



AJ & PA
M̄cBRIDE
LTD

Remote Area Tax Concessions and Payments
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

2 May 2019

Dear Commissioner,

RE: Remote Area Tax enquiry

The board of AJ & PA McBride Ltd submits the attached document to the study into Remote Area Tax Concessions and Payments as a broad scope of the issues that the company believes should be covered by the study.

Thank you for allowing an extension to the due date for submissions.

If there are any questions in relation to this document, please contact the Secretary.

This submission is not confidential.

Yours faithfully,

Nathan Wessling
Chief Financial Officer / Company Secretary
AJ & PA McBride Ltd

1.0 Preamble

AJ & PA McBride Ltd (the *Company*) is a family owned business of Pastoralists and Graziers formed in 1920. The company is one of the country's largest wool producers, running in excess of 250,000 merino sheep across ten properties in South Australia and Victoria, and covering more than 1.4 million hectares. Whilst predominantly sheep and wool focused, the company produces beef cattle and has investments in viticulture, as well as a portion of off farm commercial property.

Three of the ten properties owned by the company are wholly within the Zone B offset area; with a further two properties partially within the Zone B area. All of the company's agricultural properties are within the area defined as remote for FBT purposes.

A number of the McBride family are also pastoralists, graziers and viticulturists in their own right, with shareholders also owning at least ten additional farming properties. The views expressed in this document are representative of management and board of the company, and not necessarily those of the shareholders or wider family.

The company provides fringe benefits to staff as an extension of their position as is generally expected in the industry such as housing and keep; fuel and communications. Many of the benefits provided are FBT-exempt or have a remote area reduction applied. This submission will predominantly deal with Fringe Benefits.

2.0 Context of remote area support

The issues paper prepared by the productivity commission noted the historical context of remote area support as follows:

At the time, people in these areas faced some particular challenges: for example, most highways and truck routes were unsealed, planes were expensive and relatively dangerous, people relied on the post rather than email, and there was no or limited access to government services or modern comforts such as television and air conditioning. This heightened the costs and deprivations of geographical isolation and of living on parched earth or in the tropics. (p2)

The company would argue that the challenges noted by the commission are starker now, than when first instituted, for the following reasons:

- Chronic under-investment from successive governments has resulted in a deterioration of rural roads. Very few roads are sealed in regional and remote areas, with a number still subject to closure during high rainfall events. With declining regional population, the state of roads can be a defining factor when competing for staff and contractors.
- Communication is a massive issue for remote areas and an increasing disparity between urban and rural areas.
 - Postal services are slow and infrequent. As an example, some of the company's mail used to be delivered by train into the north-west pastoral district. After enquiry about the speed in which mail was being delivered, we found that mail was being delivered from Adelaide to the Port Augusta Post Office; being sorted; then freighted back to Adelaide; put onto the train; then the train would pass Port Augusta on the way to delivering the mail to the property. In order that the mail would be delivered more efficiently, the company now gets mail delivered by road. This is an example of where bureaucracy gets in the way of efficiency, the train still runs past the property, but no longer with our mail!
 - Rural properties still rely on landline telephony, although the company has low levels of mobile connectivity at most property homesteads. However the copper network continues to decline and the provider has little to no motivation to perform preventative maintenance, which has resulted in an increase in outages.

- Internet services are an essential tool, not just for commerce, but for schooling (including School of the Air), and for entertainment. Currently there are very few options for internet connectivity on remote sites. The company used to have an acceptable level of 3/4G mobile data connectivity however with a monopoly supplier which charged up to \$10,000/TB for data. However we have experienced an unprecedented level of bandwidth throttling on our properties resulting in an unacceptable speed of connection. This leaves satellite services as the company's only option in remote areas, and apart from the latency issues caused by this technology; residential satellite NBN are mandatorily capped, meaning that the company must restrict access for business and educational usage only. Business satellite NBN is not yet available but will cost orders of magnitude above comparable urban plans.
- The loss of essential services from regional areas, the most blatant of which was the removal of passenger rail in the 1980s, decimated rural townships. This in turn led to a reduction in commerce; then employment; then population, which then led to a further reduction in services. The net effect of this is increased city/country isolation. In particular the decline in local tradesmen can lead to remote properties having difficulty sourcing contractors.
- The increase in productivity of agricultural and pastoral pursuits have resulted in a reduction in the number of employees on properties resulting in lower levels of community. Whilst an increase in productivity is a desirable outcome, there are some detrimental side effects.

2.1 Costs of business in remote areas

Apart from the capital cost of acquiring land, the costs of every part of conducting a business in remote areas is more expensive than urban areas:

- By the very nature of the remote area; freight and logistics charges are necessarily more expensive due to the requirement of travelling further to destinations. However this is exacerbated by a lack of critical mass of population which means that per litre costs of fuel are higher than urban areas; as well as the upkeep and quality of roads is lower, thereby increasing repairs and maintenance of vehicles.
- Utilities that are taken for granted in urban areas are virtually non-existent in remote areas, such as access to mains-connected electricity; gas and water. These networks are all classed as a public good and their costs are government subsidised or regulated. When these are not available, the cost of supplying these goods is borne privately which is generally more expensive.
- Infrastructure is either substandard, more expensive or both in remote areas. For example the access to internet is restricted to satellite in many areas which has a latency barrier and either has capped usage or is restrictively expensive, particularly compared with urban alternatives such as ADSL or fixed line NBN.
- A greater distance to government and private sector services means that the remote population needs to spend more resources (time and money) to access services taken for granted by urban residence.
- The increased urbanisation of the population requires that salary packages need to be higher to attract suitable employees.
- Access to healthcare is restricted and remote areas rely on Flying Doctor clinics. This is despite the increased isolation having detrimental effects on mental health.

2.2 Benefits of regional employment

Governments should be aware of the benefits of regional employment with regional areas contributing more to the economy on a per capita basis than other parts of the state. Higher regional populations will also assist with urban social issues such as housing prices, urban sprawl and travel times/road congestion.

With increases in productivity, the critical mass of people in regional and remote areas is reducing. This is a concerning trend because reduced workers in primary industry will result in less demand for regional services, leading to reductions in government services, increased unemployment, and a further drift away from regional areas.

2.3 Design of tax system in the context of remote benefits

As noted in the issues paper, the three principles of a well-designed tax and transfer system are equity; efficiency; and simplicity.

The Fringe Benefits Tax is an inefficient tax and very difficult to understand and calculate. The Henry Taxation Review noted that 10 out of 125 taxes provides 90% of taxation revenue. Fringe Benefits Tax is one of the 115 that provide 10% of the revenue. The only reason that Fringe Benefits Tax exists in the Australian taxation system is for equity reasons, to ensure that employees are not avoiding taxation through salary packaging arrangements etc.

The productivity commission has defined equity as: individuals with a similar economic capacity should be treated in the same way, while those with greater capacity should bear a greater burden. When considering “economic capacity”, the intent is to income and wealth. However, the economic capacity of the remote population as identified above should also be considered with equity.

2.4 Defining a remote area

The Zone Offset area is defined in South Australia as the areas that are “out of hundreds” and is essentially the area under pastoral or mining lease. A remote area for FBT purposes is more than 40km from a town with more than 14,000 people at the 1981 census (Whyalla and Port Augusta); and more than 100km from a town with more than 130,000 people (Adelaide Metropolitan Area). This definition fairly arbitrary, but provides a reasonable definition of remoteness. If this definition were to be amended, a potential measure could be determined to take into account the items identified earlier in this section, for example proximity to government services; access to public transport or school bus services; or based on mobile phone coverage.

3.0 Fringe Benefits

The ATO defines a fringe benefit as “a benefit provided in respect of employment” and a benefit is “any right, privilege, service or facility”. Fringe Benefits are taxed at the highest marginal tax rate, plus Medicare levy. There are very few employees in the agricultural industry that have incomes in the top tax bracket so, unless there are reductions or exemptions for fringe benefits, then it is in the company’s interest (and the employee’s interest, from a salary packaging point of view) that taxable fringe benefits are not provided.

3.1 Are remote area fringe benefits actually a benefit?

As noted above, employees that live in regional and remote areas are at a distinct financial disadvantage to those who live in urban areas. Therefore, items defined as “fringe benefits” attempt to partially recompense employees for these disadvantages. However, there is no benefit that can be provided to a remote employee which will make them closer to a library or hospital; or to give them unlimited fast internet. Remote and regional citizens will still be at a financial disadvantage to urban employees. Therefore the characterisation of non-cash provisions provided to employees as a benefit fails the equity test of a well-designed tax.

3.2 A fundamental flaw in fringe benefits.

Fringe Benefits Tax is paid as a percentage of the grossed up value of the fringe benefit. Given that remote area costs are higher; the tax is also higher, multiplying the financial detriment of remote area expenses. This means that although the tangible benefit is the same for the employees, the taxation is higher. For example: in a town, residents have access to unlimited internet for a fixed fee, generally below \$100/month. When the company considered extending internet to staff on remote properties, the fee would have been above \$2000/month. For this reason, the company has generally restricted internet usage to educational and business usage, rather than entertainment purposes. However, if the company had extended this privilege to employees, on top of the extraordinary cost of the service, the company would have had to pay a substantial FBT amount. Whilst this is a legitimate benefit which would be subject to FBT, the question is why the same service would have such a vastly different tax amount. Again, this violates the 'equity' test. The commission could consider whether the government should assign statutory values to benefits, so that urban; regional; and remote employees are taxed the same amount for the same benefit.

3.3 Outline of remote fringe benefits

The following is a list of fringe benefits either provided to employees by the company; or benefits that would be provided if FBT legislation made it efficient to provide.

3.3.1 Housing

Almost all employees (and contractors) are provided with accommodation on the Company's properties. The main reason for this is that for the majority of the properties, there is no alternative to providing housing: there are no towns nearby. Currently providing remote area housing benefits are exempt under the section 58ZC of the Act. It is a policy of the Company that housing standards be maintained and increased in order to attract and retain staff. It should be noted that any costs on improving residential staff accommodation are input taxed supplies for GST purposes and therefore are more expensive than other overheads of the business. If the remote housing exemption were to be removed, this would provide a disincentive to improve housing due to the feedback loop identified in 3.2 above. It would probably also mean that salary packaging arrangements would need to be altered to convert the provision of accommodation in an employment contract, to a rental agreement. In order that employees would not be out of pocket, salaries would need to be increased, but net pay would not rise, compounding the complexity of the employment arrangement.

Recommendation: That a remote area exemption remain on employee housing.

Recommendation: That the provision of remote area housing for employees be considered a business expense, allowing for an input tax credit to be claimed on repairs and improvements.

3.3.2 Meals

A number of employees on company properties are "fully kept". This is defined in the Pastoral Award as follows:

'keep' will mean good and sufficient living accommodation and good and sufficient rations of sufficient quantity; sound, well-cooked and properly served by the cook...

(Clause 3, Pastoral Award 2010)

Remote area meals are exempt from FBT under section 58ZD of The Act provided that they are provided on a working day. However the ATO has added complexity to this with Interpretative Decision 2006/333, which notes that a "meal" can only be FBT free if it is ready for consumption.

This raises a number of issues including:

- Is a cooked breakfast FBT-Free, but cereal is taxable? Is toast FBT free, but only if the cook presses down the lever on the toaster?
- Is a cook's meal FBT free, as they are preparing it for themselves? Can the job description of all employees include cooking for themselves?
- Are reheated leftovers FBT free? If not, how do you apportion the cost of the meal between FBT or non-FBT. What about if the leftovers are eaten on a non-workday?
- Can the cook prepare a number of meals in advance and have staff re-heat them at their convenience (similar to a "ready-meal" in supermarkets)?

Under the provisions of the Pastoral Award, "with keep" employees are charged keep, but this keep is deducted from their pre-tax salary. This means that the value of the keep cannot be used as an employee contribution for FBT purposes. If keep was charged as an after-tax deduction, this amount would be more than sufficient to offset any complexity in the meals definition.

Recommendation: that all food provided to employees and associates (that are not meal entertainment benefits) that live on-site be classed as an exempt benefit; including food provided on non-working days such as weekends and public holidays.

Recommendation: that the deduction for keep can be considered an employee contribution for FBT purposes.

3.3.3 Residential Fuel

Residential fuel is any form of fuel used for domestic purposes and is typically gas and electricity. Residential fuel is classed as a fringe benefit, but under s59 of the Act, the value is reduced by 50%.

It is difficult to determine the benefit value of electricity because the majority of electricity meters that supply houses also supply electricity to business assets such as electric fences; pumps; offices and sheds.

Non-grid connected premises have additional complexity. These premises are either powered using town power plants, which are generally more expensive than grid power; diesel generation, which is generally more expensive than grid power; or solar generation. With power that is more expensive, the rate of tax increased, as described in 3.2 above. However, solar powered properties have a perverse outcome where the power supplied has no incremental cost to the employer, but tax is still payable as an in-house property benefit.

Residential fuel is an intrinsic part of supplying residential housing and there is an argument that all components of remote housing should be an exempt from fringe benefits tax, including fuel.

Recommendation: that in-house generated remote electricity be exempt from FBT.

3.3.4 Fuel

Motor vehicle fuel is supplied to some staff under the company and the relevant fringe benefits tax is payable on the private usage proportion of the supply. Referring to item 3.1 above, the supply of fuel to allow travel to towns would not be considered a 'benefit' when comparing to urban areas, as this supply is only to provide our employees with access to a small proportion of benefits that urban residents take for granted.

3.3.5 Communications

Telephony and internet communications are provided to staff as a legitimate business expense with incidental private usage accepted. The company does pay FBT on non-incidental private usage of company telephone and internet usage.

As an employee attraction and retention scheme, the company would like to extend the benefits of private usage internet to our employees, however current technologies and costs make this a restrictive endeavour (as noted in 3.2 above).

3.3.6 Schooling

The company assists employees from remote properties with their schooling in the form of a taxable allowance, so that it does not have a fringe benefit implication. However it should be noted that there are severe disadvantages to providing adequate schooling to remote students, particularly in secondary schooling. In some cases, boarding school is the only alternative, unless the entire family moves to a population centre. Government policy should not favour urbanisation and the company supports submissions made by the Isolated Children's Parent's Association (ICPA), such as making school fees from remote zone residents FBT free.