



*ASSOCIATION OF AUSTRALIAN PORTS
AND MARINE AUTHORITIES*

***Submission to the
Review of Business Taxation***

16 April 1999

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Executive Summary

The Association of Australian Ports and Marine Authorities (“AAPMA”) strongly supports the Review of Business Taxation. In particular, AAPMA strongly supports reforms that promote the efficiency, equity and simplicity of the business income tax system.

However, AAPMA has significant concerns with a number of the proposed business tax reform options outlined in *A Platform for Consultation*, and with the way in which these proposals might be implemented in practice.

In supporting the principles of equity and efficiency, AAPMA emphasises that where the tax system currently serves to distort the investment and resource allocation decisions of the ports industry, these distortions should be addressed as part of the current business tax reform process. Such distortions arise in the current taxation treatment of capital expenditure by ports.

Specifically, at present, there are inconsistencies in the tax treatment of capital expenditures by ports on channels and breakwaters as compared to other capital expenditures by ports. Further, there are inconsistencies between the tax treatment of capital expenditures on minerals and quarrying ports infrastructure and other ports infrastructure. Furthermore, inconsistencies in the taxation treatment of capital expenditure exist between the port industry and other transport infrastructure industries.

The inconsistent treatment of capital expenditures on ports infrastructure and between ports and other transport infrastructure industries raises competitiveness concerns within the ports industry and creates competitive distortions between ports and other transportation industries. The inconsistencies serve to distort investment decisions and capital allocations, with consequent efficiency implications.

AAPMA believes there is a strong case for reducing these distortions through the adoption of a more coherent and consistent framework for the taxation of wasting assets. In this regard, AAPMA urges the RBT to consider improving the consistency of treatment of infrastructure assets, including channels and breakwaters, through their inclusion in the proposed wasting assets model outlined in *A Platform for Consultation*.

Aside from the benefits of a simplified system for the treatment of wasting assets, reducing the distortions to investment decisions provided by the current tax system could ultimately be expected to promote the competitiveness of Australian businesses in international markets through the key role the ports industry plays in the export value chain.



1.0 Introduction

This submission has been prepared by AAPMA and its members, with the assistance of Arthur Andersen, in response to the release of *A Platform for Consultation* ("APC"), the second Discussion Paper in respect of Australian tax reform, by the Federal Government's Review of Business Taxation ("RBT") on 22 February 1999. Arthur Andersen fully endorse the views in this submission.

AAPMA represents port authorities/corporations and marine regulators. Its membership includes both government business enterprises and private enterprises. A listing of AAPMA members is included in Appendix 1.

The ports industry is particularly important in Australia due to the high dependence of the Australian economy on international trade. In particular, the international competitiveness of the ports industry is a key determinant of Australia's export performance and business costs generally. In this regard, the efficiency of Australia's ports has improved dramatically in recent years.

Tax policy issues relating to the port industry have not been considered in great detail until more recent times. This is because most ports have traditionally been owned and operated by federally tax-exempt entities, typically State Government owned entities.

However, the recommendations of the Hilmer Report have led to the corporatisation or commercialisation of Government owned port corporations/authorities and the privatisation of some others. It is expected that this process will continue. Further, the development and implementation of National Competition Policy, has led to the introduction of Tax Equivalent Regimes in each of the Australian States. Consequently, port authorities/corporations have become aware of a number of anomalies in the taxation treatment of ports.

The primary purpose of this submission is to outline the taxation, economic and practical implications of the proposed business taxation changes for Australian ports, to provide input on the options discussed in APC. This submission will also provide alternative, more viable options, where appropriate.

In order to achieve this primary objective, the submission will highlight the tax issues facing Australian ports, and the impact of the proposed business tax reforms in their ongoing businesses.

This submission has been divided into three further sections. Section 2 outlines AAPMA's stance on the APC. Section 3 considers the inconsistencies in the tax treatment of capital expenditures by ports. Section 4 deals with the proposed FBT exemption for remote area housing.



2.0 Review of Business Taxation: A Platform for Consultation

AAPMA's vision for business income taxation in Australia corresponds closely with the RBT design principles and the benchmarks for reform outlined in APC. In particular, AAPMA supports reforms resulting in an internationally competitive business income taxation system.

Moreover, AAPMA considers that the Government's business tax reform strategy should facilitate the improvement of Australia's infrastructure, including port and marine facilities. The infrastructure industry is a major contributor to economic growth and living standards.

The taxation treatment of Australia's port facilities is especially important in the context of the national objective of maximising economic growth. In particular, the efficient provision of ports infrastructure is crucial to the competitiveness of exporters in international markets and to maximising the contribution that these exporters make to economic growth.

AAPMA supports many of the business income tax reforms outlined in APC. In particular, AAPMA strongly supports the proposals to move the depreciation of all wasting assets to an effective life basis.

AAPMA believes that these issues are important in designing a business income tax system that will foster Australia's long term growth prospects in an increasingly competitive, global environment.

3.0 Inconsistencies in the Tax Treatment of Capital Expenditure incurred by Ports

AAPMA's primary business tax concern is that there are inconsistencies in the way that capital expenditure incurred by ports is treated for income tax purposes between ports and other infrastructure industries.

3.1 Tax Treatment of Capital Expenditures on Channels and Breakwaters Relative to other Capital Expenditures

At present, most ports do not qualify for any tax deductions for capital expenditure pertaining to channels (including berthing pockets and swing basins) and breakwaters.

The courts have not specifically examined the question of whether channels and breakwaters fall within the meaning of depreciable "plant" in section 42-18 of Division 42 of the Income Tax Assessment Act 1997 ("the ITAA97") for the ports industry. However, for public sector ports, the consensus in each State TER is that channels and breakwaters do not fall within the meaning of depreciable plant.

This is because channels and breakwaters have been regarded as providing the setting or environment within which income-producing activities are conducted, rather than the permanent means or apparatus



used to produce that income.

However, AAPMA believes that this view is challengeable, as without the channels and/or breakwater, the port may either not exist or have quite limited operations. Moreover, if this were the case, cargo would have to be transported through an alternative port, possibly at a significantly increased transport cost.

Further, a deduction for capital works under the structural improvement provisions in Subdivision 43-A of the ITAA97 is effectively precluded by paragraph 43-20(4)(a), which states:

“This Division does not apply to structural improvements being:

- (a) earthworks that:*
 - (i) are not integral to the installation or construction of a structure; and*
 - (ii) are permanent (assuming they are maintained in reasonably good order and condition); and*
 - (iii) can be economically maintained in reasonably good order and condition for an indefinite period;*

*for example, **unlined channels**, unlined basins, earth tanks and dirt tracks”.*

There is some uncertainty as to whether deductions for channels (other than those that are unlined) and breakwaters are precluded by the above provision.

Channels and breakwaters decline in value over their economic lives due to environmental/geological factors and due to changes in the size and design of ships. For example, channels require deepening and widening as a result of changing vessel design and to meet the competitive demands of cargo interests who require larger ships to minimise transport costs.

Moreover, all channels require regular maintenance (such as dredging) due to the persistent impact of environmental factors, such as storms, which result in a buildup of silt in channels. The maintenance requirements of channels in different locations differ accordingly.

Breakwaters may also need to be extended or repositioned in response to the deepening and widening of channels. They also require limited maintenance.

A recent example of a channel improvement project is the Geelong Channel Improvement Programme in the Port of Geelong at a cost of \$35 million. The programme will allow larger ships to service the oil refinery located in the region and will also provide significant advantages to the wheat industry, and other dry bulk cargoes, in the medium to longer term.



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The limited economic life of channels and breakwaters is recognised in the United States, where channels and breakwaters are classified as “Land Improvements” and are depreciable over the lesser of 15 years or their useful life.

Accordingly, the non-availability of deductions for capital expenditure on channels and breakwaters is inconsistent with the treatment of other capital expenditures, which are deductible under the general plant and equipment depreciation regime or Division 43 of the ITAA97.

3.2 Tax Treatment of Mining/Quarrying Ports Infrastructure Relative to other Ports Infrastructure

Further inconsistencies in the tax treatment of capital expenditure arise because some ports that principally transport minerals are able to claim a write off for such capital expenditure over 10 years, under the mineral transportation provisions in Subdivision 330-H of the Income Tax Assessment Act 1997 (“ITAA97”).

Under Division 330, expenditure on infrastructure for transporting minerals and quarry materials away from the site of mining or quarrying operations is evenly deductible over 10 years (20 years in the case of quarrying). Facilities eligible for write-off include railways, roads, pipelines and certain port facilities.

These mining transportation provisions are limited in their application to port facilities by Section 330-415 of the ITAA 1997, which provides:

“A deduction is only available under this Subdivision in respect of capital expenditure on, or by way of contribution to, a port facility or other facility for ships if:

- (a) the expenditure is not deductible under any provision of this Act other than this Subdivision; and*
- (b) the expenditure is not taken into account in working out the amount of a deduction under any provision of this Act other than this Subdivision.*

In applying Subsection (1), ignore the effect of Subsection 330-590(1) (which is about mining or quarrying deductions taking priority)”.

This limitation is in contrast to the application of the provisions to other mining transport facilities, for example road, rail and pipelines. Section 330-590 provides that these provisions will take priority over any other deductions available under the Act:

“If an amount in respect of capital expenditure is deductible by you under this Division, you cannot deduct the expenditure under any provision of this Act other than this Division. The expenditure cannot be taken into account in working out the amount of any deduction other than one under this Division”.



The current taxation treatment of channels and breakwaters in various ports in Australia is outlined in Appendix 2.

The inconsistent treatment of different capital expenditures in ports and between different ports raises competitiveness and competitive neutrality concerns within the ports industry.

3.3 Capital Expenditure Deductions in other Industries

Inconsistencies in the taxation treatment of capital expenditure exist not only between individual ports, but also between the port industry and other industries. In particular, it can be seen that capital expenditure incurred by participants in other transport infrastructure industries gives rise to income tax deductions.

For example, deductions are available for rail, road and airport infrastructure under the general plant and equipment depreciation provision or the structural improvement provisions in Division 43 of the ITAA97, but not for port infrastructure.

- Rail - track structures (sleepers, rail, ballast, etc) are depreciable plant. The Federal Commissioner of Taxation will accept a depreciation rate of 20 per cent under the diminishing value method for track structures.
- Road - capital expenditure on privately owned roads (such as Sydney's M2 Motorway) is eligible for amortisation deductions under the structural improvement provisions in Division 43 of the ITAA97, as outlined earlier.
- Air - airport runways are expressly included in the meaning of a structural improvement. Accordingly, deductions for capital expenditure on airport runways will be available for private sector owners of airports.

3.4 Options for Addressing the Inconsistencies

The inconsistencies in the tax treatment of capital expenditures outlined above serve to distort investment decisions with consequent efficiency implications.

AAPMA believes there is a strong case for reducing these distortions through the adoption of a more coherent and consistent framework for the taxation of wasting assets.

In particular, AAPMA urges the RBT to consider improving the consistency of treatment of infrastructure assets, including channels and breakwaters, through their inclusion in the proposed wasting assets model outlined in APC. We note that channels and breakwaters receive no mention in APC.



In APC, wasting assets (both tangible and intangible) are defined as those that, at the time they are acquired or created, can be reasonably expected to decline in value over time. As outlined earlier, channels and breakwaters fit this definition.

In line with the options presented by the RBT, AAPMA believes this model should have the following characteristics:

- deductions should accrue to the taxpayer bearing the economic cost of the asset;
- the cost base for deductions should be the actual cost of the asset to the taxpayer;
- the asset must be installed ready for use;
- the write-off period should be the effective life of the asset;
- the write-off method should be the diminishing value method, the prime cost method or the taxpayer's choice between these two methods; and
- in general, there should be no access to balancing charge relief on disposal of the asset.

This approach would reduce the costs of compliance and administration of the depreciation provisions, while incorporating sufficient flexibility to deal with different types of wasting assets.

Aside from the benefits of a simplified system for the treatment of wasting assets, the reduction of distortions to investment decisions provided by the current tax system could ultimately be expected to yield an economic growth dividend for the Australian economy. This growth dividend would arise as the economy's resources are allocated more efficiently, towards their highest value uses, and the tax environment within which Australian entities compete relative to international entities becomes less disadvantageous. This in turn will serve to promote the competitiveness of Australian businesses in international markets.

A key consequence of including all ports capital expenditure, including that on channels and breakwaters, in the wasting assets model proposed by the RBT is that the mining/quarrying ports capital expenditure is likely to be treated like all other wasting assets under the model. This would clearly be at a cost for those ports engaged primarily and principally in the transportation of mining/quarrying products. Around one quarter of the members of AAPMA are mining/quarrying ports.

The issue of whether special rules should apply to the resources sector is examined in APC. It is noted that under a standardised wasting assets model for the treatment of capital allowances, no special rules would apply to the resources sector. However, as highlighted in the RBT's discussion paper, *An International Perspective*, the resources sector is favourably taxed in many of the jurisdictions surveyed.



For example, in Canada, special deductions are available for certain capital exploration, development and property expenditure on exploration for oil, gas and minerals. In New Zealand, mineral mining exploration and development costs are fully deductible, including for planned expenditure up to two years in advance of expenditure.

In light of the major contribution that the resources sector makes to the Australian economy, it is important that its competitive position in international markets be maintained relative to other suppliers.

4.0 Fringe Benefits Tax Exemption for Remote Area Housing

- In *A New Tax System* (“ANTS”), circulated by the Treasurer, the Hon Peter Costello, MP, in August 1998, the Federal Government made a commitment to extend the FBT exemption for remote area housing to cover remote area housing provided by mining industry employers to their employees.
- This would provide consistent treatment of the mining industry relative to primary producers. However, it is important for equity reasons that this exemption covers remote area housing in those ports in remote areas which are engaged primarily and principally in mining transportation activities.

To maximise the effectiveness of the incentive, it is important that the “boundaries” of this FBT exemption remote area housing in ports be carefully defined. We suggest that it be defined by reference to the location of the port. In particular, AAPMA considers that the exemption should be available only to ports outside a certain distance from a major capital city (say a city with a population of 100,000 or more).



Appendix 1

Member List as at 16 April 1999

Department of Transport and Regional Services – Maritime Division

RAN Hydrographic Service

Royal Australian Navy

NSW Ministry of Forests and Marine Administration

Newcastle Port Corporation

Port Kembla Port Corporation

Sydney Ports Corporation

Melbourne Port Corporation

Port of Portland Pty Ltd

Toll WesternPort

Victorian Channels Authority

Bundaberg Port Authority

Cairns Port Authority

Department of Transport Queensland

Gladstone Port Authority

Mackay Port Authority

Port of Brisbane Corporation

Ports Corporation of Queensland

Rockhampton Port Authority

Townsville Port Authority

Ports Corp South Australia

Burnie Port Corporation Pty Ltd

Department of Transport Tasmania

Flinders Island Port Company Pty Ltd

Hobart Ports Corporation Pty Ltd



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King Island Port Corporation Pty Ltd
Port of Devonport Corporation Pty Ltd
Port of Launceston Pty Ltd
Darwin Port Authority
Department of Transport & Works NT
Albany Port Authority
Bunbury Port Authority
Dampier Port Authority
Department of Transport WA
Esperance Port Authority
Fremantle Port Authority
Geraldton Port Authority
Port Hedland Port Authority



Appendix 2

Examples of Current Taxation Treatment of Channels and Breakwaters in Australia

Port Authorities/corporations	No Deduction	Mining Transport Deductions	Other
Sydney	✓		
Newcastle		✓	
Brisbane		✓ (Part only)	
Townsville	✓		
Ports Corp Qld		✓ (Mineral ports only)	
Gladstone		✓	
Cairns	✓		
Melbourne	N/A		
Ports Corp South Australia			✓ (Final decision subject to TER Steering Committee - still pending)
Esperance		✓ (Channel deepening)	
Bunbury		✓ (Part only of channels and breakwaters)	
Albany	✓		
Geraldton	✓		
Burnie	✓		
Devonport			✓ (Government Business Enterprises Act 1995)