



Tax Laws Amendment (2007 Measures No. 6) Bill 2007

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Tax Laws Amendment (2007 Measures No. 6) Bill 2007

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Links: The [relevant links](#) to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

This Bill contains 4 Schedules – each of which has a distinct purpose that is not necessarily related to any other Schedule. Therefore, the following will separately deal with each of the Schedules.

Schedule 1: Tax deduction for capital expenditure for the establishment of trees in carbon sink forests

Purpose

This schedule amends Division 40 of the *Income Tax Assessment Act 1997* (ITAA97) to provide a tax deduction for capital expenditure for the establishment of trees primarily for the purposes of carbon sink forests. Tax deductions for these expenses are available on the following basis:

- for expenses incurred between 1 July 2007 and 30 June 2012 – 100 per cent in the year in which they were incurred, and
- for expenses for establishing forest incurred on or after 1 July 2012, 7 per cent of such expenses per year, over a 14 year and 105 day period.

Background

What is a carbon sink forest?

Trees and other plants take up (sequester) carbon dioxide from the atmosphere as they grow, through the process of photosynthesis. While soils may lose carbon, e.g. following

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cultivation, the amount of carbon in forest soils can increase over time. Forests represent a carbon sink when they are actively growing and sequestering carbon at a rate that exceeds any soil carbon and other emissions.

Thus, a carbon sink forest is a forest that is established for the primary and principal purpose of sequestering carbon from the atmosphere. However a tax deduction in relation to the cost of establishing such a forest will only be given if the trees in the forest meet conditions specified in this Bill (see below).

Can the trees in a carbon sink forest that qualifies for a tax deduction ever be cut down?

The tax deductions available in respect of expenses for establishing a carbon sink forest are available over a 14 year period if the forest is established on or after 1 July 2012, which the author understands is considerably less than the effective life of a forest. Further, in order for the tax deduction to be granted the primary purpose of such a forest must be to absorb carbon dioxide from the atmosphere. It may be argued that on the basis of these points that:

- timber plantations that are established for the purposes of felling for the production of wood products would not qualify for these particular tax deductions, and
- the expectation may be that these forests would be in existence for at least a 14 year period, though this is nowhere stated in either the Bill or its supporting documents.

It is interesting to ponder the possible consequences of the Bill's silences on whether a carbon sink forest can be cut down after the end of the 14 year period. Suffice to say that there is no measure in this particular Bill that suggests that a carbon sink forest can never be cut down.

Reduction of productive farm land?

A broader issue is whether the proposed tax deductions will encourage the further reduction of productive farm land. That is, whether these deductions will encourage farmers to take farm land out of production to establish carbon sink forests?

It may be the case that larger emitters will purchase farm land to plant carbon sink forests. However, the value of the deductions may be such that only lower value land would be suitable for this purpose. To the extent that this measure takes marginal farm land out of production it may produce an additional environmental benefit.

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Basis of policy commitment

This measure was announced in the Treasurer's media release of 8 May 2007.¹ The proposal is part of the 2007–08 Budget.

Position of significant interest groups/press commentary

The initial reaction from conservation groups to this initiative was one of scepticism. In particular, the reaction of the Conservation movement would depend on the details of the proposed arrangements.²

The Australian Conservation Foundation (ACF) has not responded to this particular initiative. But it has noted that:

Due to their impermanent nature, carbon sinks cannot permanently offset emissions from burning fossil fuels. Carbon sinks should only be established to replace vegetation where it has been lost from logging and clearing. Native vegetation must not be cleared in order to establish sinks.³

However, it would be a mistake to characterise the ACF's position as being opposed to this initiative.

The National Association of Forest Industries welcomed the announcement of this initiative.⁴

Pros and cons

This proposal may have the following advantages:

- promote the planting of forests to absorb and store excess atmospheric carbon dioxide
 - this may be of great advantage to large carbon emitters, such as power stations, in that they may gain tax deductions for undertaking projects that offset their carbon emissions

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1. The Hon. Peter Costello MP, Treasurer, [*Establishment costs for carbon sink forests deductible*](#), media release, Parliament House, Canberra, No. 39, 8 May 2007.
 2. Chris Johnson, 'Forest plan raises doubts, queries', *The West Australian*, 10 May 2007, p. 8.
 3. Australian Conservation Foundation, *Australia's Climate Change Strategy – The Real Way Forward*, p. 8. at http://www.acfonline.org.au/uploads/res_the_way_forward.pdf (accessed 13 September 2007). This report was written on behalf of a variety of environmental groups.
 4. National Association of Forest Industries, [*Budget allows forest carbon sinks to grow*](#), media release, 8 May 2007.

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- promotes the planting of forests on land that has already been cleared. Thus it has an inbuilt bias against clearing existing woodlands
- the establishment of such forests may facilitate the flow of carbon credits into any national emissions trading scheme
- allows tax deductions where small scale plantings are undertaken by small business operators
 - this may be of benefit to farmers and other small rural business, such a bed and breakfasts, situated on rural properties of sufficient size.

However, there are significant doubts whether carbon sink forests are able to make a long term positive contribution to the absorption of carbon dioxide from the atmosphere. These concerns are based on the declining efficiency of forests to absorb more carbon dioxide than they emit if the climate heats up.⁵ If this is the case then the establishment of carbon sink forests will be of limited use in absorbing excess amounts of atmospheric carbon dioxide.

The long-term security of stored carbon is uncertain, due to pests and diseases, land clearing, the threat of illegal logging, forest fires, and as noted above perhaps climate change itself. While curbing emissions of carbon dioxide by reducing consumption of fossil fuels may well bring more certain climate change benefits.

Further, some consider that there is a danger that the granting of these tax deductions may be seen as an alternative to the curbing of carbon emissions. A long-term solution to climate change may require fundamental changes in the energy sector, with a shift away from primary reliance on fossil fuels and toward renewable technologies and energy sources. Tax deductions given for carbon sequestration may, shift emphasis away from curbing carbon emissions in the energy sector.⁶ It is not clear that this is a concern held by a significant proportion of the environmental movement.

Comment

The establishment of forests may have additional environment benefits to that of absorbing atmospheric carbon dioxide. For example, they may provide additional habitat

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5. A summary of this discussion can be found at <http://www.abc.net.au/science/news/stories/s210860.htm> and http://www.planetextinction.com/planet_extinction_carbon_sink_reversal.htm and <http://www.science.org.au/nova/054/054key.htm> and <http://www.gcte.org/ccarticle.htm> (all accessed 13 September 2007).
 6. Climate Change Action Network Australia, *Using Carbon Sinks for Climate Change – Briefing Paper*, at http://www.cana.net.au/Policies_positions/policy01carbonsinks.html (accessed 13 September 2007).

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for threatened species, limit soil erosion and contribute to the factors that prevent the spread of soil salinity. It would be a mistake to assess the environmental benefits of such forests only in terms of their capacity to absorb excess carbon from the atmosphere.

Furthermore, it is unrealistic to expect that any single response to the complex dimensions of climate change will serve as a panacea. This initiative is perhaps more appropriately viewed as part of a panoply of solutions, each tackling a particular dimension of climate change.

ALP/Australian Democrat/Greens/Family First policy position/commitments

Senator Milne, the Australian Greens climate and energy spokesperson, has reportedly noted that a forest was not the same as a plantation and that this initiative should include:

- forests planted under this initiative should stand for at least 100 years
- the resulting forest must be biodiverse, that is, be made up of different species of tree and other vegetation
- the forest must be on land cleared before 1990
- it should not apply to forests established as a managed investment scheme, and
- it should not apply to forests established by large business.⁷

The establishment of specific carbon sink forests is not part of the Australian Greens policy.⁸

Financial implications

The Explanatory Memorandum notes that this measure is expected to cost some \$24.3 million to 2010–2011, as set out in the following table.

Table 1: Expected financial impact of tax deductions for establishment of carbon sink forests

2007–08	2008–09	2009–10	2010–11
–	-\$4.65m	-\$8.53	-\$11.13

Source: Explanatory Memorandum⁹

7. Chris Johnson, op. cit.

8. Australian Greens, *Re-energising Australia*, March 2007, p. 4 at <http://christinemilne.org.au/files/campaigns/extras/Re-Energising%20Australia%20long%20FINAL%2011%20May%202007.pdf> (accessed 13 September 2007).

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Key issues

The main issue is whether the proposed tax deductions will establish forests that will be of long term use in absorbing excess carbon dioxide from the atmosphere.

Main provisions

Part 1

Item 6 of Schedule 1 inserts **proposed Division 40-J** into the ITAA97. This proposed Division allows a tax deduction for capital expenditure for the establishment of a carbon sink forest.

These deductions are available under **proposed section 40-1005** provided the taxpayer owns the trees in question and the trees are on land held by the taxpayer, either under lease or as an outright owner.

Under **proposed section 40-1010** in order to claim the deductions in respect of the expenditure the tax payer must:

- carry on a business for taxation purposes
 - this prevents access to this deduction by hobby farmers with no other business income
- plant the trees for the primary purpose of carbon sequestration
 - this does not prevent the taxpayer for having a secondary purpose in planting the trees, such as improving the biodiversity of the property
- not plant the trees for the purposes of felling or using the trees for commercial horticulture, and
- not incur expenditure under either a managed investment scheme or a forestry managed investment scheme.

Comment

These last two points prevent those establishing forests for mainly commercial purposes to access the proposed tax deductions. However, the Explanatory Memorandum also notes that these rules do not prevent a commercial forestry operator from establishing a separate carbon sink forest for the purposes of engaging in trading carbon credits.

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9. The Hon. Peter Costello MP, Treasurer, Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 6) Bill 2007 (hereafter Explanatory Memorandum), 13 September 2007, p. 3.

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As noted above, only expenditure on the establishment of a carbon sink forest will be allowed as a tax deduction. This precludes other types of related expenditure be claimed as a deduction, such as:

- fencing,
- water facilities for trees in the carbon sink forest
- roads within the forest, and
- fire breaks.

These expenditures may, or may not, be claimed as tax deductions under other sections of the tax legislation, depending on the taxpayers circumstances.¹⁰

Forest quality

A significant issue is the quality of the forests that will qualify for the proposed tax deductions. **Proposed subsection 40-1010 (item 6)** also requires the taxpayer to meet certain environmental guidelines when undertaking these plantings, such as:

- the forest occupies a continuous land area in Australia of 0.2 hectares or more
- at the time the trees are established it is more likely than not that the trees will attain a ‘crown cover’ of 20 per cent or more and reach a height of at least 2 meters, and
- the land on which the trees are planted was, on 1 January 1990, clear of other trees meeting the same specifications of the first two of the above points.

The Environment Minister must, by legislative instrument, made guidelines about environmental and resource management in relation to carbon sink forests. These guidelines will be a disallowable instrument. The establishment of the trees must satisfy these guidelines in order for the relevant expenses to be claimed as a tax deduction.

Proposed section 40-1020 prevents expenditure for draining swamp or low lying land, or for clearing land, from being claimed as a tax deduction.

Forest quality comments

Minimum size

A hectare is 10 000 square meters or 2.471 acres. Thus the minimum size of the land that is used for a carbon sink forest is 20 per cent of a hectare, or 2 000 square meters. Further, this land cannot be broken up into smaller parcels of less than 0.2 hectares and still qualify for the proposed tax deduction. Thus it is possible that rural residents on smaller landholdings will be able to claim the proposed tax deductions if they also generate income from a business.

10. See Explanatory Memorandum, pp. 17–18.

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There is no requirement that the business income, against which the deduction is claimed, should have any connection with the land on which the trees are planted. Thus rural residents with offsite business income (say from a professional practice) may claim the expenditure for establishing a carbon sink forest as a tax deduction.

Crown cover

The term crown cover has been defined as the area covered by the crowns of trees growing closely together, often expressed as a percentage for the combined crown cover of trees in a defined area.¹¹

The Victorian Department of Sustainability and Environment has suggested that a 'eucalypt crown cover' of between 10 and 29 per cent is regarded as a sparse cover.¹²

The Commonwealth Department of Agriculture Fisheries and Forestry (DAFF), in its National Forest Inventory has defined a forest as:

an area, incorporating all living and non-living components, that is dominated by trees having usually a single stem and a mature or potentially mature stand height exceeding 2 metres and with existing or potential crown cover of overstorey strata about equal to or greater than 20 per cent. This definition includes Australia's diverse native forests and plantations, regardless of age. It is also sufficiently broad to encompass areas of trees that are sometimes described as woodlands.

Further the definition of a forest notes that:

the minimum crown cover for forest has been set at 20 per cent. It also marks a boundary that can be mapped reliably from satellite information in most areas.¹³

The minimum likely height of 2 meters is classed, by DAFF as a low height for forestry purposes and the minimum likely crown cover of 20 per cent is the minimum limit for what is classed as woodland in forestry terms.¹⁴ The classification of woodland appears to be the forest with the least tree density.

On the basis of these standards it could be argued that the quality of the proposed carbon sink forests is the minimum acceptable quality of a forest in Australia. Given the uncertain

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11. New South Wales Department of Primary Industry, Forest Glossary, at http://www.forest.nsw.gov.au/education/glossary/default.asp#Ltr_C (accessed 14 September 2007).
 12. Victorian Department of Sustainability and Environment, Forests, What is Crown Cover? at <http://www.dpi.vic.gov.au/DSE/nrenfor.nsf/FID/-0AF90B034A49AE474A2567F50002146C?OpenDocument> (accessed 14 September 2007).
 13. Commonwealth Department of Agriculture Fisheries and Forestry, What is a Forest, at <http://www.daff.gov.au/brs/forest-veg/nfi/forest-info/what-is> (accessed 14 September 2007).
 14. *ibid.*

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rainfall patterns in most of rural Australia, and the generally degraded soil quality of a number of rural areas, this minimum standard may be an appropriate one to apply in order to allow the widest possible range of applicants to claim the proposed tax deduction.

Why 1 January 1990?

Finally, the Australian government has committed itself to a target of 108 per cent of emissions over 1990 levels over the period 2008 to 2012.¹⁵ This year (1990) is also the base year in which the Kyoto Protocol on climate change measured the agreed emissions targets. It is interesting to note that the final text of the Kyoto Protocol allowed Australia to increase its emissions by 8 per cent over its 1990 levels.¹⁶

On the basis of set Australian policy, and in conformity with the Kyoto Protocol, it appears appropriate to only allow the proposed tax deduction on land that was clear of trees as at 1 January 1990.

Can ground be cleared for the purpose of establishing carbon sink forests?

These provisions also prevent a tax deduction being claimed for expenditure establishing a carbon sink forest planted on ground that was cleared for the purposes. As noted above, expenditure made to clear or drain the ground cannot be claimed as a tax deduction. Further, ground that has to be cleared in order to plant a carbon sink forest is most likely not to have been clear of trees as at 1 January 1990 (see proposed **subsection 40-1010(2)(c) item 6, Schedule 1**).

Biodiversity?

While the proposed legislation does not specify that the trees must be of different types (i.e. not a monoculture forest) the proposed guidelines may address this issue.

Item 9 of Schedule 1 applies the changes in **Part 1** of this **Schedule** to the 2007–08 and later income years.

Part 2

Amount of the proposed deduction after 1 July 2012

Item 10 repeals **proposed subsections 40-1005(1), (2), (3) and (4)** ITAA97 and replaces them with new provisions, from 1 July 2012. This section was inserted under **Item 6** of the

15. Explanatory Memorandum, p. 13.

16. United Nations Environment Programme, [Industrialized countries to cut greenhouse gas emissions by 5.2%](#), media release, 11 December 1997.

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Bill (see above). This change takes effect for the 2012–13 and later income years under **Item 2** of the Bill (see commencement dates above).

The main change is contained in **proposed subsection 40-1005(2)** applying after 1 July 2012, which inserts a formula for calculating the amount of expenditure allowed as a tax deduction in the 2012 and later income years.

Under the provision of **Item 6** above, 100 per cent of the expenditure incurred in establishing a carbon sink forest in the years from 1 July 2007 to 30 June 2012 will be allowed as a deduction in the year in which the expenditure occurred.

Under these changes the allowable expenditure is reduced to a fraction of the yearly establishment expenditure. The amount is reduced in accordance with the number of days the land is actually used for carbon sequestration, as measured from the actual date of forest establishment. Further, the allowable establishment expenditure deduction is:

- 7 per cent of this total a year, and
- spread over a period of 14 years and 105 days from the date the day the trees are established.

Comment

This provision is a very strong incentive for carbon sink forests to be established in the period between 1 July 2007 and 30 June 2012. That is, the proposed deduction encourages the rapid establishment of these forests during the next few years.

Further, if the trees are removed (or destroyed say by fire) at any time during the year then the tax deduction in respect of the remaining part of the year (and the remaining part of the 14 years and 105 days period) is no longer available. This is an incentive to keep the trees in the ground for at least 14 years and 105 days if they are established on or after 1 July 2012.

Selling the carbon sink forest

Proposed section 40-1035 allows a person or entity buying a carbon sink forest, on or after 1 July 2012, to gain access to the unexpired portion of the allowable yearly tax deductions. This will allow landholders or lease holders to sell their interests in a carbon sink forest to another person or entity.

Item 19 applies the provisions of **Part 2** of this Schedule from 1 July 2012.

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Schedule 2: Tobacco industry exit grants

Purpose

This schedule amends the ITAA97 to provide tax free grants under the Tobacco Growers Adjustment Assistance Program 2006 to tobacco growers who undertake to leave all agricultural enterprises for at least 5 years.

Background

What is the Tobacco Growers Adjustment Program?

In recent years, the tobacco growing industry, centred in Mareeba (Queensland) and Myrtleford (Victoria), has faced significant adjustment pressures from deregulation and the decision of tobacco manufacturers to scale back their purchases of Australian tobacco leaf.

Producer licenses were cancelled following the withdrawal of major tobacco manufacturers as buyers of Australian grown tobacco. The excise licences of tobacco growers in Northern Queensland were cancelled by the Australian Taxation Office in February 2004, and tobacco growers in Victoria and southern Queensland had their licences cancelled in October 2006, when the manufacturers ceased purchases from these regions.

In October 2006, the Australian Government announced a funding package to assist tobacco growers to restructure and move into alternative business activities. As of February 2007, the package comprises funding of \$45.9 million. Former tobacco growers in Northern Queensland are to be eligible for up to \$23.2 million, with those in Victoria and Southern Queensland eligible for up to \$21.8 million and \$900 000, respectively. The maximum grant will be \$150 000 per grower.¹⁷

The package of measures to enable farmers to exit the tobacco growing industry is similar to other packages that allowed farmers to exit the sugar and dairy industries.

These grants are not classed as income for social security purposes.¹⁸

17. Productivity Commission, *Trade and Assistance Review 2005–06*, April 2007, pp. 3.10 – 3.11.

18. Department of Family and Community Services and Indigenous Affairs, *Guide to Social Security Law*, 4.3.2.35 Other Income Exempt from Assessment - s 8(11) Exempt Lump Sums, http://www.facsia.gov.au/guides_acts/ssg/ssguide-4/ssguide-4.3/ssguide-4.3.2/ssguide-4.3.2.35.html (accessed 14 September 2007).

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Basis of policy commitment

The proposal to class these grants as tax free income was announced as part of the 2007–08 budget.¹⁹

Pros and cons

This measure gives the same tax treatment to these grants as was given to grants made Sugar Industry Reform Program to those who left the agricultural industry altogether.

Financial implications

The financial impact of this measure is shown in the following table.

Table 2: financial implications of tax free grants to tobacco growers exiting the industry

2007–08	2008–09	2009–10	2010–11
-\$1.3m	-\$1.3m	-	-

Source: budget Paper No. 2 2007–08, p. 26.

Main provisions

Item 3 amends the table in **section 53-10** ITAA97. The effect of this amendment is to exempt a grant made to a person under the Tobacco Growers Adjustment Assistance Program if they enter into an undertaking not to become the owner or operator of any agricultural enterprise within 5 years after receiving the grant.

Item 4 exempts these grants from the Goods and Services Tax (GST), under the same condition.

Item 5 applies these amendments to the 2007–08 income year and later years.

Comment

The tax free status of these grants is not jeopardised if a recipient simply continues to work in the rural sector.

19. The Hon. Peter Costello MP, Treasurer, and Senator the Hon. Nick Minchin, Minister for Finance and Administration, *Budget Measures 2007–08* (Budget Paper No. 2), 8 May 2007, p. 26.

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Schedule 3: Deductible gift recipients

Purpose

This Schedule amends the ITAA97 to update the list of deductible gift recipients (DGRs) to include one new entity and to extend the time period for DGR status for another entity.

The Council for Jewish Community Security (CJCS) is added to the DGR list from 10 August 2007 and the DGR status of the United Nations High Commission for Refugees (UNHCR) is being extended to 27 June 2012.

The CJCS appears to be a domestic Jewish organisation that provides funds to improve the physical security of Jewish educational, cultural and religious facilities.²⁰ It appears to be a relatively new organisation.

Background

What is a DGR?

A deductible gift recipient (DGR) is a fund or organisation that can receive tax deductible gifts.

To be a DGR an organisation has to be one of the following:

- included in the list of such organisations in Division 30 of the ITAA97
- fall within a category of organisations listed in Division 30 ITAA97
- be a prescribed private fund listed by name in the Income Tax Assessment Regulations 1997, or
- endorsed as a DGR by the Commissioner for Taxation.

To be entitled to DGR endorsement by the Commissioner, an organisation must:

- fall within a general DGR category in its own right, or operate a fund, authority or institution that falls into a general DGR category
- have an Australian business number
- maintain a gift fund, and

20. Naomi Levin, 'Strict rules for tax-free Jewish security funding', *Australian Jewish News*, 10 September 2007 at <http://www.ajn.com.au/news/news.asp?pgID=4032> (accessed 18 September 2007).

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- be in Australia (with some exceptions).²¹

The general categories of DGRs are:

- environmental organisations
- harm prevention charities
- disaster relief organisations
- overseas aid funds
- cultural organisations
- scholarship funds
- school building funds
- research organisations
- sports and recreation organisations
- industry, trade and design organisations
- defence organisations
- philanthropic trusts, and
- fire and emergency services organisations.²²

The above list is not exhaustive.

Basis of policy commitment

The addition of the Council for Jewish Community Security was noted by the Minister for Environment and Water Resources.²³ However, it was formally announced by the Minister for Revenue and Assistant Treasurer on the same day, 10 August 2007.²⁴

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21. ATO, Gift fund requirements for deductible gift recipients, *Fact Sheet*, at <http://www.ato.gov.au/nonprofit/content.asp?doc=/content/13269.htm&pc=001/004/006/008/001&mnu=&mf=&st=&cy=1> (accessed 29 August 2007).
 22. ATO: Deductible Gift Recipient Essentials, Fact Sheet, at <http://www.ato.gov.au/nonprofit/pathway.asp?pc=001/004/006> (accessed 29 August 2007) and Subdivision 30-B ITAA97.
 23. The Hon. Malcolm Turnbull MP, Minister for the Environment and Water Resources, *Tax deductibility for Jewish communal security*, media release, T139/07, Canberra, 10 August 2007.
 24. The Hon. Peter Dutton MP, Minister for Revenue and Assistant Treasurer, *Deductibility of gifts to the Council for Jewish Community Security*, media release, No. 098, Canberra, 10 August 2007.

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The extension of the time period during which the UNHCR has DGR status was announced on 17 August 2007.²⁵

Pros and cons

These amendments to the list of DGRs facilitate the support of various causes.

However, there is some cost to revenue flowing from these amendments.

ALP/Australian Democrat/Greens/Family First policy position/commitments

The ALP has promised support for strengthening security at Jewish educational institutions.²⁶

Financial implications

The following table illustrates the cost to revenue that may arise from the proposed amendments to the list of DGRs.

Table 3: Effect on revenue of adding various organisations to the list of DGRs

2007-08	2008-09	2009-10
-0.02m	-\$4.64m	-\$5.30m

Source: Explanatory Memorandum²⁷

Main provisions

Item 1 extends the time that the UNHCR qualifies as a DGR to 28 June 2012. **Item 2** applies this change from 28 June 2007.

Item 4 inserts the Council for Jewish Community Security into the list of DGRs in ITAA97. **Item 3** allows gifts made to this organisation to be tax deductible if made on or after 9 August 2007.

25. The Hon. Peter Dutton MP, Minister for Revenue and Assistant Treasurer, [Deductibility of gifts to Australia for UNHCR](#), media release, No. 102, Canberra, 17 August 2007.

26. Jewel Topsfield, 'Lib, Labor pledge funds to aid Jewish security', *Age*, 11 August 2007, p. 8.

27. Explanatory Memorandum, p. 4.

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Schedule 4: Farm management deposits

Purpose

This Schedule amends the Farm Management Deposits (FMD) Schedule in the *Income Tax Assessment Act 1936* (ITAA36) so that tax law is aligned with guidelines for declaring either:

- all primary producers in a geographical area, or
- a specified classes of primary producers in a geographical area

to be in exceptional circumstances.

The effect of these changes will be to allow primary producers:

- who made an FMD before their area was declared to be in exceptional circumstances,
- to draw upon those deposits within a 12 month period once an exceptional circumstances declaration has been applied to them

without losing the tax advantages of initially making the FMD.

Under existing legislation, if a primary producer has made an FMD before an exceptional circumstances (EC) declaration for their area was made, they cannot draw on that deposit before a 12 month period has expired and retain the tax advantages of doing so.

The proposed amendments to the ITAA36 base the eligibility to retain the relevant tax deductions if withdrawals are made on when the EC declaration applies to a person making the withdrawal, rather on when the EC declaration applies to the relevant geographic area.

Background

What is an FMD?

The FMD scheme is designed to allow primary producers to, in effect, shift income from good to bad years in order to deal with adverse economic events and seasonal fluctuations

The FMD scheme allows primary producers (with a limited amount of non-primary production income) to claim tax deductions for FMDs made in the year of deposit (and to reduce their PAYG instalment income accordingly). When an FMD is withdrawn, the amount of the deduction previously allowed is included in both their PAYG instalment income and their assessable income in the repayment year.²⁸

28. CCH, 2007 Australian Master Tax Guide, Topic 18-290.

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While deposits can be held in accounts of any terms (including at call accounts), the general rule is that the deposit must not be repaid within 12 months (other than because the owner dies, becomes bankrupt, ceases to be a primary producer or the amount is transferred to another financial institution).

There is an exception to the 12-month rule for persons in exceptional circumstances areas. In such cases, persons cannot make other deposits in the same tax year. Such areas are declared by the Minister for Agriculture, Fisheries and Forestry. An 'exceptional circumstances certificate' must be obtained within three months after the end of the income year of the withdrawal. The amount withdrawn is tax assessable in the income year of the withdrawal

Failure to comply with this rule may result in the deposit not being treated as an FMD from the time the deposit was made.²⁹ This would result in a denial of the claimed tax deduction in respect of the FMD made.

What are exceptional circumstances?

Exceptional circumstances (EC) are those climatic and other events of sufficient rarity and severity as to be considered outside the scope of reasonable and responsible risk management strategies. Relatively short periods of income decline, due to fluctuations in both seasonal and market conditions are not included, as farmers are expected to have strategies in place to deal with these. This means, for example, that a drought as defined in meteorological terms does not automatically qualify for EC.

For a region or industry to be declared eligible for EC assistance the event must be rare and severe. The effects of the event must result in a severe downturn in farm income over a prolonged period and the event must not be a predictable part of the process of structural adjustment.

An area or region becomes 'declared' as experiencing an EC event. The EC declaration triggers short-term support for farmers in situations beyond the scope of normal risk management, and when the future of significant numbers of farmers in a region is at risk. Support is also available to agriculture-dependent small businesses.

An area or region is said to be prima facie declared when the Australian Government Minister for Agriculture, Fisheries and Forestry receives an application for EC, agrees that a prima facie case has been established and refers the application to the National Rural Advisory Council (NRAC) for advice. The prima facie declaration triggers interim income

29. op. cit., topic 18-293

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support for farmers and agriculture-dependent small businesses while the EC application is being assessed.³⁰

The current drought

Severe and prolonged drought affects much of Australia, especially the main agricultural production areas. At present, more than 44 per cent of Australia's agricultural land has been EC declared.³¹

Pros and cons

The proposed amendments will enable a wider range of farmers to draw on their FMDs, without losing the tax advantages of first making the deposit.

Financial implications

The Explanatory Memorandum notes that the revenue of this measure is expected to be nil. However, there may be a small cost to revenue if taxpayers need to amend their prior tax assessments.³²

Main provisions

Item 1 amends paragraphs 393-37(3)(b) and (c) in Schedule 2G ITAA36. The effect of these amendments is to allow a person to retain the tax benefits of making an FMD, if it is withdrawn within a 12 month period of first making that deposit, when

- the deposit was made before they were subject to an EC declaration, and at the time of the withdrawal they are eligible to be subject to such a declaration, or
- an EC declaration applies to them within a 3 month period after the end of the income year in which such a withdrawal is made.

30. South Australian Department of Primary Industries and Resources, 'Exceptional Circumstances' Information Sheet, at http://www.pir.sa.gov.au/pirsa/drought/exceptional_circumstances (accessed 14 September 2007).

31. Ley, Hon. Sussan, 'Second reading speech: Farm Household Support Amendment Bill 2007', House of Representatives, *Debates*, 1 March 2007, p. 2.

32. Explanatory Memorandum, p. 5.

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