Grain Growers

Submission in response to the *Re:Think* - Tax discussion paper

Prepared by Grain Growers Limited

May 2015

Executive Summary

GrainGrowers welcomes the opportunity to provide input in response to the Government's Tax Discussion Paper "Re:Think". We support the Government's objective to create a better tax system that delivers taxes that are lower, simpler and fairer.

The grains industry is a fiercely competitive global industry with Australian growers exposed to global markets. The international competitiveness of the industry is impacted by a range of domestic policy and international market measures often beyond the control of the individual business.

Grain growing businesses are:

- Operating in volatile environment impacted by both production and commodity risk
- Often capital intensive, low margin operations, that are faced by either low profitability or high income variability across years
- By-and-large family owned operations that are increasingly requiring greater scale to increase profitability. This has a potential flow on effect of decreasing the likelihood of remaining defined as a small business and therefore receiving the benefits that small business assistance measures deliver.

Taxation can have a critical impact on a business' international competitiveness depending on the rates applied versus its competitors and the comparative investment costs. Conversely, taxation can also be used to assist businesses under specific circumstances. As such, appropriate policy settings are therefore critical in ensuring the industry remains internationally competitive and is able to capture available market opportunities.

There are a range of taxation measures that support the industry in managing the inherent risks and volatilities in grain growing. In particular, the Farm Management Deposit Scheme (FMD) and tax averaging allow grains businesses to smooth income across a number of years while also providing opportunities to self-manage risk, particularly in times of drought. These policies are strongly supported by GrainGrowers.

The rural levy system is critical to delivering whole of industry functions that would not occur otherwise, such as critical research and development (R&D). They provide significant productivity, efficiency and sustainability benefits to the sector and the broader economy. GrainGrowers seek ongoing government support for the system and a commitment to maintaining matched funding.

The fuel tax credit system, strongly supported by GrainGrowers, is a critical measure that avoids imposing significant costs on the sector and maintains international competitiveness. The system is not a subsidy to the industry, but rather is consistent with the broader Government principal to not tax business inputs.

GrainGrowers also supports a number of general policy and taxation measures to support small business such as accelerated depreciation, instant asset write-offs and the commitment to reduce red-tape.

We also support regional tax measures, such as the zone tax offset, that encourage Australians to work in remote areas where are there are service shortfalls.

GrainGrowers proposes a number of amendments to some existing measures. These include:

- In relation to FMD, increase the caps, allow withdrawal within 12 months in times of drought, provide access for companies and trusts, and explore whether accounts could be used as offset accounts
- Exclude capital gains tax liability for intergenerational transfers
- Either wholly abolish the luxury car tax, or provide exemption for those vehicles used for primary production activities
- Increase the $250,000 cap for non-commercial business losses
- Reduce red tape and compliance burden in the fuel tax credit system
- Increase the $2m small business threshold to better reflect the changing nature of farming businesses and ensure they continue to receive the benefits of the small business package

GrainGrowers looks forward to working with government to ensure the delivery of an efficient tax system. The sector needs a collaborative government approach to policies and programs that drive on farm profitability and competitiveness. Without such an approach, the sector will not grow and the communities and regions that rely on agriculture will inevitably suffer.

Summary of Recommendations

Recommendation 1

The development of Tax Policy needs to address and reflect the particular circumstances of farm businesses. In particular, it should recognise the inherent volatility associated with agricultural production in Australia and the changing nature of farm businesses. It should ensure that that the international competitiveness of the industry is not eroded, but enhanced, and that Australia is an attractive destination for investment.

Recommendation 2

Government to maintain commitments to:

- Assist farmers to manage volatility through the tax system, such as Farm Management Deposits Scheme, Tax averaging and zone offsets
- The Levy system, that underpins much needed R&D
- The Fuel Tax Credit Scheme for agriculture

Recommendation 3

Government to implement proposed changes to key existing tax arrangements in the areas of:

- Farm Management Deposit Scheme
- The Levy system
- Exclusion of intergenerational transfers for Capital Gains Tax
- Accelerated depreciation
- Regional Based tax incentives
- Red tape and compliance burdens relating to Fuel Tax Credits and the Small Business Tax Threshold

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1. Introduction

GrainGrowers welcomes the opportunity to provide input to the Government's Tax Discussion Paper "Re:Think". We support the Government's objective to create a better tax system that delivers taxes that are lower, simpler and fairer.

GrainGrowers is Australia's only national, independent, member-based, financially sustainable, technically resourced, grain producer organisation. Our aim is to develop and promote a more efficient, sustainable and profitable industry for all grain producers. GrainGrowers has over 18,500 grain producer members nationally, and is driven by a member elected Board consisting of six grower and two non-grower members.

GrainGrowers work in collaboration with our grain growing members, other farmer representative bodies, and experts in Australia's grains industry to deliver industry improving submissions and policies, education and events, and products and services.

Our policy development process is driven by our National Policy Group, which is made up of 15 elected grower representatives from the three major grain growing regions in Australia. GrainGrowers' National Policy Group convenes regularly to debate the important issues for grain growing businesses as they arise.

Tax is a critical component in ensuring that Australia's grains industry remains internationally competitive. GrainGrowers seeks an efficient tax system that supports and facilitates the improving competitiveness of the industry. The sector needs a collaborative government approach to policies and programs that drive on farm profitability and competitiveness. Without such an approach, the sector will not grow and the communities and regions that rely on agriculture will inevitably suffer.

GrainGrowers is intimately engaged in the broader agricultural policy debate in Australia through its Grain Commodity membership of the National Farmers Federation (NFF). We support the tax position of the NFF, which states:

> *The NFF recognises that all wealth creating sectors of the community have a responsibility to contribute to public goods, services and infrastructure – just as governments also have a responsibility to spend this money wisely by establishing taxation mechanisms to deliver public services across the community.*
>
> *Taxation can also be a very powerful mechanism to influence behaviour, and, if used effectively, encourage positive outcomes for the economy, the environment and society.*
>
> *The NFF believes the Government must carefully consider development of taxation-based mechanisms that complement and deliver equitable outcomes in areas such as climate change mitigation, drought preparedness, land use and environmental stewardship. It must also adhere to some overriding tax principles, such as avoiding taxing business adjustment, avoiding negative distortions, avoiding inflammatory outcomes and ensuring fairness and equality.*

This submission:

- Outlines the characteristics of Australia's Grains industry
- Discusses the relevant taxation arrangements for the industry, and
- Highlights opportunities for reform to the tax system to ensure that it provides a basis for competitive farm businesses into the future.

2. Characteristics of the Australian grain farming business

Grains is a fiercely competitive global industry, with Australian growers exposed to global market forces. The international competitiveness of the industry is impacted by a range of domestic policy and international market measures often beyond the control of the businesses.

Grain growing businesses are:

- Operating in volatile environment impacted by both production and commodity risk
- Often capital intensive, low margin operations, that are faced by either low profitability or high income variability across years
- By-and-large family owned operations that are increasingly requiring greater scale to increase profitability. This has a potential flow on effect of decreasing the likelihood of remaining defined as a small business and therefore receiving the benefits that small business assistance measures deliver.

There are impediments to Australia being able to extend productive capacity and access markets, and thereby capitalise on opportunities presented by growing demand in Asian markets. These impediments include:

- Our capacity to respond is limited;
    - recent yield gains have been significantly less than international competitors;
    - costs of production continues to rise, along with overall declining terms of trade
    - there are few production areas to which grains can profitably expand in the short term;
    - there is pressure on existing areas of grain production. Competition for land from mining and coal seam gas and environmental protection continues and will increase with social resistance to intensification of agricultural production.
    - salinity is also a significant issue in some grain growing regions.
- Our capacity to access markets faces constraints;
    - a range of tariff and non-tariff barriers to trade exist, that:
        - prevent Australian grains from being sold in the markets; and
        - prevent Australian grains from being able to be sold competitively in some markets. (Includes competitors having preferential trade arrangements AND having subsidies in production and supply);
    - gains are being made, however in many cases Australia is behind the progress being made by other nations who are investing significantly in market promotion (e.g. US and Canada).

The Australian grains industry also receives limited Government support by world competitor standards and is the lowest recipient in the OECD based on the measure of Total Support Estimates (TSE).

Given the importance of tax as a means for attracting investment and leveling the global playing field, appropriate policy settings are therefore critical in ensuring the industry remains internationally competitive and captures available market opportunities.

Industry snapshot

The Australian Grains Industry is Australia's foremost commodity sector delivering annual farm production of $15bn, generating employment for more than 179,000 people across Australia and providing grains to Australia's domestic grain processing and livestock sectors. Australian grain growers sustainably manage around 22 million hectares to produce an average of 40 million tonnes of grain each year across Australia.

Grain growing occurs across the country under a diverse range of conditions and is defined by three broad agro-ecological regions:

- The Northern Region, encompassing Queensland and Northern New South Wales. It is the largest source of Australia's premium hard high-protein wheat for export and domestic use. Demand for feed grains from the region's important livestock industries is a key driver of grain production.
- The Southern Region, encompassing south-eastern Australia, including central and southern New South Wales, Victoria, Tasmania, and south-eastern South Australia. Crop production systems are varied and include many mixed farming enterprises with significant livestock and cropping activities.
- The Western Region, comprises the cropping areas of Western Australia. Wheat, barley, canola and lupins are the dominant crops, with livestock enterprises in mixed farming systems often of less importance. The Western Region has a relatively small population and feed industry, and consequently exports more than 85 percent of its grain production[1].

The industry is relatively small on global scale, however, due to Australia's low population, the industry is a major exporter and accounts for a significant portion of global trade. For example, Australia produces only 3% of the world's wheat, but accounts for between 10 and 15% of global wheat trade.

As such, Australian grain growers rely on international markets with 65 percent of the industry's production being exported, valued at some $12bn per annum. This makes it Australia's largest agricultural export market and a significant contributor to the Australian economy.

Industry outlook

ABARES[2] reports that the short to medium term outlook for grains and oilseeds is to remain largely unchanged at 22.4 million hectares planted in 2015-16 rising marginally to 22.5 million hectares by 2019-20. The forecast assumes average seasonal conditions, which drier conditions likely to see a fall in plantings of canola in place of cereals. In the short term, this would see:

- wheat production forecast to rise by 3 per cent in 2015–16 to 24.4 million
- barley production forecast to fall by 6 per cent to around 7.5 million
- canola production forecast to fall by 4 per cent to 3.3 million tonnes

In terms of exports:

- The volume of Australian wheat exports is forecast to rise by 6 per cent in 2015–16 to 17.9 million tonnes, with the value of exports is forecast to increase by 12 per cent to around $6.1 billion, reflecting the forecast increase in export volume and an assumed fall in the value of the Australian dollar
- Australian barley exports are forecast to fall by 7 per cent in 2015–16 to around 5.7 million tonnes, off the back of decreased demand in China and increased competition from the United States
- Canola exports are forecast to rise by 2 per cent in 2015–16 to 2.4 million tonnes, despite a forecast fall in production

[2] ABARES (2015), *Agricultural commodities – vol 5 no 1, March Qtr 2015,* pp61-64

Over the medium term out to 2019-20,

- The proportions of crop area planted to wheat, coarse grains and oilseeds are not expected to change markedly because relative returns for these crops are expected to remain relatively stable.
- Total grains and oilseeds production is projected to rise at an average annual rate of 1.7 per cent to 42.6 million tonnes in 2019–20.
- Wheat, barley and canola yields are projected to increase at a rate of around 1 per cent a year over the projection period.
- Wheat production is projected to be 25.9 million tonnes in 2019–20, barley production 8.0 million tonnes and canola production 3.4 million tonnes.

In terms of exports over the medium:

- The volume of Australian grains and oilseeds exports is projected to rise by 1.7 per cent a year to 29.3 million tonnes in 2019–20, with a projected value of $9.3 billion (in 2014–15 dollars).
- The volume of wheat exports is projected to rise at an average annual rate of more than 1 per cent during the outlook period to 19.0 million tonnes in 2019–20, with a value of $5.7 billion (in 2014–15 dollars).
- An increasing share of Australian exports is anticipated to go to Asia instead of North Africa and the Middle East.
- Coarse grains exports are projected to increase from 7.2 million tonnes in 2016–17 to 7.5 million tonnes in 2019–20 of the back of increased demand to Asia. An increasing share of Australia's coarse grains exports is also anticipated to go to Asia.
- Feed barley exports are expected to face increasing competition from the low-cost producing countries of the Black Sea region and limit growth in Australia's exports to the Middle East.
- Australian canola exports are projected to rise by around 1 per cent a year over the medium term to 2.5 million tonnes in 2019–20.

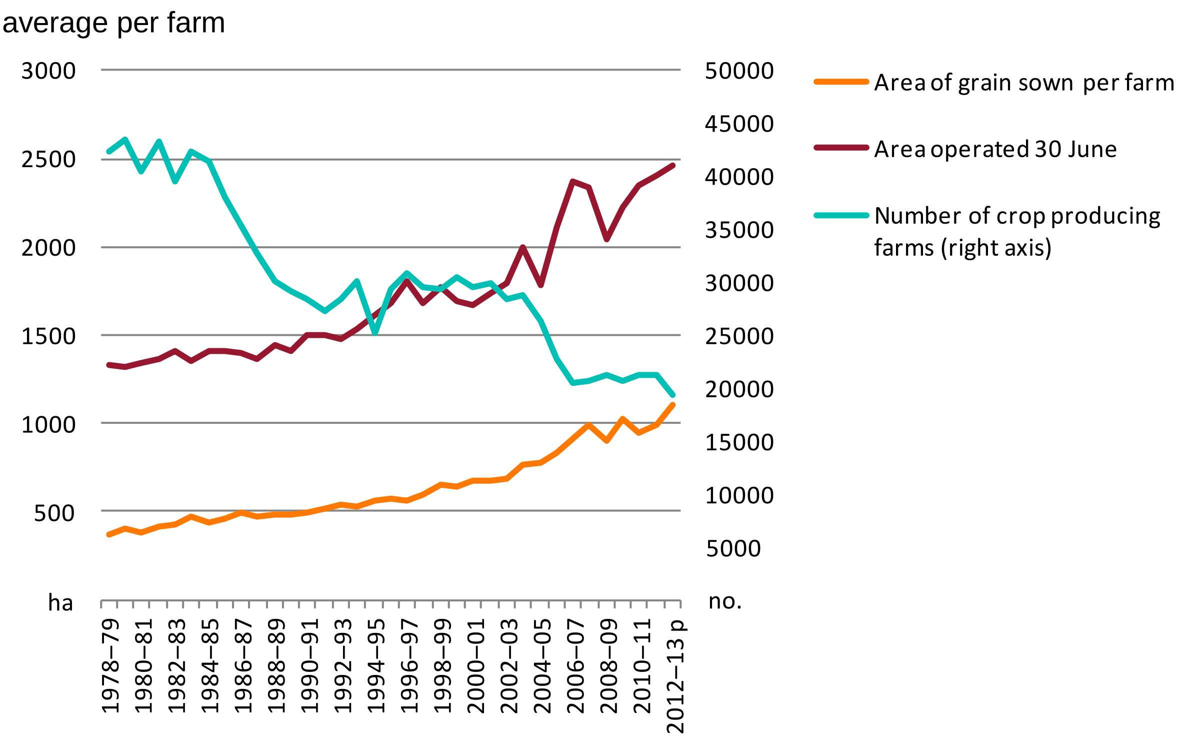
Farm structures

The vast majority of grain growing farm businesses are family owned. Australia has a strong tradition of family owned and operated farms. There are many reasons for this, however some family farms can become constrained by a lack of capital. Corporate interests are increasingly purchasing agricultural land and cropping is seen as one industry where corporate structures have some elements of competitive advantage against family owned farms, such as economies of scale that are achievable under a corporate structure with significant financial resources.

Since 1977–78 the average area of crops sown per farm has increased by an average of 3.3 per cent a year (Figure 1). The average area operated has also increased, although at the slower estimated rate of 1.8 per cent a year. Over the same period, the number of grain producing farms has declined at an average annual rate of 2.3 per cent[3].

[3] ABARES (Sept 2014), *Production costs in the Australian grains industry, 2010-11 to 2012-13,* pp13

Figure 1: Area sown to crops and number of farms, Australian grain producing farms, 1978–79 to 2012–13



p Preliminary estimate.
Note: Crops include non-grain broadacre crops (such as cotton and hay).
Source: Australian Agricultural and Grazing Industries Survey

In terms of business structures, the National Rural Advisory Council (NRAC) Report on the effectiveness of the Farm Management Deposits Scheme reported that ABARES survey data indicated that “around around 5 per cent of broadacre farm businesses are operated in an incorporated business structure such as a company. Published ATO statistics are consistent with this, reporting that 5 per cent of entities in the agriculture, forestry and fishing industries in 2009–10 were companies.

For non-corporate primary production, unpublished ATO data indicates that 57 per cent of farmers reported primary production income from partnerships in 2010–11. A further 28 per cent reported primary production income as a sole trader and 11 per cent through a trust. The remainder, less than 4 per cent, reported primary production income through some combination of partnerships, trusts and sole-trading arrangements. These proportions have not changed significantly since 2007”.[4] Evidence from GrainGrowers members suggests that there is an increasing trend away from partnerships towards trusts and companies.

The average farm cash income for the wheat and other crops industry in 2012–13 was $280 600 per farm, with reduced grain and oilseed production more than offset by higher prices for most grains and oilseeds. In 2013–14 farm cash income for the wheat and other crops industry is projected to increase to average $325 000 per farm, mainly as a result of large increases in grain production in Western Australia and South Australia. This is despite reductions in grain production in northern New South

[4] NRAC (Oct 2012), *Report on the effectiveness of the Farm Management Deposits Scheme,* pp 12

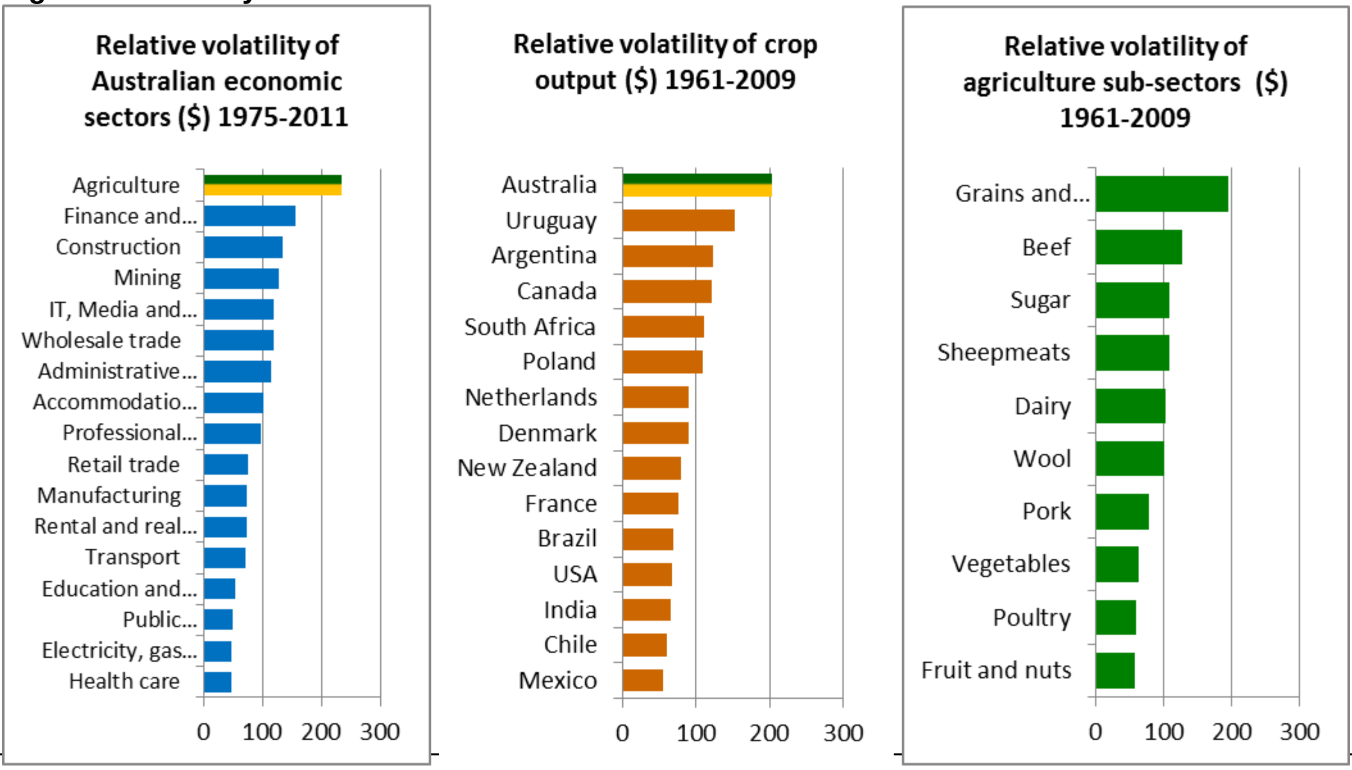
Wales and Queensland. [5] However, it is important to note that farm businesses are rarely 'average' and the reality is a spread of businesses with a range of incomes from the negative into the tens of millions. Further, due to the variable factors driving production, farm cash income is never stable and each businesses experiences large variations between years.

Agricultural volatility and risk

Agriculture, by its very nature, is highly volatile. When producing grain, farmers face two main forms of risk. Firstly, there is production risk, which is the risk associated with the generation of the actual crop. In short, this risk is largely associated with the volatility associated with climatic conditions, such as drought and is considered the greatest influencing factor on industry profitability. Secondly, farmers also face commodity price risk which is affected by market conditions and therefore the price farmers receive for their product. This is particularly relevant for an industry such as grains where such a large proportion of product is exported. Often these risks are connected. For example, if one farmer has a poor crop, it is likely others will too, which may then reduce supply and push up grain prices. In recent years farmers have also faced policy risk such as in relation to climate policy or the Murray Darling Basin Plan.

The Australian Farm Institute[6] recently considered the risk in Australian agriculture, the extent to which it is different for different commodity sub-sectors, and the extent to which the risks have changed over time. The volatility of Australian agricultural production is the second highest in the world, and for crop production, the highest of any nation. The Australian agricultural sector is easily the most volatile when compared to other sectors in the Australian economy and is almost two and half times more volatile than the average for all sectors across the economy. Of the various agricultural sub-sectors, grains and oilseeds have been the most volatile of the last three decades. These findings from the Australian Farm Institute are demonstrated in Figure 2.

Figure 2: Industry Risk Profile



5 ABARES (March 2015), *Agricultural Commodities, March Quarter 2015,*
6 Australian Farm Institute (2012), *Farm Policy Journal, Autumn Qtr*

Industry support

While there is a small number of support measures from government that seek to smooth out some of the volatility inherent in grain production, the support is comparatively low compared to competitor nations. Indeed, the most recent report from the OECD found that Australian agriculture receives the lowest for any developed nation on earth, when expressed as a percent of national GDP.

Support measures for national agriculture sectors are expressed in a number of different ways, and mainly reported as either the percent of farmers gross income received from government subsidies and support measures (%PSE) or as total support measures for the agriculture sector expressed as a percentage of national GDP (%TSE).

As highlighted in Figures 3 and 4 below, the total support measures (which includes tariffs, subsidies, and funding for activities such as R&D) sees Australia providing only 0.15% of GDP which is the lowest in the OECD. When expressed by the producer support estimate (PSE) which is the percentage of farmer's income received a consequence of government support measures, Australia ranks second lowest in the OECD at around 2% of farmer's income. This compares to an OECD average of around 18%.

Figure 3 Total Support Estimate by country, 1995-97 and 2011-13

Per cent of GDP

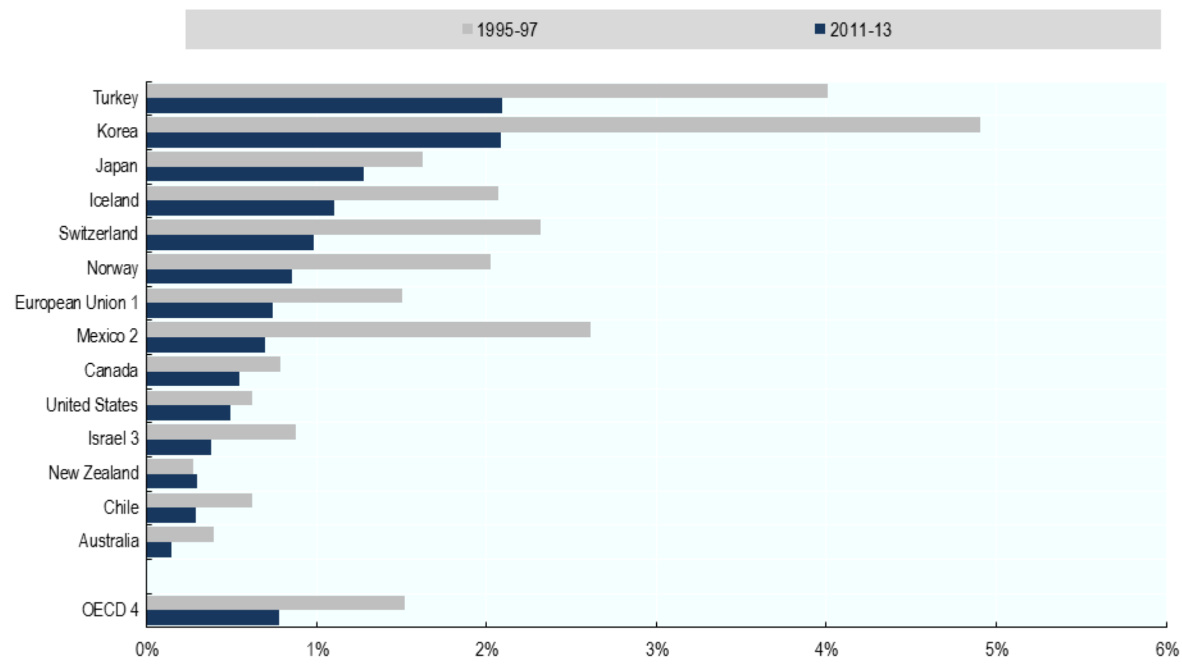
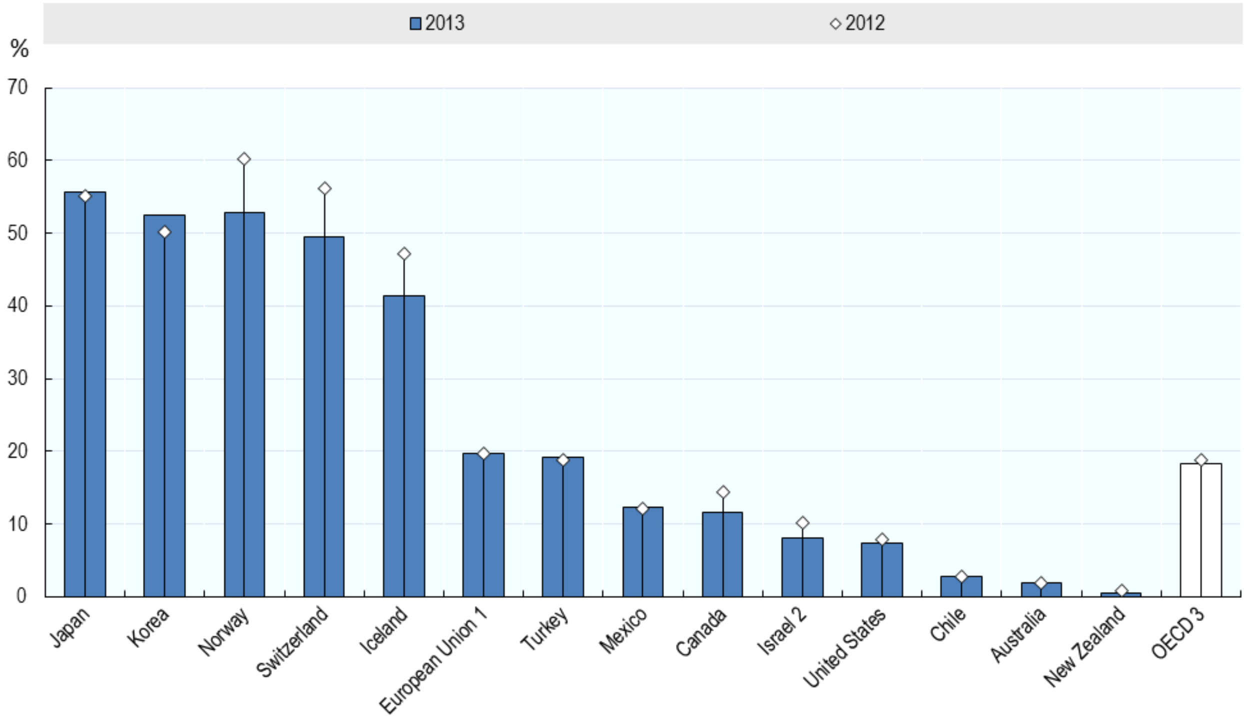


Figure 4 Producer support Estimates by country, 2012 and 2013
Percent of gross farm receipts



Implications for tax policy
Given the factors noted above, the industry requires a variety a variety of taxation measures that not only avoid adversely punishing the sector against its competitors, but actively works to support the international competitiveness of grain growing. These measures are discussed in Chapters 3 and 4.

Recommendation 1

The development of Tax Policy needs to address and reflect the particular circumstances of farm businesses. In particular, it should recognise the inherent volatility associated with agricultural production in Australia and the changing nature of farm businesses. It should ensure that that the international competitiveness of the industry is not eroded, but enhanced, and that Australia is an attractive destination for investment.

3. Existing tax system for grain farming businesses

This chapter outlines some of the various taxation measures both specifically relevant to grain growers and more broadly accesses by other businesses across the economy.

Taxation measures to deal with industry volatility

As discussed in Chapter 2, the industry is characterised by a high level of production and market risk. Most notably, the industry is confronted by production volatility largely driven by climate impacts such as drought which can severely impact profitability across years. There is a range of policy and taxation measures that aim to smooth this volatility and ensure farmers remain competitive and profitable over the short to medium term. Principal among these is the Farm Management Deposits Scheme (FMD) and Tax Averaging.

<u>The Farm Management Deposit (FMD) Scheme</u>

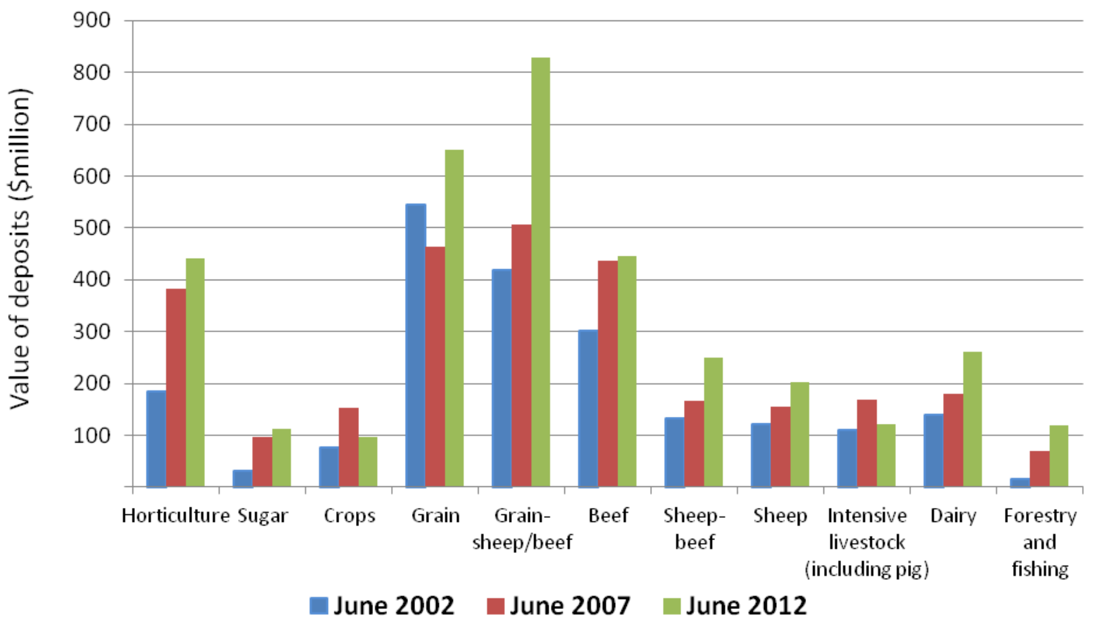
GrainGrowers strongly supports the ongoing provision of the FMD Scheme. The Scheme, implemented in 1999, is designed to increase the self-reliance of Australian farmers by helping them manage financial risk associated with climate variability and market fluctuations. It allows farmers to smooth their income over the longer term by making tax-effective deposits in higher-income years, which can be withdrawn as pre-tax farm income in later years. The scheme is consistent with the Government's objectives of encouraging farmers to have a greater self-reliance in managing drought and is particularly important given the increasing risks associated with climate change.

With exposure to a highly variable climate and to international market fluctuations, FMDs allow farmers to more effectively manage the volatility of income derived from their farming operations. The scheme to date has been largely successful. Grains, as both pure grains and mixed grains-beef/sheep businesses account for some 43% of the total number of FMDs held and 47% of the value of total national deposits. This is shown over the previous three years in the chart below.

	As at June 2013		As at June 2014		As at April 2014	
	No. of FMD accounts	Value of deposits ($'000)	No. of FMD accounts	Value of deposits ($'000)	No. of FMD accounts	Value of deposits ($'000)
GRAIN	8,250	795,297	8,840	968,147	7,450	725,188
GRAIN-SHEEP/BEEF	11,044	887,910	10,285	992,556	10,381	934,786
National Total (all industries)	**47,042**	**3,720,806**	**45,710**	**4,138,906**	**41,923**	**3,537,628**

The success of the scheme also applies more broadly to all agricultural sectors and is demonstrated by the increased uptake over the past decade as displayed in Figure 5.

Figure 5: Aggregate Farm Management Deposit holdings by industry as at June 30 each year



A recent GrainGrowers member survey[7] provided a number of important insights into the scheme, highlighted a number of concerns with FMD and sought areas for improvements to the Scheme.

- Some 90% of respondents believed that the FMD as an important taxation tool to help manage volatile cash flow across years and almost 60% of respondents held an FMD account.
- For those that did not hold FMD accounts, 40% said that they had insufficient funds to contribute. A further 20% were restricted in that they operated under either a trust or company structure.
- In relation to scheme improvements:
  - 50% of respondents proposed exploring novel changes to improve scheme functionality, such as the ability to use FMDs as an offset account
  - 50% urged expansion to allow access to those operating under a trust or company structure
  - Almost 45% urged Government to increase the $400k cap and a further 25% proposed increasing the off-farm income test beyond the $100k cap

GrainGrowers proposal to improve the scheme are discussed in Chapter 4.

<u>Tax averaging</u>
Primary producers are able to even out their income and tax payable over a maximum of five years, to allow for good and bad years. This ensures that they do not pay more tax over a number of years than taxpayers on comparable but steady incomes. The system allows those eligible farmers to receive an averaging tax offset when average income is less than their basic taxable income, but pay extra when average income is more.

[7] GrainGrowers Member Survey, ‘Tax-FMD’s’, 430 survey participants, May 2015

Farmers may opt-out of the system which is done so on a permanent basis. Consideration could be given to reviewing this position.

GrainGrowers supports the ongoing commitment to tax averaging.

Zone tax offsets

GrainGrowers supports zone tax offsets arrangement as a way of encouraging Australians to work in remote areas where there are service shortfalls. The zone tax offset is available to people who have lived or worked in remote or isolated areas of Australia that are classified as specific zones. To qualify, the person must have lived or worked in a remote area, not necessarily continuously, for at least 183 days during the income year or 183 days or more in the last two income tax years provided that they did not claim the zone tax offset in the previous year.

Research, Development & Extension (RD&E) and the levy system

Australia's rural levy system is critical to the delivery of whole of industry functions in the grains industry that would not occur if left to individual industry participants. They exist at the behest of industry which sees the system as an investment rather than a tax.

Seven grain/seed commodities currently have a levy and/or an export charge. These include coarse grains, cotton, grain legumes, oilseeds, pasture seeds, rice and wheat. The levy system includes a component for funding of research, development and extension; a component to fund National Residue Survey (NRS) monitoring; and a component to fund the biosecurity activities of Plant Health Australia (PHA). These functions benefit whole industries, their supply chains and associated communities. Almost all of the grains levy (98%) funds the industry contribution to the internationally envied research development corporation (RDC) model. In the grains industry, the Grains Research & Development Corporation (GRDC) is the service provider.

The GRDC received 57.5% ($120.2m) of its income from grain grower levies while the government provided a further 32.8% ($68.6m). The remaining income of $20.3m was derived from interest, royalties and other sources[8]. The high ratio of more than 2:1 of industry to government funding highlights how much the industry appreciates the model, the importance industry places specifically on the GRDC, and the benefits the industry as a whole receives.

Grain growers are therefore staunch supporters of the levies because of the productivity, efficiency and sustainability benefits it can bring to the sector and the broader economy. Gains from improvements in competitiveness and productivity in production are shared between all Australian grain producers but also with operators further along the supply chain including traders, handlers, marketers and exporters. To this end, GrainGrowers recognise that investment in the prosperity of the sector must be a collaborative effort including the government and those further along the supply chain. This might particularly be the case in international market support, where long term strategic positioning rather than short-term margin taking has the potential to benefit the entire industry.

GrainGrowers seeks ongoing government commitment to match funding of industry levies to the Rural Research and Development Corporations (RDCs) as a key pillar of the existing RD&E model. There is significant risk if the government reduces contributions as it would potentially undermine the industry and government partnership on RD&E and have adverse effects on the performance of the rural sector.

Fuel Tax Credit Scheme

Fuel excise was introduced in Australia in the 1920s for the specific purpose of road funding. It was extended to diesel in the late 1950s to help cover the cost of road building and maintenance. Rebates for fuel excise are a long-standing feature of Australia's tax system, existing in various forms for diesel

[8] GRDC, *Annual Report 2013-14,* p4

since 1957. The rebate scheme has continuously evolved over time until in 2006 the Fuel Tax Credits Scheme (FTCS) was introduced. The Fuel Tax Act 2006 broadened the criteria for claiming fuel tax credits by cancelling the urban-rural boundaries that previously applied and extending the rebate to lighter fleets.

Fuel tax credits are available to all businesses, in all parts of Australia. It's a long-standing policy principle that governments do not tax business inputs. The introduction of this practice would add to business costs and create economic distortions.

Under the current FTCS, the government provides a rebate of the excise and customs duty paid on diesel and like fuels purchased for specific off-road uses – mainly in the mining, agriculture and other primary production industries.   The rebate is generally payable on diesel fuel and like fuels used in the following activities:

- Primary production – forestry, agriculture and fishing (use of a road vehicle on a public road is not eligible)
- Mining operations
- Businesses where there is no ready access to a commercial supply of electricity
- Rail transport and marine transport.

The fuel tax credit reimburses Australian farmers for tax already paid on a key business input. While the liability for fuel tax falls on producers or importers, the incidence of fuel tax is generally intended to fall on on-road users of light vehicles (with a road user charge applying to heavy vehicles). Therefore, like the GST input tax credits, farm businesses who have purchased fuel on which excise has been levied (other than those using the fuel in light on-road vehicles) should be entitled to a fuel tax credit to offset the incidence of the tax.

The primary purpose of the scheme is to maintain competitiveness in key export industries, such as agriculture, in a manner consistent with the government's broader fiscal objectives. GrainGrowers believes that Fuel Tax Credits are a critical mechanism to help the farming sector to maintain a level of competitiveness in the global market.

As the Henry Tax Review stated, "…*the system is intended to remove or reduce the incidence of fuel tax from business inputs, so that its incidence falls primarily on certain private consumption of fuel. This limits the impact on production decisions. For example, fuel tax credits mean that all electricity generation using liquid fuels is effectively free of fuel tax, in the same way that coal or natural gas inputs to electricity generation are untaxed*".[9]

Historically, the tax was originally implemented to direct funds towards maintaining urban roads. While it could be argued that the revenue from excise is no longer exclusively directed to that purpose, the fact remains that farmers use diesel and pay the tax for activities that have no impact on urban roads and should not be subject to the excise that is proposed to maintain them.

The process whereby credits are claimed by businesses through the BAS, was only introduced to improve administration. The government switched to a rebate system because it's more efficient to charge all users the same price upfront for fuel and have eligible users claim back the excess excise, than to have the complexity and integrity issues involved in a certificate system in which eligible users weren't charged excise at the pump

GrainGrowers reiterates that the fuel tax rebate is a critical measure that has strong and united support from the Australian farming sector. Reducing or removing the fuel tax credits would impose significant costs on the sector and wok to further erode the industry's international competitiveness in

[9] Treasury (2008), *Architecture of Australia's tax and transfer system (Henry Review of Taxation)*

export markets. We urge government to remain firmly committed to continuation of this provision for the farm sector.

General taxation provisions

There are a range of other tax and broader policy measures of relevance to grains growers which the industry generally supports. These include:

- Accelerated depreciation for new water and fodder assets announced in the 2015 Federal Budget
- A range of other deductibles relating to farm assets, water facilities, and electricity connections and telephone lines for small businesses
- The small business tax concessions package announced in the 2015 Budget, and
- Red tape reform

There are, however, a number of improvements that can be made to the arrangements outlined above. These are discussed in Chapter 4.

Recommendation 2

Government to maintain commitments to:

- **Assist farmers to manage volatility through the tax system, such as Farm Management Deposits Scheme, Tax averaging and zone offsets**
- **The Levy system, that underpins much needed R&D**
- **The Fuel Tax Credit Scheme for agriculture**

4. Ensuring Australia's tax system provides a basis for competitive farm businesses into the future

GrainGrowers supports a number of changes to the taxation arrangements discussed in the previous chapter.

Farm Management Deposit Scheme
Given the overwhelming support for the scheme, coupled with its undoubted success in assisting many farmers to manage the inherent risks and volatility associated with agriculture, GrainGrowers proposes a number of changes to better reflect the Government's objectives.

1. Allow FMD to be used as an offset account

   A short-term improvement to the scheme would be to give FMD funds the capability to act as an 'offset' account against existing farm loans in order to leverage their full value to a depositor, as can occur with residential loans. Such a change would in practice reduce the interest payable for farm businesses when they require capital. This requires further investigation as a priority.

2. Increasing the $400k cap

   There are also a number of amendments that should be considered to the FMD measure, to improve preparation for future droughts, including raising the cap (currently $400,000) on FMD accounts in line with climate risk levels and the size of modern agricultural operations (e.g. multiples of years of input costs, particularly for grain growing businesses). The relatively low (to annual business input costs) cap of $400,000 deters large-scale grain producers from setting funds aside in FMDs and investing in their self-sufficiency. Lifting the cap would encourage more of these producers to set aside reserves through this scheme in future years.

3. Provide scope to use FMDs for trusts and companies

   As noted in the discussion in chapter 2, growers are changing their business structures for a variety of commercial reasons. These changed business structures should not preclude that ability of farmers to utilise FMDs.

4. Allow farmers to withdraw funds within the first 12 months during drought periods

   Currently, farmers affected by natural disasters can draw on their FMDs within the first 12 months without losing associated taxation benefits, as long as they are currently accessing, or have accessed, primary production Category C assistance under the Natural Disaster Relief and Recovery Arrangements. A similar provision was also available for those impacted by drought under previous Exceptional Circumstances policies. However, current inadequacies in the national drought policy mean greater tax implications for farmers withdrawing their funds within 12 months of deposit, even if the funds will be used to manage drought conditions. This needs to be rectified immediately, allowing farmers to use their FMD accounts to self-manage through drought periods without worrying about the tax implications.

The levy system

As previously highlighted, GrainGrowers is a strong supporter of the agricultural levy system and views the broad architecture of the system as sound. In its submission to the Senate Rural Affairs and Transport Reference Committee Inquiry in to industry structures and systems governing the imposition of and disbursement of marketing and R&D levies in the agricultural sector[10], GrainGrowers made a number of recommendations to improve the levy system. This included:

1. Regular review of the levy rate at a five-year interval. Review of the levy rate will ensure it is adjusted if market circumstances require it and industry sentiment supports it. (There is currently no method, independent of parliament, to review the levy rate and as such, the rate has not been changed in 16 years in the grains industry).
2. Maintenance of the current ad valorem (% rate) rather than a fixed dollar per tonne rate so the levy automatically adjusts to the prevailing market conditions and inflation, and thus reduces the necessity to review the rate more often than at 5 year intervals.
3. Review of processes around the implementation of levy rate changes with a view to changing the delay in implementation once agreed
4. Appointment of a diligent RO which can appropriately oversight the GRDC (and therefore the levy payer funds) on behalf of the production sector over the coming decades.
5. Annual, survey of the growers to hear feedback on research priorities – currently a ‘complete’ survey of all research priorities is happening every two years.
6. Consultation on industry views for an additional levy for marketing; or a component of the current pooled levy funds to be redirected for marketing. This consultation should include the development of a clearly established process to formally change the levy split, if requested by industry, to redirect the use of levy funds to areas where there is a lack of funding.
7. Review extension services in the grains industry to determine the impact that extension is having on the productivity of all major groups of farmers, including the impact of extension services on farm profitability, identifying areas of lack.

Exclusion of intergenerational transfers for Capital Gains Tax

GrainGrowers are seeking to exclude the capital gains tax liability for intergenerational transfers. This position was advocated by the National Farmers Federation in its 2014 Pre Budget Submission[11].

In the submission, the NFF wrote:

> *Australia has the highest reliance on capital taxation in the OECD, with around 35 percent of all tax revenue derived from taxes on capital income, including capital gains tax (CGT). As a share of GDP, the total tax burden in Australia on capital is around 11 per cent, the fourth highest amongst the OECD countries.*
>
> *Arguably, CGT is the most economically damaging tax for Australia’s small business sector. It is an active disincentive to risk-taking and entrepreneurship, deterring investment and job creation. Upon the sale of an asset or business, CGT detracts from the amount of capital which may be used to re-invest in other more productive assets.*

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10 http://www.graingrowers.com.au/images/30_policy/submissions/ggl%20submission%20rde%20levies.pdf

11 NFF 2014 *Federal Budget Submission* http://www.nff.org.au/submissions-search.html?categoryid=3673

The NFF is of the view that CGT has an economically detrimental 'lock-in' effect that causes an asset to be retained to avoid realising a liability even though proceeds could be deployed elsewhere and achieve higher returns. Moreover, many farm business owners can have negligible superannuation savings and use the value built up in their business for post-retirement income. The potential narrowing of the options available to reduce the impact of CGT will make achieving a reasonable retirement income more difficult.

The NFF seeks support from the government to assist in the intergeneration management of assets by the commitment to exclude capital gains tax liability for intergenerational farm asset transfers. This would go a long way towards lining up Federal and State commitments where NSW and Vic currently have exclusions for stamp duty on such transactions. The NFF views this as a simple and low cost commitment from the government that would ease some of the financial burden for new entrants into the farm sector, and also help respond to the growing concern in the sector relating to the ageing workforce with the average age of farmers approximately 58 years.

As grains commodity member of the NFF, GrainGrowers support this view.

Accelerated depreciation

The announcement in the 2015 Federal budget to allow accelerated depreciation for new water and fodder infrastructure and fencing for farmers was positively received by the grain growing industry. The measures are significant for farmers, as fodder storages can last up to 50 years and fences can last 30 years before needing replacement, and currently have long depreciation periods for tax purposes. GrainGrowers also notes that investment in silos and tanks used to store grain and other animal feed can be depreciated over just three years.

GrainGrowers appreciates that the Government has announced that it has pulled forward the starting date for this measure. However, we note that the provisions largely relate to livestock industries and we therefore urge the government to consider whether there are additional items that could be included that are more beneficial for grains.

Luxury car tax

The Tax Discussion paper notes that "the luxury car tax (LCT) has a narrow tax base, is complex and is the Australian Government's only luxury tax on a specific good or service"[12].

"The LCT applies to cars sold in or imported into Australia, with some limited exemptions, where the value of a car exceeds a GST-inclusive threshold. The LCT is currently applied at a rate of 33 per cent to the GST-exclusive value of the car (including accessories) when it exceeds the LCT threshold. For the 2014-15 financial year, the threshold is $61,884 for regular cars and $75,375 for fuel efficient vehicles. The LCT raised $476 million in 2013-14. In the past, it has been noted that the LCT's thresholds may not be an accurate representation of luxury in the car market — for example, a seven-seater family vehicle and a small sports car may both attract similar amounts of LCT".[13]

This threshold is likely to capture a range of vehicles, such as Landcruiser 4WDs, that are required for working and operating in remote Australia. Given the noted complexities and limited revenue Government receives from the LCT, GrainGrowers urges government to either wholly abolish the LCT or provide exemptions for those vehicles used for primary production activities.

[12] Treasury (2015), *Re:think, Tax Discussion Paper*, p162

[13] *Ibid*, p162

Non-commercial business loss

The Tax Discussion paper notes that the 'non-commercial' loss rules (NCL) prevent individuals from claiming losses from business activities that are more in the nature of hobbies or lifestyle choices against their other income (for example their salary) in the year it is incurred.[14]

The NCL measures do not apply if:

- You operate a primary production business and your assessable income from other sources that do not relate to your primary production business is less than $40,000, excluding any net capital gain
- The sum of your taxable income, reportable fringe benefits, reportable superannuation contributions and total net investment losses, is less than $250,000 and your business activity satisfies one of four tests (based on the income, profits and assets of the business activity and determine whether an activity may be treated as commercial in nature for the tax laws)
- The Commissioner of Taxation exercises discretion to allow the loss to be claimed

GrainGrowers agrees with the Tax discussion paper that "the tax system should not operate in a way that discourages economic activity, however, it should not support or subsidise unproductive businesses or the private activities of taxpayers. The way tax losses are treated by a tax system is relevant to this outcome".[15]

However, the current arrangements do not reflect the evolving nature of farm businesses including the need to take into account the scale required for modern farming and the need for off farm income to manage volatility. GrainGrowers therefore proposes that Government increase the $250,000 cap to address this need for farmers and further support growers to meet the government's objective of giving farmers greater capacity to be more self-sufficient in times of drought.

Red tape and compliance burden

GrainGrowers welcomes the Government's commitment to reducing red tape and the compliance burden particularly on small business. While there have been a range of positive changes in this area in recent years, there remains a number of areas that could further assist farmers to focus more on production activities and less on meeting Government reporting requirements.

<u>Fuel tax credits</u>

As previously noted, GrainGrowers strongly supports ongoing maintenance of the Fuel Tax Credits scheme as a means for minimising business input costs and avoiding distortion of investment decisions.

There are however a range of amendments that could be made to reduce the compliance burden on claimants. These include:

- Moving the rebate to point of sale rather than delayed through the BAS process
- Providing greater clarification and reducing complexities in regard to calculating percentages
- Reducing complexity for contractors who spend time on-farm and also on public roads
- Aligning fuel tax indexation with BAS periods, rather than on 1 February and 1 August (A major compliance burden occurred with the indexation in 10 November 2014, with businesses having to undertake multiple calculations during the middle of harvest; this must be taken into account for future indexations)

[14] *Ibid,* p117
[15] *Ibid,* p118

Small business threshold

GrainGrowers welcomes the various measures to both support small business financially and to reduce the compliance burden such as through annual BAS reporting. As previously discussed, grain growing businesses are largely family owned enterprises and therefore are limited in their staffing scope to deal with reporting. Furthermore, farm businesses are increasingly required to achieve greater scale in order to remain international competitive, yet profitability as price takers in the international market remains low. What this means in practice is that many farm businesses are turning over more than $2m per annum while business structures and capacities have largely remained the same. This can result in farm businesses losing the critical benefits that small businesses receive in reduced compliance, tax cuts, offsets and deductions.

While GrainGrowers understand the need to provide a threshold, we urge government to give consideration to particular circumstances of farming businesses to ensure they continue to receive the benefits of the small business package, either through a broader increase of the threshold to $5m or through a targeted package for primary production businesses.

State, Territory and local Government taxes

Apart from the Federal issues noted above, the majority of other issues raised by GrainGrowers members are based on state/local government taxes, such as stamp duty and shire rates. While these state-based taxes must be reduced, farmers are rightly sceptical following the GST's introduction, where the accompanying state tax reduction did not occur. This must occur as a matter of priority. Having said that, local governments must not be left underfunded in the redistribution process.

Recommendation 3

Government to implement proposed changes to key existing tax arrangements in the areas of:

- **Farm Management Deposit Scheme**
- **The Levy system**
- **Exclusion of intergenerational transfers for Capital Gains Tax**
- **Accelerated depreciation**
- **Regional Based tax incentives**
- **Red tape and compliance burdens relating to Fuel Tax Credits and the Small Business Tax Threshold**