

2008

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TAX LAWS AMENDMENT (2008 MEASURES No. 1) BILL 2008

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EXPLANATORY MEMORANDUM

(Circulated by the authority of the  
Treasurer, the Hon Wayne Swan MP)



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# ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
CGT	capital gains tax
Commissioner	Commissioner of Taxation
FMD	farm management deposit
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
Newstart	Newstart Allowance
the Supplement	Equine Workers Hardship Wage Supplement Payment



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# General outline and financial impact

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## Contributions to political parties

Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* and the *Income Tax Assessment Act 1936* to remove tax deductibility for contributions and gifts to political parties, members and candidates.

**Date of effect:** This measure applies to contributions and gifts made on or after 1 July 2008.

**Proposal announced:** The Government made an election commitment to remove tax deductibility for political donations in *Labor's \$3 Billion Savings Plan* announced on 2 March 2007.

**Financial impact:** This measure will have these revenue implications:

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

**Compliance cost impact:** Nil.

## Superannuation lump sum paid to a person with a terminal medical condition

Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* and the *Income Tax (Transitional Provisions) Act 1997* so that a superannuation lump sum paid to a person who has a terminal medical condition is tax free.

**Date of effect:** These amendments apply to payments made on or after 1 July 2007. As the amendments remove tax on the affected payments, the retrospective application of the changes will not disadvantage taxpayers.

**Proposal announced:** This measure was originally announced in the then Minister for Revenue and Assistant Treasurer's Press Release No. 111 of 11 September 2007.

**Financial impact:** This measure will have these revenue implications:

2007-08	2008-09	2009-10	2010-11
-\$20m	-\$25m	-\$25m	-\$25m

**Compliance cost impact:** Negligible.

## Capital expenditure for the establishment of trees in carbon sink forests

Schedule 3 to this Bill amends Division 40 of the *Income Tax Assessment Act 1997* to provide a deduction for capital expenditure for the establishment of trees in carbon sink forests.

Expenditure incurred on establishing trees in a carbon sink forest will be immediately deductible in the period 2007-08 to 2011-12. After this initial period, establishment expenditure will be deductible under a write-off rate of 7 per cent per annum.

During both the initial period and after, the conditions for the deduction will be analogous with the horticultural plant provisions.

**Date of effect:** Amendments provided for the income years 2007-08 to 2011-12 (inclusive) apply to the 2007-08 income year and later income years.

Amendments provided for the income year 2012-13 and later years apply to the 2012-13 income year and later income years.

**Proposal announced:** This measure was announced in the then Treasurer's Press Release No. 39 of 8 May 2007.

**Financial impact:** This measure will have these revenue implications:

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

**Compliance cost impact:** Low.



## **Extension of the beneficiary tax offset to the Equine Workers Hardship Wage Supplement Payment**

Schedule 4 to this Bill amends the *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997* to extend eligibility for the beneficiary tax offset to individuals in receipt of the Equine Workers Hardship Wage Supplement Payment (the Supplement).

**Date of effect:** The beneficiary tax offset applies to payment of the Supplement made during the 2007-08 income year and later income years.

**Proposal announced:** This measure was part of a broader Equine Influenza assistance package which was announced in the then Minister for Agriculture, Fisheries and Forestry's Press Release No. DAFF07/136PM of 9 September 2007.

**Financial impact:** Nil.

**Compliance cost impact:** Negligible.

## **Tax-free grants for certain tobacco growers**

Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* to provide tax-free grants, under the Tobacco Growers Adjustment Assistance Programme 2006, to tobacco growers who undertake to exit all agricultural enterprises for at least five years.

**Date of effect:** This measure will apply to all relevant payments made in the 2006-07 and later income years.

**Proposal announced:** This measure was announced in the 2007-08 Budget.

**Financial impact:** This measure will have a cost to revenue of \$1.3 million in each of the 2007-08 and 2008-09 income years.

**Compliance cost impact:** Negligible.

## **Farm management deposits**

Schedule 6 to this Bill amends the farm management deposit scheme in the *Income Tax Assessment Act 1936* to align the tax law with the guidelines for declaring either *all primary producers* in a geographical

area, or *specified classes of primary producers* within a geographical area, to be in exceptional circumstances.

***Date of effect:*** This measure will commence from 1 July 2002. This will ensure that those taxpayers that were previously disadvantaged by this inconsistency get the opportunity to receive the tax benefit.

***Proposal announced:*** This amendment was previously introduced into the House of Representatives on 13 September 2007 as part of the Tax Laws Amendment (2007 Measures No. 6) Bill 2007.

***Financial impact:*** The revenue cost 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.

***Compliance cost impact:*** Nil.

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# **Chapter 1**

## ***Contributions to political parties***

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### **Outline of chapter**

1.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936) to remove tax deductibility for contributions or gifts to political parties, members and candidates.

### **Context of amendments**

1.2 Subject to certain conditions, contributions or gifts of money or property to political parties, independent members and independent candidates are tax deductible up to a maximum of \$1,500.

### **Summary of new law**

1.3 These amendments remove the ability for taxpayers to claim specific deductions for contributions and gifts to political parties and independent members and candidates.

1.4 These amendments also remove general deductions for business taxpayers for contributions and gifts to political parties, members and candidates. They also preclude such contributions or gifts from forming part of the cost base or reduced cost base of any capital gains tax (CGT) asset. These changes do not affect the principle found in the general tax deduction provision that individuals should be able to claim a deduction where the contribution is related to their employment.

1.5 This measure applies in relation to contributions and gifts made on or after 1 July 2008.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Division 30 of the ITAA 1997 does not allow deductions for contributions and gifts to political parties and to independent candidates and independent members.</p> <p>Only employees or office holders may claim deductions for political gifts and contributions incurred in earning assessable income as a general deduction. Also, taxpayers who are not employees or office holders cannot include political contributions or gifts in the cost base or reduced cost base of any CGT asset.</p>	<p>Division 30 of the ITAA 1997 allows deductions for contributions and gifts to political parties and to independent candidates and independent members.</p> <p>Taxpayers may claim political gifts and contributions incurred in earning assessable income or carrying on a business as a general deduction.</p>

## Detailed explanation of new law

1.6 Various references to political gifts and contributions are removed from Division 30, including repealing the main provisions in Subdivision 30-DA. As a result, gifts and contributions made by taxpayers (including those for membership fees) to political parties, independent members and independent candidates are no longer deductible under these provisions. [Schedule 1, items 4 to 10, Subdivision 30-DA, subsections 30-5(1), 30-15(2) and item 87 in the table in subsection 30-315(2)]

### Example 1.1

Mary wishes to support a registered political party, and consequently makes a \$1,000 gift to the party. The gift is not deductible.

### Example 1.2

Bob earns his income by being employed as an engineer and is a member of a political party for which he pays \$50 a year in membership fees. The membership payment is not incurred in earning his assessable income, and is therefore *not* deductible.

1.7 Division 26 of the ITAA 1997 sets out amounts that cannot be deducted, or deducted in full, from assessable income. To ensure that a deduction is not available:

- a section is added to Division 26 to deny taxpayers who are not employees or office holders from deducting contributions and gifts to political parties, members and candidates under other parts of the Act, including the general deduction provision in section 8-1 of the ITAA 1997. The general deduction provision allows deductions for losses or outgoings to the extent that they are incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for the purposes of gaining or producing assessable income. This amendment applies to gifts and contributions to parties, members and candidates at the federal, state and local government level; and
- the CGT provisions are amended so that such expenses also do not form part of the cost base or reduced cost base for capital gains purposes. This ensures that no capital loss or reduced capital gain can arise from such contributions or gifts.

*[Schedule 1, items 3, 11 and 12, section 26-22, subsections 110-38(6) and 110-55(9F)]*

### **Example 1.3**

XYZ Ltd is a proof reading company specialising in political publications. XYZ Ltd is looking to maintain its corporate profile, and to this end makes contributions to political parties. This amendment ensures that XYZ Ltd is unable to claim these contributions under section 8-1 as a loss or outgoing necessarily incurred in carrying on its business or for the purpose of gaining or producing its assessable income.

1.8 The existing general tax deduction provision continues to apply to employees and office holders. Contributions to political parties remain deductible provided that they meet the general deduction requirements of section 8-1. In other words, a deduction will be available where the amount contributed is incurred in gaining or producing assessable income (similar to an accountant being eligible for a deduction for annual subscriptions paid to a society of accountants). The new Division does not seek to extend the ordinary deduction requirements of section 8-1.

*[Schedule 1, item 3, section 26-22]*

**Example 1.4**

A Member of Parliament pays a compulsory levy to retain their party membership. This would generally be deductible under section 8-1.

**Example 1.5**

A Member of Parliament pays for a ticket to attend a fundraising event hosted by their party where a substantial sit-down dinner is provided. The ticket price generally would *not* be deductible under section 8-1.

## **Application and transitional provisions**

1.9 These amendments apply to contributions and gifts made on or after 1 July 2008. [*Schedule 1, item 15*]

## **Consequential amendments**

1.10 The reference to contributions to political parties in the non-operative index of provisions about deductions is amended to refer to the new section in Division 26. [*Schedule 1, item 2, section 12-5*]

1.11 The references to ‘independent candidate’ and ‘independent member’ are repealed from the ITAA 1997 Dictionary. [*Schedule 1, items 13 and 14, definition of ‘independent candidate’ and ‘independent member’ in subsection 995-1(1) of the ITAA 1997*]

1.12 The provisions for tax deductions for political donations were expanded by the *Electoral and Referendum Amendment (Electoral Integrity and Other Measures) Act 2006*. Among other things, the amendments provided for additional deductions for contributions and gifts to independent candidates and independent members. Consequently, minor amendments were made to subsection 78A of the ITAA 1936 (which denies deductions for certain gifts) to cover individuals who were able receive tax deductible donations. These minor amendments are reversed. [*Schedule 1, item 1, subsections 78A(2), (3) and (4) of the ITAA 1936*]

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## **C**hapter 2

# ***Superannuation lump sum paid to a person with a terminal medical condition***

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### **Outline of chapter**

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax (Transitional Provisions) Act 1997* so that a superannuation lump sum paid to a person who has a terminal medical condition is tax free.

### **Context of amendments**

2.2 The taxation treatment of a superannuation lump sum payment differs depending on the age of the recipient and whether the payment is from a taxed or an untaxed source. For example, superannuation lump sums paid to members of taxed schemes below preservation age are taxed at a maximum rate of 21.5 per cent (inclusive of the Medicare levy). For members of untaxed schemes below preservation age, superannuation lump sums are taxed at a maximum rate of 31.5 per cent up to \$1 million, and at the top marginal rate plus the Medicare levy for amounts above \$1 million.

2.3 These amendments provide that a superannuation lump sum paid from either a taxed or an untaxed source to a person with a terminal medical condition is tax free.

### **Summary of new law**

2.4 Section 303-10 is inserted into Division 303 of the ITAA 1997 with the effect that a superannuation lump sum paid to a person with a terminal medical condition is non-assessable and non-exempt income.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
A superannuation lump sum paid to a member in respect of whom a terminal medical condition exists is non-assessable and non-exempt income.	The taxation treatment of a superannuation lump sum payment to a fund member differs depending on the age of the member and whether the payment is from a taxed or an untaxed source.

## Detailed explanation of new law

2.5 Division 303 of the ITAA 1997 deals with the taxation of superannuation benefits paid in special circumstances. Section 303-10 is inserted into Division 303 with the effect that a superannuation lump sum member benefit received by a person is not assessable income and is not exempt income if a ‘terminal medical condition’ exists in relation to the person at the time they receive the payment or within 90 days after they receive it. The circumstances in which a ‘terminal medical condition’ will be taken to exist in relation to a person will be prescribed in the *Income Tax Assessment Regulations 1997*. [Schedule 2, item 2, section 303-10 of the ITAA 1997, and item 3, definition of ‘terminal medical condition’ in subsection 995-1(1) of the ITAA 1997]

2.6 A consequential amendment is made to section 11-55 of the ITAA 1997 to include a reference to section 303-10 in the list of non-assessable non-exempt income provisions. [Schedule 2, item 1, section 11-55 of the ITAA 1997]

## Application and transitional provisions

2.7 The amendments made by this Schedule apply to payments made on or after 1 July 2007. As the amendments remove tax on the affected payments, the retrospective application of the changes will not disadvantage taxpayers. [Schedule 2, item 5]

2.8 A transitional provision will apply for the 2007-08 financial year. Under this transitional provision the 90-day period from when a payment is received (referred to in section 303-10) can be extended to 30 June 2008 if this results in a longer period. [Schedule 2, item 2, note to section 303-10 of the ITAA 1997, and item 4, section 303-10 of the *Income Tax (Transitional Provisions) Act 1997*]



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## **C**hapter 3

# **Capital expenditure for the establishment of trees in carbon sink forests**

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### **Outline of chapter**

3.1 Schedule 3 to this Bill amends Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997) to provide a deduction for capital expenditure for the establishment of trees in carbon sink forests.

### **Context of amendments**

3.2 Carbon sink forests are forests which are established for the primary and principal purpose of sequestering carbon from the atmosphere. The carbon stored in the growing forest can then be used for greenhouse gas abatement purposes.

3.3 The costs of establishing trees in a carbon sink forest are capital in nature and income may be generated from exploiting rights over the carbon sequestered in the trees. Currently the costs of establishing trees in carbon sink forests are not deductible.

3.4 Capital expenditure for the establishment of trees in carbon sink forests will be inserted as a separate Subdivision in Division 40 of the ITAA 1997. Division 40 provides for a uniform capital allowances system. That system provides general rules that allow deductions for the decline in value of depreciating assets based on their effective lives. As well, Division 40 provides write-offs for certain other capital expenditures, which do not result in a taxpayer holding a depreciating asset, if that expenditure satisfies certain specific conditions.

3.5 Proposed Subdivision 40-J will be inserted to allow a deduction for capital expenditure for the establishment of trees in carbon sink forests.

## Summary of new law

3.6 Establishment expenditure will be immediately deductible for trees established in carbon sink forests in the 2007-08 to 2011-12 income years (inclusive). After this initial period, establishment expenditure will be deductible over 14 years and 105 days at a rate of 7 per cent per annum.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Establishment expenditure will be immediately deductible for trees in carbon sink forests established in the 2007-08 to 2011-12 income years (inclusive). After this initial period, establishment expenditure will be deductible over 14 years and 105 days at a rate of 7 per cent per annum.	Establishment expenditure incurred on trees in carbon sink forests is currently not deductible on revenue account, but may form part of the cost base for the relevant interest in land.

## Detailed explanation of new law

3.7 Proposed Subdivision 40-J will be inserted into Division 40 of the ITAA 1997 to allow deductions for establishment expenditure on trees in carbon sink forests.

### Income years 2007-08 to 2011-12 (inclusive)

#### *Who is entitled to the deduction?*

3.8 Taxpayers carrying on a business can deduct capital expenditure incurred on establishing trees in a carbon sink forest. The requirement that taxpayers must be carrying on a business is sufficiently broad to allow those businesses who wish to abate their own greenhouse gas emissions via a carbon sink forest to be eligible for the deduction. [Schedule 3, item 6, paragraphs 40-1010(1)(a) to (c)]

3.9 The primary and principal purpose of establishing the trees must be for carbon sequestration and can not include the purposes of felling the trees or for using them in commercial horticulture. This deduction will only apply to those taxpayers who establish trees as part of a carbon sink forest. [Schedule 3, item 6, paragraphs 40-1010(1)(d) and (e)]

### **Example 3.1**

A company acquires land and plants trees for the primary and principal purpose of carbon sequestration. The landholder also runs a tourism business, taking advantage of the spectacular location to run a bed and breakfast and accompanying hiking tours. The hiking routes run through the carbon sink forest to the edge of the property which takes in the panoramic views.

The company will be entitled to deductions for expenditure on establishing the carbon sink forest, as the primary and principal purpose is one of carbon sequestration and the secondary purpose of tourism is not an excluded purpose.

### **Example 3.2**

A company specialises in the propagation of new species of trees for the purpose of commercial horticulture. The company acquires land and conducts 0.2 hectare test planting of a new species of waterless trees. They plan to tend the test planting for a number of years before the species will be ready for commercial sale. The trees in the test planting sequester carbon and the company decides to trade in carbon credits to supplement the tending costs.

The company will not be entitled to any deduction under the carbon sink forest provisions for establishing the trees as their primary and principal purpose was not one of carbon sequestration (see paragraph 40-1010(1)(d)). In addition, the purpose of commercial horticulture is excluded under subparagraph 40-1010(1)(e)(ii).

3.10 The deduction is not available for expenditure on establishing trees in a carbon sink forest incurred by a managed investment scheme or a forestry managed investment scheme. [*Schedule 3, item 6, paragraph 40-1010(1)(f)*]

3.11 This does not exclude a forestry manager entity from operating a separate business of trading in carbon offsets generated from an adjacent carbon sink forest.

3.12 A taxpayer can deduct the capital expenditure incurred on establishing trees for the primary and principal purpose of carbon sequestration if one of the following is satisfied:

- the taxpayer owns the trees and any holder of a lease, lesser interest or licence relating to the land occupied by the trees does not use the land for carbon sequestration purposes [*Schedule 3, item 6, subsection 40-1005(5), item 1 in the table*];

- the trees are attached to land that the taxpayer leases (from anyone), or holds under a quasi-ownership right granted by an exempt Australian or exempt foreign government agency, and the lease or quasi-ownership right entitles the taxpayer to use the land for carbon sequestration. Further, if there is another entity that holds a lesser interest or licence relating to the land, that entity must not use the land for carbon sequestration [*Schedule 3, item 6, subsection 40-1005(5), item 2 in the table*]; or
- the taxpayer is the licensee relating to the land occupied by the trees and uses the land for carbon sequestration purposes as a result of that licence [*Schedule 3, item 6, subsection 40-1005(5), item 3 in the table*].

3.13 Together, these rules ensure that the taxpayer who can claim the deduction is the taxpayer with the least interest in the land who is using the land for the primary and principal purpose of carbon sequestration. This will ensure that only one taxpayer is entitled to a deduction under section 40-1005 in respect of capital expenditure in establishing trees in a carbon sink forest on a given area of land.

### **Example 3.3**

A company enters into a lease agreement with a landowner so that the company can establish trees for the purpose of carbon sequestration. The company then incurs expenditure to establish trees which satisfy subsection 40-1010(2). There is no other taxpayer that has a lesser interest in that land who is using the land for the primary and principal purpose of carbon sequestration. The company is therefore eligible to claim a deduction for the trees established on that land.

### **Example 3.4**

Company A enters into a lease arrangement over 25 hectares of land with a landholder. The lease enables company A to use the land for the primary and principal purpose of carbon sequestration. Company A also incurs capital expenditure on the establishment of trees on 15 hectares of the land for the primary and principal purpose of carbon sequestration.

Company A subsequently enters into an agreement with company B to establish trees in a carbon sink forest on the other 10 hectares of land. Under the agreement company B is granted a licence over those 10 hectares allowing it to use the land and the trees for the primary and principal purpose of carbon sequestration.

As company B is using the land and the trees for the primary and principal purpose of carbon sequestration and it has the least interest in

the 10 hectares of land, company B satisfies the conditions in the table in subsection 40-1005(5).

Company B pays company A to establish the trees on the 10 hectares for which company B has the licence. The expenditure incurred by company B is capital in nature. The expenditure in relation to the trees is also covered under section 40-1010. As company B has the least interest in that land and is using the land for the primary and principal purpose of carbon sequestration, it satisfies the condition in the table in subsection 40-1005(5) for the trees, and company B is able to claim the deduction for the expenditure it incurred. Even if the expenditure incurred by company A on establishing trees in the carbon sink forest on the 10 hectares of land is capital in nature, company A is not eligible for the deduction under section 40-1005 for the establishment expenditure as company B has a lesser interest in the 10 hectares of land and uses that land for the principal and primary purpose of carbon sequestration by the trees.

The expenditure incurred by company A in relation to the trees on the 15 hectares is covered under section 40-1010. As company A has a lease over the land on which it has established the trees that enables it to use the land for the primary and principal purpose of carbon sequestration and there is no holder of a lesser interest in the land company A satisfies a condition in the table in subsection 40-1005(5). Company A is therefore able to claim the deduction for the expenditure it has incurred.

3.14 The amount of the deduction for an income year is the amount of the expenditure incurred on establishing the trees. [*Schedule 3, item 6, subsection 40-1005(2)*]

***Condition for deduction***

3.15 The deduction is only available for expenditure incurred on establishing trees in a forest that can achieve the characteristics of a carbon forest sink forest. [*Schedule 3, item 6, paragraph 40-1010(1)(g)*]

3.16 The trees, when established, must satisfy the following conditions:

- at the end of the income year, the trees occupy 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 they will:
  - attain a crown cover of 20 per cent or more; and
  - reach a height of at least two metres; and

- on 1 January 1990, the area occupied by the trees was clear of other trees that:
  - attained, or were more likely than not to attain, a crown cover of 20 per cent or more; and
  - reached, or were more likely than not to reach, a height of two metres or more.

*[Schedule 3, item 6, subsection 40-1010(2)]*

### **Example 3.5**

A company acquires 0.5 hectares of land suitable for growing trees for the purpose of establishing carbon sink forests in the 2008-09 income year. The company establishes a plot of trees covering a geographically connected 0.3 hectare land area and another geographically separated plot of trees covering a 0.1 hectare land area in the 2008-09 income year.

The plot of trees covering the 0.1 hectare land area does not satisfy the condition in paragraph 40-1010(2)(a). The plot of trees covering the 0.3 hectare land area does satisfy the condition in paragraph 40-1010(2)(a).

As a result, the company will be able to claim a deduction for the capital expenditure incurred on establishing the 0.3 hectares of trees (as long as the trees will satisfy the remaining conditions in subsection 40-1010(2)), but will not be able to claim a deduction for the second plot (the 0.1 hectares).

### **Example 3.6**

Continuing Example 1.5, the company established the remaining 0.1 hectare of land in the 2009-10 income year. This planting will be geographically connected to the planting that occurred in the 2008-09 income year (the other 0.1 hectare of land referred to in Example 1.5). As a result, the 0.2 hectare of trees satisfy the condition in paragraph 40-1010(2)(a) and will be considered a carbon sink forest, assuming all other conditions in subsection 40-1010(2) are met, for the carbon sink forest.

The company will be entitled to a deduction under subsection 40-1005(1) for capital expenditure the company incurred on establishing the second plot (regardless of what year the costs were incurred).

The deduction for capital expenditure on establishing a carbon sink forest will not be available until subsection 40-1010(2) is satisfied.

3.17 Australia is a party to the *Kyoto Protocol to the United Nations Framework Convention on Climate Change*. Australia has a target under the *Kyoto Protocol* to limit emissions to 108 per cent of 1990 levels over the period 2008 to 2012, and follows internationally agreed rules in accounting for progress towards this target. The conditions in paragraphs 40-1010(2)(a) to (c) align with the criteria for carbon sink forest activities that can contribute to Australia's greenhouse gas target. This ensures that the tax deduction encourages the establishment of forests that can contribute to Australia's target.

3.18 The establishment of the trees must meet the requirements of the *Environmental and Natural Resource Management Guidelines* issued by legislative instrument, by the 'Climate Change Minister' (see paragraph 3.43). [*Schedule 3, item 6, paragraph 40-1010(2)(d) and subsection 40-1010(3)*]

#### ***When the deduction is available***

3.19 For trees established wholly within an income year, the deduction is available in the income year the trees are established and if subsection 40-1010(2) is met. [*Schedule 3, item 6, paragraphs 40-1010(1)(a) to (g)*]

3.20 Where some or all of the trees are established after the end of the income year, but within the first four months of the following income year, expenditure incurred in the previous income year is immediately deductible. [*Schedule 3, item 6, subsection 40-1005(3)*]

3.21 Expenditure incurred in the four months from the end of the income year will be deductible in the year it is incurred. [*Schedule 3, item 6, subsection 40-1005(1)*]

3.22 Deductions for any prepayment of expenditure that would be incurred in the four months from the end of the income year are still subject to Subdivision H of Division 3 of the *Income Tax Assessment Act 1936*.

#### **Example 3.7**

A company acquires 0.5 hectares of land suitable for growing trees for the purpose of establishing carbon sink forests in the 2008-09 income year. The company establishes a plot of trees covering a geographically connected 0.3 hectare land area and another geographically separated plot of trees covering a 0.1 hectare land area in the 2008-09 income year.

The plot of trees covering the 0.1 hectare land area does not satisfy the condition in paragraph 40-1010(2)(a), at the end of the income year.

The plot of trees covering the 0.3 hectare land area does satisfy the condition in paragraph 40-1010(2)(a).

However, in the four months after the 2008-09 income year, the company completes the 0.1 hectares that connects both the first 0.1 hectare and the 0.3 hectare plantings, resulting in a total of the 0.5 hectares as one planting. As such, all costs incurred until the end of the 2008-09 income year are deductible in the 2008-09 income year. The costs incurred in the four months after the end of the income year are deductible at the end of the 2009-10 year.

### **Example 3.8**

A company acquires 0.5 hectares of land suitable for growing trees for the purpose of establishing carbon sink forests in the 2008-09 income year. The company establishes a plot of trees covering a geographically connected 0.3 hectare land area and another geographically separated plot of trees covering a 0.1 hectare land area in the 2008-09 income year.

The plot of trees covering the 0.1 hectare land area does not satisfy the condition in paragraph 40-1010(2)(a). The plot of trees covering the 0.3 hectare land area does satisfy the condition in paragraph 40-1010(2)(a).

The remaining 0.1 hectare is established after the four-month period at the end of the 2008-09 income year (ie, late in the 2009-10 income year) and therefore does not satisfy the four-month rule. This leads to the 0.1 hectare established up until the 2008-09 income year and the new 0.1 hectare just planted, satisfying subsection 40-1010(2) at the end of the 2009-10 income year.

The costs incurred in the 2008-09 income year on the 0.1 hectares as well as the additional 0.1 hectares established in the 2009-10 income year, will be deductible at the end of the 2009-10 income year.

3.23 Where a deduction has been claimed because trees are established in the first four months of a new income year and further trees are established before the end of that same income year, the initial planting must be ignored for the purposes of calculating whether the trees occupy the size requirement in paragraph 40-1010(2)(a). [*Schedule 3, item 6, subsection 40-1005(4)*]

### **Example 3.9**

A company acquires three hectares of land suitable for growing trees for the purpose of establishing carbon sink forests in the 2008-09 income year. The company establishes a plot of trees covering a geographically connected 0.1 hectare land area in the 2008-09 income year.



However, in the four months after the 2008-09 income year, the taxpayer completes a further 0.1 hectares that connects the 0.2 hectares as one planting. As such, all costs incurred until the end of the 2008-09 income year are deductible in the 2008-09 income year. The costs incurred in the four months after the end of the income year are deductible at the end of the 2009-10 income year.

Over the remaining months in the income year, the company establishes the remaining 2.8 hectares. The costs of the final 2.8 hectares are deductible in the 2009-10 income year. This final 2.8 hectares is considered to be a separate planting for the purposes of the 0.2 hectare requirement in paragraph 40-1010(2)(a).

### ***Notice of establishment***

3.24 The owner of the trees must give a notice to the Commissioner of Taxation (Commissioner) providing all information necessary to determine whether all conditions in subsection 40-1010(2) are met. *[Schedule 3, item 6, paragraph 40-1010(1)(h)]*

3.25 The notice must be given to the Commissioner no later than the earlier of:

- the lodgment of the taxpayer's income tax return; or
- five months after the end of the income year.

*[Schedule 3, item 6, subsection 40-1010(4)]*

3.26 The notice may include, but is not limited to:

- the Australian Business Number of the entity that gives the form to the Commissioner;
- the latitude and longitude of a central point within the area occupied by the trees, as determined by reference to the Geocentric Datum of Australia;
- the species of trees established;
- the estimated number of trees established per hectare of the area occupied by the trees;
- the rationale for the probability of meeting subsection 40-1010(2); and
- the amount of expenditure incurred in establishing the trees on the woodlot.

3.27 This notice will allow the Commissioner to seek confirmation from the Secretary to the Department of Climate Change (Climate Change Secretary — see paragraph 3.43) that the trees established will be able to achieve the characteristics of a carbon sink forest. [*Schedule 3, item 6, subsection 40-1010(8)*]

3.28 However, the Climate Change Secretary must give the Commissioner a notice if the Climate Change Secretary is satisfied that one or more characteristics of a carbon sink forest has *not* been met or *may not* be met [*Schedule 3, item 6, subsection 40-1010(5)*]. The characteristics of a ‘carbon sink forest’ are defined in paragraphs 3.15 to 3.18.

3.29 No deduction can be claimed if the Climate Change Secretary is not satisfied that subsection 40-1010(2) has been, or will be, met and has given the Commissioner a notice stating this. [*Schedule 3, item 6, subsections 40-1010(5) and (6)*]

3.30 A taxpayer may apply to the Administrative Appeals Tribunal for a review of a decision taken by the Climate Change Secretary in relation to the notice provided to the Commissioner. [*Schedule 3, item 6, subsection 40-1010(7)*]

3.31 The Climate Change Secretary is required to provide the taxpayer a copy of the notice under section 27A of the *Administrative Appeals Tribunal Act 1975*.

3.32 This notice will ensure that a deduction is only available in respect of trees that can achieve the characteristics of a carbon sink forest.

#### ***Establishment expenditure***

3.33 *Establishment expenditure* is expenditure incurred on establishing trees for the purpose of carbon sequestration. [*Schedule 3, item 6, paragraph 40-1010(1)(d)*]

3.34 *Establishment* occurs when the trees are planted, grown from seed or deliberately regenerated from natural seed sources in their long-term growing medium, in the ground, in a permanent way.

3.35 ***Carbon sequestration*** by a tree or forest means the process by which the tree or forest absorbs carbon dioxide from the atmosphere [*Schedule 3, item 6, section 40-1015*]. An amendment to subsection 995-1(1) is also made to include this definition [*Schedule 3, item 8, definition of ‘carbon sequestration’ in subsection 995-1(1) of the ITAA 1997*].

3.36 The costs of establishing trees for the purpose of carbon sequestration may include the following:

- the costs of acquiring the trees or seeds;
- the costs of planting the trees or seeds;
- the costs of pots and potting mixtures where the potted plants are being nurtured prior to being established in their long term growing medium, in the ground, in a permanent way;
- the costs incurred in grafting trees and germinating seedlings;
- the costs of allowing seeds to germinate (whether by broadcasting, deliberate regeneration or planting seeds directly);
- any costs incurred on preparing to plant which may, in some cases, include that part of the costs of ploughing, scarifying, contouring, top dressing, fertilising, weed spraying, stone removal, and top soil enhancement that is for the purpose of establishing trees for carbon sequestration; and
- the costs of surveying the planted area.

3.37 Establishment expenditure incurred on establishing trees for the purpose of carbon sequestration does not include expenditure on other plants (eg, trees for felling, horticultural plants). However where trees are used for associated purposes, for example, companion planting for the purpose of carbon sequestration, then expenditure incurred in establishing those trees will fall within the operation of proposed Subdivision 40-J.

3.38 Establishment expenditure does not include expenditure incurred in draining swamps or low-lying land or on clearing land. [*Schedule 3, item 6, section 40-1020*]

3.39 Expenditure on assets separate from the trees is not considered to be establishment expenditure. Examples of this include:

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

3.40 Expenditure incurred on rights that allow access to land or for carbon credits to be traded in the future is not considered to be establishment expenditure. Even though this expenditure may be incurred at the time of establishment, it is not considered to have a sufficient nexus for a direct expense to be incurred on establishing the trees. Examples of these costs include the costs of acquiring a right to enter land and establish the forest (commonly known as forestry rights) and the costs of acquiring the right to create a carbon credit (commonly known as carbon sequestration rights).

3.41 Nothing in this measure denies a taxpayer access to other provisions in the tax law that may provide deductions for expenditure on failed projects.

***Non-arm's length transactions***

3.42 The amount of capital expenditure on which a deduction is based cannot exceed the market value of what the expenditure was for, if any of the parties to an arrangement under which the expenditure is incurred are not dealing at arm's length. *[Schedule 3, item 6, section 40-1025]*

***Climate Change Minister and Climate Change Secretary***

3.43 An amendment is made to subsection 995-1(1) to include a definition for the 'Climate Change Minister' and the 'Climate Change Secretary'. The ***Climate Change Minister*** is the Minister administering the *National Greenhouse and Energy Reporting Act 2007*. The ***Climate Change Secretary*** is the Secretary of the Department that administers the *National Greenhouse and Energy Reporting Act 2007*. *[Schedule 1, items 9 and 10, definition of 'Climate Change Minister' and 'Climate Change Secretary' in subsection 995-1(1) of the ITAA 1997]*

**Income year 2012-13 and later income years**

***Who is entitled to the deduction?***

3.44 Taxpayers carrying on a business and who satisfy the conditions outlined in paragraph 3.12 can deduct capital expenditure incurred by them or another establishing entity on the establishment of trees for the purpose of carbon sequestration. *[Schedule 3, item 12, subsection 40-1005(1)]*

3.45 The primary and principal purpose of establishing the trees must be for carbon sequestration and can not include felling the trees or using the trees in commercial horticulture. This deduction will only apply to trees planted as part of a carbon sink forest. *[Schedule 3, item 12, paragraphs 40-1010(1)(d) and (e)]*

3.46 The deduction is not available for expenditure incurred on trees in a carbon sink forest by a managed investment scheme or a forestry managed investment scheme. *[Schedule 3, item 12, paragraph 40-1010(1)(f)]*

3.47 A forestry manager entity may operate a separate business of carbon trading by establishing a qualifying carbon sink forest.

3.48 The trees must meet the conditions for deduction as outlined in paragraphs 3.15, 3.16 and 3.18.

***How is the deduction calculated?***

3.49 The deduction is worked out using the following formula:

$$\text{Establishment expenditure} \times \frac{\text{Write-off days in income year}}{365} \times \text{Write-off rate}$$

*[Schedule 3, item 12, subsection 40-1005(2)]*

3.50 The types of expenditure included in establishment expenditure are as set out in paragraphs 3.33 to 3.41.

3.51 The *write-off days in income year* is the number of days in the income year starting on the first day of the income year in which the trees are established and ending 14 years and 105 days later. The first day of the income year is 1 July unless the taxpayer has, or is transiting into or out of, a substituted accounting period. *[Schedule 3, item 12, subsection 40-1005(2)]*

3.52 The number of write-off days does not include days in the income year on which the taxpayer did not use the land for the purpose of carbon sequestration by the trees, or did not meet the conditions for the deduction as set out in paragraph 3.12. Therefore, if the taxpayer sells their trees during the income year, the number of write-off days in the income year does not include the days after the sale of the trees. *[Schedule 3, item 12, paragraph 40-1005(2)(a)]*

3.53 The *write-off rate* is constant at 7 per cent per annum. *[Schedule 3, item 12, subsection 40-1005(2)]*

3.54 This deduction will allow a straight line write-off of 7 per cent per income year over 14 years and 105 days. However, the taxpayer is not able to deduct more than the total amount incurred on establishing the trees. *[Schedule 3, item 12, subsection 40-1005(3)]*

**Example 3.10**

Matthews Carbon Sinks Services Ltd establishes trees for the purpose of carbon sequestration on 1 September 2012. Matthews Carbon Sinks Services Ltd incurred establishment expenditure of \$400,000.

The allowable deduction for these trees is:

**2012-13 income year**

$$\text{Establishment expenditure} \times \frac{\text{Write-off days in income year}}{365} \times \text{Write-off rate}$$

$$\$400,000 \times \frac{365}{365} \times 7\% = \$28,000$$

**2013-14 income year**

$$\$400,000 \times \frac{365}{365} \times 7\% = \$28,000$$

**2027-28 income year**

As the write-off period is 14 years 105 days after the first day of the income year in which the trees were established, 105 days are remaining in the 2027-28 income year.

$$\text{Establishment expenditure} \times \frac{\text{Write-off days in income year}}{365} \times \text{Write-off rate}$$

$$\$400,000 \times \frac{105}{365} \times 7\% = \$8,054.79$$

That is, \$8,000 as subsection 40-1005(3) limits the deduction to the amount of capital expenditure incurred.

***Notice of establishment***

3.55 At the time the trees are established, the owner of the trees must give a notice to the Commissioner. Further details are provided in paragraphs 3.24 to 3.32.

***Non-arm's length transaction***

3.56 The amount of capital expenditure on which a deduction is based cannot exceed the market value of what the expenditure was for, if any of the parties to an arrangement under which the expenditure is incurred are not dealing at arm's length. *[Schedule 3, item 6, section 40-1025]*

***Destruction of trees in a carbon sink forest***

3.57 A taxpayer cannot claim the deduction for trees in a carbon sink forest if the trees are destroyed. The number of write-off days used in the formula in paragraph 3.51 will not include the days in the income year after which the trees were destroyed.

3.58 However, an extra deduction for any undeducted establishment expenditure will be allowed for an income year if the trees are destroyed in an income year after they are established and the write-off period has not ceased. *[Schedule 3, item 20, section 40-1030]*

3.59 To work out the deduction, the first step is to calculate the total amounts the taxpayer could have deducted for the trees for the period that starts when the trees were established and ends when they were destroyed. *[Schedule 3, item 20, subsection 40-1030(2), paragraphs (a) and (b) of step 1]*

3.60 Secondly, *subtract* from the capital expenditure incurred for establishing the trees, the result from step 1 as well as any amount received for the destruction (such as the proceeds of an insurance policy). The remaining amount is the deduction allowed for the destruction. *[Schedule 3, item 20, subsection 40-1030(2), paragraphs (a) and (b) of step 2]*

3.61 This deduction for destruction is in addition to any other deduction for the trees for the income year under these provisions. *[Schedule 3, item 20, subsection 40-1030(3)]*

**Example 3.11**

Matthews Carbon Sinks Services Ltd establishes trees for the purpose of carbon sequestration on 1 September 2012. Matthews Carbon Sinks Services Ltd incurred establishment expenditure of \$400,000.

On 8 February 2015, the trees are destroyed due to fire. An insurance payout of \$200,000 is received.

The deduction is worked out as follows:

**Step 1**

**2012-13 income year**

$$\$400,000 \times \frac{365}{365} \times 7\% = \$28,000$$

**2013-14 income year**

$$\$400,000 \times \frac{365}{365} \times 7\% = \$28,000$$

**2014-15 income year**

The trees are destroyed on 8 February. The number of days in the 2014-15 income year that the expenditure can be written off is 223 days:

$$\$400,000 \times \frac{223}{365} \times 7\% = \$17,107$$

Total amount that could have been deducted = \$73,107

**Step 2**

Establishment expenditure: \$400,000

*Less* result from step 1: \$73,107

*Less* any insurance moneys received: \$200,000

Total deduction available for destruction of trees: \$126,893

This is in addition to the deduction of \$17,107 the taxpayer would have claimed for the trees for that income year.

3.62 If trees in a carbon sink forest, which received an immediate deduction, are destroyed, no extra deduction can be obtained. This is because the total amount of the establishment expenditure is deducted in the income year in which it is incurred and there is no undeducted establishment expenditure. Therefore, this extra deduction for destruction is not available for trees established in carbon sink forests that receive an immediate deduction in the 2007-08 to 2011-12 income years (inclusive).



***Obtaining information for the acquisition of trees in a carbon sink forest***

3.63 When a taxpayer acquires trees in a carbon sink forest from another entity in circumstances that makes the taxpayer eligible to claim the deduction, section 40-1035 will ensure sufficient information is given to a taxpayer who acquired the trees in a carbon sink forest from the last taxpayer who deducted an amount for this capital expenditure. *[Schedule 3, item 20, subsection 40-1035(1)]*

3.64 The inclusion of amounts of establishment expenditure used by the entity in calculating the deduction, as well as the period when the deductions started in the calculations for the trees, must continue to be applied by the taxpayer who acquired the trees.

3.65 The taxpayer who acquired the trees may, within 60 days of satisfying a condition in subsection 40-1005(5), give a written notice to the other entity seeking certain information *[Schedule 3, item 20, subsections 40-1035(2) and (3)]*. Only one notice can be served on the other entity *[Schedule 3, item 20, subsection 40-1035(8)]*. The written notice must address the following matters:

- a request that the other entity provide information as to the amount of establishment expenditure for the trees, and the first day of the income year in which the trees were established *[Schedule 3, item 20, subsection 40-1035(2)]*;
- the other entity has at least 60 days in which to reply to the taxpayer who acquired the trees *[Schedule 3, item 20, paragraph 40-1035(3)(b)]*; and
- the notice must advise the other entity that failure to comply with the request will subject the entity to a penalty of 10 penalty units if the entity does not have a reasonable excuse and fails or intentionally refuses to comply with the notice *[Schedule 3, item 20, subsection 40-1035(4)]*.

3.66 Where the other entity is a partnership, the notice is properly served where the taxpayer gives the notice to any one of the partners of the partnership. *[Schedule 3, item 20, paragraph 40-1035(5)(a)]*

3.67 The obligation to provide the information requested by the taxpayer is imposed on each of the partners, not the partnership. In order to discharge the obligation, any one of the partners may respond to the request. *[Schedule 3, item 20, paragraph 40-1035(5)(b)]*

3.68 There is a penalty of 10 penalty units if a partner fails, or intentionally refuses, to comply with the request for information from the taxpayer. *[Schedule 3, item 20, subsection 40-1035(6)]*

## **Application and transitional provisions**

3.69 Amendments provided for the income years 2007-08 to 2011-12 (inclusive) apply to the 2007-08 income year and later income years. *[Schedule 3, item 11]*

3.70 Amendments provided for the income year 2012-13 and later years apply to the 2012-13 income year and later income years. *[Schedule 3, item 21]*

## **Consequential amendments**

3.71 An amendment is made to subsection 40-50(1) to ensure that expenditure for the establishment of trees in carbon sink forests cannot be written off under Subdivision 40-B of the uniform capital allowances provisions. *[Schedule 3, item 4, subsection 40-50(1)]*

3.72 An amendment is made to section 40-630 to ensure that trees in carbon sink forests cannot be deducted under Subdivision 40-G of the uniform capital allowances provisions. *[Schedule 3, item 5, subsection 40-630(2B)]*

3.73 An amendment is made to section 70-120 to ensure that a taxpayer cannot claim a deduction under the trading stock provisions for felling a carbon sink forest. *[Schedule 3, item 7, subsection 40-120(5)]*

3.74 Consequential amendments are made to paragraphs 40-1010(1)(b) to (f), (h) and (4)(a) for changes to the write-off rate to 7 per cent for the income year 2012-13 and later income years. *[Schedule 3, items 13 to 19]*

3.75 Consequential amendments are made to the guide material in section 12-5 to reflect the introduction of this measure. *[Schedule 3, items 1 and 2, section 12-5, item in the table headed 'capital allowances' and after the item in the table headed 'travel expenses']*

3.76 A consequential amendment is made to the simplified outline of Division 40 to reflect the introduction of this measure. *[Schedule 3, item 3, section 40-10, at the end of the table]*

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## **C**hapter 4

# **Extension of the beneficiary tax offset to the Equine Workers Hardship Wage Supplement Payment**

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### **Outline of chapter**

4.1 Schedule 4 to this Bill amends the *Income Tax Assessment Act 1936* (ITAA 1936) and the *Income Tax Assessment Act 1997* (ITAA 1997) to extend eligibility for the beneficiary tax offset to individuals in receipt of the Equine Workers Hardship Wage Supplement Payment (the Supplement).

### **Context of amendments**

#### **Equine Workers Hardship Wage Supplement Payment**

4.2 The Supplement provides ex-gratia income support to individuals who can demonstrate loss of their primary source of income, which is derived from the commercial horse industry, as a direct result of the Equine Influenza outbreak and its associated quarantine and movement restrictions.

4.3 The Supplement was part of a broader Equine Influenza assistance package which was announced on 9 September 2007.

4.4 The rates of the Supplement are equivalent to the single rate, couple rate and single with dependent child rate of Newstart Allowance (Newstart) depending on the applicant's circumstances. Applicants must satisfy an income test but there are no assets or activity tests.

### **Taxable status**

4.5 It is a general principle of income tax law that any payment received by a person as income support, or as a replacement for lost salary, wages or other assessable income, is taxable. Therefore, payments of the Supplement will be taxable in the hands of the recipient as they will be treated as ordinary income.

4.6 Newstart is also a form of income support which is received as ordinary income by the recipient. However, Newstart is a rebatable benefit to which the beneficiary tax offset applies. This ensures that any person who receives Newstart for the full year, and has no other income, pays no tax on the Newstart income.

4.7 This amendment will extend the beneficiary tax offset to the Supplement to ensure consistent taxation treatment with the taxation treatment of Newstart.

## **Summary of new law**

4.8 This measure amends:

- subsection 160AAA(1) of the ITAA 1936 to include the Supplement in the definition of ‘rebatable benefit’ to which the beneficiary tax offset applies; and
- section 13-1 of the ITAA 1997 to list the Supplement as a payment that is allowed a tax offset.

## **Detailed explanation of new law**

### **Include the Equine Workers Hardship Wage Supplement Payment in the definition of rebatable benefit for beneficiary tax offset purposes**

4.9 Subsection 160AAA(1) of the ITAA 1936 has a definition of ‘rebatable benefit’ for the purposes of the beneficiary tax offset. Included in the definition of rebatable benefit are payments made under provisions of the *Social Security Act 1991* such as Newstart.

4.10 This amendment to subsection 160AAA(1) of the ITAA 1936 includes the Supplement as a ‘rebatable benefit’ to which the beneficiary tax offset applies. This ensures that taxpayers in receipt of the Supplement are treated consistently with recipients of Newstart.  
*[Schedule 4, item 1, subsection 160AAA(1)]*

4.11 Subsection 160AAA(3) of the ITAA 1936 provides that where a taxpayer receives an amount of ‘rebatable benefit’ greater than the tax-free threshold, the taxpayer may be entitled to a tax offset.

### **Include the Equine Workers Hardship Wage Supplement Payment in the Division 13 guide of tax offsets**

4.12 Section 13-1 of the ITAA 1997 lists payments that are allowed a tax offset and the relevant provision of the ITAA 1936 or ITAA 1997 that provides that offset. Payments are listed under headings classifying the type of payment.

4.13 The first amendment to section 13-1 of the ITAA 1997 will include the Supplement in the list of payments that attract a tax offset and direct readers to the item headed 'social security and other benefit payments'. [*Schedule 4, item 2, section 13-1*]

4.14 The second amendment to section 13-1 lists the reference to the Supplement under the item headed 'social security and other benefit payments'. [*Schedule 4, item 3, section 13-1*]

### **Application and transitional provisions**

4.15 These amendments apply to assessments for the 2007-08 income year and later income years.



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## **Chapter 5**

### ***Tax-free grants for certain tobacco growers***

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#### **Outline of chapter**

5.1 Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide tax-free grants, under the Tobacco Growers Adjustment Assistance Programme 2006, to tobacco growers who undertake to exit all agricultural enterprises for at least five years.

#### **Context of amendments**

5.2 On 26 October 2006, the then Minister for Agriculture, Fisheries and Forestry announced that tobacco growers will receive up to \$150,000 from the Australian Government to assist them to move into alternative business activities.

5.3 Generally, government grants paid to assist businesses to exit an industry are assessable under the capital gains tax (CGT) provisions, rather than as ordinary or statutory income.

5.4 The former Government decided to make the grants tax free for those tobacco growers who undertake to exit all agricultural enterprises for at least five years.

#### **Summary of new law**

- 5.5 This measure amends:
- section 53-10 of the ITAA 1997 to list the Tobacco Growers Adjustment Assistance Programme 2006 grant as exempt income; and

- subsection 118-37(1) of the ITAA 1997 to exempt the Tobacco Growers Adjustment Assistance Programme 2006 grant from CGT for Tobacco Growers Adjustment Assistance Programme 2006 grant recipients who fulfil certain conditions.

## **Detailed explanation of new law**

### **The Tobacco Growers Adjustment Assistance Programme 2006 grant as exempt income**

5.6 Section 53-10 of the ITAA 1997 lists various payments which are wholly or partly exempt from income tax. The exemptions may be subject to certain conditions as listed within the section.

5.7 The amendment to section 53-10 of the ITAA 1997 ensures that the Tobacco Growers Adjustment Assistance Programme 2006 grant is exempt from income tax. *[Schedule 5, item 3, section 53-10]*

5.8 This exemption only applies to those recipients who undertake to exit all agricultural enterprises for at least five years. This provides certainty for those grant recipients who qualify for the exemption.

### **The Tobacco Growers Adjustment Assistance Programme 2006 grant is exempt from CGT**

5.9 Subsection 118-37(1) of the ITAA 1997 lists various payments for which capital gains and losses are disregarded for tax purposes.

5.10 The amendment to subsection 118-37(1) of the ITAA 1997 ensures that the Tobacco Growers Adjustment Assistance Programme 2006 is exempt from CGT. *[Schedule 5, item 4, subsection 118-37(1)]*

5.11 This exemption only applies to those recipients who undertake to exit all agricultural enterprises for at least five years.

## **Application and transitional provisions**

5.12 This measure applies to the 2006-07 and later income years. *[Schedule 5, item 5]*



## **Consequential amendments**

5.13 A reference to the Tobacco Growers Adjustment Assistance Programme 2006 grant is added to the table in section 11-15 of the ITAA 1997. *[Schedule 5, item 2]*

5.14 The reference to ‘sugar industry exit grants’ is shifted from section 11-10 to section 11-15 of the ITAA 1997. *[Schedule 5, items 1 and 2]*



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## **C**hapter 6

# **Farm management deposits**

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### **Outline of chapter**

6.1 Schedule 6 to this Bill amends the farm management deposit (FMD) scheme in the *Income Tax Assessment Act 1936* (ITAA 1936) to align the tax law with the guidelines for declaring either *all primary producers* in a geographical area, or *specified classes of primary producers* within a geographical area, to be in exceptional circumstances.

### **Context of amendments**

6.2 Schedule 2G to the ITAA 1936 contains the provisions for FMDs. An FMD is a tax-linked, financial risk management tool for eligible primary producers. It is designed to allow eligible primary producers to set aside income in profitable years for subsequent withdrawal in low-income years. This reduces the risk to eligible primary producers of income variability owing to factors such as drought.

6.3 FMDs cannot be withdrawn within 12 months of the deposit other than because the owner dies, becomes bankrupt, ceases to be an eligible primary producer, or transfers their deposit to another financial institution. Failure to comply with this rule may result in the deposit not being treated as an FMD from the time the deposit was made.

6.4 The FMD scheme provides an exception to the 12-month rule for primary producers who conduct their primary production business wholly or partly in exceptional circumstance areas. These persons are able to withdraw deposits early and still retain the tax benefit in the year of income in which the deposit was made. This is subject to the exceptional circumstances declaration not being in force when the deposit was made.

6.5 An exceptional circumstances declaration allows eligible primary producers, who have an exceptional circumstances certificate, access to their FMD within 12 months of deposit and the retention of their tax benefits.

6.6 To confirm their exceptional circumstances status at the time of the relevant withdrawal, the owner of the FMD will have until three months after the end of the year of income, in which the withdrawal was made, to obtain an exceptional circumstances certificate from the Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs. This ensures that primary producers will be able to take advantage of the exceptional circumstances concession prior to the certificate actually being issued.

6.7 A minor inconsistency exists under the current law, which denies eligible primary producers the tax benefits of an FMD as a consequence of withdrawing their FMD early. This inconsistency exists because certain classes of primary producers are in an area that has previously been declared in exceptional circumstances, even though the exceptional circumstances declaration did not apply to them because of their producer class.

## **Summary of new law**

6.8 This measure will remove a minor inconsistency where an eligible primary producer is denied the tax benefits as a consequence of withdrawing their FMD early when they are in an area that has previously been declared in exceptional circumstances, even though the exceptional circumstances declaration did not apply to them because of their producer class.

## **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
<p>Eligible primary producers can retain the tax benefit when withdrawing from their FMD within 12 months if, at the time of the withdrawal, they:</p> <ul style="list-style-type: none"><li>• are eligible to be issued an exceptional circumstances certificate; and</li><li>• made the FMD before the exceptional circumstances declaration applied to them.</li></ul>	<p>Eligible primary producers can retain the tax benefit when withdrawing from their FMD within 12 months if, at the time of the withdrawal, they:</p> <ul style="list-style-type: none"><li>• are conducting a primary production business in the geographical area that is declared to be in exceptional circumstances; and</li><li>• made the FMD before the exceptional circumstances declaration applied to their geographical area.</li></ul>

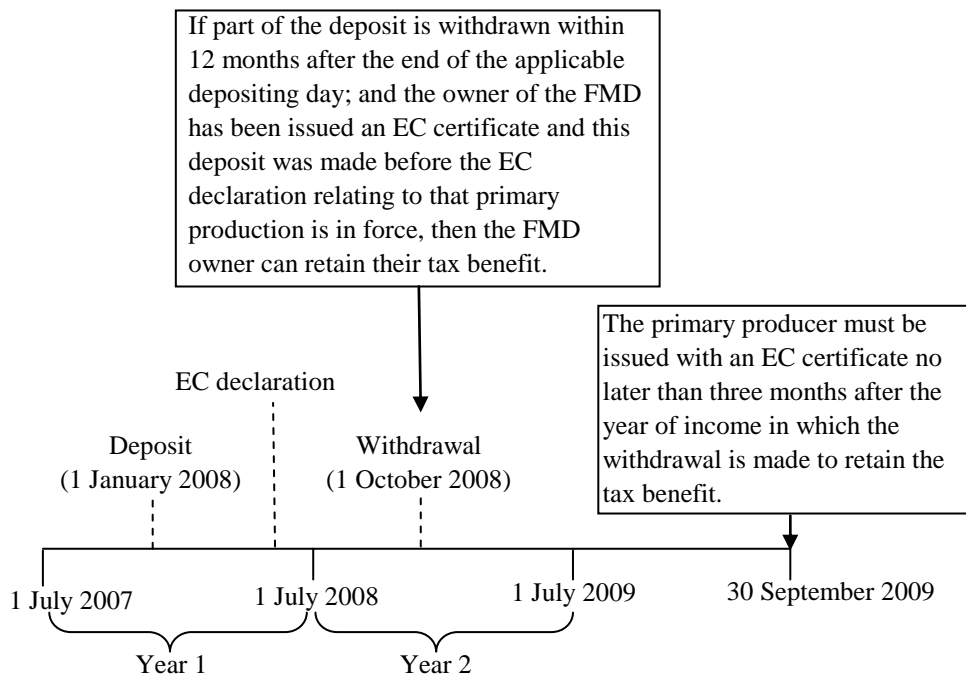
## Detailed explanation of new law

6.9 Eligible primary producers can retain the tax benefit in the year the FMD is made, despite the withdrawal of all or part of their FMD within 12 months if:

- the withdrawal is made in the year of income following the year of income in which the deposit occurs;
- at the time of the withdrawal, the owner of the FMD is eligible to be issued an exceptional circumstances certificate in relation to their primary production business;
- the owner of the FMD obtains an exceptional circumstances certificate no later than three months after the year of income of the withdrawal; and
- the owner made the deposit before the exceptional circumstances declaration relating to that primary production business was in force.

*[Schedule 6, item 1, paragraphs 393-37(3)(b) to (d) in Schedule 2G to the ITAA 1936]*

### Diagram 6.1



EC — exceptional circumstances

## **Application and transitional provisions**

6.10 This measure will commence retrospectively from 1 July 2002. This will ensure that those taxpayers that were previously disadvantaged by this inconsistency get the opportunity to receive the tax benefit, despite the early withdrawal of their FMD. *[Schedule 6, item 2]*

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Item 8, definition of 'carbon sequestration' in subsection 995-1(1) of the ITAA 1997	3.35
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#### **Schedule 4: Tax offset for Equine Workers Hardship Wage Supplement Payments**

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#### **Schedule 5: Tobacco industry exit grants**

<i>Bill reference</i>	<i>Paragraph number</i>
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**Schedule 6: Farm management deposits**

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