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Sent by email only to:
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Subject **Rabobank's Submission**
Government's Tax Discussion Paper "Re:think" of March 2015

Dear Task Force

Rabobank welcomes the opportunity to join the national conversation on tax reform and to provide a submission to the Government's "Re:think Tax Discussion Paper."

WHO IS RABOBANK?

Rabobank Australia Limited (Rabobank) is a part of the international Rabobank Group, the world's leading specialist in food and agribusiness banking. Rabobank has more than 110 years of experience in providing banking and financial services to businesses involved in all aspects of food and agribusiness.

In its home country of the Netherlands, Rabobank is structured as a cooperative and operates in 42 countries, servicing the needs of approximately 10 million clients worldwide through a network of more than 1,600 offices and branches.

In Australia, and also New Zealand, Rabobank is one of Australasia's leading rural lenders and a significant provider of business, corporate banking and financial services to the food and agribusiness sector. Rabobank has 61 branches throughout rural Australia and employs approximately 600 people.

The longevity and sustainability of the food and agricultural industry in Australia is integral to our own and our clients' business performance.

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<u>BACKGROUND:</u> Why Is Agribusiness Important To Us, Let Alone Australia?

Australian food and agriculture product suppliers are well accustomed to operating in a highly dynamic and competitive global environment. Looking ahead, there are many reasons to suggest that this environment is only going to become even more dynamic and more competitive, requiring Australian farmers and manufacturers to become more agile. Put simply, Australia cannot afford to stand still for too long, and any plan to boost the competitiveness of Australian agribusiness will undoubtedly require greater awareness and coordinated action from all stakeholders (including Australia) to achieve maximum benefit for the industry and the wider economy.

Against this backdrop and in many respects, Rabobank strongly believes that the long-term objective for Australian food and agriculture is two-fold:

1. to <u>contribute</u> to feeding the world,
2. but also to maximise the <u>value</u> that producers can extract from the products they supply.

Food Security

The issue of food security is a continually increasing concern on a global scale. With the world's population predicted to grow by 2 billion by 2050, there is a substantial focus on drivers of productivity and efficiencies in agricultural production, with global food production needing to lift 70% by 2050 in order to fulfil the predicted demand (*Source: FAO, High Level Expert Forum on How To Feed The World in 2050, "Global Agriculture Towards 2050")*

Food security is built on the following pillars which must be achieved simultaneously:

1. **Food availability** – ensuring sufficient quantities of food are available on a consistent basis, determined by the level of food production, stock levels and net trade;

2. **Food access** – economic and physical – having sufficient resources to obtain appropriate foods for a nutritious diet. Concerns about insufficient food access have resulted in a greater policy focus on incomes, expenditures, markets and prices.

3. **Food utilisation** – appropriate use of food based on knowledge of basic nutrition and care, as well as adequate access to services (water, health, sanitation).

4. **Food stability** – of food prices and supply, impacted by adverse weather conditions, political instability or economic factors. *(Source: FAO, WHO)*

Rabobank's global vision is to feed the world sustainably. Recognising that we can only realise this vision through the efforts of others, our mission is to enable the economic success of our clients and the vitality of their communities so that they can feed the world and sustainably achieve their goals and ambitions.

More specifically, we will be looking to enable farmers to grow more food, actively improve global food and agribusiness (F&A) value chains, participate in continuous dialogue around balanced nutrition and support our clients in building enterprises resilient to volatility and strengthening cooperation.

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Regional Communities - Sustainable development through client engagement

Rabobank facilitates an ongoing dialogue with its customers through a platform called Client Councils.

The dialogue has led to increased insights into challenges and opportunities of agricultural enterprises and more widely, rural communities. Outcomes not only refer to the core economics of farming but wider issues affecting families and communities, which are equally as critical to the sustainability of Australian agriculture.

Despite the geographical diversity of our councils, there is a consistency to the themes tabled by our clients across all states.

Theme	Description
Industry Capacity	• Challenges of attracting and retaining youth for careers in agriculture • Challenges with succession planning • Pressure on the agricultural workforce at large and limitations for growth caused by labour shortages
Sustainability	• Water availability • Land degradation • Waste management • Challenges in co-existence of agricultural and mining activities
Education	• Access to agricultural education • On the job development and recognition of skills • Access to quality education for farming families
Urban/Rural Divide	• 65% of Australia's population living in five largest cities • Potential disconnect from Australia's rural heritage • More objective communication to ensure more effective engagement in the urban / rural divide
Rural Health	• Access to health care • Denial of health issues • Early identification of mental health issues

The above themes have become the charter of our Client Councils and extension is now sought into concrete initiatives developed with our council members and facilitated by Rabobank and industry stakeholders.

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The changing demographic landscape of Australian rural communities

In a recent research project from KPMG, initiated by Rabobank, into the past developments and expected trends of rural demographics it was found that the agricultural workforce has suffered a steep decline.

Over the period 2001-2011, whilst Australia's total workforce had grown by 21%, the agricultural workforce declined by 30%. This represents a significant gap and illustrates a direct pressure on the growth potential of Australian agriculture. In addition, this trend also illustrates the attractiveness of other industries like the mining sector and other urban-based job opportunities.

This is certainly shown in the states of Western Australia and Queensland where the growth of the workforce was respectively 32% and 31% (relative to 21% nationally) and the decline of the agricultural workforce was 36% and 26% respectively (relative to 30% nationally).

An important observation is that the young members of the workforce often leave rural communities, favouring urban based jobs or better paid jobs in other industries. From a social point of view, these communities become less attractive for young people to live in. This has a flow-on effect to the vitality of the community where the viability of the retail sector suffers and then it becomes more challenging to attract professionals such as doctors and teachers to these areas.

In combination with evidence of decline in the vitality of some rural communities, it is interesting to note that over the same period, Australian agricultural has enjoyed moderate production increases that have been achieved with less people. Ongoing farm mechanisation, rationalisation through farm consolidation, conversions from intensive labour sectors and a more efficient use of temporary resources like backpackers and (international) seasonal workers have enabled the industry to mitigate some of the risks around the declining workforce to date.

There is the expectation over the longer term that agricultural workforce numbers will decline. At the same time the average age of a farmer is 58 and the 65+ age group is the only age range seeing an increase in workforce numbers forming a potential risk to the longer-term sustainability of agricultural enterprises.

Recent competitiveness research

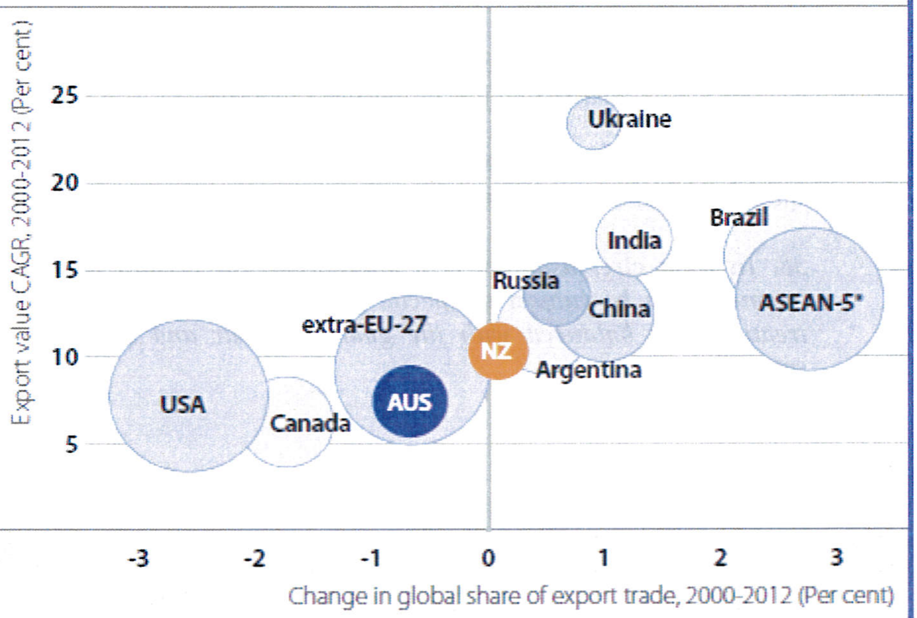
Rabobank's Food and Agribusiness Research and Advisory team has recently (10 April, 2014) released a report to clients titled "Competitive Challenges" which highlights six key issues of critical importance to Australia's competitiveness on the global agricultural stage:

1. Rising production costs on-farm and beyond the farm gate
2. International market access
3. Logistics infrastructure (in)efficiencies
4. Regulatory pressures
5. Capital constraints
6. Product innovation and development

The report goes on to highlight that the competitiveness of Australia's food and agriculture sectors generally compares favourably in a global context, a position that has underpinned their prominent role in global trade over the years.

However, this situation is far from static, and many global competitors are busy expanding competencies and building on their own strengths and/or fast finding ways to address limiting factors to their competitiveness and growth potential.

Figure 1: Global exports of food and agriculture products, 2012



Source: World Trade Organisation, Rabobank, 2013

*ASEAN-5: Indonesia, Malaysia, Philippines, Thailand and Vietnam.
Note: Size of bubble corresponds to the relative value of trade for each country/region.

Accordingly, over the past decade, highly resourceful developing countries have begun to assume a greater role in global export trade of food and agriculture products (Figure 1). The potential of countries in South America and Eastern Europe is obvious, but interestingly even some major food- importing countries/regions such as China and the ASEAN-5 also appear to be playing a greater role on the export landscape. While these countries exhibit vast demand for food and agriculture imports from outside the region, equally they have been generating large and rising intra-regional trade flows, facilitated by a strong commitment to liberalising trade within the region.

This rise of low-cost suppliers from developing countries has increased the focus on the relative on- farm cost competitiveness of traditional suppliers in developed countries. In many cases, the comparison is not very flattering, causing many developed countries to step-up efforts in other areas to bolster their competitiveness.

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Consequently, we see the Australian tax system as a means to achieving these broad goals and we provide the following recommendations, observations and comments for the Government to consider as part of its tax reform agenda to bring to its next election.

RECOMMENDATIONS, OBSERVATIONS AND COMMENTS

Rabobank has broken down its submission into two broad sections and, as requested, focussed on ideas rather than prescribing solutions. The sections are:

A: issues faced by our clients in the **Australian agribusiness industry**, and

B: specific issues that could assist Rabobank, and the **financial industry** as a whole, in assisting the agribusiness industry.

In short, our responses look to the Australian agribusiness industry to address the following specific question listed in the Re:think paper:

> ***38. In what circumstances is it appropriate for certain types of businesses to be subject to special provisions? How can special treatment be balanced with the goal of a fair and simple tax system?***

SUMMARY:

A. Client / Agribusiness Industry Issues:

A.1 Rabobank recommends a continued focus on improving market access for Australian exports and on developing high value products / produce for export into targeted global markets.

A.2 Rabobank advocates sustainable development and farm business profitability.

B. Bank / Financial Industry Issues:

B.1 Reintroduction of the phase-down of interest withholding tax.

B.2 Removal of LIBOR cap for foreign branches altogether not just an administrative solution of substituting another cap.

B.3 The non-introduction of a bank deposit levy.

B.4 Zero-rating of B2B financial services.

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DISCUSSION

A. Client / Agribusiness Industry Issues:

A.1 Rabobank recommends a continued focus on improving market access for Australian exports and on developing high value products / produce for export into targeted global markets. Tax policy settings should centre on a shift away from competing in highly commoditised global markets and towards supplying high value targeted markets.

Rabobank believes that the focus of the Australian agricultural industry needs to change to a **value proposition** so as to differentiate product from a commodity base. Below we outline the general principles that we believe can assist to achieve this proposition.

In the Government's Green Paper "The Agricultural Competitiveness" released in October 2014, the Government confirmed at page xi that ".... *agriculture continues to be **substantially export oriented**" (our emphasis added).*

The successful negotiation by the Government's recent free trade agreements with neighbouring countries is a welcomed boost for the food and agribusiness industry but even so, Australian suppliers are finding it more and more difficult to compete on price and basic quality parameters in global markets, as our competitors have improved their product quality and service credentials. Consequently, we need to recognise that:

- Australia is not and is not likely to become the food bowl of Asia. We currently supply only 6% of agricultural exports (by value) into the Asian region.
- Australia's agricultural sector has a relative high cost of production (high labour and machinery cost)

Given our relatively high cost structures viz-a-vis our global competitors, agricultural suppliers in Australia need to find ways to differentiate and add greater value to the products that we provide and export to the world to ensure continued competitiveness.

Measures that increase the product value in the minds of customers and ultimately act to lessen competitive pressures could include

- leveraging off inherent Australian product characteristics such as product integrity, diseases free status and traceability,
- understanding and meeting the needs of customers around product quality and service reliability,
- differentiating products through sustained innovation and branding.

In short, we need to ensure that Australian products are the preferred choice of global customers.

Case Study – Australian wine on the global stage

The Australian wine industry provides one example where local food and beverage companies have made a telling mark on the world stage for value added and branded products. The intent shown by the Australian wine industry to grow beyond their home markets through the use of innovative production and marketing practices has enabled *them to successfully establish brands that now rank amongst the worlds most valued.*

In recent times, Australian wine companies have encountered heightened competition in world markets. Lower cost competitors such as Chile, as well as more heavily subsidised competitors in Europe, have significantly improved their value and mainstream market product offerings which has eroded the value proposition of local suppliers.

This has resulted in a need for Australian suppliers to continue to build on their knowledge of market dynamics and consumer behaviour, which serves to underpin their ability to better tailor products and marketing strategies, and in turn build brand equity and pricing power in global markets.

From a Tax Reform perspective we propose further measures to improve innovation and R&D investment in agribusiness so that we can crystallise our **value proposition**.

To start, Rabobank congratulates the Government's recent announcement to provide additional rural R&D funding under the Rural R&D for Profit program. However, this is only the start. What are needed are further tax incentives for farmers to "have a go" and innovate. To increase economies of scale and to risk capital.

Although R&D drives innovation around knowledge and best practice, other factors will determine the uptake and success of these innovations at the farm level, that is, "extension".

How do we "extend" this innovation? Well, in the area of business management and financial awareness, Rabobank understands the value of extending farmers in this area and to this end, it has developed two unique programs. ***The Executive Development Program*** for farm owners and decision makers and ***The Farm Managers Program*** designed specifically for our next generation of farmers which are run annually for approximately 40 participants from Australia and New Zealand. Both programs are financially subsided by Rabobank and since 1999 Rabobank has delivered these programs to over 500 Australian farmers.

Rabobank believes that there continues to be an essential role for Government support for these agribusiness education programs and indeed "extend" these types of programs to share innovation throughout the Australian agribusiness community. For instance, the now discontinued ***Farmready*** was an important program to encourage and educate Australian farmers to find new methods of farming that were ecologically sound as well as profitable.

A.2 Rabobank advocates sustainable development and farm business profitability

Rabobank believes that there is an opportunity for government to use the tax system to improve the sustainability and business profitability of the agribusiness industry, which will assist with addressing the issues outline below.

The vast majority of farms in this country are family owned and operated. Indeed, the Agricultural Competitiveness Green paper at pages x and xi recognises the importance of the "family farming model" and the benefits that local knowledge and strong regional communities can provide to efficient farming.

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Notwithstanding these goals, Rabobank has found anecdotally through our Client Councils that many of our farmers that the "family farming model" is under some serious challenges especially in attracting and retaining workers, let alone youth for careers in agriculture, succession planning for existing family farms and the knock-on effects to regional communities with a declining workforce and the challenges to attract professionals such as doctors and teachers.

The Australian farming population is ageing. According to the Australian Bureau of Statistics, the age profile of Australian farmers (as at 2011) has changed markedly over the last 30 years (i.e. in one generation). The median age of farmers increased by nine years to 58 and the proportion of farmers aged 55 years and over almost doubled (from 26% to 47%), while those aged less than 35 years fell from 28% to just a meagre 13%.

Specifically, Rabobank suggests the following tax proposals:

- The small business threshold of $2m annual turnover for various tax incentives could be made more effective by increasing it to $5 million to take in more medium-sized businesses.

- Further broaden the effectiveness of the Farm Management Deposit (FMD) scheme which currently provides farmers the ability to smooth their taxable income given this industry has naturally greater earnings volatility, with crops and produce subject to unpredictable weather patterns and diseases. Looking at the take up of FMDs by our customers, Rabobank would recommend that the maximum deposit limit of currently $400,000 increase to $1 million, which would enable a greater number of farmers to benefit from this income smoothing mechanism, especially across periods of income volatility. This recommendation is also in line with the recommendations made to the government in the Agricultural Competitiveness Green paper at page 44.

- The Government should also consider doing more to incentivise farmers to invest and adopt new technologies that would lead to more efficient production and a lower cost of per unit of output. Adoption of new and improved technology and know-how will be fundamental to ensuring primary production in Australia can continue to grow in term of output; compete on increasingly competitive global market; and yet be done by fewer farmers. To facilitate and promote modernisation of the farm production equipment, Rabobank recommends that the newly introduced $20,000 immediate tax write-off on business equipment be expanded to $100,000 for farmers investing in new primary production technology.

- Further incentives could be allowed to encourage structured capital investment in agribusiness, rather than limiting the growth of many family farms to their capacity to borrow debt and reinvest its profits.

  Perhaps by introducing an "inclusive and co-operative" hybrid tax entity whereby equity (to various degrees) is held by both the investor and the farm operator with liability limited to one of the equity holders (e.g. other than to the value of the farmer's family home), or even with the option to elect to be treated as a partner in a partnership or to be treated and taxed as a company so as to accommodate the wishes of both equity holders. Such a flexible tax entity may allow additional equity investment from outside the family and hopefully maintain the family farm concept. A further positive benefit of this may be to encourage younger generations to see farming through this entity as a viable employment and business option.

That said, we acknowledge that such a model is not without its difficulties, both taxation (as evidenced from the failed mass marketed managed agricultural investments of yesteryear) and commercial (governance, shared decision making, different skills). However, Rabobank would encourage further investigation into possible alternative structured investment in agriculture.

B. Bank / Financial Industry Issues:

B.1 Reintroduction of the phase-down of interest withholding tax

Five years ago, on 11 May 2010, the Australian Federal Government announced that it will phase out Australian interest withholding tax (WHT) in respect of interest paid by financial institutions on certain offshore borrowings. This was a response to two separate reviews on tax reform, namely the Johnson Report and the Henry Tax Review.

In those reports, the Government recognised that where Australian interest WHT applies, it may be passed on to Australian borrowers through higher interest rates and may also bias the funding choices of financial institutions (currently, withholding tax is levied at 5% for funds from an offshore parent and 10% for interest paid to non-resident retail borrowers). Further, WHT on such funds is not in accordance with the proposition of Australia being a financial centre in our region. Many of our OECD counterparts have no WHT on such borrowings, which compromises Australia's foreign banks to raise cheaper funds from offshore to lend to their customers in Australia. This structural tax impediment prevents foreign banks from providing better and more competitive lending rates to their customers. To improve lending competition which would ultimately benefit the Australian borrower, Rabobank recommends the Government to reconsider and reintroduce the phasing out of this WHT.

Rabobank would welcome the re-introduction of this measure and agrees with the recommendations by both the Johnson Report and the Henry Tax Review.

B.2 Removal of LIBOR cap for foreign branches altogether not just an administrative solution of substituting another cap.

As a corollary to the above, Rabobank recommends the ultimate removal of LIBOR cap for foreign branches altogether, and not just the administrative solution of substituting another cap. Currently, any excess rate above LIBOR (or another benchmark) with respect to borrowings from its offshore parent, will be denied a tax deduction.

Australia's new transfer pricing rules more than adequately covers this situation and as such the continuance of such a benchmark not only complicates but also unnecessarily adds compliance costs in meeting this requirement. The removal of the LIBOR cap will also lead to a more competitive lending environment, which ultimately will benefit the Australia borrower.

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B.3 The non-introduction of a bank deposit levy

In an era where there is generally a recapitalisation of banks under Basel III and the ever increasing requirement from our regulators, Australian Prudential Regulation Authority, to reach minimum capital targets, one questions whether the introduction of the proposed, but currently illusionary, 5bps bank levy is appropriate in the current economic environment, especially if one considers that in practice the incidence of such an additional tax will inevitable be borne by some combination of depositors, borrowers and/or shareholders.

Indeed, the Financial System Inquiry (FSI) itself has recommended against the levy, arguing that it is preferable to retain an ex-post funding model that avoids placing an ongoing financial burden on the industry. The FSI concluded that the imposition of a levy should only occur if the Financial Claims Scheme is triggered and insufficient funds are recovered through liquidation of assets.

In the 2015 Budget Paper No.1, Treasurer Joe Hockey states:

> *"From 2016, subject to the Government's response to the Financial System Inquiry, any payments under the Financial Claims Scheme relating to ADIs would initially be met from the Financial Stability Fund announced in the 2013 Economic Statement. .... In this case a levy* ***could*** *be applied to ADIs."*
> *(our emphasis added)*

Rabobank thus recommends against the introduction of a bank deposit levy which is in line with the recommendation of the FSI.

B.4 Zero-rating of B2B financial services

Under Australia's GST system most financial services are input taxed. The most undesirable feature of input taxation is the over-taxation of business consumption of financial services and "zero-rating of B2B financial services" would address this deficiency in our GST system.

GST is charged on the value added at each stage of the economic chain of supply and is designed to be borne by the ultimate personal end-consumers. This is achieved by allowing businesses to charge GST on their supplies and recover the tax paid on acquisitions relating to the making of supplies.

Any departure from this usual operation of GST or the creation of any exemption, such as treating financial supplies as being 'input-taxed', creates two problems namely:

1. The over-taxation of taxpayers providing financial services as unable to recover the additional GST costs, inevitably and eventually pass on that GST cost to its business customers through higher prices, who in turn passes the disproportionate increased GST cost onto the ultimate end consumer, and

2. Inefficient use of resources as financial suppliers attempt to minimise the impact of GST by 'self-supplying' services, thereby possibly increasing their own costs of production which once again are inevitably and eventually passed onto the ultimate end consumer who has to pay higher prices for the financial supplier's goods and services.

More than 10 years ago, the New Zealand government addressed these inequalities and inefficiencies by introducing a "zero-rating business to business (B2B) regime".

Broadly speaking, under the B2B, a financial service supplier:

- charges GST on its supply at a **special GST rate** of 0% (so as to avoid unintended consequences with the rest of the GST Act as to whether the supply is "exempt")
- to **business** customers only (not individuals)
- that **predominately** (in NZ, this is set at 75%, over the previous 12 months)
- makes **taxable supplies** to its own customers and are entitled to claim back GST paid on its inputs.

Such a B2B regime does not bring about any additional tax implications to businesses or final consumers, however, it does have the advantages of removing the potential for tax biases arising from input-taxed financial services resulting in the more efficient use of our resources and the potential for lower prices of the financial supplier's goods and services being passed onto the ultimate end consumer (or at least as increased returns to its shareholders).

Rabobank recommends the introduction of a form of the GST B2B regime into Australia's GST system (perhaps as part of a package to increase the current GST rate and reductions in the corporate tax rate(s) for all taxpayers, to levels that are comparable with other OECD countries).

Other General Comments

Anedoctally, Rabobank also sees the current Australian taxation system as:

- **complex** to understand. There are simply too many taxes, levies and duties requiring taxpayers to be aware of varying rates, thresholds, exemptions and applications within the tax itself as well the interaction between the taxes, levies and duties. In the agribusiness industry alone, besides income tax and GST, there are 97 primary industry levies imposed on 73 agricultural commodities with 18 recipient bodies. This leads to inefficient use of resources, higher levels of uncertainty and additional compliance costs for all taxpayers.

- **high compliance obligations** for all taxpayers. Although we welcome the impetus to simplify our tax system, we are also wary that there appears to be ever increasing levels of regulation in Australia, and indeed worldwide. Our concern is that it appears that taxation authorities around the world are requiring more and more data (both in quantity as well as contemporeanity) about taxpayers' affairs, some of which they are requiring third parties to collect and disclose. There are additional costs associated with gathering, sorting and allocating such a large amount of data that need to be properly recognised, addressed and administered.

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As such, Rabobank supports general tax reform that will address these broad but systemic tax issues and welcomes the government's initiative to include the Australian electorate in this important discussion.

CONCLUSION

Australia's food and agriculture sector is experiencing a renaissance around the world as emerging markets and suppliers act to alter the global competitive landscape. An agile, innovative and competitive agricultural sector remains essential to the ability of an industry to compete in global markets, especially as Australian suppliers look to continue to participate in the growth on offer in fast- growing but lower-income markets in the Asian region.

This submission acknowledges that the Australian food and agricultural industry in combination with the Government must look to a modern tax system to support competitiveness.

Yours sincerely

George Yau
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Rabobank Australia