Mackay's Banana Marketing Co Pty Ltd
ABN: 60 078 638 534

32 Butler Street, Tully QLD 4854
PO Box 220, Tully QLD 4854
P: 07 4088 7800
www.mackaysmarketing.com.au

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Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Committee

RE: Changes to the R&D Tax Incentive and impact of Tax Policy on the Banana Industry

Mackays Marketing was established in 2001 to manage banana marketing and sales from a cooperative of large-scale farming families. Today it markets the bananas, avocadoes and papaya from Far North Queensland for no less than ten 2nd, 3rd and 4th generation growers supplying the major supermarkets and wholesalers with quality Australian produce to all Australian states and territories. Mackays Marketing and its growers employ directly more than 1,700 employees in Far North Queensland.

We are extremely concerned by the Australian Government's proposed changes to the *Research and Development Tax Incentive Programme,* as announced in the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019*. There are also a two FBT matters that we have addressed in this submission.

The proposed changes seek to introduce a new integrity measure that will ultimately reduce the R&D premium available to many agricultural companies, including the banana industry. Specifically, the proposed changes will effectively reduce our tax benefit associated with investment in innovation from 8.5c on the dollar to 4.5c (effectively halving the benefit), whilst also resulting in increased uncertainty due to the inability to determine in advance of a financial year the correlating tax offset.

As you are aware the banana industry is facing the challenge of TR4 which has the potential to devastate the Far North Queensland banana industry with the loss of thousands of jobs and drastically reduce the availability of Australia's number one healthy snack food. A major research effort is required to find a solution to this devasting disease. We find it difficult to understand why the government would be reducing the R&D incentive to the banana industry at this time.

The banana industry, like most of the fresh produce sector, is high cost and apart from the TR4 challenge requires an increased R&D spend in order to foster innovation. The proposed changes to the R&D incentive in our view unfairly penalise the industry and reduce the benefits of undertaking much needed R&D.

The growth and success of the fresh produce industry has been built on R&D which is focused on product and agronomic innovation, including the development of IP and plant genetics, improved yield per hectare of production and agronomic practices which are world leading. This has involved risk in the expenditure of capital that could have been allocated elsewhere, however the R&D tax incentives have been vital in securing the investment in innovation.

Investment in innovation remains an important goal for Mackays Marketing and its growers, however the uncertainty associated with the proposed changes may now cause us to defer or otherwise cancel innovation projects that improve products and processes, importantly create and sustain jobs in regional and rural Australia and ensure the survival of the banana industry. This will also consequently place us at an unfair disadvantage to our global competitors and risk R&D innovation being lost offshore, while also making us less resilient at a time when the Australian agricultural sector is facing a number of critical and immediate challenges including drought, extreme weather and slowing productivity growth.

The Government's proposed changes will reduce the benefit associated with conducting R&D activities in Australia, consequently making Australia less competitive on a global scale and prompting reduced risk-taking and investment in innovation. When taking into account the fact that Australia's R&D spend as a percentage of GDP continues to fall, is comparatively low by international standards (1.79% for the 2017/18 year as per ABS statistics) and also below the OECD average (2.37%), the Government's attempts to eliminate $1.8 billion from the Research and Development Tax Incentive will adversely impact our business, the fresh produce industry and the broader Australian economy, including regional and rural Australia.

Some key insights as to how the proposed changes will adversely impact our business:

- **Intensity measure: Inherent disadvantage due to our cost base:** The intensity measure fails to take into account recommendations by the Senate Committee to incorporate a methodology capable of offsetting the adverse impact to different industries that may be disadvantaged as compared to low cost input sectors. For growing businesses in the banana industry, it will be increasingly difficult to exceed the 4% R&D intensity premium by nature of our cost base. This would limit us to a 4.5% benefit compared to the current 8.5% benefit.

- **Intensity measure will reduce our ability to employ technical staff and maintain or grow our R&D spend**: The proposed intensity measure will have the opposite impact of that intended by the R&D incentive – at 4.5% benefit, we will have limited ability to invest in R&D and employ talented staff in Australia.

- **Retrospectivity and impact on current R&D projects:** We and our associated companies have a number of projects underway that involve R&D activities and have been developed with the R&D Tax Incentive. If enacted, the Bill will take effect for income years commencing on or after 1 July 2019. This will have an immediate impact on current projects, potentially resulting in the reduction of scope of R&D and/or relocating it to another country. Furthermore, given that the central policy objective of the R&D Tax Incentive is to promote additional investment in R&D, it is difficult to reconcile how a retrospective application would serve the program's additionality target or spill over. Any proposed changes to the R&D Tax Incentive should be widely consulted on and have a commencement date at least a year or more into the future to allow companies to plan for it.

We understand that it is important to ensure the integrity of the R&D Tax Incentive Programme, however we urge the government to reconsider the proposed changes to ensure that it is done in a way that does not unfairly disadvantage the Australian banana industry.

The banana industry offers **remote area housing** to both prospective and existing employees and the current FBT concession makes this a practical and cost-effective way to attract and retain skilled employees. The Productivity Commission has made recommendations which would place such concessions under threat and if they were enacted into tax law, would see the banana industry incur significant additional costs to employ people in Far North Queensland. The government must carefully consider the unintended consequences of the Productivity Commission's recommendations on employers and employees in rural and remote areas.

Banana farming operations require that certain employees are provided with **Tools of Trade** vehicles in order to perform their work duties in rural or regional areas. In order to provide certainty to remote area employers, we would welcome a separate FBT exemption for tools of trade vehicles specifically for remote areas which either increases the maximum private travel thresholds to reflect realistic distances relevant to remote areas or removes the requirement to track private travel. The current ATO guidelines are unrealistic and onerous e.g. a trip is deemed private if a detour is more than two kilometres.

The production and harvest of bananas is a highly labour-intensive business and our people are vital to the success of the industry. Our growers employ numerous backpackers or working holiday makers. Understanding that backpackers spend their earnings in local towns, the **income tax on working holiday makers** is also tax on regional communities and tourism businesses. For Mackays Marketing and the communities our growers operate in, the tax removes a considerable amount from those local communities and reduces the attractiveness of working in Far North Queensland.

We look forward to working with you to support the future of the banana industry in 2020.

Yours sincerely

[redacted]

Paddy Watts
CFO
Mackays Marketing
[redacted]
Mailing Address: PO Box 220, Tully QLD 4854

Attachment: The impact of tax policy on the fresh produce industry

The impact of tax policy on the fresh produce industry

- R&D Intensity Test
- Remote Area Benefits
- Tool of Trade Vehicles
- ‘Backpacker Tax’

December 2019

Australian Fresh Produce Alliance
Growing a healthier Australia

About

The Australian Fresh Produce Alliance (AFPA) is made up of Australia's key fresh produce growers and suppliers. The members include:

- Costa Group,
- Perfection Fresh,
- Montague,
- One Harvest,
- Pinata Farms,
- Fresh Select,
- Mitolo Group,
- Mackay's Banana Marketing,
- Driscoll's,
- 2PH Farms,
- LaManna Premier Group,
- Rugby Farming,
- Freshmax, and
- Fresh Produce Group.

These businesses represent:

- half the industry turnover of the Australian fresh produce (fruit and vegetables) sector - $4.5 billion of the $9.1 billion total,
- a quarter of the volume of fresh produce grown in Australia - 1 million of the 3.9 million tonne total,
- more than a third of fresh produce exports - $410 million of the $1.2 billion export total,
- more than 1,000 growers through commercial arrangements, and
- more than 15,000 direct employees through peak harvest, and
- up to 25,000 employees in the grower network.

The key issues the AFPA is focusing on include:

- packaging and the role it plays in product shelf life and reducing food waste landfill,
- labour and the need for both a permanent and temporary supply of workers,
- market access to key export markets for Australian produce,
- product integrity both within and outside of the supply chain,
- pollination and research into alternative sources, and
- water security, including clear direction as to the allocation and trading of water rights.

The AFPA's aim therefore is to become the first-choice fresh produce group that retailers and government go to for discussion and outcomes on issues involving the growing and supply of fresh produce.

Products grown by AFPA Member companies include:

Apples	Broccoli	Fioretto	Oranges	Strawberries
Apricots	Broccolini	Green Beans	Peaches	Sweet Corn
Asparagus	Brussel	Herbs	Pears	Table grapes
Avocado	Sprouts	Lemons	Pineapples	Tomatoes
Baby Broccoli	Butternut	Lettuce	Plums	Water Cress
Baby Corn	Pumpkin	Mandarins	Potatoes	Wombok
Bananas	Cabbage	Mango	Cucumber	
Beetroot	Cauliflower	Mushrooms	Raspberries	
Blackberries	Celery	Nectarines	Salad leaf	
Blueberries	Cherries	Onions	Spinach	

Summary

As with many industries the fresh produce industry must invest in R&D to improve both its technical and production capabilities, while ultimately improving profitability. An R&D tax system which recognises the requirement for such investment and the level of risk associated with this is therefore crucial to ensuring industry continues to invest in R&D.

There is both a public and private benefit from R&D investment through increased productivity and capital creation which contribute to GDP growth and our standard of living. Fresh produce plays a unique role in providing healthy and nutritious food for our population which is needed to maintain health and well being and reduce public expenditure on what are chronic and preventable diseases, including type II diabetes and obesity.

The geographic diversity of the fresh produce industry and the nature of seasonal crops necessitates that the industry operates in regional and remote locations. This makes it challenging with respect to sourcing sufficient labour supply which is also skilled and incentivised to work, live and raise a family in such locations. Once again, the tax system plays a key role in making this possible through recognising the challenges and difficulties that come with operating a business in remote areas. Therefore, appropriate and targeted Fringe Benefits Tax (FBT) concessions must be maintained in order to ensure business can continue to access the key inputs they need to make their business successful, namely labour.

By reducing earnings, the ‘backpacker tax’ has had a significant impact on the attractiveness of working in Australia as a backpacker, particularly in fresh produce. It is a tax that leads to perverse outcomes, including promotion of the black economy through untaxed cash payments to backpackers.

Understanding that backpackers spend their earnings in the towns they work and in the tourism industry, the income tax on working holiday makers is also a tax on regional communities and tourist businesses. For the AFPA and the communities that the companies operate in, the tax removes nearly $20 million a year from those local communities. During one of the worst droughts on record this a tax that rural and regional Australia cannot afford, and with a federal budget surplus it is a tax that is not required.

This paper outlines proposed changes to tax laws relating to R&D and FBT and their application by the ATO and the continued operation of the discriminatory backpacker tax which have the potential to adversely impact the fresh produce industry by reducing the incentive to invest in the development of individual enterprise with the consequent negative impacts on employment and economic activity in rural and regional Australia.

1. R&D intensity test

In the 2018/19 Federal Budget various measures were announced to overhaul the existing R&D tax incentive regime, including the introduction of an R&D expenditure intensity test applicable to companies with an aggregated annual turnover of $20 million or more.

This measure was considered by the parliament in 2019 and the Senate Economic Legislation Committee asked that the proposed changes be reconsidered including a reworked formula for the intensity test.

On December 5, the Government has reintroduced a new bill however in most aspects it is identical to the previous bill including the measure seeking to tie the rates of the non-refundable R&D tax offset to the incremental intensity of R&D expenditure as a proportion of total expenditure for the year. The marginal R&D premium has been simplified compared to the original bill with now three bands of R&D spend intensity proposed as follows:

- Four and a half percentage points for R&D expenditure between 0% and up to and including 4% R&D intensity
- Eight and a half percentage points for R&D expenditure greater than 4% and up to and including 9% R&D intensity
- Twelve and a half percentage points for R&D expenditure above 9% R&D intensity

The new bill is to apply to tax years commencing after 1 July 2019.

Potential impact on fresh produce industry

Research and development is vital to the fresh produce industry's operations and its growth objectives, as it continually seeks innovative solutions to technical agronomical challenges and opportunities to maximise the quality and variety of its fresh produce. The current R&D tax incentive benefit of 8.5% of R&D expenditure has been an important financial incentive for the industry to continue to undertake research and development activities while being able to absorb some of this risk through the tax system.

If the R&D intensity test were to be enacted in the form described above, the incremental tax benefit for R&D activities for one major fresh produce company would likely reduce by 50% as illustrated below using rounded cost data for financial year ended 30 June 2018.

Example of Major Fresh Produce Company

R&D Expenditure	$6.2 million
Total Expenditure	$816 million
R&D Intensity	0.8%
Incremental R&D tax benefit available	4.5%

It is clear that the current design of the R&D intensity test would be unnecessarily punitive to high-cost industries such as the fresh produce industry. It also introduces uncertainty for industries making R&D investment decisions and has the potential to create inequality for domestic versus foreign owned entities undertaking R&D activities in Australia.

Fresh produce companies are undertaking genuine R&D in order tackle various technical challenges, improve environmental adaptability and to maximise opportunities for growth. Therefore, AFPA agrees with the original feedback from the Senate Economics Legislation Committee that the R&D intensity formula should be reworked in close collaboration with high cost industries, or better still, urge Government to reconsider the introduction of a R&D intensity test at all.

2. Remote area benefits

The Productivity Commission recently reviewed all remote area benefits provided by government, including Fringe Benefit Tax (FBT) concessions and exemptions, making the following draft recommendations:

- Remove the existing exemption for remote area housing owned or leased by an employer and make this a 50% concession (i.e. reduce FBT by 50% instead of exempting it). The 50% concession would not be available unless there was insufficient nearby accommodation apart from that provided by the employer.
- Make assistance with remote area rent and interest fully subject to FBT i.e. remove the existing 50% concessions.
- Make remote area holiday transport fully subject to FBT i.e. remove the existing 50% concession.
- Limit the 50% concession for remote area utility assistance to situations where this is an operational requirement (i.e. where it must effectively be supplied by the employer) and only in conjunction with employer-provided housing.
- Limit exemptions for meals for primary production employees.

Potential impact on fresh produce industry

The fresh produce industry operates across a significant number of rural and regional communities and in many of these locations, are the major source of employment. It is imperative that fresh produce companies can source the highest calibre of people to work in rural and remote locations. This often involves the provision of housing and other benefits to ensure a worker is willing to not only relocate but to also establish a household in the particular location.

The fresh produce industry offers remote area housing to both prospective and existing employees and the current FBT concession makes this a practical and cost-effective way to attract and retain skilled employees. The Productivity Commission has made recommendations which would place such concessions under threat and if they were to be enacted into tax law, would see fresh produce employers incur significant additional costs to employ people in rural and remote areas of operation.

Based on FBT year 2019 data, one employer anticipates that if the Productivity Commission recommendations were to be enacted, the additional FBT costs incurred would be in the range of $268,000 to $536,000 per year, depending on whether the employer can access the proposed 50% taxable value concession.

The government must carefully consider the unintended consequences of the Productivity Commission's recommendations on employers in rural and remote areas.

Type of Benefit Remote area house	Taxable Value	FBT benefit obtained under current concessions/ exemptions	Proposed changes to FBT remote area concessions/exemptions	Potential Impact
1 house	$10,400	$9,222	Change the current exemption to a 50% concession, available only if there is insufficient accommodation in the area.	$4,611
2 houses	$23,920	$21,212		$10,606
7 houses	$109,200	$96,838		$48,419
11 houses	$171,600	$152,174		$76,087
21 houses	$289,380	$256, 621		$128,310

3. Tool of Trade vehicles

Under the current FBT laws, Tool of Trade (TOT) vehicles are generally exempt from FBT provided that certain conditions are met, mainly that private use by employees using these vehicles is minimised. The ATO has recently published guidance on this FBT exemption, which is intended to simplify record keeping requirements for employers to access the FBT exemption for the TOT vehicles they provide to employees. The ATO's guidance requires that the following conditions are met in order to access the FBT exemption without any further record keeping requirements:

(a) you provide an eligible vehicle to a current employee;

(b) the vehicle is provided to the employee for business use to perform their work duties;

(c) the vehicle had a GST-inclusive value less than the luxury car tax threshold at the time the vehicle was acquired;

(d) the vehicle is not provided as part of a salary packaging arrangement and the employee cannot elect to receive additional remuneration in lieu of the use of the vehicle;

(e) you have a policy in place that limits private use of the vehicle and obtain assurance from your employee that their use is limited to use as outlined in subparagraphs (f) and (g) of this paragraph;

(f) your employee uses the vehicle to travel between their home and their place of work and any diversion adds no more than two kilometres to the ordinary length of that trip, and

(g) for journeys undertaken for a wholly private purpose (other than travel between home and place of work), the employee does not use the vehicle to travel;

(i) more than 1,000 kilometres in total, and

(ii) a return journey that exceeds 200 kilometres.

Impact on fresh produce industry

Fresh produce farming operations require that certain employees are provided with TOT vehicles in order to perform their work duties, with the majority of those provided being to employees in rural or regional areas.

The employees who are provided with these TOT vehicles use them predominately for work duties, including travel to and from work. However, for practical reasons, they may on occasion have to use the TOT for other private travel. If these employees were located in metropolitan areas, such occasional private travel would still be below the private use thresholds per the ATO guidance however given that most fresh produce employees with a TOT vehicle live and work in rural or regional areas, even a single private trip may breach the 200 kilometre return journey threshold and a handful of private trips will quickly breach the 1,000 kilometre total threshold.

Whilst the ATO's efforts to make this FBT exemption more accessible are appreciated, they do not appear to consider the practical reality for rural workforces and therefore may unduly penalise rural employers such as fresh food producers, where the use of a TOT vehicle is vital to their operations.

One employer estimates that if it is not able to access the FBT exemption for its TOT vehicles due to inability to meet the private use thresholds, it may incur additional FBT costs upwards of $260,000 per FBT year.

In order to provide certainty to remote area employers, to minimise the compliance burden and in recognition of practical realities of remote area living, AFPA would welcome a separate FBT exemption for TOT vehicles specifically for remote areas which either increases the maximum private travel thresholds to reflect realistic distances relevant to remote areas or removes the requirement to track private travel all together. The later approach would be consistent with other FBT exemptions for work-related items such as electronic devices or tools of trade.

4. ‘Backpacker Tax’

From July 2017, The Income Tax Rates Amendment (Working Holiday Maker Reform) Bill 2016 applied a 15 per cent income tax rate to the income of people under 417 (Working Holiday) and 462 (Work and Holiday) visas, on amounts up to $37,000. This was presented as a ‘budget repair’ measure to support the return of the Australian Government budget to a surplus. The budget has returned to surplus but the tax remains in place.

In addition to the income tax changes, from July 2017 the Government increased the tax rate on departing Australia superannuation payments (DASP) for working holiday makers to 65% (up from 35 per cent for the taxable component – taxed element, and 45 per cent for taxable component – untaxed element).

Impact on the fresh produce sector

The production and harvest of fruit and vegetables remains a highly labour intensive business and our people are vital to the success of the Australian fresh produce industry. The AFPA members collectively employs 22,000 people a year, including up to 12,000 working holiday makers.

AFPA members have committed to:

- Creating a culture of pro-active management by improving the sector’s employment practices and reputation, through proactively meeting all employment and duty of care requirements and obligations,
- Working with retailers, suppliers and growers to ensure that industry can adopt and maintain management systems required to comply with relevant laws and standards of sustainable and ethical employment, and
- Collaborating to mitigate the risks of modern slavery and poor labour practices in member businesses and their supply chains, and reporting under the Modern Slavery Act 2018.

By reducing earnings, the ‘backpacker tax’ has had a significant impact on the attractiveness of working in Australia as a backpacker, particularly in fresh produce. The table below summarises the impact on an individual backpacker who works the average 3 month period in fresh produce.

Earnings for a backpacker who works the average 3 months in Fresh Produce

		Current (15% tax, 65% tax on super)	**Proposed** (remove income tax, reduce super tax to standard 35%)
Gross Earnings	12 weeks x 38 hours x $24.36 =	$11,108.16	$11,108.16
Income Tax		$1,666.22	0
Net earnings		$9,441.94	$11,108.16
Superannuation	$11,108.16 x 9.5% =	$1,055.27	$1,055.27
Tax on Super		$685.92	$369.34
Net Super Payment		$369.34	$685.92

It is common practice for persons engaged in the fresh produce industry to undertake harvest (picking) work to do so under a piece rate agreement which means they are paid for the amount of produce they pick based on their productivity. By definition this means that although every worker receives the same piece rate, the more produce that is picked then the more income which is earned. Such arrangements have been an important part of the horticultural sector for a number of years.

Conventional economic theory and reality shows that the more a person is taxed, the less productive they are likely to be because the incentive of earning additional income is cancelled out, or at the very least negatively impacted in the knowledge that more of that income is being taken away in tax.

There is also the risk that less reputable employers in the sector will engage backpackers illegally and not report their income. By moving to cash, wage expenses for employers will be reduced while net wages for working holiday visa holders will, in many cases, be greater than their taxed rate.

Understanding that backpackers spend their earnings in the towns they work and in the tourism industry, the income tax on working holiday makers is also tax on regional communities and tourist businesses. For the AFPA and the communities that the companies operate in, the tax removes nearly $20 million a year from communities. During one of the worst droughts on record this a tax that rural and regional Australia cannot afford, and with a federal budget surplus it is a tax that is not required.