Submission

Australia's Future Tax System

Introduction

Greening Australia is Australia's largest environmental NGO with offices in all states and territories and many rural and regional locations around Australia. We have been in existence for 27 years and have a staff of 350 and a turnover of $50M per annum.

Our work is the large scale transformation of degraded landscapes. This is achieved through the restoration, expansion and establishment of biodiverse native forests, woodlands and other vegetation systems.

In Greening Australia's view Australia's future tax system must enable Australia to achieve sustainable economic growth. Impediments in the current system need to be addressed and incentives for investment in sustainable development need to be introduced.

We believe that a tax system that will position Australia for the future will provide the following:

- Incentives for investment in environmental services;
- Recognition of the real value of Australia's natural resources; and
- Support for Australia's transformation to a low carbon economy.

Submission

Greening Australia will address questions contained in the Consultation Paper Summary by identifying some of the current barriers to conservation work in Australia and institutional reform that could overcome these barriers.

1. Incentives for investment in environmental services: Rates and Land Tax

Property-based rates levied by local governments and State-based land taxes are barriers to conservation activities in Australia. Rates and land taxes are applied very differently to various types of land depending on the status of the landholder. A range of exemptions and concessions from rates and land taxes are available for different classes of land.

There is considerable scope for targeting rate and land tax incentives for natural resource management by extending exemptions and concessions to land that is managed for nature conservation.

In general, the rationale for special consideration and concessions in relation to rates and land tax is based on the provision of a public benefit.

Opportunities to extend existing arrangements could include the following:

(*Binning & Young-Conservation Hindered, 1999*)

Exemptions: An exemption from rates and tax should be given to all lands covered by a legally binding conservation agreement. New South Wales provides a precedent for such an exemption;

Differential Rating: All local governments in Australia have the capacity to levy differential rates. Where differential ratings are based on rural land or primary production, these could be extended to land that is managed for conservation within formal land use plans.

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Consideration of restrictions on development potential: The development potential of land is generally considered in valuing land for rating and land tax purposes. All States have procedures to ensure land valuations take account of the impact of planning provisions. However there is scope to ensure that regulations relating to vegetation clearing are taken into account and that the presence of legally binding conservation agreements is recorded on land valuation data files. Provision should also be made to have high conservation lands valued on the basis of their existing conservation use, rather than potential future uses (e.g. sub-division for real estate development). Queensland provides a useful model for implementation of these policy options in relation to rural lands.

Impact of income tax: Landholders *carrying on a business* on their land are able to deduct the cost of rates and land tax from their income tax. There is an opportunity to extend this provision to land covered by a legally binding conservation agreement (e.g. by extending the definition of "taxable purpose" in order to qualify for a deduction).

The cost of providing exemptions from rates and land tax make it difficult for Local Government to take an active roll in providing incentives for the conservation of native vegetation on private land. In the absence of leadership and support from Commonwealth and State governments, it is unlikely that such programs will play a significant role unless there is a fundamental shift in the value that State and the Commonwealth Governments place on conservation undertakings.

Such a shift is occurring as a result of the recognition of the damaging effects of climate change and the urgent need to conserve and build resilience in Australia's natural systems by restoring and connecting high value conservation areas; extending the natural reserve system; restoring degraded soil-landscapes; improving river health; re-establishing natural drainage systems and biodiverse habitat.

The link between conservation and land management in sustainable agriculture is increasingly being recognized by farmers, NRM practitioners and governments.

2. Valuing our Natural Resources

Nicholas Stern has recognized climate change as a monumental market failure. Why? Because the market had failed to price carbon and failing to do so has not placed a value on the biosphere upon which life is dependant. For human beings to live sustainably, precious natural resources and natural infrastructure must be valued in the market including water quality and native vegetation.Whether by way of direct taxation or other financial instrument, the market must reflect the real value of Australia's diminishing natural resources and natural infrastructure

3. Support for Australia's transformation to a low carbon economy.

The use of an emissions trading scheme as the least cost approach to the reduction of Australia's greenhouse emissions, provides the opportunity for much more than carbon mitigation.

Once there is a price on carbon, a carbon market worth potentially billions of dollars can be leveraged to halt and reverse the degradation of Australia's environmental assets through the establishment of large scale carbon forests and woodland sinks.

Recent amendments to the tax law-*Tax Laws Amendment (2008 Measures No.2) Act 2008* provide a tax incentive for investment in carbon sinks.

Greening Australia believes that the new tax law and the accompanying guidelines give rise to a number of issues and need to be reconsidered.

What constitutes a carbon sink forest for the purpose of the Act?

Subdivision 40J provides very little direction on what constitutes a carbon forest sink. As it stands, plantation monocultures and biodiverse (habitat rich) native forests both qualify as carbon sink forests, despite having significantly different qualities and impacts.

Greening Australia recognises an enduring role for plantation forestry as part of a mixed land use model that should also includes a sustainable mix of biodiverse native forests, traditional agricultural crops and grazing. However there are no ecological reasons why mono-cultures of non-native species are needed for carbon sinks.

After much research and development, fast growing (short-rotation) and uniform plantations systems have been developed to provide profitable timber products. In contrast, carbon sinks need to be long-lived, low risk, self-replacing and resilient. Tree uniformity and fast growth are not imperatives for carbon sinks.

Biodiversity Outcomes

Biodiverse carbon offsets are based exclusively on biodiverse native forest and woodland sinks.

Greening Australia's definition of a biodiverse carbon sink is:

"A planting that restores a self-replacing diversity of regionally native vegetation on land cleared prior to 1990."

The qualities that distinguish biodiverse native forest carbon sinks from other carbon sink forests are:

- The plantings are self replacing – they self-regenerate after natural disturbances such as fire and storms;
- They are sourced from seed native to the bioregion in which they are planted;
- They are suited to local soil, slope and climatic conditions;
- They restore native ecosystems, re-establishing original forest cover with the return of under storey and native grasses;
- They strengthen current stocks of carbon locked up in native forest by connecting and restoring remnant vegetation;
- Over the longer-term they re-establish natural drainage systems, natural water flows and improve water quality by reducing soil erosion and sedimentation;
- Plantings are at least 100 ha in size and more than 100 m wide to ensure permanency and self replacement;
- They are actively managed for at least 100 years;
- They are most capable of adaptation to climate change including hotter temperatures, lower and more variable rainfall, and more frequent fires;
- They represent the lowest environmental and financial investment risk; and
- They inject private sector capital into conservation and the expansion of the National Reserve System.

Biodiverse carbon plantings deliver both mitigation and adaptation outcomes. If the intent of the Tax Act is to ensure that forest sinks deliver real and sustained abatement as part of the national contribution to tackling climate change, then it makes sense for forest and woodland sinks to be supported by a tax break.

However only biodiverse forest sinks as defined, have the capacity to deliver long-term emissions mitigation and climate change adaptation because they are inherently resilient. For this reason Greening Australia's submission to the Senate Select Committee ***Inquiry into legislation underpinning carbon forest sinks*** argued that the tax incentive for carbon sink investment should apply only to biodiverse native forest sinks.

As it stands, additional tax incentives or financial instruments are now required to encourage investment in biodiverse carbon sinks. Because the establishment of a biodiverse carbon sink is the establishment of a *forest system*, the establishment costs are higher than those for a plantation sink. As environmental services have no current market value, the true value of biodiverse sinks is not recognised by the market.

Biodiverse native forest sinks achieve multiple environmental benefits beyond emissions reductions. A tax incentive that recognises the real value of a biodiverse sink, the long-term investment and environmental security associated with it and the higher up-front costs of establishment, is an investment in Australia's future.

The rationale for special consideration and concessions in relation to rates and land tax based on the provision of a public benefit could be extended to land used for the establishment of a biodiverse carbon sink.

Opportunities identified above with respect to encouraging private sector investment in conservation, equally apply here:

Differential Rating:

Where differential ratings are based on rural land or primary production, extending these to land managed for biodiverse carbon sinks;

Impact of income tax:

Landholders *carrying on a business* on their land are able to deduct the cost of rates and land tax from their income tax. The scope of *carrying on a business* should be expanded to include the business of establishing a biodiverse carbon sink.

Alternatively, the general deduction provisions in section 8-1 of the ITAA 1997 may be expanded such that a deduction is allowed where an outgoing is incurred in gaining or producing assessable income *or other relevant purpose.* The intention being that the term *or other relevant purpose* refers to climate change mitigation and beneficial environmental outcomes.

Alternatively, the approach adopted in the "blackhole" provisions in s40-880 of the ITAA 1997 which use a more general nexus mechanism, may be adopted. This would merely require that the relevant expenditure is incurred *in relation to your business*(s 40-880(2)) provided that the business is carried on for a *taxable purpose* (s 40-880(3)).

As well:

Expanding the definition of deductible expenditure to include the cost of purchasing land and other costs currently treated as non-qualifying expenditure under subdivision 40-J;

Providing an additional investment allowance of 10%-30% for other costs associated with the establishment of a biodiverse carbon sink forest;

Providing an exemption from state taxes, such as stamp duty, on transactions related to biodiverse carbon sinks. *It is recognised that the Australian Government would have to negotiate with the states and territories with respect to the exemption.*

Expanding the Scope of Subdivision 40J tax deductions to include "manufacturers of carbon" -those who own the carbon property rights, have incurred the costs associated with the establishment of a biodiverse carbon forest sink but who do not meet the requirement under the legislation to own, lease or hold a licence over the land on which the trees grow.

Impact on the agricultural sector

The potential impact on the farming sector of a carte blanche tax incentive to invest in carbon forest sinks, includes the increased uptake of productive agricultural land for plantation forestry and the dislocation of farming communities.

With respect to rural communities, unchecked plantation forestry will place further pressure on an industry already struggling with the impacts of prolonged drought and climate change. (Greening Australia recognises a legitimate role for plantation forestry but not as the 'default afforestation' activity -this must be the preserve of our diminishing biodiverse native forests.)

The contribution of biodiverse carbon sinks to sustainable farming livelihoods includes the following:

- Protecting the best agricultural soils from:

Salinity	e.g. Liverpool Plains
Erosion	e.g. Wind prone regions such as the Wimmera

- Development of new rural businesses on marginal land–e.g. native seed collection; carbon habitat plantings, forest maintenance, and measuring carbon yield
- Diversification of farm enterprises (carbon farming on portions of existing farms). Note research evidence that farms with a 30% or greater cover of trees are more economically and environmentally sustainable than farms with less the 30% tree cover (Walpole et al 1999).

Given the recent changes to the tax law, incentives need to be provided to encourage investment in biodiverse carbon sink development that supports and complements agriculture.

4. Conclusion

Greening Australia recognises the vital role that Australia's Future Tax System can play in Australia achieving environmentally sustainable development:

The tax system of the future must help protect Australia's natural resources:

- Tax incentives and concessions associated with land rates and taxes that currently apply to primary production, should be extended to conservation.
- Land valuation should take account of the value of conservation as a legitimate type of land use.

Greening Australia is calling for a broad review of the tax treatment of *reafforestation* in Australia to be undertaken to ensure the different environmental (public good) outcomes and the costs and benefits associated with the establishment of timber producing forests, plantation carbon sink forests and biodiverse carbon sink forests are reflected in the tax legislation.

The desired outcome of the review is for an integrated policy position to be adopted that ensures taxpayers who incur greater costs by providing significant additional public benefits to the environment (e.g. through the establishment of biodiverse carbon sinks), are provided with both adequate tax relief, and appropriate tax incentives.

Further, the approach adopted under some of the deductibility provisions in the tax system (such as the Landcare operations deduction provided in section 40-630 of the ITAA1997 which requires a primary production business to be carried on, or a nexus between the taxable business and the use of the land) should be reconsidered as part of this broader review to ensure the tax system is updated to support new environmental initiatives and avoid adverse tax consequences for pioneering businesses by denying them a deduction for costs incurred.

Greening Australia would be pleased to discuss the position outlined in this submission

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