



Note: This Digest replaces an earlier version dated 20 February 2008.

Tax Laws Amendment (2008 Measures No. 1) Bill 2008

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Economics Section

Contents

Cumulative financial impact	4
Committee consideration	4
Schedule 1 Political contributions and gifts	5
Purpose	5
Background	5
Basis of policy commitment	6
Position of significant interest groups/press commentary	6
Pros and cons	6
Coalition/Australian Democrat/Greens/Family First policy position/commitments	7
Financial implications	8
Main provisions	8
Schedule 2 Superannuation lump sums paid to a member having a terminal medical condition	9
Purpose	9
Background	9
Taxation of superannuation lump sums	9
Basis of policy commitment	10
Position of significant interest groups/press commentary	10

Pros and cons	10
Financial implications	11
Main provisions	11
Schedule 3 Capital expenditure for the establishment of trees in carbon sink forests.	12
Purpose.	12
Background	12
What is a carbon sink forest?	12
Can the trees in a carbon sink forest that qualifies for a tax deduction ever be cut down?	12
Reduction of productive farm land?	13
Basis of policy commitment.	13
Position of significant interest groups/press commentary	13
Pros and cons	14
Coalition /Australian Democrat/Greens/Family First policy position/commitments.	15
Financial implications	16
Key issues.	16
Main provisions	17
Part 1	17
Forest quality	18
Forest quality comments	18
Part 2	20
Amount of the proposed deduction after 1 July 2012.	20
Selling the carbon sink forest.	21
Schedule 4 Tax offset for Equine Workers Hardship Wage Supplement Payment	22
Purpose.	22
Background	22
What is the Equine Workers Supplement Payment?	22
What is the beneficiary tax offset?	22
Equine Influenza – Current Disease Status	23
Basis of policy commitment.	23
Position of significant interest groups/press commentary	23
Pros and cons	23
Financial implications	24

Main provisions	24
Schedule 5 Tobacco industry exit grants	24
Purpose.	24
Background	24
What is the Tobacco Growers Adjustment Assistance Program?	24
Basis of policy commitment.	25
Position of significant interest groups/press commentary	25
Pros and cons	26
Financial implications	26
Main provisions	26
Schedule 6 Farm Management Deposits	27
Purpose.	27
Background	27
What is a Farm Management Deposit?	27
What are exceptional circumstances?	28
Pros and cons	29
Financial implications	29
Main provisions.	29

Tax Laws Amendment (2008 Measures No. 1) Bill 2008

Date introduced: 13 February 2008

House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent for most schedules. **Schedule 3, Part 2** commences on 1 July 2012.

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/>.

Cumulative financial impact

The following table shows the projected cumulative financial impact of all the measures in this particular Bill.

Table 1 : Cumulative Financial Impact of the Bill

Year	2007-08	2008-09	2009-10	2010-11	2011-12
Financial Impact \$m	-21.3	-30.6	-23.4	-25.9	11

Source: Explanatory Memorandum pp. 3-5.

Overall, the Bill's provisions are projected to have a negative \$90.6 million impact on revenue.¹

Committee consideration

Given the current political make up of the Senate it is possible that this Bill may be referred to a Senate Committee. In particular, comments made by the Australian Greens and Democrats spokespersons on similar measures for the granting of tax deductions for the planting of carbon sink forests contained in now lapsed Tax Laws Amendment (2007 Measures No. 6) Bill, that are almost identical to the proposed measures in **Schedule 3** of the current Bill, indicate that similar efforts will be made to refer this Bill to a Senate committee for further examination.

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1. The Hon. Wayne Swan MP, Treasurer, *Explanatory Memorandum* to the Tax Laws Amendment (2008 Measures No. 1) Bill 2008, 13 February 2008, pp. 3-5.

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This Bill makes a number of different amendments to taxation legislation. The following provides separate comment on the changes in each schedule.

Schedule 1 Political contributions and gifts

Purpose

Schedule 1 amends the *Income Tax Assessment Act 1997* (ITAA97) and the *Income Tax Assessment Act 1936* (ITAA36) to generally deny individual taxpayers a tax deduction in respect of political party membership fees paid after 1 July 2008. This schedule also denies a tax deduction to both individual and corporate tax payers in respect of contributions or gifts made to:

- political parties
- members of parliament (both State, Territory and Federal)
- members of a local governing body (such as a local council), and
- candidates (both party nominated and independent) for political office

on or after 1 July 2008.

Employees or office holders may continue to claim tax deductions for these amounts incurred in earning tax assessable income.

Background

Currently, a tax deduction is available in respect of the above contributions and gifts made to political parties registered under Pt XI of the *Commonwealth Electoral Act 1918* or registered under relevant State or Territory legislation, under Division 30-DA ITAA97. The maximum deduction for both individuals and companies is \$1500 per annum.²

A tax deduction in respect of these amounts was limited to \$100 per annum for contributions/gifts made before 22 June 2006. Before this date the deduction was only available in respect of gifts/contributions made to parties registered under the above Commonwealth Act. This meant that gifts/contributions made to:

- independent candidates
- State/Territory political parties
- members of State/Territory parliaments, and

2. Section 30-243 ITAA97.

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- all State/Territory political candidates made before 22 June 2006 did not qualify for any tax deduction.³

Basis of policy commitment

The denial of tax deductions for political gifts/contributions was announced by the then Shadow Minister for Finance, The Hon. Lindsay Tanner MP on 2 March 2007.⁴ The policy of removing the tax deductibility of political gifts/contributions was first announced by the then Leader of the opposition, the Hon. Kim C Beazley MP on 3 October 2006.⁵

Position of significant interest groups/press commentary

It has been argued that increasing the tax deductibility threshold for political donations/contributions from \$100 to \$1500 per annum encourages participation in the democratic process. That is, making political gifts/contributions tax deductible encourages citizen's democratic participation.

However, it has also been argued that the existence of such a high threshold skews political influence to the wealthier in society who have a greater capacity to contribute and who will receive proportionately higher (tax-payer funded) subsidies for making these donations.⁶

One press report argued that the removal of tax deductibility for these gifts/contributions would anger many political party members, especially those in the Australian Labor Party.⁷

Pros and cons

There are several reasons for the abolition of political gifts/contributions tax deductibility:

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3. Changes increasing the available tax deduction to the \$1500 p.a. and extending the scope of this tax deduction implemented by the *Electoral and Referendum Amendment (Electoral Integrity and Other Measures Act 2006* (No. 65 of 2006).
 4. The Hon. Lindsay Tanner MP, Minister for Finance and Administration, 'Labour's \$3 billion savings plan', *media release*, 2 March 2007.
 5. The Hon. Kim C Beazley MP, Leader of the Opposition, 'A Nation Building Role for the Public Service', *The Don Dunstan Oration*, Adelaide, 3 October 2006.
 6. Norm Kelly, 'Electoral reforms a threat to democracy', *Brisbane Institute Article*, 3 August 2006.
 7. Siobhain Ryan, 'Party fees to lose tax-free status', *Australian*, 15 November, 2007, p. 7.

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- it would have a positive financial impact, saving the government an estimated \$31.4 million between 2009–2010 and 2001–2012
- it may cause individuals to more carefully consider the direction of their political support, and
- remove any potential financial advantage (however significant) that higher income donors may receive in making a tax deductible donation.

However, there are some points in favour of retaining this tax deduction. The availability of a \$1500 tax deduction is of greater importance to individual donors than to corporate or wealthy donors. Insofar as the absence of a tax deduction discourages a large number of smaller donors from contributing, it allows corporate and wealthier donors to make up a greater proportion of a political party's/candidate's source of funding. It may be argued that this potentially increases the influence of corporatist and wealthier individual's influence on political decision making.

This last point has to be tempered by the realisation that currently it is unlikely that smaller donors to political parties or candidates exercise much influence simply on the basis of their donations alone.

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

Family First has indicated its support for the abolition of tax deductibility for gifts/contributions to political parties.⁸ Senator Murray stated that the Australian Democrats would oppose any increase in the amount allowed as a tax deduction in respect of political donations.⁹ Senator Bartlett also expressed the personal view that tax deductions in respect of political donations should be removed.¹⁰

A range of other views on this matter are in the report of the Joint Standing Committee on Electoral Matters entitled *the 2004 Federal Election – Polling day 9 October 2004*.¹¹

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8. Senator Steve Fielding, 'Family first opposes political party money grab', *media release*, SF. 68, 16 June 2006.
 9. Senator Andrew Murray, Second reading speech: Electoral and Referendum Amendment (Electoral Integrity and Other Measures) Bill 2006, Senate, *Debates*, 16 June 2006, p. 5.
 10. Senator Andrew Bartlett, Second reading speech: Electoral and Referendum amendment (Electoral Integrity and Other Measures) Bill 2006, Senate, *Debates*, 19 June 2006, p. 19.
 11. The Joint Standing Committee on Electoral Matters, *The 2004 Federal Election – Polling day: 9 October 2004*, Report of the Inquiry into the conduct of the 2004 Federal election and matters related thereto, September 2005, p. 330 and following, p. 377 and following.

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Financial implications

The following table outlines the projected financial impact of this particular measure.

Table 2: Financial impact – Abolition of tax deductibility for political donations

Year	2008–09	2009–10	2010–11	2011–12
Financial impact \$m	-	10.1	10.3	11.0

Source: Explanatory Memorandum p. 3.

Main provisions

Item 3 of Schedule 1 inserts new **section 26-22** into the ITAA97. This new section prevents a tax deduction for membership fees, gifts/contributions to political parties, electoral candidates or members of an Australian legislature or local governing body.

However **sub clause (2) of Item 3** allows a deduction to be claimed where such fees, gifts or contributions are necessarily incurred in the person gaining or producing tax assessable income.

The Explanatory Memorandum notes, for example, that a compulsory levy to retain a Member of Parliament's membership of a political party would still be tax deductible under the general tax deduction provision of section 8-1 ITAA97.

Item 9 repeals the whole of **Division 30-DA** ITAA97. This particular Division contains existing legislation allowing a limited tax deduction for political party membership fees and gifts/contributions to political parties.

Items 11 and 12 insert new **subsections** to **sections 110-38** and **110-55(9E)** ITAA97. These are consequential amendments to ensure that political party membership fees and political gifts/contributions do not form part of the cost base of an item subject to Capital Gains Tax and thereby reduce the amount of taxable income assessable when a gift/contribution is made to a political party.

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Schedule 2 Superannuation lump sums paid to a member having a terminal medical condition

Purpose

Schedule 2 amends the ITAA97 and the *Income Tax (Transitional Provisions) Act 1997* so that superannuation lump sum benefits paid to a terminally ill person on or after 1 July 2007 are tax free.

Background

Taxation of superannuation lump sums

A superannuation benefit may be paid to person if they are permanently incapacitated.¹² However, where such payments take place they are subject to tax, depending on the person's age and the source of the funds.

Commonly, lump sum payments made to the permanently incapacitated are made to persons who are well below their preservation age.¹³ Accordingly, upon withdrawal, the tax impost is

- 21.5 per cent for benefits paid from a taxed superannuation scheme, or
- 31.5 per cent for benefits of up to \$1 million paid from untaxed superannuation scheme and the top marginal rate plus Medicare levy for amounts over \$1 million from such schemes.

A taxed superannuation scheme is one that has been subject to the superannuation fund income tax of 15 per cent on tax deductible contributions (i.e. superannuation guarantee and salary sacrifice contributions) and a nominal 15 per cent on the investment earnings of such schemes. About 90 per cent of all Australian superannuation funds are taxed

12. Item 103 of Part 1 of Schedule 1 of the Superannuation Industry (Supervision) Regulations 1994.

13. A person's preservation age is the age at which they can withdraw their superannuation on a concessional tax basis if they meet a condition of release for these benefits. For those born before 1 July 1960 the preservation age is 55. For those born between 1 July 1960 and 30 June 1964 the preservation age rises from 55 to age 59. For those born in or after 1 July 1964 their preservation age is 60. Superannuation Industry (Supervision) Regulation 6.01.

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superannuation schemes. An untaxed superannuation scheme is one that has not been subject to this particular tax. These schemes are more common in the government sector.¹⁴

Basis of policy commitment

This measure was first announced by the then Minister for Revenue and Assistant Treasurer on 11 September 2007.¹⁵ In his press release Minister Dutton noted that he was particularly concerned by the plight of Mrs Christina Fiddimore, a Sydney mother with terminal cancer then aged 44.

Position of significant interest groups/press commentary

This measure follows a period lobbying both by lawyers from the Baker & McKenzie Group (working on behalf of cancer patients) and through the press.¹⁶ It was no surprise that press reports welcomed the initial announcement of this measure in September 2007.¹⁷

The Association of Superannuation Fund of Australia (ASFA) has strongly supported this measure.¹⁸

Pros and cons

The tax free payment of superannuation benefits to persons with a terminal illness will allow them to finalise their financial affairs, pay for expensive medical treatment and provide for their dependents before death.

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14. Only 10 per cent of superannuation fund members are members of defined benefit schemes. Australian Government, *A plan to simplify and streamline superannuation – Detailed Outline*, May 2006, p. 5.
 15. The Hon Peter Dutton MP, Minister for Revenue and Assistant Treasurer, Australians with terminal illness will be able to draw super tax free, *media release*, No 111, Canberra, 11 September 2007.
 16. Michelle Innis, 'Grave concerns for sick super tax', *Sydney Morning Herald*, 18 April 2007, p. 14, Alex Boxsell, 'Lawyers' super service for cancer patients', *Australian Financial Review*, 28 September 2007, p. 60, and Jill Margo, 'The terminally ill deserve better', *Australian Financial Review*, 6 September 2007, p. 66.
 17. Fleur Anderson, 'Tax break for terminally ill', *Australian Financial Review*, 12 September 2007, Annette Sampson, 'Super help for the sick', *The Age*, 7 November 2007 and Anne Lampe, 'Tax-free payout for terminally ill', *The Age*, 28 November 2007.
 18. ASFA, 'Welcome changes to super early release benefits for terminally ill', *media release*, 12 September 2007.

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There is a slight cost to revenue from the proposed changes.

Financial implications

The following table illustrates the projected financial impact of this measure.

Table 3: Projected financial impact of tax free lump sum payments to the terminally ill

Year	2007–08	2008–09	2009–10	2010–11
Financial impact \$m	-20	-25	-25	-25

Source: Explanatory Memorandum p. 4.

Main provisions

Item 2 of Schedule 2 inserts new **section 303-10** into the ITAA97. The effect of this new section is to classify a superannuation lump sum as a tax free amount if:

- the recipient has a terminal medical condition at the time of payment, or
- if the recipient is diagnosed as having a terminal medical condition within 90 days of receiving the payment.

Item 3 provides that the meaning of the term ‘terminal medical condition’ will be prescribed in regulations. These regulations have been tabled as the ‘Superannuation Industry (Supervision) Amendment Regulations 2008 (No. 1).¹⁹ These regulations provide, in essence, that a terminal medical condition exists where two medicinal practitioners (one of whom must be a relevant specialist) certify that “the person suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within 12 months after the date of certification”.

Item 4 amends the *Income Tax (Transitional Provisions) Act 1997* to give the same tax treatment for superannuation lump sums received by the terminally ill during the 2007–2008 year only.

Item 5 applies amendments made by this schedule to payments made on or after 1 July 2007.

19. Senator the Hon. Nick Sherry, Minister for Superannuation and Corporate Law, ‘Unrestricted Access to Superannuation Benefits for Persons with Terminal Medical Conditions’, *media release*, No. 007, 15 February 2008.

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Schedule 3 Capital expenditure for the establishment of trees in carbon sink forests

Purpose

Schedule 3 amends the ITAA97 to allow a tax deduction in respect of capital expenditure incurred in the establishment of trees in carbon sink forests.

Background

Similar measures were introduced into Parliament in Schedule 1 of the Tax Laws Amendment (2007 Measures No. 6) Bill 2007. This Bill lapsed with the calling of the 2007 election.

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 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 years and 105 days period if the forest is established on or after 1 July 2012, which the author understands is less than the effective life of a forest (though this is a disputed fact).²⁰ That is, it would be generally uneconomic for these trees to be cut down before this period had passed. Thus it would appear to make little sense to remove these trees before this period had expired. It may be argued that on the basis of these points that the expectation may be that these forests would be in existence for at least a 14 year and 105 day period, though this is nowhere stated in either the Bill or its supporting documents.

20. Other commentators have argued that this period is the effective life of a commercial forest. See Senator Christine Milne, Selection of Bills Committee Report, Senate, *Debates*, 20 September 2007, p. 5.

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Suffice to say that there is no measure in this particular Bill that suggests that a carbon sink forest can never be cut down. Rather, there is every expectation that the trees would remain in the ground for at least 14 years and 105 days. However, if such a forest was removed then the tax deductions would cease from that point in time.

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.

Basis of policy commitment

This measure was announced in the then Treasurer's media release of 8 May 2007.²¹

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.²²

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.²³

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

21. The Hon. Peter Costello MP, the then Treasurer, [Establishment costs for carbon sink forests deductible](#), media release, Parliament House, Canberra, No. 39, 8 May 2007.

22. Chris Johnson, 'Forest plan raises doubts, queries', *The West Australian*, 10 May 2007, p. 8.

23. 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.

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The National Association of Forest Industries welcomed the announcement of this initiative.²⁴

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
- promotes the planting of forests on land that has already been cleared. Existing forests cannot be felled to plant new carbon sink forests
- 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.²⁵ 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.

24. National Association of Forest Industries, [Budget allows forest carbon sinks to grow](#), media release, 8 May 2007.

25. 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).

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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.²⁶ 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 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 an 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 range of solutions, each tackling a particular dimension of climate change.

Coalition /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 amount of water used to support these trees should be first assessed
- 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.²⁷

26. 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).

27. Chris Johnson, op. cit. also Stephanie Peatling, 'Doubts raised over trees for carbon plan', *Sydney Morning Herald*, 21 September 2007, p. 7.

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In commenting on the Tax Laws Amendment (2007 Measures No. 6) Bill 2007 Senator Milne repeated many of the above points and also expressed concerns that productive farm land would be taken out of production by the planing of forests to secure tax benefits. The Senator suggested that this may occur if large carbon dioxide emitters, such as cement and aluminium companies, brought up farm land and planted trees to procure the tax benefits. The Senator was also concerned that such practices would potentially distort any carbon trading market established in Australia.²⁸

The establishment of specific carbon sink forests is not part of the Australian Greens policy.²⁹

Also commenting on the Tax Laws Amendment (2007 Measures No. 6) Bill 2007 Senator Bartlett of the Australian Democrats, noted that the measures relating to tax deductions for expenses incurred in planting carbon sink forests were quite complex. Consequently, these measures required further consideration by a Senate Committee.³⁰

Financial implications

The financial implications of this particular measure are outlined in the following table.

Table 4: Projected financial impact of tax deduction for the establishment of carbon sink forests

Year	2007–08	2008–09	2009–10	2010–11
Financial impact \$m	-	-4.7	-8.5	-11.1

Source: Explanatory Memorandum p. 4.

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.

28. Senator Christine Milne, Selection of Bills Committee Report, Senate, *Debates*, 20 September 2007, p. 5.

29. 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).

30. Senator Andrew Bartlett, Selection of Bills Committee Report, Senate, *Debates*, 20 September 2007, p. 7.

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Main provisions

Part 1

Item 6 of Schedule 3 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 harvesting or horticulture 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.

As noted above, only expenditure on the establishment of a carbon sink forest will be allowed as a tax deduction. The government has indicated that 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

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- fire breaks.³¹

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

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 Climate Change Minister must, by legislative instrument, make 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.

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

31. See The Hon. Wayne Swan MP, op. cit., p. 23.

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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.³²

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.³³

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.³⁴

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.³⁵ 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 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?

32. 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).

33. 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).

34. 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).

35. *ibid.*

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Finally, by becoming a party to the Kyoto Protocol to the United Nations Framework Convention on Climate Change the Australian government has formally committed itself to a target of 108 per cent of emissions over 1990 levels over the period 2008 to 2012. It should be noted that the previous government had informally committed itself to this target. 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.³⁶

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 3**).

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 11 of Schedule 3 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 12 repeals **proposed subsections 40-1005(1), (2), (3) and (4)** ITAA97 and replaces them with new provisions, from 1 July 2012. This section is inserted under **Item 6** of the 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).

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

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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 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.

Proposed **section 40-1030** allows deductions for carbon sink forests destroyed (say by fire) during the income year in which they were destroyed. However, the deduction is not allowable for the remaining time of the 14 year period referred to above.

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

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Schedule 4 Tax offset for Equine Workers Hardship Wage Supplement Payment

Purpose

Schedule 4 of this bill amends the ITAA97 and the *Income Tax Assessment Act 1936* (ITAA36) so that recipients of the Equine Workers Hardship Supplement Payment (the Supplement) are eligible for the beneficiary tax offset.

Background

What is the Equine Workers Supplement Payment?

The Supplement is an ex-gratia payment directly assisting workers involved in commercial horse industries who lost their job, or most of their income, and sole-traders whose incomes have effectively ceased, as a direct result of the Equine Influenza quarantine and movement restrictions. Eligible applicants received the equivalent of the Newstart Allowance rates - for a single, couple, or single with dependent child(ren) - for up to 12 weeks from 25 August 2007. This assistance was extended after the end of the first 12 week period and ended on 8 February 2008.³⁷

These payments were part of an initial \$114 million package of measures for people, businesses and equine organisations facing additional costs and significant hardship, as a direct result of the Equine Influenza quarantine and the movement restrictions currently in place.³⁸

What is the beneficiary tax offset?

Taxpayers whose assessable income includes certain government benefits are entitled to a rebate of tax known as the "beneficiary rebate" under ITAA36 subsections 160AAA(1) & (3). A tax offset and a tax rebate are different names for the same tax benefit. Examples of government payments that entitle a taxpayer to the beneficiary rebate are:

- certain Australian social security payments — i.e. Newstart allowance, sickness allowance, special benefit, partner allowance, mature age allowance and widow allowance
- the parenting payment (partnered) to the extent that it is not already tax exempt

37. The Hon Peter McGauran MP, Minister for Agriculture, Fisheries and Forestry, 'EI assistance package extended to \$227 million', *media release*, DAF07/168PM, 21 October 2007.

38. Department of Families, Housing, Community Services and Indigenous Affairs, *Equine Influenza Assistance*, [Fact Sheet](#), 14 September 2007 (accessed 15 January 2008).

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- exceptional circumstances relief payments or payments of restart income support (formerly called drought relief payments), and
- income support payments for those affected by Cyclone Larry or Cyclone Monica (for the 2005–06 to 2007–08 years only).³⁹

Equine Influenza – Current Disease Status

There have been no new cases of equine influenza since Christmas 2007 with no known infected properties in New South Wales and Queensland. However, some restrictions on the movement of horses remain in place.⁴⁰

Basis of policy commitment

The Explanatory Memorandum notes that the availability of this tax offset was announced by the then Minister for Agriculture, Fisheries and Forestry on 9 September 2007.⁴¹ However this particular press release does not contain a specific announcement concerning this particular tax offset. It is not otherwise clear when the application of the beneficiary tax offset to recipients of the Supplement was first announced.

Position of significant interest groups/press commentary

To date no comment has been made on the application of the beneficiary tax offset to recipients of the Supplement.

Pros and cons

The Supplement is essentially the payment of a NewStart Allowance to those whose income has either ceased, or been severely affected by the outbreak of equine influenza. The extension of the beneficiary tax offset to this group puts them on the same footing in relation to tax matters as those receiving other Commonwealth government payments. Thus, it is an equity, as much as a welfare, measure.

39. CCH, *Australian Master Tax Guide 2008*, Topic 15-146 – Beneficiary Rebate.

40. Department of Agriculture, Fisheries and Forestry, ‘Major milestone in horse flu eradication’, *media release*, DAF08/004D, 15 February 2008 and National Management Group: Equine Influenza, ‘No new EI infected properties in Australia since Christmas’, *communiqué*, NMGEI08/15, 15 February 2008.

41. The Hon. Peter McGuran MP, Minister for Agriculture, Fisheries and Forestry, ‘\$110 million Equine Influenza Assistance’, *media release*, DAF07/136PM, 9 September 2007.

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Financial implications

The Explanatory Memorandum notes that this measure will have a negligible financial impact.⁴²

Main provisions

Item 1 of **Schedule 4** amends **subsection 160AAA(1)** ITAA36 so that the Supplement is a benefit payment that qualifies the recipient to claim a beneficiary tax rebate.

Items 2 and **3** amend the list of payments in **section 13-1** ITAA97 that qualify the recipient to claim a tax offset.

Item 4 applies the provisions of **Schedule 4** to the 2007–08, and later, income years.

Schedule 5 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. This measure previously came before Parliament in Schedule 2 of the Tax Laws Amendment (2007 Measures No. 6) Bill 2007. As noted above, this particular Bill lapsed with the calling on the 2007 election.

Background

What is the Tobacco Growers Adjustment Assistance 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

42. The Hon. Wayne Swan MP, Treasurer, op. cit., p. 5.

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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.⁴³

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.⁴⁴ Generally, government grants paid to assist business to exit an industry are assessable under the capital gains tax (CGT) provisions rather than under the ordinary or statutory income tax laws. The former government decided to make these particular grants tax free for tobacco growers who undertake to exit all agricultural enterprises for at least 5 years.⁴⁵

Basis of policy commitment

The proposal to class these grants as tax free income was announced as part of the 2007–08 budget.⁴⁶

Position of significant interest groups/press commentary

To date little comment has been made on the proposed measure.

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

44. 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).

45. The Hon. Wayne Swan MP, Treasurer, op. cit., p. 35.

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

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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 implications of this particular measure are outlined in the following table.

Table 5: Projected financial impact of tax free grants for certain tobacco growers

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

Source: Explanatory Memorandum p. 5.

Main provisions

Item 2 of Schedule 5 amends the list of ordinary or statutory income which is exempt income (and therefore not taxable income) if derived by certain entities in **section 11-15** ITAA97 to include tobacco industry exit grants paid under the Tobacco Growers Adjustment Assistance Program 2006.

Item 3 amends **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.

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Schedule 6 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.

This measure was also previously considered by Parliament in the Tax Laws Amendment (2007 Measures No. 6) Bill 2007. Again as previously noted, this particular Bill lapsed with the calling of the 2007 election.

Background

What is a Farm Management Deposit?

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. When an FMD is withdrawn, the amount of the deduction previously allowed is included in both their tax assessable income in the repayment year.⁴⁷

47. CCH, *Australian Master Tax Guide 2007*, 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.⁴⁸ 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

48. *ibid*, Topic 18–293.

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support for farmers and agriculture-dependent small businesses while the EC application is being assessed.⁴⁹

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.⁵⁰

Main provisions

Item 1 of Schedule 6 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.

Item 2 applies the provisions of this Schedule to income tax assessments for the 2002–03 and later income years.

49. 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).

50. The Hon. Wayne Swan MP, Treasurer, op. cit., p. 6.

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