AGFORCE

Advancing Rural Queensland

Reform of the Taxation System

Response to Re:think Tax Discussion Paper

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AGFORCE

AgForce Queensland Industrial Union of Employers
ABN 21 241 679 171
Second Floor, 110 Mary Street, Brisbane, Qld, 4000
PO Box 13186, North Bank Plaza, cnr Ann & George Sts, Brisbane Qld 4003
Ph: (07) 3236 3100.
Fax: (07) 3236 3077
Email: agforce@agforceqld.org.au
Web: www.agforceqld.org.au

Introduction

AgForce is the peak lobby group representing the majority of beef, sheep and wool and grain producers in Queensland. The broadacre beef, sheep and grains industries in Queensland generated around $4.5 billion in gross farm-gate value of production in 2012/13. AgForce exists to ensure the long term growth, viability, competitiveness, sustainability and profitability of its members within these industries. Our members provide high-quality food and fibre products to Australian and overseas consumers, manage more than half of the Queensland landscape and contribute significantly to the social fabric of rural, regional and remote communities.

As flagged in the 2014-15 Budget papers, in conjunction with the structural reforms desired in the Budget, the Australian Government will complete a White Paper on the Reform of Australia's Tax System. This process is intended to focus on developing well considered, longer-term tax reform, consistent with principles of fairness and simplicity and that supports sustainable growth in the living standards of Australians.

Australian agriculture operates within a variable climate and faces the ongoing challenges of fluctuating international prices for produced goods. The Productivity Commission have reported that *'Over the period 1974-75 to 2003-04, agriculture registered the highest volatility in year-to-year output growth of all ANZSIC industry divisions — with an index of volatility more than two and a half times greater than the average for all industries… Output volatility in agriculture was also substantially higher than the next most volatile industries (construction, finance and insurance and mining).'*[1] The result of these influences is significant fluctuations in incomes across time and consequently there is a need for a taxation system and policies that can deliver equitable outcomes both for the primary producer facing these challenges and the broader society.

AgForce supports the government's desire to create a better tax system that delivers taxes that are 'lower, simpler and fairer' and welcomes the opportunity to make a submission to the discussion paper. We acknowledge that those sectors of our society that generate wealth and economic activity, such as broadacre agriculture, have a responsibility to make their contribution to the delivery of public services and infrastructure that ensures reasonable standards of living for us all.

A simpler system

While supporting a reduction in the complexity of tax affairs and reducing compliance costs, in delivering a 'simpler' tax system it is important that any proposed streamlining does not include taking a 'one size fits all' approach which results in not effectively considering the unique features of agriculture and agricultural enterprises in Australia. The current tax system rightly identifies that primary producers face a number of specific challenges due to this variable and often remote operating environment and as a result features a number of structures, in the form of income averaging, targeted concessions and other arrangements such as fuel tax credits, to accommodate this fact.

Whilst the current system also features incentives for investment in activities that deliver broader public good outcomes, including for environmental sustainability e.g. Landcare operations, and effective disaster management, increasing investment through tax initiatives for regional communities and land managers in the rural sector would provide long-term sustainable outcomes for the environment more generally.

[1] Productivity Commission 2005, Trends in Australian Agriculture, Research Paper, Canberra

Lower taxes
In seeking to deliver 'lower' taxes any systemic reforms should ensure that broadacre producers are not subsequently exposed to a greater tax liability than they already experience, and that any increases in taxes levied at one level of government are at least offset by reductions in tax levied by that same or another level of government. For example, the Henry Tax Review supported the application of federal consumption and land taxes to broader bases, such as including fresh food and all land, while also removing a number of inefficient state-imposed duties such as on land transfers or insurance. Further the Henry review advocated applying a threshold land value for a federal land tax that effectively exempted most agricultural land.

In seeking to ensure greater economic activity and labour utilisation it is important that greater taxation costs are not ultimately imposed on the individual primary producer, who has limited capacity to pass on such costs to both domestic and overseas customers and so largely bears increases in tax as an absorbed cost to their business.

A fairer system
For tax reforms to gain support they must be viewed as delivering fundamentally fair outcomes. A 'fairer' taxation system must also consider the intersection between the tax and transfer system and providing a welfare safety net that features appropriate settings around assets and means tests for primary producers that do not act against efforts to be self-reliant in the face of climatic and market downturns, and to plan for retirement or business succession.

Returns on agricultural investment accrue over the longer term, often decades after the decision to invest has been made, and any transition to new tax settings must account for this or risk delivering inequitable outcomes and a loss of confidence in the overall system.

This submission will outline a number of the principles that should be taken when considering taxation of the broadacre agriculture sector and comments on some of the specific agriculturally-relevant elements of the current tax system.

Principles of taxation of broadacre agriculture

In reforming the tax (and transfer) system AgForce would propose the following considerations to government as they seek to balance a number of potentially-conflicting policy outcomes:

- sectors that generate wealth and economic activity, including broadacre agriculture, have a responsibility to contribute to funding the efficient delivery of public services and infrastructure that ensures reasonable minimum living standards for all Australians, including those in regional, rural and remote areas
- the taxation and transfer system should be fair, equitable, stable and transparent
- the taxation system should be efficient, as should government spending, with compliance and related business structuring costs minimised as much as possible
- the taxation system should facilitate the competitiveness of broadacre agriculture and minimise detriments to its economic growth
- the specific circumstances of agriculture and rural life, including climate and income volatility and the close interlinkage between the primary production business and the producer's household, must be addressed appropriately and coherently within the tax and transfer system
- primary producers have a limited capacity to pass on increased tax and compliance burdens to their customers and so largely absorb these costs, detracting from their capacity to lift employment, productivity and profitability within their businesses
- the tax and transfer systems should not impede adjustment and industry succession but facilitate new entrants and investment into the sector

- agricultural investment decisions largely accrue returns over longer terms with appropriate transition periods required when implementing significant reforms to the tax system
- to capture the economic activity and diversification opportunities represented by growing international food demand, tax settings favouring investment and R&D into Australian agriculture should be implemented
- as significant stewards of natural resources the tax system should offer the opportunity to incentivise primary producer activities resulting in broader public good and environmental outcomes.

Characteristics of broadacre agriculture

In 2012-13 nationally the agriculture, fisheries and forestry sector had $665 million in taxation liabilities, with companies covering $430 million, individuals $133 million and goods and services tax (GST) of $103 million. Fringe benefits tax (FBT) added a further $18 million but this was offset by a net loss of $18 million in the Excise, luxury car tax and wine equalisation tax (WET) categories. Agriculture's contribution represented 0.5 pc of total industry collections with industry taxpayers on average having a lower taxable income than businesses of the same structure in the general economy[2].

The Australian Tax Office (ATO) small business definition is a business with an aggregated turnover of less than $2 million. Under this definition the large majority of broadacre enterprises in Queensland in 2014 qualify as small businesses (95 to 98 pc), with the exception of the cotton industry which has about 22 pc of businesses over this threshold (See Table 1). Further the majority of these businesses are operated either without any employees, particularly for specialist beef and livestock-grain operations, or up to the threshold of 20 employees, occurring largely within cotton and some sheep operations (See Table 2).

Table 1. Number of broadacre enterprises in Queensland at June 2014 by size - turnover

	Zero to less than $50k	$50k to less than $200k	$200k to less than $2m	$2m or more	Total
Sheep Farming (Specialised)	189 (35 pc)	159 (29 pc)	183 (34 pc)	12 (2pc)	543
Beef Cattle Farming (Specialised)	8,615 (50 pc)	4,745 (27 pc)	3,656 (21 pc)	337 (2pc)	17,353
Sheep-Beef Cattle Farming	361 (33 pc)	273 (25 pc)	424 (39 pc)	32 (3 pc)	1,090
Grain-Sheep or Grain-Beef Cattle Farming	976 (39 pc)	723 (29 pc)	758 (30 pc)	65 (3 pc)	2,522
Other Grain Growing	370 (26 pc)	381 (27 pc)	607 (42 pc)	74 (5 pc)	1,432
Cotton Growing	74 (15 pc)	57 (12 pc)	245 (51 pc)	106 (22 pc)	482

Source: ABS 8165.0 Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014

Statistics from the ATO[3] for the 2011/12 financial year indicate that business structuring in Australian agriculture is dominated by family partnerships (46 pc of 215,000 records), followed by sole traders/individuals (31 pc), trusts (14 pc) and companies (8 pc). Of note the agriculture, forestry

[2] Commonwealth of Australia, Supporting primary producers under the Australian taxation system. DAFF, 2011
[3] Taxation statistics 2011–12: Selected taxation items, by industry for 2011–12 income year and 2012-13 financial years, Australian Taxation Office.

and fisheries industry grouping represents about 30 pc of all Australian partnerships, 7 pc of sole traders, 4 pc of trusts and just 2.1 pc of companies. However, the number of unincorporated business structures in agriculture is declining over time as business owners seek to more flexibly and effectively manage income and business assets as well as legal and tax/duty liabilities[4].

Table 2. Number of broadacre enterprises in Queensland at June 2014 by size – employees

	None	1-19	20-199	200+	Total	2013/14 Entry Rate (pc)	2013/14 Exit Rate (pc)
Sheep Farming (Specialised)	360 (66 pc)	179 (33 pc)	4 (1 pc)	0	543	12	11
Beef Cattle Farming (Specialised)	14,739 (85 pc)	2,554 (15 pc)	59 (0.3pc)	3	17,355	11	10
Sheep-Beef Cattle Farming	741 (68 pc)	342 (31 pc)	6 (1 pc)	0	1,089	13	11
Grain-Sheep or Grain-Beef Cattle Farming	2,030 (81 pc)	482 (19 pc)	10 (0.4 pc)	0	2,522	9	11
Other Grain Growing	1,068 (75 pc)	353 (25 pc)	11 (1 pc)	0	1,432	7	8
Cotton Growing	255 (53 pc)	217 (45 pc)	10 (2 pc)	0	482	8	12

Source: ABS 81650 Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014

Importantly Australian agriculture receives very low levels of support from public funds, totalling only 1.9 pc of gross farm gate receipts in 2013, down from 10 pc in the early 1990s, and compared to an OECD average in 2013 of 18.2 pc and to 7.4 pc in the United States[5]. Countries like Norway, Japan, Switzerland and Korea retain public policies that provide over half of their farmer's gross receipts and countries like Brazil and Russia that compete with Australia have either increased support levels or are maintaining support (e.g. Russia at over 15 pc).

Most of the recent reduction in public funding support in Australia has come as governments reduced drought assistance expenditure, with Australian farmers also receive no distorting market price supports such that domestic and international market process are aligned[6]. This means that domestic primary producers are fully exposed to the forces of international marketplace competition. The limited remaining government support is currently largely made up of research and development, drought, structural adjustment and environmental programs and, importantly for this submission, tax concessions.

Australian agriculture has already done much of the 'heavy lifting' in relation to removing distorting policies and increasing its productivity and openness to international trade, particularly in the face of ongoing and, in some cases, increasing producer protections in our competitor countries. For tax reforms to gain support they must be viewed as delivering fundamentally fair outcomes, and these outcomes should be considered within the broader international context, as the discussion paper has itself identified.

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[4] Connolly, E, Norman, D, and West, T 2012, Small Business: An Economic Overview, Small Business Finance Roundtable, Sydney; and Bishop J, and Cassidy N 2012, 'Trends in National Saving and Investment', Reserve Bank of Australia Bulletin March Quarter 2012, Reserve Bank of Australia, Sydney.

[5] http://www.oecd.org/tad/agricultural-policies/producerandconsumersupportestimatesdatabase.htm#tables, accessed May 2015

[6] OECD (2014), Agricultural Policy Monitoring and Evaluation 2014: OECD Countries, OECD Publishing.

Effectiveness of the current taxation system for broadacre agriculture

The tax discussion paper specifically highlights the increasing effects of globalisation and the opportunity for attracting foreign and other investment; the need to secure greater productivity and workforce participation in the face of declining terms of trade; and managing an ageing population.

Desirable tax system characteristics

The Henry Tax review[7] identified a number of characteristics of any tax system that AgForce would be supportive of, including:

- Transparent access to information
- Any tax Advisory Board to the ATO to include agricultural and rural representatives
- Sufficient time to adjust to any changes and the grandfathering of provisions so the benefits of past legal business-structuring decisions are not unfairly compromised
- Secure state-level agreement to overall changes, so that reforms at the Commonwealth level are not compromised by the retention or increase of state or local government taxes
- Government has a responsibility to ensure efficiency of expenditure and administration.

In relation to communication, the ATO has indicated that it is moving to greater digital interaction with taxpayers. This is problematic in rural and remote areas that lack reliable internet connections or have slow speed connections. While exemptions apply from digital submission of Business Activity Statements, there is no such exemption for Superstream requirements, which is compulsory from 1 July 2016. Such requirements will increase compliance costs. An exemption from Superstream digital submission should be made available to rural and remote taxpayers without appropriate internet access.

There may also be benefits in raising the level of awareness of primary producers, and potentially their accountants and advisors, of tax structures and concessions that are available to them to ensure that they are being fully utilised, and to further understand any barriers to their uptake.

Small business definition and thresholds

There are a range of definitions that governments apply to small business and which need revising and standardising to enable more relevant comparisons to be made, e.g. agriculture's contribution to the economy, issues identification, etc. For example the ATO applies a $2 million gross revenue/turnover threshold, and the ABS applies a threshold of less than 20 employees as part of its small business surveys. Where possible for consistency a single definition should be applied across governments.

While these settings currently accommodate the majority of Queensland broadacre industries, 22 pc of cotton-growing enterprises do exceed the turnover threshold of $2 million. As agricultural enterprises continue to grow in scale these thresholds of what is defined as a 'small business' must remain relevant. The Henry review recommended lifting the turnover threshold to $5 million and AgForce supports this recommendation.

It is important to recognise that small business bears a disproportionate share of the tax compliance burden[8] and simplified small business reporting requirements would result in significant benefits for broadacre primary producers. For example, the annual cost of accounting services to broadacre businesses in Queensland in 2014 was around $3,900 and this cost has increased on average by about $55 per annum per farm (in 2014/15 dollars), that is 1.5 pc year on year since 1990[9].

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[7] Australian Government 2010, Australia's Future Tax System Review (Henry Tax Review), Australian Government, Canberra.
[8] Australian Government 2010, Australia's Future Tax System Review (Henry Tax Review), Australian Government, Canberra
[9] http://apps.daff.gov.au/AGSURF/agsurf.asp, accessed 27 May 2015

Jurisdictional inefficiency
The Commonwealth, States and local government all raise taxes (state taxes like payroll tax, stamp/transfer duty and land tax etc. cover just over half the state's expenditure), many of which have been identified as being economically inefficient in that they act to reduce business activity. Given the structure of our Federation, reform and simplification of taxes and levies must be co-ordinated and supported across jurisdictions in order to deliver the greatest benefits.

As a sector agriculture has a lower rate of turnover in its workforce, with about half of the workforce being in their current job for 10 years or more, and about a third being in their current job for 20 years or more, a share 2 to 3 times higher than other sectors of the economy[10]. The Productivity Commission found that regardless of seasonal conditions, entry rates in agriculture were lower (around 11 pc) than in many other industries (including mining, manufacturing, construction, retail trade, accommodation, finance and business services, education, health and community services), which averaged around 19 pc[11].

AgForce has advocated to the Queensland government to remove stamp duty on intergenerational farm transfers that involve a financial consideration and so to come into line with other jurisdictions. Stamp duty on property transfers represents a significant disincentive for industry adjustment, consolidation and increased business activity. The Henry review advocated replacement of inefficient state duties with a broad based land tax, but also recommended providing a low value (on a $/m^2 basis) threshold that would effectively exclude most agricultural land. Given the long occupancy periods of primary producers a move to apply land tax in replacement of stamp duty would likely result in a net increase in tax burdens unless a specific exclusion or concession is applied. This is examined further below.

Further, the Queensland State Government currently charges a 9 pc duty on general insurance policies which increases the cost of these valuable risk management tools and reduces their attractiveness to potential users. Given the inherent income volatility of the agricultural sector this is a counter-productive policy. AgForce is supportive of the development of a multi-peril insurance market for agriculture that delivers cost-effective protection to assist producers to more effectively manage increasing climatic variability.

Expansion of Land tax
It has been stated that the burden of a tax will fall to a greater extent on:
- a person consuming a product or owning a factor of production for which the demand or supply is unresponsive to a change in its price
- a person consuming a product with no ready substitutes or
- a person owning a factor of production that is relatively immobile.

With the fixed and essential nature of land supply to agriculture, it follows then that applying a tax on land ownership will fall directly on those primary producers who own land, particularly given their limited capacity to influence the prices of their products.

The average value per farm of land and fixed improvements used by broadacre agriculture in Queensland is around $4 million and the average annual long term (1990 to 2014) farm business profitability of broadacre agriculture (at full equity and including capital appreciation) is $115,000[12]. Applying an annual land tax of 1 pc to this average value of land and fixed improvements would

[10] Productivity Commission 2005, Trends in Australian Agriculture, Research Paper, Canberra
[11] Productivity Commission 2009, Government Drought Support, Report No. 46, Final Inquiry Report, Melbourne
[12] http://apps.daff.gov.au/AGSURF/agsurf.asp, accessed 27 May 2015

represent a cost of $40,600. Given the limited capacity of producers to pass on additional costs this would represent a potential reduction of 35 pc of annual farm business profitability, if the full final burden fell on the business and there were no offsetting changes to other taxes being applied[13]. This would potentially be offset by a reduction in stamp duty at time of purchase, however this offset would occur relatively infrequently in the life of a primary producer compared to a land tax annually applied.

The Henry review recommended setting a tax free threshold on a value per square metre basis so there would be no liability on most agricultural land (Recommendation 53)[14]. This approach would be supported by AgForce for the reasons outlined above.

GST coverage

There has been much recent discussion about lifting the rate or broadening the base of the Goods and Services Tax (GST) as a key reform to the current tax system. Due to a lack of available analysis on the issue, AgForce does not currently have a specific policy on the application of the GST to fresh food. Significant and comprehensive modelling on the impacts to both agribusiness and the broader community is needed, including consumer research to better understand what may happen both in terms of purchasing choice and value, and the effect of concurrently removing other indirect taxes such as stamp duty. Applying a GST on fresh food has the potential to result in a substitution effect between relatively higher-priced red meat products and white meats like chicken and pork[15]. This may have an impact on domestic demand for beef and sheep meat, however the export market may also act to offset some of this effect. Practically, most primary producers are already registered for GST and therefore would already have the systems in place to collect and pay GST should that be required.

Should the decision be made by government to apply the GST to fresh food then consideration should be given to allocating a proportion of any additional income stream towards supporting public good outcomes on farms. This could include environmental programs, such as Landcare-type projects, and the building of further resilience to climate risks.

Treatment of companies

While less than 10 pc of agricultural businesses are currently incorporated, a permanent reduction in the company tax rate of at least 1.5 pc would be welcome, with the expectation that progressively more broadacre businesses will move to that structure in future as farmers take on equity partners and corporatise farm management operations. A simpler corporate tax system would encourage investment, provide security for business assets and assist intergenerational asset transfers in farm succession, for example as a corporate trustee of a family/discretionary trust structure and trading on behalf of those beneficiaries entitled to the income and/or the assets.

Capital Gains Tax

There is an impact from Capital Gains Tax (CGT) on the transfer of assets in farm family succession and complex CGT rules apply to family trusts and companies. To encourage farm succession and consolidation of smaller, more marginal properties, consideration should be given to providing a CGT concession for intergenerational transfers and also aligned with the removal of stamp duty in Queensland. This will be valuable in the recovery period from the current drought covering over 80 pc of Queensland, particularly given the low financial reserves generally existing in enterprises in these areas. Existing CGT concessions generally applying to small business should continue (including

[13] Department of the Treasury, The excess burden of Australian taxes, March 2010.
[14] p 48 of the Part 1 Overview
[15] Meat and Livestock Australia, pers. Comm.

exemptions at retirement, the 50 pc reduction in active business asset capital gains, and rollover relief into new business assets within 2 years).

R&D Tax incentive and Statutory Levies
Delivery of an effective stream of innovation and a research, development and extension (RD&E) system that delivers for industry is vitally important for enabling Australian agriculture to find the productivity gains necessary to offset declines in terms of trade and to compete effectively against heavily subsidised competitors overseas.

Effectively targeted tax incentives contribute to this productivity and AgForce strongly supports the continuation and expansion of government initiatives supporting RD&E for the following reasons:

1. Sustainable agriculture will require annual productivity growth of 2 pc over the next 35 years
2. Declining RD&E and education has been identified as one of the key reasons for the observed productivity growth slowdown
3. Poor rates of uptake of R&D ideas and transformative methodology in agriculture is generally leading to poor productivity growth and sustainability
4. Declining ability for research centres such as Cooperative Research Centres, Universities and government departments to obtain funding from government for RD&E
5. The economics of agriculture is in decline unless RD&E can be maintained at a sufficient level to sustain productivity and growth.[16]

AgForce also supports the collection of statutory levies to be used for RD&E and greater industry investment into innovation. We look to the government to identify and provide greater incentives to lift the intensity of this private investment, such as through the taxation system and in terms of encouraging public/private investment partnerships.

Superannuation for primary producers
Many farmers do not have surplus funds available to invest regularly into their superannuation and so for many the sale of their farm provides the funds for their retirement and effectively forms their superannuation base. With 23 pc of farmers being aged 65 and over in 2011[17], many farmers continue to farm beyond the pension age and then sell this asset, often after the age of 75. Under the current rules these producers are precluded from placing any proceeds into superannuation in this situation. This should be addressed by making changes to the superannuation settings for those who continue to work their farms and sell after age 75.

Road user charging
The Henry tax review recommended the development of mass-distance-location pricing for heavy vehicles, to ensure that heavy vehicles pay for their specific marginal road-wear costs. The review included recognising that farm vehicles may be used infrequently and on a limited range of roads and so the costs of maintaining telemetry devices for user charging are likely to outweigh any efficiency benefits and so a regime based on self-assessment of distance and roads travelled would be better in these circumstances (Recommendation 62). It should also be clearly recognised that road user charging of transport operators will likely see costs simply passed back to the primary producers who contract the shipment. As identified before primary producers have limited capacity to pass these costs onto their customers and so would largely bear this as an additional impost.

Recommendation 64 of that review also included an additional loading on heavy vehicles operating on routes where road freight is in direct competition with rail, where this improves the efficient allocation of freight between transport modes. It should be noted that in Queensland there are

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[16] Australian Farm Institute Conference, Brisbane, 2012
[17] ABS, 1301.0 - Year Book Australia, 2012

significant limitations on access to rail for seasonal primary production goods where this is in competition with the more consistent resource sector demand. As such additional loading on road transport where reasonable alternatives do not exist would be inequitable and is not supported by AgForce.

Tax loss trading and temporary incentives to reduce rural debt
As stated in our submission to the Agricultural Competitiveness White Paper process, AgForce has supported the Australian government further investigating tax loss trading to assist farm cash-flow in low-income years. This is to examine viable structuring of the scheme and to ensure there are no adverse consequences, such as perversely incentivising the artificial creation of tax losses.

In light of the current severe drought in Queensland, AgForce also supports the government examining providing a degree of tax deductibility for a limited period for reductions in core enterprise debt for small agricultural businesses. This could potentially include 20 pc of pre-existing farm debt over a 10 year period to allow Queensland broadacre producers to more easily recover from the current crippling drought impacts. Structuring of such a scheme would also need to ensure there are no adverse consequences arising from its instigation, such as new debt being included.

Effectiveness of current concessions for broadacre agriculture

It is important in the context of a difficult federal government budgetary position to reiterate AgForce's support for the range of existing agriculture-sector-specific concessions and mechanisms that are currently in place. This includes the retention of provisions relating to; income averaging; Farm Management Deposits (FMD); capital expenditure deductions (water facilities, fodder storage assets, fencing, Landcare); fuel tax credits; valuation of livestock from natural increase; treatment of abnormal receipts and disaster-related measures (forced disposal of livestock, spreading insurance recoveries, etc.); deferral of profit on second wool clips; and the asset depreciation provisions, tax relief under hardship, and zonal tax offsets available to all taxpayers depending on their location.

This section of the submission will provide comments on some of these specific concessions and make suggestions for their further improvement and streamlining.

Income averaging
Within a progressive income tax system there is the potential for period inequity in the taxation of individuals and non-incorporated businesses whose incomes fluctuate between assessment periods compared with those who earn a more stable income. As stated in the introduction, output from Australian agriculture is two and a half times more volatile than the average for all industries.

The majority (80 to 90 pc) of Australian primary producers use the tax averaging provisions[18] to reduce this effect of fluctuating incomes on tax payable and this can operate together with FMDs, or separately (which may possibly be more effective in reducing period inequity). Average claims by individuals are in the order of $1, 500[19]. Tax averaging allows current taxable income to be assessed at the tax rate applicable to their average income in the current and the four preceding years.

AgForce believes that income averaging should be maintained by the government to minimise the extent that variable timing of income influences tax liabilities over time. Further, there is merit in investigating allowing farmers to opt back into income tax averaging provisions to recognise changing circumstances or on the basis of having received adverse advice in the past from an accountant or other advisor.

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[18] Productivity Commission, Government Drought Support Review, 2009.
[19] Commonwealth of Australia, Supporting primary producers under the Australian taxation system. DAFF, 2011

It would also be desirable if PAYG provisions were streamlined to manage tax expenses impacting in times of low cash flow within the annual business cycle.

Farm Management Deposits (FMD)
The Productivity Commission have reported that *'Agricultural activities, because they generally have a larger environmental component, are different to production systems elsewhere in the economy. Many of these physical and biological factors, such as variations in rainfall and the onset of disease, are largely outside the control of farmers, yet they can have a significant effect on the level of production, input use, prices and the performance of farms.'*[20]

The FMD Scheme is very successful in assisting eligible primary producers deal more effectively with variability in cash flows (tax management and income smoothing) and helps them to manage their financial risk in low-income years by building up cash reserves and ultimately improving self-reliance. FMDs enable pre-tax primary production income to be set aside in years of higher income and to be drawn down in poorer income years, such as during drought. Income deposited into an FMD account is tax deductible in the year the deposit is made and it becomes taxable income in the year in which it is withdrawn. FMDs are also useful for addressing variable incomes for those who have opted out of income averaging arrangements.

FMDs are interest-paying, term deposits of up to $400,000 in total held in authorised financial institutions and are made by someone actively engaged in primary production and who earns less than $100,000 in non-primary production income in the year of deposit. It can also be from the beneficiary of a trust engaged in primary production. The deposit must be held for at least 12 months, unless a natural disaster occurs, to be classed as a FMD and to retain the tax benefits. From mid-2014 the Scheme was amended to allow consolidation of accounts held for more than 12 months and be permanently exempted from the unclaimed moneys provisions. These recent changes to FMD accessibility and security are supported.

The continual growth over time of deposits in the FMD scheme illustrates its value to Australian agriculture and this is presented in Figure 1. As withdrawn FMDs redeposited before the end of the financial year offset the initial withdrawal, such that there can be nil income and no tax payable, there are also cash flow and overdraft management benefits given the variability of agricultural incomes. The Productivity Commission has previously supported retention of the FMD Scheme[21].

As at end March 2015 there was about $3.5 billion held in FMDs nationally in 42,100 accounts. In Queensland, broadacre beef, sheep and grains enterprises held $377 million in 4,183 accounts for an average of $90,150. When the current drought started, around June 2012, $406 million was held in 4,792 accounts indicating a significant drawdown (8 pc) to date of held funds by the broadacre sector during this period and highlighting the value of FMDs in managing climate risk for holders.

AgForce are also supportive of extending access to FMDs to companies because, while a flat tax rate of 30 pc currently applies to those structures, there are benefits in managing cash flow for expenditure purposes. For example buying inputs or capital items when most appropriate for the business rather than simply coinciding with a high-income year.

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[20] Productivity Commission 2005, Trends in Australian Agriculture, Research Paper, Canberra
[21] Productivity Commission, Government Drought Support Review, 2009, Page 201.

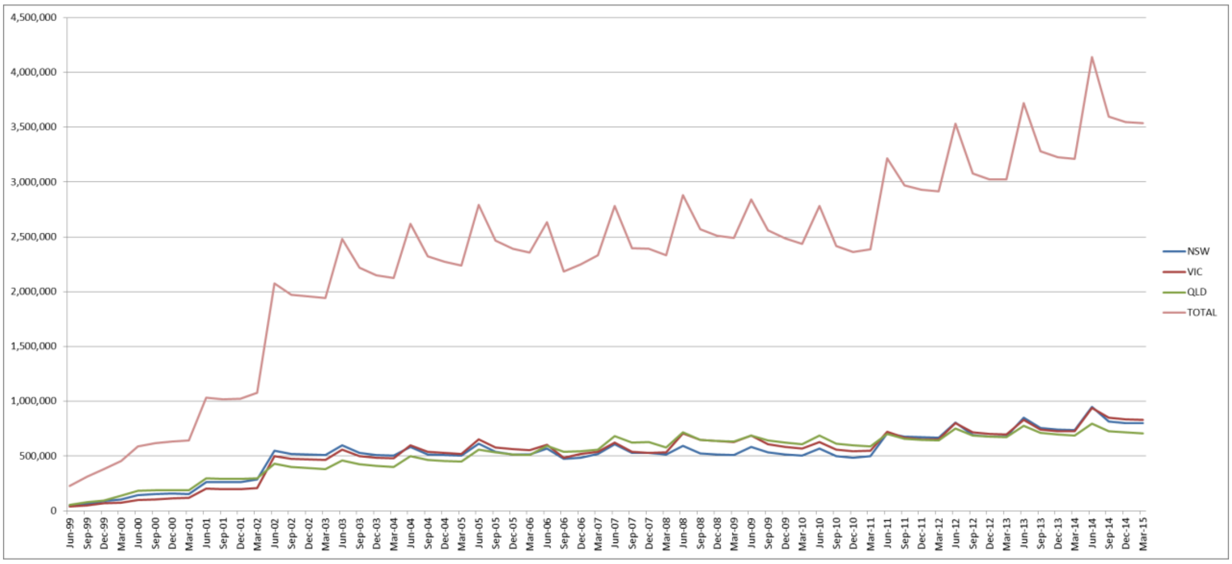

Figure 1. Total amounts ('000s) of FMD held nationally and in NSW, Victoria and Queensland since 1999. Source: Federal Department of Agriculture website.

In reviewing FMDs AgForce would recommend the government investigate:

- In line with the climate risk policy direction of encouraging resilience and self-reliance, a lifting of the deposit limit, preferably in line with multiples of annual input costs for enterprises, or alternatively to $1 million and indexed annually for administrative simplicity.
- following the removal of Exceptional Circumstances drought declarations, re-establishing early access provisions to FMDs in times of severe drought
- given the changing structuring of primary production businesses, extending direct access to FMDs to companies, as identified by the Department of Agriculture[22], and to agribusiness trusts given trust taxation arrangements may also be rewritten through this review process
- raising further the off-farm income limit and indexing it annually because off-farm income sources may be what allows a person to continue to farm and provide funds for farm capital improvement
- enabling FMDs to act as an off-set to other farm loans held at the authorised financial institution to maximise the financial value of that reserve.

Treatment of abnormal receipts and valuation of livestock

These provisions relate to forced disposal of livestock or double wool clips due to drought or other natural disasters and allow profits to be deferred over the following five years (or used to reduce the cost of replacements in any of the five years, with any remaining profit included in assessable income in the fifth year) or to the following year respectively. These concessions are not hard to access and are useful for managing the impacts of abnormal incomes and the tax implications of such income during a natural disaster.

Our members have also raised the updating of current ATO valuations of the natural increase of sheep and cattle for taxation purposes. There seems limited evidence that the applied tax value compared to the greater actual market value delays destocking decisions during drought.

Fuel tax credits and luxury car tax

The diesel fuel rebate for agricultural enterprises using vehicles off public roads is vital to supporting the competitiveness of these rural industries, with diesel also used for electricity generation for

[22] Review of the FMD Scheme, DAFF Canberra, April 2006

those located off the electricity grid. While about 45 pc of claimants for fuel tax credits in 2012/13 were from the agriculture sector this represented just 12.6 pc of the total fuel tax credits paid[23]. The fuel tax credit is a very important concession to producers (by average claim size[24]), reflects the policy principle that tax should not be imposed on business inputs, and should be retained. AgForce would support the federal government looking to harmonise the fuel tax credits system to include aviation gasoline that is used for agricultural purposes.

Given the necessity of four wheel drive technology for safer driving in rural and remote areas, AgForce supports the continuation of the luxury car tax concessions for these vehicles. The Henry tax review recommended the luxury vehicle tax be abolished as an inefficient tax on consumption and this is supported.

Asset depreciation provisions

The primary production sector is characterised by significant capital costs and AgForce supports the federal government announcement in the 2015 Budget to simplify the depreciation schedules for water and fencing infrastructure by including depreciation in the year of expenditure and we strongly support the bringing of this change forward from 1 July 2016. We also support the capacity to depreciate fodder storages over three years. These accelerated depreciation changes will help in incentivising preparedness for climate risks, help to boost productivity and also reduce, to some extent, the complexity of the multitude of depreciation schedules for farm plant and equipment.

Government figures[25] suggest that average annual claims for depreciation in individual tax returns are in the order of $10,000, increasing up to $20,000 for partnerships, $38,000 for trusts and $55,000 for companies. The low value asset pooling approach for deprecation purposes also helps to simplify tax compliance costs.

Zonal tax offsets

ABARES statistics reveal that many rural and remote regions display lower than average incomes combined with higher than average living expenses and a relative lack of publically funded amenities including in telecommunications, health, education and transport. In the interests of equity, to address these issues the government has provided tax offsets on the basis of geographical location.

AgForce would support the government revisiting and updating the zonal tax offsets policy to ensure the system is actually effective in offsetting the increased costs of living and the relative lack of services in rural and remote areas, and for its utility in making these areas more attractive places to live and work in order to fill workforce shortages and take pressure off the infrastructure of our major urban centres.

Non-commercial loss treatment

CPA Australia in their submission to the Agricultural Competitiveness Green Paper proposed revising the non-commercial loss rules to encourage investment, by firstly removing the $250,000 maximum income threshold or raising it to $1 million; and secondly increasing access to the primary producer exception to the non-commercial loss rules by raising the income threshold. This would be a step towards bringing the treatment of rural businesses into line with the broader framework applying when deductible expenses exceed the income earned (including interest on the loan borrowed to finance the investment, i.e. negative gearing).

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[23] Australian Tax Office, Taxation statistics 2011–12: Selected taxation items, by industry for 2011–12 income year and 2012-13 financial years

[24] Commonwealth of Australia, Supporting primary producers under the Australian taxation system. DAFF, 2011

[25] Commonwealth of Australia, Supporting primary producers under the Australian taxation system. DAFF, 2011

Treatment of trust income
Utilising trust structures are a safer, more predictable option for passing business assets like family agricultural land down to later generations but can be a complex process and require professional advice. The rules for the taxation of trusts and transfer of assets could be reviewed and simplified to reduce the complexity in managing the tax affairs of these types of business structure. The extension of the availability of FMDs to these business structures should be a part of this review and rewrite process.

Tax and transfer system and climate risk management

Droughts have a substantial impact on agricultural employment. For example the 2002/03 drought, resulted in the loss of around 70,000 agricultural jobs, a decline of around 15 per cent, whereas the 1982/83 and 1994/95 droughts produced losses of around 6,000[26]. Their extended impact on productivity means that drought-related changes can happen up to many years after the event. Drought also exacerbates farm family succession issues and farmers should be encouraged to incorporated drought management planning into their business model.

Over 70 pc of primary producers in Exceptional Circumstances (EC) declared areas over the six years to 2007/08, managed without EC assistance[27]. Those that did not receive assistance were characterised by greater farm net cash incomes, off-farm investment income and off-farm wage and salary income, plus the lowest debt levels of all groups of farmers. It is clear that risk management and financial resilience are key ingredients to ensuring sustainable self-reliance in the face of climate variability.

There are a number of initiatives supporting climate resilience that potentially intersect with the tax and transfer system. In terms of assisting producers prepare for a ‘manageable’ drought where the onus lies firstly with the producer to be self-reliant, the following are key elements that intersect with the tax and transfer system**:**

- Establishment of a cost-recovery insurance market, particularly for the cropping sector – assistance in establishing a viable marketplace could include making premiums tax deductable (potentially temporarily at more than 100 pc of cost to establish a critical mass of participants) and waiving of state stamp duties. This would have positive spinoffs in attracting further investment in the agricultural sector
- Industry-relevant and attractive Farm Management Deposits - with further changes as outlined previously
- Accelerated depreciation or other tax incentives for preparedness assets identified in a strategic farm plan – the recent Budget announcements about immediate depreciation in the year of expenditure for water and fencing infrastructure and over 3 years for fodder storages are welcome and in line with AgForce requests. Such tax breaks are repaid through future taxable income generation, reduced government assistance required for future events and can free up funds for labour employment or more business for local suppliers.
- Building Farm Business grants or concessional loans or tax treatment for new entrants who have not had time to prepare, e.g. reduced taxation rates in the first few years of a farming career
- Ongoing and securely funded Rural Financial Counselling Services – to ensure high quality service delivery and advice

[26] Productivity Commission 2005, Trends in Australian Agriculture, Research Paper, Canberra
[27] Productivity Commission 2009, Government Drought Support, Report No. 46, Final Inquiry Report, Melbourne

- Access to strategic farm planning (including clear decision trigger points) and profitability-linked, business cycle relevant training, higher order business and financial skills and best management practices skilling, potentially through a return of the FarmBis training program
- Re-think tax initiatives and support for farmers implementing sustainable farm management practices that: improve available resources, soil and habitat ecology; reduce reliance on fertilisers, chemicals, stock medicines; and develop farming systems that can be profitable, viable and sustainable into the future
- Ongoing incentives for producer participation in R&D and support for educating producers in the uptake of new technologies and utilisation of RD&E through joint initiatives of government bodies and the farming sectors.

Maintaining assistance during the recovery phase from drought is also valuable to ensure viable farm business operations return to production and productivity.

Incentivising change

Incentives for rural employment
The government should review employment conditions applying to farm workers so that the ancillary benefits of farm-based work are not downgraded by their treatment under taxation, for example housing is a key issue for attracting rural workers. Further the recent decision to remove the tax free threshold from working holiday-makers will have implications for labour supply in agriculture, particularly in many areas where it is difficult to attract a local workforce. Zonal tax offsets also have a role to play in encouraging an increase in the rural workforce.

Incentives for environmental management
Weeds in Queensland cost an estimated $600 million annually[28] and pest animals have hard-to-quantify financial, social and environmental impacts which are in the order of tens of millions of dollars in lost income and costs of control[29]. In order to provide a stimulus for investment in natural resource management above the general **duty of care** expectations, the government should provide a basis for rebates (ideally 120 - 150 pc) or concessions for infrastructure, pest and weed management and land condition improvements through the 'Landcare Operations' provision of the *Income Tax Assessment Act 1997* for producers with a property plan[30]. The definition of Landcare could be widened to include nature conservation activities. This would be a great way to reward producers who invest in land and infrastructure improvements on their properties, provide an incentive to complete a property plan and undertake more active weed and pest management.

Further tax incentives would assist in the uptake of agricultural best practices such as Grazing Best Management Practice (BMP) which provides valuable training and land management skills that directly secure benefits to reef management, water management, farm ecology and generally improve on-farm performance and profitability.

There are also opportunities to enable demonstration and trading of ecosystem services for identified high value conservation areas however this would require including 'management of ecosystem services' to the definition of a primary producer within the tax framework'[31].

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[28] https://www.daf.qld.gov.au/plants/weeds-pest-animals-ants/weeds, accessed 4 June 2015
[29] https://www.daf.qld.gov.au/plants/weeds-pest-animals-ants/pest-animals/impacts-of-pest-animals, accessed 4 June 2015
[30] http://www.ato.gov.au/Business/Primary-producers/In-detail/Deductible-capital-expenditure/Landcare-operations/, accessed April 2014.
[31] http://www.ato.gov.au/Business/Primary-producers/In-detail/Who-is-a-primary-producer-/Who-is-a-primary-producer-/, accessed April 2014

Consideration should also be given to enabling landholders as lessors to access the Landcare provisions.

The Queensland Cattle Industry Biosecurity Fund

The current tax and constitutional structure precludes the Queensland government from imposing a levy on producers for the purposes of supporting a proactive industry fund to manage biosecurity issues. The regulatory framework needs to be flexible enough to allow industries to collect, via the state government, funds for the purposes of wider industry and societal benefit.

Conclusion

AgForce supports the government's desire to create a better tax system that delivers taxes that are 'lower, simpler and fairer' and this submission contains our perspective on what needs to be considered by governments in doing so. For the future viability and sustainability of agricultural enterprises and rural, regional and remote communities, it is important that their unique features and needs are considered and incorporated effectively into any reformed system. AgForce looks forward to seeing how the recommendations in this submission to the Issues Paper are addressed and to making further contributions to the next steps of the White Paper process.