Chapter 2

Tax arrangements for foreign investment in Australian agriculture

2.1 Rather than presenting a comprehensive overview of the taxation arrangement for foreign investment, this chapter outlines the main issues raised with the committee regarding taxation arrangements for foreign investment in agriculture. As such, the focus is on areas that are more problematic in terms of tax regulation and special attention is given to the arrangements for foreign government entities. The chapter finishes with evidence the committee received that current tax arrangements are stifling domestic capital investment in agriculture and Australia's ability to develop the industry to meet future global challenges.

2.2 The general principles for foreign investors reducing their tax exposure were clearly outlined by the Australian Taxation Office (ATO):

> At a high level, tax planning mechanisms seek to arbitrage between differences in tax that may be available in relation to:
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> - **who** is taxed (eg an individual, company, trust etc),
> - **where** something is taxed (in Australia or in a lower taxing jurisdiction),
> - **what** is taxed (eg revenue / capital, dividend / interest, royalty / fee etc),
> - **when** something is taxed (bring forward losses, defer income), or
> - **how** something is taxed (eg rollover calculations, uplifts, valuations etc).
>
> With their easier access to low tax jurisdictions, foreign owned entities are more able to take advantage of **who**, **where**, **what**, **when** and **how** something is taxed by structuring transactions or the location of their functions, assets and risks so as to 'earn' more in lower taxed jurisdictions.[1]

2.3 As a result there are a number of mechanisms that foreign investors can use to minimise the tax payable in Australia. These include 'the substitution or creation of debt to extract additional income out of Australia and into a lower taxed jurisdiction.' In addition, foreign companies can use 'conduit arrangements whereby an overseas asset (say a company) is purchased through Australia by a foreign owned entity using an Australian subsidiary that they control.'[2]

2.4 There were three aspects of foreign taxation arrangements that the committee found to be of particular concern: transfer pricing; capital gains tax exemptions and passive income.

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1 ATO, answer to questions on notice, 9 May 2012, (received 5 June 2012), emphasis in original.

2 ATO, answer to questions on notice, 9 May 2012, (received 5 June 2012).

2.5 As will be shown in the evidence below, there are a number ways that these tax arrangements are vulnerable to loopholes that may:

- result in revenue leakage for the Australian government;
- potentially distort the agricultural market by unduly favouring foreign investment and multinational business structures; and
- cause disincentives for Australian capital investment in agriculture.

Transfer pricing

2.6 One of the key issues raised throughout the hearings was the degree of effectiveness of transfer pricing as a mechanism for taxing the transfer of certain products from Australia to another country. Transfer pricing can be defined as 'the prices charged when one entity of a multinational group buys or sells products or services from another entity of the same group in a different country.'[3]

2.7 Mr Stuart Hamilton, Assistant Deputy Commissioner, Large Business and International, ATO explained the four main methods of establishing the appropriate tax arrangements for transfer pricing:

> ...[1.] There is the comparable uncontrolled price, so you look at what product is available in the market at arm's length and the price of that and how it varies over time. [2.] You can do cost plus, so given the costs that have been incurred, what is a reasonable mark-up for the activity undertaken. [3.] You can do resale minus, which is what it was sold at and work back to a cost. [4.] Or you can do what is called the transactional net margin method, which is basically a profit split, so you look at the two enterprises involved and you work out, given the expenses, given the personnel, given the functions, assets and risks involved, what would be a fair and reasonable profit split between the two entities.[4]

2.8 The committee is aware that transfer pricing rules can be difficult to enforce and that there is potential for significant tax revenue to be lost by the Australian Government. For example, the Treasury submitted to the Economics Legislation Committee in August 2012 that there is '$1.9 billion of tax in dispute related to transfer pricing issues in current audits'.[5]

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3 Bernard Pulle, *Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012*, Bills Digest No. 160, 2011–12, Parliamentary Library, 19 June 2012, p. 4.

4 Mr Stuart Hamilton, Assistant Deputy Commissioner, Large Business and International, ATO, *Committee Hansard*, 9 May 2012, p 10.

5 The Treasury, Submission 21, p. 5, to the Senate Economics Legislation Committee, *Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012 [Provisions]*, 14 August 2012.

2.9 When asked for a perspective of the issue of possible revenue leakage due to difficulties in enforcing transfer pricing rules, Mr Brian Wilson, Chair, Foreign Investment Review Board (FIRB) conceded that from his experience, tax was a major issue for companies when considering investments and therefore it is an issue FIRB consults with the ATO on:

> …I might say that one of the factors that [is] involved in large-scale investment banking transactions is that tax is usually a major part of the transaction. So the two of us on the board who do have an investment banking background have probably spent many years dealing with tax lawyers and tax barristers on domestic and cross-border tax issues.
>
> ...one of the components of the national interest test is compliance with Australian laws and protecting Australia's revenue. It is the role of the Foreign Investment Review Board in making its recommendations to the Treasurer and in consulting the other parts of government, as we do, to be aware where there may be, as a consequence of the transaction structure or restructuring of the business, the potential for revenue leakage. We can and we do consult with the tax office on those matters.[6]

2.10 However, the ATO acknowledged that when issues arose in terms of prosecuting breaches of transfer pricing rules, the process was time consuming and often difficult. As Mr Hamilton told the committee:

> Our transfer pricing cases tend to take a long time. If you are aware of the SNF case, you would be aware that we are not always successful in raising the issue of comparability.[7]

Tax on not-for-profit agricultural production

2.11 In examining the issue of transfer pricing, the committee looked into the possible tax arrangements for the international transfer of not-for-profit agricultural production. To this end the committee received evidence from the ATO which stated that, in general, tax would not be paid in the case where:

> The investment was not in relation to a business venture. For example if the investment was in relation to a farm and there was no ultimate sale of the goods produced in Australia and the goods were distributed to needy persons. If there is genuinely no sale of product or profitable purpose at any stage, an arm's length amount of the value of product leaving Australia [an

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6 Mr Brian Wilson, Chair, FIRB, *Committee Hansard*, 16 October 2012, p. 13.

7 Mr Stuart Hamilton, Assistant Deputy Commissioner, Large Business and International, ATO, *Committee Hansard*, 9 May 2012, p 10. The Tax Commissioner versus SNF Australia Pty Ltd 'case concerned whether the taxpayer paid more than the arm's length price for products acquired from overseas related parties so that the Commissioner could apply the transfer pricing rules to adjust the purchase price for income tax purposes.' For more information see: http://law.ato.gov.au/atolaw/view.htm?DocID=LIT/ICD/VID731of2010/00001 (accessed 22 November 2012).

> amount imputed through the transfer pricing mechanism] would not be 'income' for the sovereign state or foreign company.[8]

2.12 The evidence from the ATO indicates that when no income is generated (such as not-for-profit agricultural production for foreign food security, especially by foreign government entities), no tax is payable by the relevant entity. The committee examined this issue further through a specific hypothetical scenario:

> **Senator NASH:** …Say I am a sovereign entity, I have come over to Australia, I have bought 10 000 acres and I am growing wheat. I export that wheat back to my home nation for humanitarian purposes, not for sale at any point, to distribute as food. Would you provide on notice the different ways, if there are different ways, that that sovereign entity could be taxed. I know you have been talking about a mass of different things. I just want the different permutations of how that could be taxed.
>
> **Mr O'Neill:** I am happy to take it on notice, but I think I can get to the point very quickly, if it is useful. The transfer-pricing rules will apply because there is an international transaction, in this theoretical example. The transfer-pricing rules will deem an arms-length consideration, whether or not there is a point of sale at any time.
>
> Because of the deemed arms-length price, there is an apportionment of that profit to the Australian enterprise. So if the arms-length price is $100, having regard to the business model and the functions, assets and risk in Australia as part of that business model, some part of that arms-length price of $100 will be attributed to the Australian entity as profit, whether or not there was a sale at any time.[9]

2.13 Mr O'Neill's response above appears to be inconsistent with the evidence quoted in paragraph 2.11 and with additional evidence received in an answer to a question on notice. This evidence also indicated that in general terms, it was possible in the scenario above that tax may not be payable. The ATO stated:

> In the farming scenario, the conditions that can give rise to an Australian tax liability for sovereign or private investors are:
>
> - there is a taxpayer
> - the taxpayer is carrying on a business in Australia, and
> - the taxpayer derives income as a result of business activity.

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8 Tabled document, 16 August 2012, correspondence from the ATO to Senator Heffernan dated 22 June 2012. See: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=rrat_ctte/firb_2011/submissions.htm. In following up with an answer to a question on notice, the ATO also stated that it 'has never seen a sovereign entity, with Australian farm assets, seeking to avoid Australia's tax system by purporting to export its produce for non commercial purposes.' ATO, answer to question on notice, 16 August 2012, (received 6 September 2012).

9 Mr Michael O'Neill, Assistant Deputy Commissioner, Large Business and International, ATO, *Committee Hansard*, 16 August 2012, p. 6.

> Where the transfer pricing rules adjust an amount to reflect the arm's length amount, it is the adjusted amount that is relevant for all purposes of the income tax law.
>
> Where a sovereign entity invests in an Australian farm through an Australian company which carries on business here, the company is taxable on its profits.
>
> Where a sovereign entity invests directly (that is, not through an Australian company) in an Australian farm, carries on business in Australia and derives income, Australia's international tax rules can apply to tax that income. The indicators of whether or not someone is carrying a business of primary production are discussed in detail in Taxation Ruling TR97/11, which is available on the ATO website at www.ato.gov.au.[10]

2.14 The Taxation Ruling TR97/11 states that:

> Subject to all the circumstances of a case, **where an overall profit motive appears absent and the activity does not look like it will ever produce a profit, it is unlikely that the activity will amount to a business.** [bold in original][11]

2.15 This also appears to be consistent with evidence taken at a previous hearing with the ATO:

> **Senator FAWCETT:** The end point that the chair is probably coming to is that if country X has a sovereign holding in Australia, grows wheat—and let us assume they do not claim anything; they just self-fund the whole operation and they grow however many tonnes of wheat—
>
> **Mr Hamilton:** And they export it. Would they be taxable? No.
>
> **CHAIR:** That is the answer.
>
> **Senator NASH:** So that is the answer. I am just checking it. So there is no tax payable if they do not claim anything and then they export the grain.
>
> **Mr Hamilton:** If they are not there to make a profit then they would not be in the income tax system, because they are not earning income.[12]

2.16 On a related topic, the committee heard evidence that if properly developed by the Australian agricultural sector, contributing to the global food task on a not-for-profit basis could be both more beneficial for those requiring humanitarian assistance and for Australian business than some existing overseas aid programs. As Mr David Farley, Chief Executive Officer and Managing Director, Australian Agricultural Company (AAco), told the committee:

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10 ATO, answer to question on notice, 16 August 2012, (received 6 September 2012).

11 ATO, *Tax Ruling TR 97/11*, p. 5. http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR9711/nat/ato/00001 (accessed 15 November 2012).

12 Mr Stuart Hamilton, Assistant Deputy Commissioner, Large Business and International, ATO, *Committee Hansard*, 9 May 2012, p. 12.

> Australia has been great at distributing dollars to humanitarian crises around the world. Yet the smarter developed countries meet those crises with generally finished food products. They will add value to rice, to wheat, to meat and to peaches, plums et cetera and ensure that there are warehouses of revolving stock. So Australia could capture the value add. More importantly, it is very difficult to corrupt food, as opposed to dollars, once it hits. Also, food being delivered in containers is more effective than a pipeline of cash, which can take a month to get there. We are fortunate to know how long we can live without water and food, and most of the time we are fortunate enough to live under the pretext that even though the operation has been successful the patient died. Australia should be addressing Australia's humanitarian crisis response, and it is not dollars that answer that question; it is adding value to revolving stocks of agricultural product within the country.[13]

Committee view

2.17 The committee strongly supports fair and commercially orientated foreign investment that creates wealth and jobs in the Australian agricultural sector. However it is clear from the evidence presented above and throughout the remainder of this report, that there are some apparent deficiencies in the current tax arrangements for foreign investment in Australian agriculture which require much closer examination. Accordingly, the committee is of the view that the government should review the tax arrangements for foreign investment to ensure Australians continue to benefit from the further development of Australia's agricultural sector.

Recommendation 1

2.18 The committee recommends that in order to prevent tax revenue leakage and market distortions, the government undertake an extensive review of the tax arrangements applying to foreign investments and acquisitions in the agricultural sector.

2.19 The committee considers that although the evidence given by the ATO regarding transfer pricing was at times inconsistent, based on the evidence received it is reasonable to conclude that a sovereign entity investing directly in Australia and exporting for non-commercial purposes (such as for humanitarian reasons) could avoid paying tax in Australia. From the ATO's answer to a question on notice, the Tax Ruling TR97/11 and oral evidence presented to this committee, it is reasonable to conclude that in such a scenario there is no business undertaken and no income generated and therefore there is no tax liability for the investor.

2.20 The committee considers that either the government should unambiguously rule out such a possibility, or if it is unable to, it should explain why tax revenue leakage from foreign investment in these circumstances is warranted. The government

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13 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, pp 18–19.

should also estimate the future extent to which any such leakage may occur over a five, ten, twenty and fifty year period.

2.21 The committee was concerned with how this tax arrangement could be used by foreign governments seeking to improve their food security. Given the future population projection in the region and the ever increasing global food task, the committee considers that it is a realistic possibility and that such arrangements could significantly distort future Australia's agricultural markets. The committee considers that tax exemptions for not-for-profit purposes arising from agricultural production from foreign government entities have the potential to undermine Australian tax revenues and are not an appropriate substitute for the Australian Government's foreign aid program. As such, the committee considers that not-for-profit investment by foreign government entities for humanitarian purposes should only be conducted when it is explicitly part of the Australian Government's foreign aid program.

2.22 The committee is of the view that as a general principle, foreign government entities should invest in Australian agricultural land and businesses on a commercial basis and not for food security purposes.

2.23 The committee considers that the erosion of the tax base from multinational companies reducing their tax liabilities is a direct threat to Australia's sovereignty. Without strong protections against tax revenue leakage, the Australian government's ability to provide Australians with the public services and infrastructure that are essential for the country's future is diminished.

2.24 The committee is aware that tax revenue leakage is a major problem well beyond the agriculture industry. As indicated in recent press reports, companies such as Google, Apple and eBay are using complex international arrangements in order to pay minimal tax in Australia. In another high profile case of tax minimisation, the ATO made an 'unsuccessful attempt to stop the $1.4 billion reaped by the private equity group TPG from the float of Myer leaving the country without being taxed.'[14]

2.25 The committee notes the government's current review of tax arrangements for transfer pricing and is pleased by the Assistant Treasurer's recent announcement that the proposed reforms 'will help Australia protect its tax base.'[15] The committee urges the government to ensure the protection of tax revenue remains a key principle of any proposed amendments to Australia's tax laws that are presented to parliament.

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14 For example see Ben Butler and Georgia Wilkins, "How savvy multinational curb their tax bills", *Sydney Morning Herald*, 17 November 2012, (online version accessed 26 November 2012).

15 The Hon David Bradbury MP, Assistant Treasurer and Minister Assisting for Deregulation, "Progressing Reforms to Australia's Transfer Pricing Rules", Media Release No 144, 22 November 2012.

Recommendation 2

2.26 The committee recommends that as part of the broader review outlined in Recommendation 1, the government should review Australia's tax laws that apply to tax exemptions for not-for-profit activities for foreign entities. The review should examine ways to prevent tax revenue leakage when foreign government entities undertake agricultural production in Australia for humanitarian purposes or for food security.

Recommendation 3

2.27 The committee recommends that the government require that any non-commercial production from agricultural land and businesses by foreign government entities (including for the purposes of food security) is undertaken within relevant Australian Government foreign aid programs.

Capital gains tax arrangements

2.28 At a general level, the committee heard evidence that capital gains tax exemptions were one of the key ways that foreign companies may be able to reduce their tax liability in Australia. Two examples of this tax minimisation arrangement were given by the ATO. The first was:

> ...a foreign resident can disregard a capital gain or loss unless the relevant capital gains tax asset is a direct or indirect interest in Australian real property, or relates to a business carried on by the foreign resident through a permanent establishment in Australia. The definition of real property includes a lease of Australian land and mining, quarrying or prospecting rights where the materials are situated in Australia.[16]

2.29 A second example was:

> ...concessions are available for certain foreign venture capital investments which are designed to encourage foreign investment into the Australian venture capital market and to promote the development of the Australian venture capital industry. The measures involve the taxation of certain venture capital institutions as "flow-through" vehicles and a capital gains tax exemption for certain gains made by foreign residents on venture capital investments (as well as a corresponding exemption for gains or profits that are on revenue account) in certain cases.[17]

2.30 The ATO also informed the committee of the possible capital gains tax arrangements available to foreign investors regarding non-commercial loans. It also

16 ATO, answer to question on notice, 9 May 2012, (received 5 June 2012).

17 ATO, answer to question on notice, 9 May 2012, (received 5 June 2012).

acknowledged that such circumstances may be used to avoid tax scrutiny, as indicted in the following exchange:

> **CHAIR:** I want to ask a question about non-commercial loans. …I can set up an entity in Australia and give them an interest free facility for 30 years, with that entity having an Australian entity… But for the purposes of foreign investment introspection they are an Australian company. They fly under the radar. …If I have a non-commercial arrangement that includes a contractual agreement to revert the asset to the supplier of the loan—who happens to be a sovereign state—what are the capital gains tax implications of that?...
>
> **Mr O'Neill:** … I will go through some of the tax implications prior to that 30-year point. If we are aware of the loan and the loan was interest free then we would run two tests to rule first on whether the company breaches the thin capitalisation ratios. …In addition to whether the company is too heavily debt laden, there is a question about whether the zero pricing on the loan facility would be an arm's length price. We could impute an interest rate to even up that situation. A third element would be whether the transaction is in fact a loan. In some circumstances, because of either the general anti-avoidance rules and the general doctrine of sham, the real intent of the parties is that that is an acquisition arrangement. In using our general anti-avoidance rule or the sham doctrine, the commissioner can look through to the underlying reality of the transaction and that might alter the capital gains tax consequences, for example, because there would not be a transfer in 30 years because the ownership has been there from the start.
>
> **CHAIR:** …If you [are] a country that is trying to avoid scrutiny of sovereign funds, this sounds like a good scheme.
>
> **Mr O'Neill:** It may be an attempt to fly under the radar…[18]

2.31 The issue of minimising capital gains tax was also explored in situations involving takeovers of Australian firms without an exchange of money. As the evidence from the ATO showed, although in most cases the appropriate tax would be paid, the regulation was not watertight:

> **CHAIR:** …I wonder about the tax implications of...capital gains exchange. Is it possible for an Australian company to be taken over without any money changing hands?
>
> **Mr O'Neill:** It could be that money does not change hands, but there would have to be some value shift. If there was a swap of the share ownership, there would have to be something in return. Often there is a share swap. If the company was sold without anything in return, that would breach the Corporations Law and the tax law.
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> **CHAIR:** So it would not be possible—
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> **Mr O'Neill:** Very difficult.

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18 Mr Michael O'Neill, Assistant Deputy Commissioner, International Branch, ATO, *Committee Hansard*, 17 February 2012, pp 56–57.

> **CHAIR:** to enact in year 1, instead of year 30, a legal transaction that was going to occur in year 30 so that it was an automatic transfer.
>
> **Mr O'Neill:** I guess smart lawyers can think of all sorts of things; it is possible.
>
> **CHAIR:** That is what is worrying me.
>
> **Mr O'Neill:** But that is not our experience.[19]

2.32 The scenario of a 30-year interest free loan was later discussed in a question on notice. The committee asked the ATO to consider a potential case where a provincial government lent a facility to a person (who may be a government official) as a 30-year interest free loan that would revert back to the provincial government at the end of the lease. In such a case, the ATO was asked: 'when the asset reverts to the government, how would [the ATO] treat that for capital gains tax purposes?' The ATO's response was:

> The focus of the scenario is where the asset reverts from the "person" to the provincial government. This is a capital gains tax event as the asset's ownership or at least the ability to use and enjoy that asset has passed from the "person" to the provincial government.
>
> There are 3 possible outcomes:
>
> 1) if the "person" (a real person or a company) is a resident of Australia, the capital gain would be taxable;
>
> 2) if the "person" is a non-resident of Australia, they would be taxed on any capital gains where the asset is Australian real property; or
>
> 3) if the "person" was acting as agent for the foreign Government then the person would not have use and enjoyment in their own right so any gain would not be taxable.[20]

Committee view

2.33 The committee is reassured by outcomes 1 and 2 listed above as these outcomes indicate that commercial arrangements would fall properly under the tax system. However, outcome 3 remains of concern as foreign governments and their agencies may pursue ways of avoiding tax liabilities that would otherwise be payable by private companies. Food security is already a key motive for foreign investment by some countries (for example, the initial investments of the Qatari government owned company Hassad Australia) and this will only increase over time as the global food task increases. Therefore, the committee is of the view that there is the potential for cases such as those outlined above to become more prevalent and for the Australian public not receive to the tax revenue from Australian produce and land that is warranted.

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19 Mr Michael O'Neill, Assistant Deputy Commissioner, International Branch, ATO, *Committee Hansard*, 17 February 2012, pp 57–58.

20 ATO, answer to question on notice, 9 May 2012, (received 5 June 2012).

2.34 As recommend below, this issue should be considered as part of a broader review of tax arrangements for foreign investment in Australian agriculture.

Passive income

2.35 The ATO also indicated to the committee that passive income was a further avenue for foreign investors to avoid tax liabilities in Australia. According to evidence received from the ATO, income tax would generally not need to be paid if:

> The income was 'passive' income, for example interest, earned by a sovereign state from investments in Australia would be exempt from tax under the doctrine of sovereign immunity. Similarly for income from dividends where its investment was of a non commercial nature (for example under 10% holding) and falls within the sovereign immunity exemption.[21]

2.36 The same evidence noted that 'running a farm for profit is not passive income and would be taxable'.[22] However, the committee later heard evidence from the ATO that there were instances where the passive income exemptions for sovereigns investing in Australia could apply to the agricultural industry:

> **CHAIR:** ... On the passive income for a sovereign tax exemption …if I am a sovereignty and I finance Senator Nash in Australia into a means of production, do I pay tax on the interest that Senator Nash pays me?
>
> **Mr O'Neill:** It depends really on the form of the finance. If a sovereign is lending into Australia, interest returned to the sovereign is typically exempt.[23]

Committee view

2.37 The committee is of the view that aspects of both capital gains and passive income tax arrangements for foreign investment are potential loopholes that unfairly favour foreign investors, particularly foreign government owned entities. This gives rise to possible market distortions that can result in disincentives for domestic capital investment (as will be shown in more detail below) and, in particular, foreign government owned entities avoiding full tax liabilities in Australia.

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21 Tabled document, 16 August 2012, correspondence from the ATO to Senator Heffernan dated 22 June 2012. See: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=rrat_ctte/firb_2011/submissions.htm.

22 Tabled document, 16 August 2012, correspondence from the ATO to Senator Heffernan dated 22 June 2012. See: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=rrat_ctte/firb_2011/submissions.htm.

23 ATO, *Committee Hansard Proof*, 16 August 2012, p. 7.

Recommendation 4

2.38 The committee recommends that as part of the broader review outlined in Recommendation 1, the government should investigate ways of developing more rigorous tax liability arrangements for both government-owned and private foreign entities, particularly in relation to capital gains and passive income. In this regard, further efforts should be considered to limit the scope for foreign investors to use business structures, and other possible loopholes, not available to domestic competitors in order to reduce their tax burden.

Pathways for business – tax on domestic entities versus foreign entities

2.39 In addition to concerns about tax loopholes leading to possible revenue leakage, the committee heard evidence that the current tax arrangements are more favourable for foreign investors than domestic investors. Furthermore, not only were Australian companies said to be disadvantaged, but the current tax arrangements could also significantly undermine Australia's ability to contribute to the global food task in the coming decades. The evidence provided by Mr Farley was compelling and accordingly it is reproduced below quite extensively:

> ...if we look at the debate about where the money comes from, one thing that is very clear in Australian agriculture is that we are not attractive markets to invest in our own land. We have heard this morning about the opportunities… and why we are attractive to foreign capital, because of the taxation advantages both on capital and working capital conditions. They can bring capital into the country. Yet we export our capital because the taxation is more attractive offshore than onshore. If we could finally get to this point then of working out where taxation is, and then ultimately to the point of where do the ASIC [Australian Securities and Investments Commission] rules, especially whether it is under trust arrangements or under public listed or private listed, play themselves in here, then we need to make sure we can conduct ourselves as a country properly on top of it.[24]

2.40 The evidence from Mr Farley put foreign capital investment and Australia's tax arrangements into an historical perspective as he noted AAco's origins as a foreign investor in Australian agriculture. At the same time, he argued that there were significant future opportunities in the industry, if arrangements to encourage capital investment could be developed:

> **Mr Farley:** …why do people come to Australia to invest? Because the taxation haven they allow themselves to be in in Australia in agricultural land has an appeal to it. I am fortunate that I am probably representing the original foreign investor in Australian agriculture. We started in 1824 and at the time we arrived with £1 million and a number of sheep and were given

24 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, p. 11.

> a million acres of land in what was called the wastelands of New South Wales. Today we would describe that wasteland as the Hunter Valley. We were successful in developing towns, Maitland, Tamworth and others, which were all part of the station complexes. Agriculture takes time but the more interesting thing about agriculture today with our demographers and financial analysts is that we have much more ability with the technical tools we have got and the intellect we have got to predict the future. It is happening now at a lot faster rate and with a lot smarter capital…
>
> **Senator GALLACHER:** So what you are saying is that the people with the deeper pockets and the longer vision are not the Australian investors.
>
> **Mr Farley:** Correct. I am also saying that the Australian investor has not got the opportunity to enjoy the taxation breaks that the foreign investor has.[25]

2.41 The committee heard evidence that it is potentially more attractive to invest in one of the AAco's foreign shareholders than to invest direct in AAco in Australia due to tax arrangements:

> **Senator BACK:** …It almost is the case that Australian shareholders would be wise to invest their funds offshore through one of your foreign investors and invest back in AAco through that foreign instrumentality to enjoy the taxation benefits—perversely, that is the case.
>
> **Mr Farley:** Unfortunately, you are correct, and it does seem perverse in the world we live in today. The unfortunate part for agribusiness enlisted investors in Australia is that, if we could share with our institutional funds and our self-regulated funds for our retirees the same taxation benefits that are available to our offshore shareholders, I am sure my share price and that of the other listed agricultural entities would not be trading at a 50 per cent discount to NTA [Net Tangible Assets] today.[26]

2.42 Mr Farley also detailed the prospects for developing large-scale agricultural projects in Australia if the domestic taxation arrangements were reformed. In this regard, Mr Farley compared Australia's opportunities to some of the world's major agricultural regions:

> …We do have the potential for large-scale projects, don't get me wrong there, but first of all I do think the financial and economic playing field or pathway needs to be equalled and levelled for Australians to participate. Secondly, the projects are definitely there. We have the soil types and especially the soil types that have the ability to have good water holding characteristics. We operate uniquely in the north in what is called a dry tropic as opposed to a wet tropic, so we have a defined period of production. We are unique in the extent that we are a young country but we

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25 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, pp 12–13

26 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, p. 20.

> can travel the world, whether in the [Mato Grosso] or the plains of Bahia in Brazil or alternatively in the floodplains of Louisiana and Alabama, there are plenty of examples around the world in the northern hemisphere geographically soil type wise of how quickly we could put production together. Whether it is the Kimberley region of Western Australia or whether it is the Katherine region on the Uluru aquifer around Katherine itself in the Northern Territory or cross into the Gulf or down onto the rolling plains in central Queensland, we have the opportunity for large projects again.[27]

2.43 Aside from the benefits that could result in the development of large-scale agricultural projects, Mr Farley indicated that coordinated tax and industry reform could have significant benefits for Australia's tax revenue. To achieve this, Mr Farley highlighted the 'gateways' that agricultural produce passes through:

> All agricultural produce in Australia has to pass through a gateway. If it is cotton it passes through a cotton gin, a warehouse and a port. If it is sugar it passes through a sugar mill to refine it, a warehouse and then a port. If it is wheat it is passed through a silo complex and across to a port. In the case of meats, whether it is chicken, pork, cattle or lamb, it passes through an abattoir where it is broken down to its various cuts, a distribution chain and to the market. All of those add value to it because generally in agriculture the parts are worth more than the whole. If Australia is only realising its income tax potential on the whole, in other words the live cattle weight or the hot standing carcass weight in cattle, or in cotton the module weight or module advance, we will be passing offshore a powerful amount of revenue that has the ability to generate a tax base to further develop and underwrite all of our society.[28]

2.44 Furthermore, Mr Farley pointed to the need to examine the role of foreign investors who hold influential commercial positions in relation to the gateways for Australia's agricultural produce:

> I am sure that if we look at it now, considering that our agricultural gateways in particular have been sold off to foreign investment—our meat industry is run by a duopoly, as well as our grain and sugar industries—and determine who is the pure price maker to Australian producers, it is the gateway assets themselves. They are the ones who are reporting price, making price and taking positions. Then ultimately, when those products go out of the country and are traded two or three times, are we realising the full opportunity to grow our nation off the toils of our resources? We need to be aware and have a greater intimate knowledge of how the pricing structures

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27 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, p. 14.

28 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, p. 15.

> work and how our current taxation systems work over the ownership of the asset, the commodity and the commodity flow.[29]

2.45 Specifically, Mr Farley suggested two key changes to assist in the establishment of taxation arrangements that are more encouraging of Australian investment and to 'make the playing field level' with foreign investment. The first change relates to capital gains tax and making long-term investment by Australian companies in Australian agriculture more attractive:

> If you want to make the playing field level, you will level it out to what the foreign investment capital can have now. I sense that that is probably inappropriate and it is just an accident of time that those pathways are there. I do think the most attractive point will be to ensure that the investment exit when it happens at a point in time is treated away from the current capital gains tax that the investment would have to pay. If it was made more attractive that the funds as they were being realised over the life of the horizon once the investment was complete with a little bit more appealing on exit, I am sure it would be a lot more appealing on the entry.[30]

2.46 The second change also related to long-term investment incentives for Australian companies (and in particular superannuation funds) by providing broader arrangements for such companies that invested in projects that demonstrated improvements to Australian agriculture:

> …it is whether we can be balancing out the taxation of the overall fund if a percentage of its funds over a 20- or 30-year period were designed at developing Australia's capacity and competency and technology within agriculture that if a fund was demonstrating to Australia that it was putting money, that that demonstration could give them tax credits on the performance of all their funds. I am sure there are smarter, wiser men than me who could address the issue, but the reality is that we have one of the world's best harvesting nets of superannuation dollars for long-term horizons, in other words the horizons of the working life of men and women, and we should be able to make Australian agriculture and the demand for Australian agriculture attractive for Australians to invest in.[31]

Committee view

2.47 Although the committee has not fully examined Mr Farley's two specific suggestions, the committee supports his general argument about the need to improve tax incentives for domestic capital investment in Australian agriculture. Therefore, the

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29 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, p. 15.

30 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, pp 13–14.

31 Mr David Farley, Chief Executive Officer and Managing Director, AAco, *Committee Hansard*, 10 August 2012, p. 14.

committee urges the Government to consider the evidence received by the committee in order to improve Australia's long-term agricultural development.

Recommendation 5

2.48 The committee recommends that as part of the broader review outlined in Recommendation 1, the government review the tax barriers for Australian organisations that limit Australian investment in long-term development projects in Australian agriculture. The review should explicitly compare tax arrangements for domestic entities to those faced by potential foreign investors in Australian agriculture. The review should also consider possible reforms of tax regulation to improve incentives for Australian capital investment in agriculture.