Supplementary
Submission
No 8a

ZONAL TAXATION

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NSW BUSINESS CHAMBER SUBMISSION

Inquiry into Zonal Taxation

Supplementary Submission to the Committee on Investment, Industry and Regional Development

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Introduction and overview

The NSW Business Chamber (NSWBC) welcomes the opportunity to make a supplementary submission to the Legislative Assembly's Committee on Investment, Industry and Regional Development (the Committee) Inquiry into Zonal Taxation.

As you may be aware, NSWBC is one of Australia's largest business support groups, with a direct membership of more than 20,000 businesses and providing services to over 30,000 businesses each year. NSWBC works with businesses ranging in size from owner operators to large corporations, and spanning all industry sectors from product-based manufacturers to service provider enterprises.

Operating throughout a network in metropolitan and regional NSW, NSWBC represents the needs of business at a local, State and Federal level, advocating on behalf of its members to create a better environment for industry.

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Background

The NSWBC thanks the Committee for its consideration of the issues raised in our first submission to this inquiry.

Our first submission noted some of the complexities of zonal taxation arrangements providing preferential treatment to one region over another, notwithstanding the pragmatic case for variances in policy to cater to specific regional issues. The submission argued the economic and social needs of NSW's urban and regional communities are different and it is appropriate for governments to employ targeted measures and investment (beyond tax policy) to support the needs of regional NSW. Examples in the submission included businesses operating close to state borders and geographic areas facing significant structural adjustment. The views expressed in NSWBC's original submission are unchanged.

This supplementary submission will briefly examine some of the additional issues raised in the Interim Report released in January 2018 while reinforcing the case for payroll tax relief as a means to support regional NSW. As part of this, NSWBC considers there to be arguments in favour of providing regional NSW earlier access to more favourable policy settings before extending them to metropolitan areas. While this principle primarily applies to the consideration of payroll tax relief, it equally applies when considering potential stamp duty concessions for regional commercial properties. However, NSWBC is cautious about entrenching additional complexity in our tax system and maintains other policy levers may be more suited to meeting the needs of regional NSW.

This submission will begin by outlining the broader case for payroll tax relief as a measure to support regional businesses before considering the merits of the two-tiered approach to payroll tax adopted by Victoria. It will follow by examining the proposal for regional stamp duty concessions for purchasers of commercial property and will conclude by re-emphasising some of the challenges faced by the state's cross-border regions.

The broader case for a minimum payroll tax threshold of $1 million

Ahead of the 2018-19 NSW Budget NSWBC proposes an increase in the payroll tax threshold to at least $1 million per annum along with annual assessments to ensure NSW remains competitive. On top of the tax savings it would deliver, NSWBC estimates a $1 million threshold would reduce tax administration costs by up to $40 million.

Why is a threshold increase needed?

One of the biggest impediments to business growth is incurring a payroll tax liability once payrolls exceed $750,000. In practice, this means a business with around 10 employees paid at the average full time wage incurs a 5.45% premium on the wages of additional employees (or employee hours). In addition, businesses incur new tax administration costs, which we estimate to be over $10,000 per annum once they exceed the current payroll tax threshold.[1]

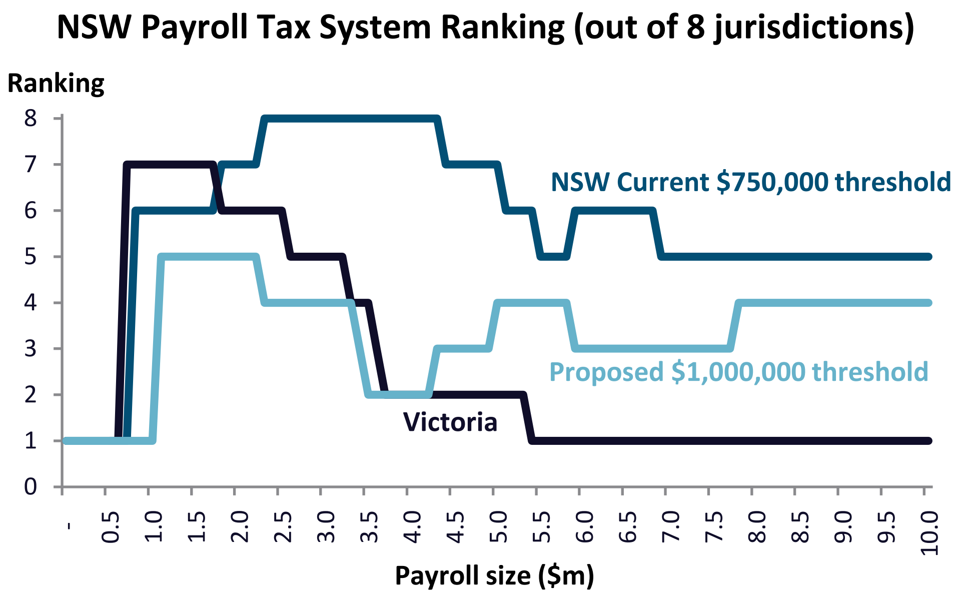
The NSWBC is supportive of arrangements that would reduce the burden of payroll tax for all businesses. Small and medium enterprises account for around 70% of the workforce so it is important that regional and small business across NSW are incentivised to grow and continue to support employment creation.

A threshold increase would ensure the benefits of payroll tax relief are more evenly distributed throughout NSW. Regional NSW has a higher relative share of businesses just over the payroll tax threshold whereas Sydney has around 2.5 times as many businesses with 200 employees or more (in relative terms). This means a dollar of payroll tax relief delivered via a rate reduction would disproportionately flow to businesses located in Sydney whereas a threshold increase would benefit all businesses that incur payroll tax liabilities.

A threshold increase would also be highly effective in improving the competitiveness of regional businesses facing competition from businesses in other states. NSW has the third lowest threshold in the country and is particularly uncompetitive at payrolls of between $2 million and $4.5 million. While NSW has a more competitive rate than some smaller jurisdictions (such as ACT, Northern Territory and Tasmania), higher thresholds in these jurisdictions mean that NSW only starts to become competitive at payrolls beyond around $7 million. For larger firms, payroll tax competitiveness is primarily determined by the payroll tax rate and so NSW is less competitive than most jurisdictions.

It is particularly concerning that businesses in Victoria, which offers a suitable benchmark for NSW given the structure of our economies, have access to more favourable arrangements at almost every payroll value.

[1] NSWBC Pre-Budget submission 2017-18, Payroll Tax Survey (p.22). https://www.nswbusinesschamber.com.au/getattachment/Issues/Issues/Taxation-and-Regulation/Ensuring-responsible-budget-management/NSWBC-Budget-Submission.pdf.aspx



Note: Ranking by size of payroll tax liability excluding rebates and other adjustments (includes deduction regimes built into NT and QLD systems, metropolitan rate used for Victoria)

Threshold and tax rate adjustments are the primary levers for improving the competitiveness of our payroll tax system. While lowering the payroll tax rate would improve payroll tax competitiveness, the NSWBC observes that doing so in any meaningful manner would have a significant Budget impact. On the other hand, increasing the threshold would allow a more aggressive reduction in the effective rate of payroll tax paid by SMEs than could be achieved with a rate reduction within the same funding envelope.

Recommendation

The payroll tax threshold should be increased to at least $1 million per annum. Threshold increases should be prioritised to ensure the benefits of payroll tax relief flow to regional NSW. Once a $1 million threshold is achieved, the benefits of rate reductions should be explored.

Recommendation

A formal annual mechanism should be implemented to facilitate adjustments to rates and thresholds to ensure the competiveness of NSW’s payroll tax system over time.

Victorian payroll tax arrangements

A discounted rate of payroll tax has applied to regional employers in Victoria from 1 July 2017. Under these arrangements, regional businesses are subject to a payroll tax rate of 3.65 per cent compared with 4.85 per cent for metro employers. Regional employers are defined as those based in regional Victoria with at least 85 per cent of Victorian taxable wages paid to regional employees. Regional Victoria for the purposes of the payroll tax discount includes all of Victoria excluding metropolitan Melbourne.

Are similar arrangements suitable for NSW?

Principles of good tax policy generally require that taxes minimise their impact on the decisions (commercial or otherwise) of taxpayers. For businesses, this includes decisions about how they produce goods and service and where they choose to locate. A tax change that alters business decisions to a significant extent is inefficient because it discourages businesses from doing what is otherwise is in their best interests (for example, using a lower-cost factor of production). The costs of tax inefficiencies are borne by both businesses and consumers.

However, in the short run, there may be some grounds to consider arrangements specific to regional NSW including (though not necessarily restricted to):

- *To offset cross-border disparities* — arrangements for cross-border regions could be adopted to enable businesses to compete with competitors in jurisdictions with a more favourable payroll tax regime.
- *Temporary macroeconomic adjustment and fine-tuning* — payroll tax could be leveraged as a policy lever to address economic disparities in circumstances where metro Sydney is at a different point in an economic cycle than the rest of NSW.
- *Promotion of regional development as a means to alleviate pressures facing Sydney* — regional payroll tax arrangements could potentially encourage employers and employees to relocate.

In view of these factors there is merit in considering whether regions could be given early access to more favourable payroll tax arrangements. For example, regional employers could be given immediate access to a higher threshold. But this in itself is contingent on whether a transitional arrangement is required. The NSWBC considers the Victorian approach (all of state excluding metro Melbourne) provides a suitable template for defining regional employers for these purposes.

Recommendation

In the context of NSWBC's recommendation for a $1 million threshold, regional employers should gain immediate access to the higher threshold (or other more favourable arrangements) if a higher threshold is delivered via a transition over a number of Budgets.

Transfer duty concessions for commercial property in regional areas

NSWBC's 2016 Thinking Business Report *Taking on Tax: Reforming NSW Property Taxes* found replacing transfer duty with a broad-based land tax would generate a 1 per cent boost to the NSW economy (equivalent to more than $5 billion annually); 10,000 new jobs; and more than $1,400 in additional consumption each year for the average household.[2]

The NSWBC maintains transfer duty rates and thresholds need to evolve with the property market otherwise transfer duty will continue to grow both in absolute and relative (in proportion to the NSW economy and government revenue).

NSWBC notes the Committee is examining whether there is a role for transfer duty concessions for buyers of commercial property in regional areas to stimulate business investment and assist younger entrepreneurs.

The NSW Government's own estimates are that collecting a dollar of transfer duty costs 80 cents in welfare losses (compared with near zero for more efficient taxes).[3] This alone provides a strong argument in favour of any policy initiative that would reduce transfer duty. Concessional arrangements for transfer duty would deliver a larger efficiency dividend than concessional arrangements for most other taxes (given the economic cost of transfer duty).

On the other hand, NSWBC is cautious about ad-hoc reform proposals where they come at the expense of a holistic approach to property tax reform. There is an opportunity for the Committee to examine whether it is possible to target changes to the rate and threshold structure in a way that concentrates benefits to regional NSW. This could be achieved by identifying the transaction value ranges (and associated changes to rates and thresholds) that would deliver proportionally higher relief to regional NSW. As with the approach outlined for payroll tax, regional NSW could be given earlier access to any new rates or threshold identified as part of this process.

Recommendation

NSW's reliance on transfer duty should be reduced and there is merit in exploring whether changes in the rate and threshold structure could be made to support regional NSW and small business.

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[2] Taking on Tax: Reforming NSW Property Taxes (2016), p6. https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/Thinking%20Business%20Reports/FINAL-NSWBC-NCOSS-Taking-on-Tax-Report.pdf
[3] Box 5.1, 2016 NSW Intergenerational Report.

Cross-border challenges remain

NSWBC's initial submission drew attention to some of the specific disadvantages faced by NSW businesses operating within close proximity to a neighbouring jurisdiction.

Differences in state policies have a more profound impact on cross-border communities because it impacts on decisions about where economic activity occurs. The benefits of having a business locate on the NSW side of the border are subtle but real. For example, it has implications for where a business pays tax, it impacts the accessibility of jobs and may impact amenity and vitality of a regional community.

Recent changes to Victoria's payroll tax regime have exacerbated difficulties felt by NSW communities close to the Victorian border. A recent increase to the ACT threshold, which is now at $2 million, and a $1.1 million threshold in Queensland also affects NSW businesses. There is a need to reduce the impact of payroll tax disparities where they have a disproportionate impact on cross-border communities.

The NSWBC proposal to increase the payroll tax threshold to $1 million on its own would deliver a significant improvement for NSW's cross-border regions. For example, a $1 million threshold would mean a NSW business with a payroll of around $1.9 million would face a more competitive payroll tax regime than their counterparts in regional Victoria who currently face a payroll tax threshold of $625,000.

For the Albury region, this would mean that around 98 per cent of businesses would have access to equivalent or favourable effective rates of payroll tax compared to their counterparts across the border.[4] While a threshold increase would go a significant way toward mitigating disparities in payroll tax between NSW and Victoria, around 140 large employers in the Albury region (with 20 employees or more) would continue to face less favourable payroll tax arrangements (at varying degrees depending on the size of their payroll). Targeted measures that ensure cross border competitive neutrality need to be examined to address this issue.

Other issues affecting cross-border regions

As noted in NSWBC's initial submission, regional infrastructure is an important policy lever for promoting regional development while at the same time ensuring that NSW residents have access to sufficient opportunities and amenity no matter where they live.

NSWBC notes that some stakeholders raised concerns relating to the discounting of benefits that flow across state borders when assessing infrastructure projects.[5] This practice may lead to an undersupply of infrastructure as it becomes prohibitively difficult for projects to stack up against the traditional criteria.

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[4] Based on business counts data. Albury regional defined to include the SA2 boundaries of Albury East, Albury North, Albury South, Albury Region and Lavington.
[5] For example, see submission by Albury City Council, p3.

Decision-making should be guided by more than a narrow assessment of financial costs and benefits and NSW's cross-border communities ought to be able to expect an equivalent level of services as comparable communities located elsewhere in the state. Broad selection criteria, which provide weighting to these considerations, should be developed as part of efforts to enhance traditional cost-benefit frameworks so that they can better take into consideration non-market benefits.

Recommendation

Infrastructure selection criteria should ensure that cross-border communities have access to equivalent services and amenity as comparable communities elsewhere in the state.