



**MARITIME UNION OF AUSTRALIA (MUA)**

**FOLLOW UP SUBMISSION TO THE REVIEW OF  
AUSTRALIA'S FUTURE TAX SYSTEM**

**SHIPPING AND CORPORATE TAX**

**25 SEPTEMBER 2009**

## Introduction

The Maritime Union of Australia (MUA) made a submission to the Review of Australia's Future Tax System on 20 October 2009.

The House of Representatives Standing Committee on Infrastructure, Transport, Regional Development and Local Government tabled its report entitled *Rebuilding Australia's Coastal Shipping Industry* following an Inquiry into Coastal shipping policy and regulation on that same day. Since that time, the industry stakeholders have been in discussion with the Government on possible responses to the Report's Recommendations.

The Recommendations with particular relevance to the work of the Review of Australia's Future Tax System and which are the subject of this submission are:

***Recommendation 5:*** *The Committee recommends that the Australian Maritime Group examine ways to introduce an optional tonnage tax regime in Australia that is linked to mandatory training requirements. The introduction of an optional tonnage tax should then be coordinated with the implementation of other reforms recommended in this report by the Reform Implementation Group referenced in Recommendation 14 (a process recommendation).*

***Recommendation 6:*** *The Committee recommends the re-introduction of accelerated depreciation arrangements. The re-introduction of accelerated depreciation arrangements should be coordinated with the implementation of other reforms recommended in this report by the Reform Implementation Group referenced in Recommendation 14.*

On 10 September 2009 the union met with representatives of the Review of Australia's Future Tax System. We were invited to submit any further views on the issue of shipping and corporate taxation.

## Shipping and corporate tax

### International competitiveness features of Australian shipping

According to advice the union has been given by the Department of Infrastructure, Transport, Regional Development and Local Government (DoITRD&LG), based on modeling undertaken by the Bureau of Infrastructure, Transport and Regional Economics (BITRE) the so called international competitiveness gap between an Australian owned, financed and crewed trading vessel compared to a foreign owned, financed and crewed vessel is in the range of Aust \$2.5 M to \$5.00 M per annum depending on the type of vessel and the assumptions used regarding capital costs and other variables.

It is important to understand that when considering this comparison, it is only relevant in comparing the cost of operating an international trading vessel in the international; trades where labour and capital is sourced in Australia and the vessel is registered under the *Shipping Registration Act 1981* relative to a vessel where the capital and labour is sourced on foreign country and it is flagged in a foreign registry where the corporate tax is zero or close to zero.

It is not an appropriate comparison when comparing the cost structure on an Australian registered vessels operating in the Australian coastal trade. Such vessels are in the domestic freight market and their cost structure should be compared to the other domestic freight modes of road, rail and aviation, all of which are subject to the full range of Australian laws, including industrial laws.

The Government's decision to make a Regulation under s34 of the *Fair Work Act 2009* (FWA) to extend the operation of the FWA so that it covers all seafarers working on Australian vessels or working regularly in Australian waters so that those seafarers have the benefit of Australian workplace relations laws and a fair safety net of employment conditions, to apply from 1 January 2010, will substantially alter the modeling results in any case.

Notwithstanding that new policy, the BITRE analysis as we understand it shows that the tax component of that competitiveness gap is in the order of \$1.00 M per annum, or somewhere between 20% and 40% i.e. that an Australian corporate owner/operator who pays the Australian corporate tax rate of 30% is bearing a 20% to 40% higher capital cost structure than a foreign owner/operator who flags their vessel in a tax free foreign registry or in a tonnage tax registry (where the effective tax rate is close to zero).

Australia, which has the 5<sup>th</sup> largest global shipping task (measured in tonne/kilometers) has a massive capital outflow for shipping services. May 2009 ABS data shows that Australia currently has an \$8.4 B debit in international freight transport, offset by only \$617 M in freight transport credits, resulting in a net debit of \$7.8 B (early 2009). The burden of this capital transfer, or domestic investment deficit, falls predominantly on Australian labour, with foreign labour being a significant beneficiary.

Estimates by Braemar Seacope Australia (see presentation to NatShip 2009 Conference at <http://www.amsa.gov.au/natship09/documents/speakers/FINAL%20PPT%20-%20PEGUM,%20Tony.pdf>) show that Australia incurred demurrage payments of \$1.84 B (in 2008). The whole of those demurrage payments went to foreign corporations as the owners/operators of the foreign ships. Demurrage costs as a net capital outflow will continue to rise while ever Australia is reliant on the purchase of foreign shipping services i.e. while ever the tax system positively discourages capital investment in Australian ships (demurrage is incurred because FOB shipping terms, where the buyer controls the shipping, results in massive capital inefficiency and capacity under utilisation in circumstances where the capital owner transfers the risk (cost) of capital idleness to the cargo seller). Similarly, the burden of this cost on capital allocation (capital inefficiency) falls on domestic labour through higher domestic prices or lower shareholder (capital income) returns. It is widely accepted in the shipping industry that CIF or DES shipping terms, where the seller controls the shipping, results in much more efficient capital utilisation.

### **The impact of current tax arrangements on investment in Australian ships**

The net effect of the current Australian corporate tax arrangements is to discourage investment in Australian ships and to encourage offshoring of Australian shipping – both its domestic and international dimensions.

Furthermore, the effect of the current Australian corporate tax arrangements as applied to shipping, when combined with the current regulatory arrangements provided by Part VI of the *Navigation Act 1912*, and their administration under Ministerial Guidelines for Granting Licenses and Permits to Engage in Australia's Domestic Shipping, is to create a partial tax haven for foreign shipping in the Australian domestic sea freight transport sector. While a freight tax is applied and is passed on to the consignee, the capital owners pay no Australian corporate tax (and probably no corporate tax anywhere in the case of a large proportion of those foreign ships) while operating under permits in the Australian coastal freight transport system. Both the early 2009 G20 and G8 meetings committed to address tax havens through globally coordinated efforts.

In our view, the need to consider alternatives to the current corporate tax arrangements that would attract Australian and foreign investment in Australian registered/Australian operated ships (albeit under a two tiered shipping registration system i.e. with creation of an Australian International Ships Register, under a reformed *Shipping Registration Act 1981* that also encouraged ship financing from Australia) is necessary to achieve a genuine freight transport market in Australia, and to meet wider policy objectives regarding investment nationally significant infrastructure.

We also believe there is an arguable case for market failure, contrary to the assertion of Latrobe University's Harry Clark and David Prentice in their paper entitled *A Conceptual Framework for the Reform of Taxes Related to Roads and Transport* prepared for Treasury in June 2009 where the idea of a tonnage tax was dismissed (we might add with no analysis). We say that market failure is evidenced by the absolute absence of investment in Australian shipping for the past 15 years. The corporate tax arrangements applying to this capital sector in the international market is clearly established and is eroding our ability to participate in shipping unless we have broadly equivalent access mechanisms (like for example a tonnage tax). We say that such market failure should then define the rationale for intervention given Australia's reliance on shipping to meet specific national objectives, like keeping open the supply lines that contribute to the 99% of our tradeable goods that move by sea.

### **Options for the future**

It is our submission that the requirement for alternative corporate taxation arrangements for taxing ship capital should be based on the following objectives:

- The elimination of the Australian domestic sea freight sector as a tax haven, for foreign ship owners consistent with the G20 and G8 commitments to eliminate tax havens.
- The elimination of ship capital allocative inefficiencies in the Australian component of the international commodity export market supply chain.
- The reduction of the tax burden on Australian labour and elimination of the tax transfer benefits to foreign labour.
- To assist in retaining capital benefits from shipping in Australia to assist reinvestment in ships.
- To bring Australia into closer alignment with international corporate tax arrangements impacting on shipping investment aimed at creating a level playing field for ship capital investment which would address market failure.

- To achieve a better equilibrium in capital flows for shipping services, with consequential positive impact on the Balance of Payments.
- To increase tax revenue to Australia (from both labour and capital) and to increase shippings' contribution to GDP.

We note that significant sections of the corporate sector have called for a reduction of the corporate tax rate in Australia. A reduction of the corporate tax rate to 15% for example, would not achieve an objective of attracting investment in ships in Australia due to the widespread global availability of zero corporate tax options or tonnage tax options (which is low tax option) in virtually every trading nation across the globe (see for example the Deloitte publication entitled Shipping Tax Overviews at [http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/ShippingTaxOverviewsBrochure\\_Feb06.pdf](http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/ShippingTaxOverviewsBrochure_Feb06.pdf)).

We note also that the Australia's Future Tax System Consultation Paper of December 2008 raised the issue of an ACE (Allowance for Corporate Equity) model of corporate taxation, as a potential feature of a new corporate tax model, and that the issue has since been advocated by business interests. We note that the ACE model might achieve the objectives for a corporate tax system for the shipping industry as outlined above. We understand that the ACE model favours high capital cost investments and investments where the returns flow unevenly over a long period of the investment. Both those are features of ship investment, which also typically operates on low relative returns on capital. We note however that the ACE model would need to be accompanied by the availability of forms of depreciation allowance.

We believe the Department of Infrastructure, Transport, Regional Development and Local Government (perhaps in cooperation with the Bureau of Infrastructure, Transport and Regional Economics (BITRE)) in conjunction with Treasury should undertake modeling of the impact of an ACE model of corporate taxation relative to a both the existing corporate tax arrangements (at 30% and at say 15%) and a tonnage tax. The factors to be considered in that modeling would be:

- The fact that a proportion (probably a relatively small proportion in the initial years) of investment in Australian ships under favorable tax arrangements would be by foreign entities.
- There would be both investment in bareboat charters (a type of renting of ships) as well as in purchase of ships.
- Traditional financing models and the impact of the mortgage features of the current *Shipping Registration Act 1981* would need to be considered.

Notwithstanding the fact that the Australia's Future Tax System is examining alternative corporate tax models, there is clearly an international standard that applies in shipping and that is a tonnage tax. This is a widely used and recognised, easy to administer system that is already applicable to many corporate entities in Australia who have ship operations e.g. Rio Tinto flagging vessels in the UK to take advantage of the UK tonnage tax system. It must be recognised that one an entity opts in to the tonnage tax regime, they must pay the tax regardless of profit or loss for the periods of opt in.

### **Indirect benefits of stimulating investment in Australian ships**

The indirect impacts of changes to corporate tax arrangements, should they be designed in such a way as to stimulate investment in Australian ships, will be to:

- Create sustainable employment for Australians.
- Create a supply of domestic skills to sustain Australia's maritime industries.
- Provide a genuine competitive national freight transport market in Australia.
- Increase national productivity.
- Add to our maritime security capability.
- Add to our national defence capability.
- Reduce greenhouse emissions from freight transport.
- Complement the labour reforms currently under consideration as part of the Government's response to addressing the Recommendations of the Parliamentary Inquiry Report on Australia's domestic shipping policy and regulation entitled *Rebuilding Australia's Coastal Shipping Industry*.

## Revitalisation of Australian shipping

### **An important element of the National Transport Plan agreed by COAG, and a vital component of national infrastructure which will deliver long term productivity improvement for the nation**

- It will provide a more competitive domestic freight transport system; and
- It will provide a more efficient export commodity market – by enabling commodity producers/shippers to provide flexible shipping options for their customers (avoidance of demurrage, reducing shipping queues, better ship utilisation).

### **The proposed fiscal measures are aimed at:**

- Driving investment to replace old tonnage; to maintain a viable domestic maritime base in Australia
- Delivering greater competition in the freight transport sector by providing genuine competitive choice for shippers
- Creating a basis for Australia to leverage competitive advantage in the international commodity market and through combined coastal and international ship utilisation (called triangulation) by ensuring a regulatory and fiscal regime that ensures Australian based companies can operate ships in the international shipping market

### **A revitalised Australian shipping industry will:**

- Reduce capital outflows (offshore ship purchase and chartering)
- Attract foreign investment (ship investment, shipping infrastructure investment, regional training),
- Increase taxation revenue from the sector (permit shipping is currently creating a tax haven for international shipping) – investment in shipping creates a new tax base – broadens to tax intake
- Contribute positively to GDP
- Contribute positively to the Balance of Payments
- Require only modest calls on the budget, and only in the start up years of a new national shipping policy that includes tax measures that encourages capital investment in ships.

### **The context for tax reform for Australian shipping**

***Regulating wages and conditions of seafarers who are engaged on Australian registered ships in international shipping and whose operator has chosen to enter the tonnage tax regime***

The MUA acknowledges that, based on international experience, the creation of an internationally competitive Australian shipping registration system for Australian entities who propose to operate in international shipping and who may choose to enter the tonnage tax regime may require additional measures over and above the tonnage tax and improved seafarer income taxation arrangements to assure their international competitiveness.

We note that some of the nations who have adopted a tonnage tax and related policy packages to support and grow their international shipping have devised seafarer employment arrangements that involve the use of foreign or non-domiciled ratings, covered by national collective agreements.

Some nations who have adopted such a policy recruit their non domiciled seafarers only from specified developing nations (and from specified and audited seafarer employment agencies within those nations) who meet minimum standards in relation to seafarer training and certification and who have ratified the ILOs core labour standards Conventions. We note that in a number of such nations the operator must reach agreement on a CBA that meets at least minimum national labour standards, which would not necessarily mean a maritime Award standard if applied to the Australian context.

The rationale for those models that include non domiciled seafarers is that the non domiciled seafarers return to their nation of domicile, and they receive wages that are higher than the standards in their domestic seafarer labour market, with positive repatriation benefits.

These arrangements are often linked to Government regional development policies whereby Governments seek to use managed labour mobility programs to support regional development. We note the Rudd Government has also made policy statements supporting labour mobility and skills development as part of the Government's commitment to regional national building and regional security.

The MUA does not currently have a policy on the use of such employment arrangements in Australia. However, should a discussion emerge on such an approach as a possible feature of the employment arrangements to accompany a tonnage tax in Australia, the MUA signals that any potential resolution would require as a minimum, agreement with employers on the conditions under which all seafarers could be employed on Australian registered ships.

The MUA also notes that some of the overseas employment models involve labour agreements which will permit non-domiciled workers to be engaged on rates of pay that are comparable to the domiciled nations domestic seafarer wages while meeting the flag nation's minimum national standards, including leave and other entitlements.

There are varying requirements across different nations regarding the ratio of nationals V non-domiciled seafarers. This too would require consideration in the Australian context if modified employment arrangements were proposed as part of an Australian tonnage tax proposal.

Once again, all such arrangements would require consideration as part of a total policy package if they are raised as being important in the Australian context.

***How do labour agreements for non domiciled seafarers work under, for example, the Swedish model?***

Take a vessel with a crew complement (operational crew) of 16 seafarers, requiring employment of 32 seafarers on a 2 crew system.

Under some overseas models like Sweden, up to 50% of the crew can be foreign non-domiciled seafarers. So, in a circumstance where 16 of the crew are foreign non-domiciled seafarers where they work without accruing leave under the typical Australian seafarer swing system, the actual crew number required to operate the ship falls to 8, as no replacement crew is required for the 50% foreign non-domiciled component of the crew.

Therefore the Swedish employer only requires 24 seafarers to crew the vessel, not 32 as would otherwise be the case – a reduction of 25% in crew numbers which delivers the Swedish employer a major labour cost saving.

**What does the MUA seek from the Federal Government to underpin the revitalisation of Australian domestic and international shipping?**

The MUA seeks the following from the Federal Government:

- Amendments to the *Income Tax Act* to provide for a tonnage tax or alternatively, appropriate taxation arrangements that would attract investment in Australian ships and shipping.
- Reintroduction of an accelerated depreciation allowance.
- Reform of the *Shipping Registration Act 1981*, around 3 key reforms:
  - Maintenance of a comprehensive registration system for vessels participating in the coasting trade aimed at supporting the cabotage provisions in Part VI of the *Navigation Act 1912*;
  - Creation of an internationally competitive registration system for entities who propose to operate in international shipping and who may choose to enter the tonnage tax regime (if adopted); and
  - Revision of provisions which impede the facilitation of financing and leasing of vessels from and within Australia.
- Reform of the *Navigation Act 1912* to provide for a ship registration agency which is separately administered from Flag and Port State Control regulation within AMSA.
- Reform of the ship licensing provisions in Part VI of the *Navigation Act 1912*.
- Reform of the Ministerial Guidelines for the issuing of permits and consideration of their translation into Regulations.
- Reforms to the administration and funding of seafarer training by Government, as well as a new incentive to support training of Timorese and PNG nationals (and perhaps those from other regional developing nations – in the Pacific).
- Reform of seafarer income taxation.
- An ETS that provides a level playing field between international and Australian flagged shipping in the domestic trade (this has now been included in the Governments CPRS White Paper).

- Early ratification and implementation of the ILO Maritime Labour Convention (MLC).
- The possible establishment of a new role for AMSA in managing a Certificate of Equivalency procedure to facilitate the maintenance of high standards for all seafarers engaged in Australian international shipping.
- Better integration of the role of Customs and DEEWR in determining that ships crew have been paid appropriately before a vessels embarks on an overseas voyage.