Shipping Reform (Tax Incentives) Bill 2012 [and] Tax Laws Amendment (Shipping Reform) Bill 2012

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Shipping Reform (Tax Incentives) Bill 2012 [and] Tax Laws Amendment (Shipping Reform) Bill 2012

Date introduced: 22 March 2012

House: Representatives

Portfolio: Infrastructure and Transport (Shipping Reform (Tax Incentives) Bill 2012) and Treasury (Tax Laws Amendment (Shipping Reform) Bill 2012)

Commencement: The Shipping Reform (Tax Incentives) Bill 2012 commences on 1 July 2012. The Tax Laws Amendment (Shipping Reform) Bill 2012 commences on Royal Assent.

Links: The links to the Bills, its Explanatory Memorandum and second reading speeches can be found on the Bills’ home pages for the Shipping Reform (Tax Incentives) Bill 2012 and Tax Laws Amendment (Shipping Reform) Bill 2012, or through http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation. When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the ComLaw website at http://www.comlaw.gov.au/.

Purpose

The purpose of the Shipping Reform (Tax Incentives) Bill 2012 (Shipping Reform Bill) is to establish a regime whereby corporations may be issued with a certificate as the first step in establishing eligibility to access relevant tax incentives set out in the Income Tax Assessment Act 1997.

The purpose of the Tax Laws Amendment (Shipping Reform) Bill 2012 (Tax Amendment Bill) is to amend the:

- Income Tax Assessment Act 1997 (ITAA 97)
- Income Tax Assessment Act 1936 (ITAA 36) and
- Taxation Administration Act 1953 (TAA)

to establish tax incentives in relation to Australian shipping.

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Background

Outline of the package

The Bills covered in this Digest are part of a broader package of Bills which seek to implement the Government’s shipping policy reform, ‘Stronger Shipping for a Stronger Economy’. The other related Bills are the:

- Coastal Trading (Revitalising Australian Shipping) Bill 2012
- Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Bill 2012
- Shipping Registration Amendment (Australian International Shipping Register) Bill 2012

Together, these Bills seek to implement the Stronger Shipping for a Stronger Economy package. The main features of this package are:

- tax reforms to remove barriers to investment in Australian shipping and to foster the global competitiveness of the shipping industry
- a strengthened and simplified regulatory framework with a transparent licensing regime supported by clearly stated objectives
- the establishment of an Australian International Shipping Register (AISR) to encourage Australian companies to participate in the international trades and
- establishment of a Maritime Workforce Development Forum to progress key maritime skills and training priorities.

These two Bills implement the first of the above dot points.

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The decline of Australian flagged shipping and the expansion in world seaborne trade

This package of Bills has been introduced to counter a severe decline in Australian registered vessels (that is, Australian flagged shipping). The Government has pointed out that:

- since 1996 the number of Australian flagged trading vessels has declined from 55 to 22, with only four trading on international routes\(^6\)
- employment on Australian flagged trading vessels has reduced from 2400 to 1300
- more than 99 per cent of Australia’s international trade is carried by ships, yet only 0.5 per cent of our export trade is carried on Australian flagged vessels and
- the average age of the Australian trading fleet is 19 years, compared to a global average of 12 years.\(^7\)

The Government has described this as a missed economic opportunity.\(^8\) This decline has taken place at a time when Australia’s overall freight movement task has been increasing. While road and rail have taken increasing shares of the overall movements, demand for sea transport to and from Australia, and around its coast, has also been increasing during this period.\(^9\) In short, the demand for cargo services in Australia and on its coast has increased – but Australian flagged shipping has not benefited from this increased demand.

During this period world seaborne trade has expanded. In 1990 the total of world seaborne trade cargo loaded was 5984 million tonnes. By 2010 this figure had reached 8408 million tonnes.\(^10\) It has also taken place against a continued expansion in world shipping capacity, as the following quote illustrates:

> The year 2010 saw record deliveries of new tonnage, 28 per cent higher than in 2009, resulting in an 8.6 per cent growth in the world fleet. The world merchant fleet reached almost 1.4 billion deadweight tons [dwt] in January 2011, an increase of 120 million dwt over 2010. New deliveries stood at 150 million dwt, against demolitions and other withdrawals from the market of approximately 30 million dwt. Since 2005, the dry bulk fleet has almost doubled, and the

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\(^{6}\) A Albanese (Minister for Infrastructure and Transport), *Creating investment in Australian shipping*, media release, 22 March 2012, viewed 2 April 2012, http://parlinfo/parlInfo/download/media/pressrel/1515491/upload_binary/1515491.pdf;fileType=application/pdf#search=%22Shipping%22. The four vessels on international routes are all LPG tankers.

\(^{7}\) Department of Infrastructure and Transport, *Stronger shipping for a stronger economy*, op. cit., p. 1.

\(^{8}\) Ibid.


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containership fleet has nearly tripled. The share of foreign flagged tonnage reached an estimated 68 per cent in January 2011.¹¹

That the Australian flagged trading fleet has declined during a period when both world seaborne trade and shipping capacity has expanded is undeniable. However, that fact, of itself, is not necessarily a reason to undertake the proposed reforms. As readers would be aware, modern economies are always changing, with different industries declining and expanding simultaneously. The Government's reasons for making the proposed changes are discussed below.

**Tax regimes of other maritime countries**

The proposed tax incentives are in response to tax and investment incentives operating in other maritime nations. Much has been made of the increase in the ships registered in open shipping registry countries (sometimes called flags of convenience).¹² However, Australia is not, and most likely will never be, an open shipping registry country. So comparisons of the proposed tax measures with the tax and regulatory regimes of open registry countries are inappropriate. Rather, comparisons with the tax regimes of members of the Organisation for Economic Cooperation and Development (OECD) countries, that have attracted shipping to their national shipping registers, may be of greater use.

Beginning in the late 1990s, developed countries, particularly in Europe, actively initiated shipping support mechanisms in an attempt to address the decline in their shipping fleets. These included:

- favourable tax regimes for ship owners
- cost-offsets in employing domestic seafarers
- ship-financing schemes
- the encouragement of training and career development and
- the establishment of second national shipping registers for vessels engaged in the international deep sea trade.¹³

The result has been an increase in additional tonnage back to national registers. The following case study illustrates this point:

The United Kingdom introduced a tonnage tax in 2000 for registered shipping in the place of the previous taxation arrangements.¹⁴ Between April 2001 and the end of December 2011 the

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¹¹. UNCTAD, op. cit., p. 35.
¹². In 2011 more than 68 per cent of the world’s tonnage was registered under a foreign flag (UNCTAD, ibid., p. 46). Open registers allow ships from other countries to register as opposed to national registers which only allow a ship from its country registration rights (The Committee, Rebuilding Australia’s Coastal Shipping Industry, op. cit., p. 9).
¹⁴. A tonnage duty or tax is a duty imposed on vessels in proportion to their capacity. The vital principle of a tonnage duty is that it is imposed, whatever the subject, solely according to the rule of weight, either as to the capacity to carry or the actual weight of the thing itself. This tax is widely applied to European flagged vessels in the place of normal income tax regimes.

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United Kingdom shipping register increased from about 6.5 to 17.9 million gross tonnes (1,469 ships in December 2011). The average age of vessels entering the register was 8 years, of those leaving the register the average age was 19 years. A substantial number of entries into the UK register have been newly built ships.

Comment

Most European countries have replaced their normal company tax arrangements applying to shipping companies with a tonnage tax on vessels flying a particular country’s flag. The measures in this package do not contain such a provision.

Why reform the shipping industry?

In a speech given in December 2010, the Minister for Infrastructure and Transport outlined the reasons for revitalising Australia’s shipping industry. Among these reasons are:

- capturing additional returns from the export/import trade by the expanded provision of shipping services
- creating an environment where major resources exporters can expand their operations into dedicated shipping
- expanding skilled employment opportunities in industries outside the resources sector
- providing a skilled workforce for the operation of the both the shore and seagoing sides of the industry
- reducing risks of a major maritime accident caused by the use of older ships and
- reinforcing and expanding the skills base and personnel for the support of the Royal Australian Navy.

Package development

The current package of Bills was developed in a process that had its beginnings in the 2007 election campaign. During the 2007 election the Australian Labor Party undertook to revitalise Australia’s

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coastal shipping industry and enhance maritime skills training.\textsuperscript{18} These undertakings were repeated during the 2010 election, while additional detail was provided on proposed tax changes for Australian shipping.\textsuperscript{19}

In March 2008 the Minister for Infrastructure, Transport, Regional Development and Local Government referred to the then House of Representatives Standing Committee on Infrastructure, Transport, Regional Development and Local Government, an inquiry into Australian coastal shipping policy and regulation. That Committee reported in October 2008.\textsuperscript{20}

On 16 February 2009 the establishment of the Shipping Policy Advisory Group was announced. This group assisted the Government in preparing its official response to the Parliamentary Committee’s report of 2008. It reviewed the Committee’s recommendations and advised the relevant Minister of initiatives for revitalising the Australian shipping industry.\textsuperscript{21} While the Maritime Union was represented, this group was largely made up of shipping industry representatives.

On 1 December 2010 the Minister for Infrastructure and Transport established three Reference Groups:

- the Regulation Reference Group advised on, and provided input to, the implementation of regulatory arrangements for coastal shipping reform
- the Taxation Reference Group provided advice and input for changed taxation arrangements applying to Australian registered shipping and
- the Workforce Skills Reference Group advised on, and provided input to, the development of maritime skills.\textsuperscript{22}

While these working groups had both government and union representation, they were dominated by industry representatives.


\textsuperscript{21} A Albanese (then Minister for Infrastructure, Transport, Regional Development and Local Government), \textit{Shipping advisory group established}, media release, Canberra, 16 February 2009, viewed 2 April 2012, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2FCCTS6%22


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On 1 December 2010 the Government also released a discussion paper on the reform of Australian shipping.23 Industry was invited to make submissions in response to this paper by the end of January 2011. A total of 46 submissions were received, some 32 of these submissions are now publicly available.24 These submissions also provided input to the above-mentioned Reference Groups.

In addition to the Reference Groups, general industry forums were held on 10 November and 1 December 2011. Department of Infrastructure and Transport (the Department) and Treasury officials have also held more focussed discussions with industry representatives on the tax incentive framework.25

Draft legislation was released on 19 December 2011 (for the Coastal Shipping Bills) and 20 February 2012 (other Bills).26 More than 20 submissions were received on the exposure drafts of this legislative package.27 As a result of the submissions received on the above mentioned Coastal Shipping Bills, a second exposure draft of the legislation was released in March 2012.

Basis of policy commitment

The Minister for Infrastructure and Transport announced this package of shipping reforms on 9 September 2011.28

Committee consideration

These Bills, together with the other Bills in this package, were referred to the:


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• Senate Economics Legislation Committee
• Senate Education, Employment and Workplace Relations Legislation Committee and
• House of Representatives Standing Committee on Infrastructure and Communications.

The Senate Economics Legislation Committee is due to report by 19 June 2012. The Senate Education, Employment and Workplace Relations Legislation Committee decided not to release a substantive report, instead recommending that the Senate rely on the report to be produced by the Economics Legislation Committee. The House of Representatives Standing Committee on Infrastructure and Communications tabled its report, which recommended that the House pass the Bills, on 24 May 2012. A dissenting report by the Coalition members of the Committee recommended that the House not pass the Bills. The dissenting report stated:

The new regulatory scheme for coastal shipping embodied in these bills (“New Scheme”) is deeply flawed and will not achieve its stated objectives. We highlight three key flaws in the New Scheme:

• It is likely to significantly increase costs to users of coastal shipping, and that cost burden will be passed on throughout the economy
• The claimed benefits depend on a compact with unions including the Maritime Union of Australia (MUA) which has not yet been agreed
• The objective of revitalising the Australian shipping industry is unlikely to be achieved.

Policy position of non-government parties/independents

The Coalition has objected to the proposed shipping tax concessions in the following terms:

The decision to grant more generous income tax and depreciation arrangements will be welcome [sic] by seafarers and the Australia’s [sic] shipping industry, but this gesture will

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undoubtedly encourage other Australian industries facing international tax disadvantages to demand similar concessions.

Those industries would have a fair case. If it’s good enough for the shipping industry then why not food producers, car manufacturers or the tourism industry? If seafarer’s income earned offshore is tax-free why not other overseas workers?

QANTAS and other Australian airlines face massive competition from airlines based in low tax countries or who receive special government concessions.  

Generally, the Coalition appears to be concerned that the proposed changes, including the proposed tax incentives, are the result of pressure from the Maritime Union. The Coalition is also concerned that the package, particularly the elements relating to the licensing of foreign vessels to work on Australian coastal routes, will reduce competition for shipping services and increase shipping costs.  

Position of major interest groups

The Maritime Union of Australia supports the proposed reform package. Reportedly, Shipping Australia Limited also supports the broad direction of the proposed reforms.

Media comment on the proposed reform package, reflecting views from a variety of organisations, has been mixed:

- ship owning interests are very favourable towards the package, however

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33. W Truss (Shadow Minister for Infrastructure and Transport), Shipping reforms: Albanese pushing an empty vessel, media release, 9 September 2011, viewed 2 April 2012, http://parlinfo/parlInfo/download/media/pressrel/1078754/upload_binary/1078754.pdf?fileType=application/pdf&search=%22Shipping%22


37. Shipping Australia Limited is a peak industry body. Its members are listed at http://shippingaustralia.com.au/list-of-members/


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users of shipping services are reported to be concerned that this package will raise shipping rates on Australian coastal routes.  

one prominent economist is concerned that the tax concessions given to shipowners will be appropriated by the Maritime Union in the form of higher wage claims and less onerous working conditions and  

other comment suggests that the proposed reforms will lead to low or no productivity growth in Australian shipping.

The bulk of critical comment on the proposed legislative package has been reported by *The Australian*.

**Financial implications**

The Explanatory Memorandum to the Tax Amendment Bill indicates that the financial impact of the package (mainly the tax incentives) is $254.5 million over the forward estimates period. The following table illustrates this impact in yearly terms:

| Table 1 - Financial Impact of Shipping Reform Package $m |
|-------------|-------------|-------------|-------------|
| 49          | 66.8        | 68.7        | 70          |

Source: Explanatory Memorandum

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41.  H Ergas, ‘Feathering a bed for the return of bludging fred’, *The Australian*, 2 December 2011, p. 12, viewed 2 April 2012, [link](http://parlinfo/parlInfo/download/media/pressclp/1265861/upload_binary/1265861.pdf;fileType=application/pdf#search=%22Shipping%20reform%22)

42.  Editorial, ‘Albanese has set out to sink productivity reform’, *The Australian*, 3 December 2010, p. 15, viewed 2 April 2012, [link](http://parlinfo/parlInfo/download/media/pressclp/403208/upload_binary/403208.pdf;fileType=application/pdf#search=%22Shipping%20reform%22)

43.  Explanatory Memorandum, Tax Laws Amendment (Shipping Reform) Bill 2012, 22 March 2012, p. 4, viewed 31 May 2012, [link](http://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r4787_ems_db76b9c8-c0a1-49dc-ab0c-5fa3c5220e0/upload_pdf/366477.pdf;fileType=application%2Fpdf) and Explanatory Memorandum, Shipping Reform (Tax Incentives) Bill 2012, 22 March 2012, p. 2, viewed 31 May 2012, [link](http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fems%2Fr4788_emsd6e01491-3862-4207-9f90-e942343d31d2%22;rec=0)
Main issues

The major issue is whether Australia should follow other comparable OECD countries in maintaining, and where possible expanding, a national flagged merchant marine.

Key provisions – Shipping Reform Bill

Should Parliament pass this Bill it will be known as the Shipping Reform (Tax Incentives) Act 2012. This title is important as the operation of the provisions of the Tax Amendment Bill depend on an Act of this name passing into law.

The Shipping Reform Bill allows a corporation to apply for a certificate or a notice for a vessel. The Bill sets out requirements that must be met before a certificate or notice will be granted. A corporation that is granted a certificate can be eligible for tax incentives under the ITAA 97. A corporation that is applying for a certificate for the first time can maximise the tax incentives by acquiring a notice. A notice is only relevant for the first income year that the corporation seeks tax incentives for a particular vessel.44

Schedule 1

Part 1 - Preliminary

Clause 6 of the Shipping Reform Bill allows the relevant Minister to make regulations requiring certain management activities to be conducted in Australia in order for a company to be eligible for the Income Tax Exemption (ITE). These management activities may include (but are not limited to):

- strategic management
- technical management
- commercial management and
- crew management.

Part 2 – Certificates for vessels

Subclause 8(1) of the Shipping Reform Bill requires the Minister to issue a certificate to an entity for a vessel if:

- that entity is constitutional corporation
- the requirements of clause 10 are met for a vessel for one or more days during the certificate year (see below) and
- during the income year the vessel was used, or was available for use, wholly or mainly for business or commercial activities involving carrying shipping cargo or shipping passengers on voyages.

44. See Note 1 under clause 14 of the Shipping Reform Bill.

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To be eligible for the ITE, the entity will also need to satisfy management and training requirements. The management requirements will be set out in regulations to be made under clause 6 (discussed above). The training requirements are being formulated by the Maritime Workforce Development Forum for the consideration of the Minister and will be specified in regulations.\footnote{Explanatory Memorandum, Shipping Reform (Tax Incentives) Bill 2012, op. cit., p. 8. The regulations will be made for the purpose of the proposed definition of ‘training requirements’ at subclause 5(1) of the Shipping Reform Bill.} A certificate issued under clause 8 that confirms that the entity meets the management and training requirements will be a ‘shipping exempt income certificate’ (subclause 9(2)). Again, the name is important as the possession of this particular certificate in respect of a vessel is required for the operation of the provisions of the Tax Amendment Bill outlined below.

Clause 8 refers to both an ‘income year’ and a ‘certificate year’. An income year is generally a financial year, but can be any 12 month period over which a tax paying entity assesses their income for tax purposes.\footnote{See definition of the term ‘income year’, in section 995-1 ITAA 97.} The term ‘certificate year’ is not further defined in this Bill, but it may not be the same as an entity’s income year.

**Subclause 9(1)** provides that the Minister must not issue a certificate for a vessel for a certificate year where:

- the entity does not have a certificate for the vessel in respect of the previous income year
- the entity did have a certificate in respect of that vessel for that previous income year or an earlier income year and
- there are less than ten income years between the last occasion when a certificate was issued in respect of that vessel and the certificate year.

Effectively this clause requires that a vessel that had a certificate, but lost it due to non-compliance with the specified conditions, be excluded from the related tax concessions for a ten-year period. The Minister has the power to reduce this ten-year period under **subclause 9(3).**

**Clause 10** sets out the requirements for vessels to qualify for the issue of a certificate. Such vessels must:

- be at least 500 gross tonnes (but can be as low as 200 gross tonnes in certain circumstances)
- be registered under the *Shipping Registration Act 1981* (that is, Australian-flagged) and
- not be an ‘excluded vessel’ (some excluded vessels are fishing, recreational, offshore industry, salvage, tugboats, those operating mainly within harbours or inland waterways and defence vessels).\footnote{Government amendments to the Shipping Reform Bill will insert a definition of ‘excluded vessel’ at subclause 5(1) and allow the Minister to make a determination to clarify what is, and is not, an excluded vessel. Government amendments to the Shipping Reform (Tax Incentives) Bill 2012, viewed 31 May 2012, [http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Famend%2Fr4788_amend_5748a20c-0817-4d88-8b4a-c28de33d262a%22;rec=0](http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Famend%2Fr4788_amend_5748a20c-0817-4d88-8b4a-c28de33d262a%22;rec=0)}
Clearly, the issue of a certificate is aimed mainly at large, commercially-owned, ocean-going cargo and passenger vessels.

Clause 13 allows the Minister to revoke a certificate if he or she is satisfied that the certificate should not have been issued, or the corporation fails to comply with a Ministerial request for information issued under subclause 19(1). Subclause 13(2) allows the Minister to request remedial action by an entity before a certificate is revoked.

**Part 3 – Notices for vessels**

As set out above, a corporation that is applying for a certificate for the first time can maximise the tax incentives for the first income year by obtaining a notice. The Explanatory Memorandum to the Shipping Reform Bill states that a notice is designed to:

(a) provide a certain level of comfort for the applicant that they will subsequently qualify for a certificate (Clause 8) and hence can seek to complete the first step in accessing the various tax concessions provided under the cognate amendments to the ITAA 97 contained in the Tax Laws Amendment (Shipping Reform) Bill; and

(b) provide the Department with timely data in order to quantify the extent to which the Australian shipping industry is being assisted by these tax concessions.\(^{48}\)

Subclause 14(1) provides that the Minister must, on application, give a notice (referred to as an ‘eligibility notice’ at subclause 17(1)) to an entity that meets certain requirements. These requirements mirror the requirements set out at subclause 8(1) for the issuance of a certificate, except that, appropriately, the usage requirements are prospective in relation to a notice (‘the vessel will be used, or be available for use’ – paragraph 14(1)(c)) and retrospective in relation to a certificate (‘the vessel was used, or was available for use’ – paragraph 8(1)(c)).

As is the case with certificates, a notice may also confirm that the entity meets the management and training requirements (subclause 14(2)).

Clause 17 allows the Minister to revoke a notice if he or she is satisfied that the notice should not have been issued, or the corporation fails to comply with a Ministerial request for information issued under subclause 19(1). Subclause 17(2) allows the Minister to request remedial action by an entity before a notice is revoked.

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\(^{48}\) Explanatory Memorandum, Shipping Reform (Tax Incentives) Bill 2012, op. cit., p. 11.

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Part 4 – Requesting information and documents

The provisions of Part 4 allow the Minister to request information or documents relevant to whether the requirements for a certificate or notice are being met (subclauses 18(1) and (2)). The information or document may be requested from any person who the Minister believes, on reasonable grounds, is capable of giving the information or producing the document. However, recognising the importance of maintaining legal professional privilege, subclause 18(3) provides that Part 4 does not apply to a lawyer who is acting, or has acted, for the corporation that was issued with the certificate or notice.

Part 5 – Miscellaneous

Clause 24 allows the Administrative Appeals Tribunal (AAT) to review the Minister’s decisions about the issuance, revocation and variation of certificates and notices, and about whether a corporation that is excluded for non-compliance should be excluded for less than ten years.

Clause 28 allows regulations to be made. Such regulations may include prescription of fees for applications for certificates or notices.

Key provisions – Tax Amendment Bill

Schedule 1 – Exempt shipping income

Schedule 1 of the Tax Amendment Bill amends the ITAA 97 to create a new category of tax exempt income for ship operators who meet certain requirements. Proposed section 51-100 of the ITAA, to be inserted by item 4 of Schedule 1 of the Tax Amendment Bill, provides that, to qualify for the income tax exemption, a ship operator must have obtained a ‘shipping exempt income certificate’ in relation to a vessel under section 8 of the proposed Shipping Reform (Tax Incentives) Act 2012 (currently the Shipping Reform Bill, discussed above). However, not all shipping activities qualify for the income tax exemption. A distinction is made between ‘core shipping activities’ and ‘incidental shipping activities’.

Core shipping activities is defined at proposed section 51-110 of the ITAA 97 as activities directly involved in shipping cargo or passengers on a commercial basis. Proposed subsection 51-110(2) provides an inclusive list of examples of core shipping activities – including crewing the vessel, providing the containers that carry shipping cargo on the vessel, and providing shore excursions to shipping passengers of the vessel. Proposed paragraph 51-110(2)(r) allows further activities to be classified as core shipping activities in regulations. Proposed subsection 51-110(3) allows regulations to be made to specify activities that are not core shipping activities. All income generated by an eligible vessel that is derived from core shipping activities is exempt from income tax.

Incidental shipping activities is defined at proposed section 51-115 of the ITAA 97 as activities that are incidental to core shipping activities. Income derived from incidental shipping activities is only
exempt from income tax if it does not exceed 0.25 per cent of the income derived from core shipping activities (proposed subsection 51-100(2) of the ITAA 97).

The income tax exemption is a significant tax concession.

Loss wastage rule

**Items 2 and 3 of Schedule 1** amend existing sections 36-10 and 36-17 of the ITAA 97 to modify the approach taken to the application of tax losses against net exempt income. The current approach requires an entity with a tax loss to reduce that loss by the value of its net exempt income. The entity’s assessable income can then be reduced by the remaining amount. As a simplified illustration of how these provisions currently work, assume that a corporation has:

- a tax loss of $20 million
- net exempt income of $10 million.

Under the current arrangements, the entity would be required to deduct its entire net exempt income from its tax loss, before the remaining figure could be deducted from its assessable income. That is, a tax loss of $10 million could be offset against the entity’s assessable income.

Under the proposed approach, 90 per cent of the entity’s net exempt income will be disregarded when calculating its tax losses. Using the example figures above, the entity’s tax loss would be reduced by only ten per cent of its net exempt income, that is, by only $1 million, so that its deductible tax losses would be $19 million.

Expressed another way, this allows bigger tax losses to be generated from a qualifying ship. This is a significant concessional measure for ship owners operating qualifying Australian flagged shipping.

**Schedule 2 – Capital allowances**

**Part 1**

**Part 1** of Schedule 2 of the Tax Amendment Bill makes changes to the depreciation arrangements for a vessel in relation to which a certificate has been issued under section 8 of the proposed Shipping Reform (Tax Incentives) Act.

Under current arrangements, an asset owner may depreciate an asset based on a self-assessed ‘effective life’ of that asset or may rely on the effective life determined by the Commissioner of Taxation (the Commissioner) under section 40-100 of the ITAA 97. Currently the Commissioner has determined the effective life of various commercial shipping vessels in the range of 15 to 30 years.\(^\text{49}\) However, some assets have a ‘statutory cap’ on their effective life, which is set out at section 40-102

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of the ITAA 97. If a statutory cap applies to an asset, and that statutory cap is less than the effective life determined by the Commissioner, the capped effective life will prevail. Currently there is no statutory cap on the effective life of any shipping vessels. Item 4 of Schedule 2 inserts a new item in the table in existing subsection 40-102(4) of the ITAA 97, which sets out the capped life of various assets. The effect of this amendment is to cap the effective life of a vessel that has been issued with a certificate under section 8 of the proposed Shipping Reform (Tax Incentives) Act to ten years. This means that such a vessel may be fully depreciated over a ten-year life. Put another way, the operating entity may deduct ten per cent of the ship’s value from their taxable income each year for a ten year period.

However, item 5 inserts new subsection 40-102(4A) into the ITAA 97. The effect of this amendment is that if an operating entity makes use of the income tax exemptions described above for a particular tax year, it cannot also make use of maximum ten-year life of the ship for tax purposes for the same tax year.

Item 6 inserts new section 40-103 into the ITAA 97, to allow the operating entity to change between using the income tax exemption described above, or the capped effective life provisions, as may be most advantageous to that entity from a tax point of view.

Item 9 applies the amendments in Part 1 of Schedule 2 to vessels held by the operating entity on, after, or before 1 July 2012 - but only from that date.

Part 2

Part 2 of Schedule 2 of the Tax Amendment Bill amends the ITAA 97 to allow the assessment balancing adjustment amount to be deferred until the second income year after that amount arises.

What is a ‘balancing adjustment amount’?

A balancing adjustment amount arises when an asset (in this case a ship) is sold and the sale amount is either above, or below, the asset’s depreciated value for tax purposes. If the sale amount is more than the asset’s depreciated value, the amount of the excess is treated, for tax purposes, as assessable income. If the sale amount is below the ship’s depreciated value, then the amount of the shortage is a deduction from income.

As explained in the Explanatory Memorandum to the Tax Amendment Bill, under current arrangements, the balancing adjustment would be assessed in full in the income year in which the ship is sold.\(^{50}\)

Item 11 of Schedule 2 of the Tax Amendment Bill inserts new subsection 40-285(5) into the ITAA 97, to defer the assessment of a balancing amount arising from the sale of a vessel to the second income year, where:

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\(^{50}\) Explanatory Memorandum, Tax Laws Amendment (Shipping Reform) Bill 2012, op. cit., p. 35.

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• a certificate under Part 2 of the Shipping Reform (Tax Incentives) Act 2012 applies to the vessel on the day that the sale occurs and
• the operating entity was taking advantage of the capital allowances provisions noted above.

A balancing adjustment amount can be ‘rolled over’ in some circumstances. Where a roll-over is chosen, a positive balancing adjustment amount from the sale of a certified vessel will only be included in the taxpayer’s assessable income to the extent that it exceeds the cost of a new certified vessel acquired by the taxpayer.

The requirements that must be met to obtain this roll-over relief are set out at new section 40-362 of the ITAA 97, inserted by item 12 of Schedule 2 of the Tax Amendment Bill. In summary the taxpayer will be eligible for roll-over relief if:

• a vessel (the first vessel) is sold
• the taxpayer holds a certificate under the Shipping Reform (Tax Incentives) Act 2012 that applies to the first vessel on the day that the sale occurs
• roll-over relief under section 40-340 of the ITAA 97 does not apply in relation to the first vessel
• on the day occurring two years after the sale of the first vessel, the taxpayer holds another vessel (the second vessel) for which a certificate (other than a shipping exempt income certificate) has been issued under the Shipping Reform (Tax Incentives) Act 2012
• the taxpayer acquired the second vessel no more than one year before, or two years after, the sale of the first vessel and
• the taxpayer chooses to apply roll-over relief under proposed subsection 40-362(2) of the ITAA in relation to the second vessel.

To give a very simplified example of how this roll-over relief might work, assume the first vessel is sold for $30 million and at the time of the sale it has an adjustable value of $20 million. The taxpayer buys a second vessel for $7 million no more than one year before the sale of the first vessel, or two years after the sale of the first vessel, and still owns that second vessel two years after the sale of the first vessel. The taxpayer chooses to apply roll-over relief. The taxpayer holds a certificate for the first vessel on the day that it is sold and for the second vessel on the day that the taxpayer chooses to apply roll-over relief. In these circumstances, only $3 million from the sale of the first vessel will be included in the taxpayer’s assessable income. This measure is designed to encourage eligible vessel owners to purchase newer vessels.

**Schedule 3 – Seafarer tax offset**

**Item 2 of Schedule 3** inserts new subdivision 61-N into the ITAA 97. The effect of this new subdivision is to allow a refundable tax offset to be claimed by an entity that employs Australian resident seafarers on foreign voyages. The seafarer does not personally benefit from this tax offset.
What is a refundable tax offset?

A refundable tax offset is one where the full amount of the offset is paid, even if that amount exceeds the taxpayer’s liability. In this case, a shipowner may effectively be in a position, due to the operation of the abovementioned tax concessions, where they do not pay any income tax and have no other tax liabilities. The full amount of the seafarer’s tax offset would be paid to that company as a tax refund. Normally a tax offset would only operate up to the limit of a taxpayer’s tax liability.

New subsection 61-705 of the ITAA 97 provides that a company is entitled to this particular tax offset if it:

- is an Australian corporation and
- employs at least one Australian resident as a seafarer (that is, as a master, officer, engineer, integrated rating et cetera) for a period of at least 91 days in an income year to undertake overseas voyages on certified vessels.

New subsection 61-710 of the ITAA 97 specifies the amount of this tax offset as thirty per cent of the gross payments made to the seafarer(s). Such gross payments are those that incur a withholding obligation under section 12-35 or subsection 12-60(1) of Schedule 1 of the Tax Administration Act 1953 and can be made up of wages, salary, leave payment, bonuses and allowances paid to the seafarer(s) in question. The Explanatory Memorandum to the Tax Amendment Bill clarifies that this includes payment to undertake employment-related training.\(^{51}\)

Schedule 4 – Exempting bareboat charters from royalty withholding tax

‘Withholding tax’ is tax that is deducted at the source of a payment. Tax must be withheld on some payments (including royalties) paid to non-residents of Australia.\(^{52}\) Section 128B of the Income Tax Assessment Act 1936 sets out who is liable to pay withholding tax. Subsection 128B(3) of the ITAA 36 clarifies who is not liable to pay withholding tax. Currently, payments made by Australian companies to lease a vessel on a ‘bareboat’ basis from a non-resident lessor are subject to royalty withholding tax. Although this tax is imposed on the lessor, in practice it increases the cost to the Australian lessee. Item 1 of Schedule 4 of the Tax Amendment Bill inserts new paragraph 128(B)(3)(m) into the ITAA 36. The effect of this proposed amendment is to exempt lease payments in respect of certain qualifying vessels leased by an Australian resident company from a non-resident lessor under a bareboat charter arrangement from royalty withholding tax. This will reduce leasing costs for such vessels.

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51. Ibid., p. 49.

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What is a bareboat charter?

A bareboat charter is an arrangement in which the shipowner provides only the ship and gives the charterer (in this case the Australian resident company) complete control, management and operation of the vessel for an agreed leasing period. The charterer has to appoint the crew and pay all operating costs including stores and fuel.

This provision reduces the costs of an Australian company charting vessels to be part of the Australian merchant fleet.

Schedule 5 – Shipping information

Subdivision 355-B of the Taxation Administration Act 1953 deals with disclosure of confidential taxpayer information by taxation officers. It is an offence, under the subdivision, for taxation officers to disclose tax information that identifies an entity, or is reasonably capable of being used to identify an entity, except in certain specified circumstances. Section 355-65 of the TAA provides that it is not an offence for a taxation officer to disclose information for designated government purposes. The table at subsection 355-65(4) of the TAA specifies disclosures that may be made in relation to corporate regulation, business, research or policy. Item 1 of Schedule 5 of the Tax Amendment Bill inserts a new entry into the table at subsection 355-65(4) to allow taxation officers to disclose information given to them for the purpose of administering the Shipping Reform (Tax incentives) Act 2012 to the Department that administers the Act but only for the purposes of administering the Act.