 20 May 2015, the former Federal Treasurer, Joe Hockey stated that a special tax zone for Northern Australia was 'worthy of consideration' as part of the White Paper on Northern Australia which was due to be released at that time.<sup>47</sup>

ANDEV, a think tank supported by Gina Reinhart, supports the creation of a 'Northern Economic Zone' that will offer tax advantages to attract and retain investment. They contend that Special Economic Zones have been very successful internationally in encouraging economic growth in underdeveloped regions. The zone could offer, for example:

- Lower personal income tax or tax rebates for those who live and work in the Northern Zone
- No payroll tax
- No fringe benefits tax
- No stamp duty<sup>48</sup>

However, the White Paper specifically rejected the idea of a Special Economic Zone.<sup>49</sup>

### *B Tax Credits for Development*

The Commonwealth Government is offering a variety of tax offsets for early stage innovation companies and for R&D expenditure. This type of tax concession could be offered to businesses

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<sup>45</sup> Australian Government, above n 9, 41.

<sup>46</sup> Judith Ireland and Daniel Hurst, 'Prime Minister Kevin Rudd has announced a special economic zone in northern Australia', *Sydney Morning Herald*, 15 August 2013.

<sup>47</sup> Xavier La Canna, 'Northern Australia tax zone worthy of consideration, Treasurer Joe Hockey says', 105.7 ABC Darwin, 20 May 2015, 10:18am.

<sup>48</sup> ANDEV, Australians for Northern Development and Economic Vision. <<http://www.andev-project.org/about-us/whats-needed/>>

<sup>49</sup> Xavier La Canna, 'Northern Australia tax zone worthy of consideration, Treasurer Joe Hockey says', 105.7 ABC Radio, Darwin, 20 May 2015.

and investors that want to establish themselves in the north. They are already being provided to investors and businesses in order to encourage development and innovation so they could be extended to target new businesses being established in the north. Businesses could be offered a special capital allowance rate for their establishment costs and additional tax deductions associated with the cost of doing business in remote areas, similar to the remote zone offset for individuals.

Other taxation considerations could consist of State and NT tax concessions on Payroll tax and Stamp Duty. While these tax concessions are less than those that could be offered by the Commonwealth Government, they do assist new businesses.

## V CONCLUSION

The Australian Government's White Paper on developing the North is a start in the right direction but words must be followed by actions. The Northern part of Australia will not reach its full potential without Commonwealth, State and territory intervention in the form of tax benefits for both individuals and businesses. The north of Australia is hot in the summer and is remote from the major population centres of Australia in the south. The cost of living is higher than the costs faced by other Australian individuals living and working in the south in major urban and regional centres. The cost of airfares to the major cities in Australia is higher than the cost of airfares to Singapore and Indonesia. Darwin is the natural gateway to Asia. The north does not have the population or infrastructure needed to attract businesses without some financial incentives.

As discussed above, in order to attract individuals to live and work in the north the remote zone offset needs to be increased to take into account the cost of living in the north and the remoteness of the work environment. The climate is also an important consideration. Employers would benefit if they were not required to pay higher wages and salaries in order to attract staff. The actual cost of food and other necessary goods are higher than the prices paid by employees in the South. All politicians should be required to spend a substantial period of time living and working in the North, especially during the 'wet season' in order to see for themselves what it is actually like to live in those conditions.

For new businesses to be attracted to the north the Commonwealth and State and Northern Territory governments must make it financially attractive for new businesses to establish themselves in the north. It is contended in this paper that the existence of free-trade agreements between Australia and its northern neighbours is not enough to attract investment to the north. It is also contended in this paper that the taxation concessions related to the promotion of innovation by enterprises by the Commonwealth Government will not necessarily result in business development and investment in the north without some additional taxation benefits. In this respect, a SEZ should be given more consideration by the Government. Without something

extra in the form of taxation benefits, the north may fail to develop in the way in which many governments over the last 200 years have wanted it to.