

Marlene Ciganovic
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Registered Tax Agent

5th November 2009

Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir / Madam

RE: Inquiry into Tax Laws Amendment (2009 Budget Measures No.2) Bill 2009

I am a Chartered Accountant and Registered Tax Agent in public practice since 12th August 1993. I make the following submission on behalf of one of my clients involved in the Dairy industry, who would be profoundly negatively impacted by the proposed amendments to the existing non-commercial business losses (NCL) legislation (Schedule 2 – the quarantining of non commercial business activities).

The legislation will have an adverse affect on the Australian dairy industry as investors such as my client will exit the industry altogether. New entrants would also then be discouraged to enter the industry. Of course this negative impact will be felt across rural Australia generally.

The Australian dairy industry is already undergoing a very difficult period, as highlighted by the Inquiry into Competition and Pricing in the Australian dairy industry.

The consequence of the proposed amendment is that large legitimate businesses will be caught up in the drive to address hobby farms, because regardless of the size and scale of a business, any tax loss will be quarantined if the adjusted taxable income threshold of \$250,000 is exceeded.

Details of my client:

My client is a successful and prominent medical specialist. As part of his retirement planning he purchased a dairy property in Victoria in 2005. The land consists of 887 acres and was purchased for ~\$3.1m in total. Since purchase the farm is being transformed from a tired farm to a modern dairy farm now milking 430 plus cows (double the size of the average dairy farm), employing three full time workers and producing in excess of 2.5 million litres of premium milk a year. To achieve this result a lot of expenditure has been required.

Although the farm has made a loss for each financial year owned thus far, it will eventually be commercially viable, subject to many influences outside of the owner's control. The losses have been caused mainly by:

1. The dramatic decline in the price of milk

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2. High input costs, in particular the high cost of grain, fertilizer, hay & silage – the result of the drought.
3. Expenses required upgrading the farm following the purchase – a milk vat, fencing, drainage, tracks, electricity supply infrastructure, flood wash, feed bins, pasture improvement, herd, staff housing, shed modifications etc – so far in excess of \$500,000 and an ongoing process.

The current market value of my clients herd exceeds the cost, thus the unrealized profit can be deferred for some years, delaying the profitability of the business.

The result of the legislation being passed will be devastating for the farm. As my client could no longer fund the farm, it would need to be sold this financial year. Potential buyers would be scarce, resulting in a rock bottom price being received for the land, plant and herd alike. The break fees of the long term Bank Bill alone would be financially overbearing. The farm would be sold at the least desirable time of the year. Three workers would lose their jobs and the local area a business that has been spending in the order of \$1.5 million a year.

Comments:

1. Purpose of the Amendment:

The NCL legislation as it stands already addressed the deduction of losses from 'hobby businesses'. The Amendments would be discriminatory for many legitimate businesses that would be penalised due to circumstances that are not directly related to the business.

2. Uncertainty:

The Introduction of the income requirement test to the NCL provisions will have adverse consequences to many regional industries. The Australian dairy industry and Australian farmers in general operate in one of the most stable and richest food economies in the world. Currently the Dairy farmers in particular are not benefiting from the efficiency gains obtained for the past many years. The price of milk per litre that my client is currently receiving is well below the benchmark cost of production.

The longer term plan for my client is for a very well established state-of-the-art dairy farm. He plans to have up-to-date infrastructure, a maximum herd of around 600 milking cows, well drained paddocks etc.

My client can apply to the Commissioner for relief, and wait in hope that the business is assessed as being genuinely commercially viable. However, my client planned to commit further financial resources within the next three months in the order of up to \$250,000, as the farm requires major repairs or replacement of the existing milking platform. This important upgrade has been put on hold as we are uncertain about the future of the farm without a decision from the Commissioner. How can a business such as this develop with these constraints?

Also, it is not clear in the legislation if the Commissioners discretion can be relied upon in future years.

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3. Compliance Costs:

Contrary to the statement in the legislation, the compliance cost impact is not “low”, mainly due to the need to obtain an independent expert report confirming that the business is genuinely commercial.

4. Possible changes to the existing NCL provisions:

- a. I propose that there is further review of the existing NCL provisions instead of this radical change to quarantine losses for high income earners. Application of the four objective tests should be kept in place, but with changes for high income earners. In particular, an increase in the income threshold requirement of the business, and/or an increase of the real property or other assets test thresholds.
- b. If the Bill is to be implemented, the date of application should be 1st July 2010, not from 1st July 2009. This will give existing businesses time to consider the various options.
- c. To “Grandfather” the current NCL legislation for existing businesses. I.e. leave current legislation in place where the outlay has already been made, and make the proposed changes only to new business owners in the future.

Summary:

The proposed \$250,000 income requirement test is ill devised, as many legitimate and genuinely commercial business structures owned by individuals and partnerships will be forced to exit those businesses. In contrast, many inefficient and hobby-type activities will be able to continue (the ones I suspect the Government wished to target) as their owners would earn less than the \$250 000 income requirement.

It is a fact that the current availability to offset business losses from other income encourages investment. Rural and regional Australia in particular will be grossly disadvantaged if these Amendments are passed.

Yours faithfully

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