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General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Reference: Gary Essex:JJA

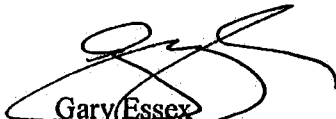
Subject: Tax Treatment of Water Infrastructure Improvement Payment

Dear Sir or Madam;

Enclosed please find our submission for the Tax Treatment of Water Infrastructure Improvement Payments.

If you wish to discuss the submission, kindly do not hesitate to contact our office.

Yours faithfully


Gary Essex
Partner

Document Reference: 86861_1

Submission – Tax Treatment of Water Infrastructure Improvement Payments

Summary

The government is proposing to introduce legislation that will have retrospective effect.

The legislation is to have application to qualifying water infrastructure improvement payments made under certain Commonwealth Government programs. The stated purpose of the legislation is to eliminate the timing difference between when payments received are taxed and when deductions are available. The government is to be applauded for this action.

Broadly it is proposed that:

- Payments received under the programs will be tax free (non assessable non exempt)
- Expenditures made under the programs will be non deductible

Under existing legislation the taxation situation is:

- Payments received are taxable as a combination of Net Capital Gains for transfer of water entitlement (CGT event A1) and an assessable bounty or subsidy (Section 15.10)
- Expenditures made are deductible either under general provisions (Division 8) or specific provisions (Subdivision 40F or 40G)

In many instances tax payers will be worse off under the proposed retrospective legislation. This is because no deduction is allowed for monies spent that relate to the taxpayer disposing of a capital asset.

We believe that retrospective legislation that puts a taxpayer in a worse position should be avoided.

To this end we recommend one of the following no detriment courses of action:

- Present legislation is retained with the following adjustment that all monies expended under a qualifying water infrastructure improvement payment are an outright allowable deduction in the year the payment is made. This will not only remove the timing difference acknowledged by the Government, but will also allow a full tax deduction for the organisation's contribution to the project; or
- Those who have entered into arrangements prior to the announcement of the proposed legislation have a choice as to whether to apply the current legislation or the proposed legislation

We detail our reasoning's below by giving examples of how both irrigation operators and individual irrigators could be worse off under the proposed legislation.

Background

In 2010 Coleambally Irrigation Cooperative Limited (CICL) were considering entering into a funding arrangement with the Department of Sustainability Environment Water Population & Communities (The Dept) under the Private Irrigators & Infrastructure Operators Program (PIIOP). This program is part of the Federal Government SRWUIP funding program and thus would be subject to the proposed legislation.

The program was to provide funds to CICL to be spent on making improvements:

- to CICL's irrigation infrastructure; and
- to CICL member's irrigation infrastructure

This would result in improved efficiency in the irrigation system allowing for the permanent transfer of water to the Commonwealth. The Commonwealth can then return the water to the environment.

i) Infrastructure Operator – CICL

The program is to provide funding so that CICL could spend money on repairing and improving its irrigation infrastructure. The outcome of this spending would be that the system will operate more efficiently. The practical outcome of the efficiency gains is that CICL will need less water to deliver the same amount of water to its irrigator members.

As part of receiving the funding CICL agree to transfer to the Commonwealth [REDACTED] of water entitlement. This entitlement is to come off its conveyance licence. This will allow the Commonwealth to meet its goals of returning water to the environment.

Therefore at the end of the projects to be undertaken under the scheme, the operating system of CICL will have the same or similar productive capacity as prior to undertaking the projects. However CICL will have given up an asset ([REDACTED] water entitlement) to the Commonwealth.

Therefore it is arguable that CICL as a standalone organisation is economically worse off having entered into the project – that is an irrigation system with a similar capacity but less entitlement.

Taxation Consequences of PIIOP – present legislation

Concerned about the taxation consequences of receiving such a large sum of funding, CICL sought a Binding Private Ruling from the Australian Taxation Office on the matter (Private Ruling No 1011 637 871 314).

Broadly, the Binding Private Ruling confirmed the following:

- There would be taxation consequences for CICL in receiving the part of the monies that would be spent on CICL irrigation infrastructure assets

- There would be no taxation consequences to CACL for CACL receiving monies to be spent on individual irrigator's irrigation infrastructure assets. Individual irrigators would be responsible for their own taxation outcomes

With respect to the monies received by CACL that would be spent on irrigation infrastructure assets owned by CACL, the ATO confirmed the following:

- Part of the funds received by CACL was in respect of the transferring of water entitlements to the Commonwealth. The portion of the funding received with respect to the transfer of the water entitlements was a capital amount to be assessed under the CGT rules (CGT event A1).
- Part of the funds received that did not relate to the transfer of water entitlements would be assessed as a bounty or subsidy (Sec 15-10).

The issue of deductibility of expenditures made under the program was not addressed in the Private Binding Ruling. It goes without saying that the monies when spent by CACL will be deductible expenditure. The only question that remained was under which provisions the expenditure would qualify for deduction (ie Division 8 or Subdivision 40F or 40G).

Once the Binding Private Ruling was received, CACL undertook modelling to determine how entering the program would impact it from a tax point of view.

Therefore in summary:

- The productive capacity of the irrigation infrastructure is substantially the same after the projects have been undertaken as it was before;
- CICL would give up an asset with a market value of [REDACTED];
- CICL would incur a tax loss of [REDACTED];
- The tax loss could be carried forward to be offset against future assessable income

Taxation Consequences – proposed legislation

Under the proposed legislation, the proceeds are non assessable non exempt income and the related expenditure is specifically non deductible.

According to the explanatory memorandum issued with the exposure draft any capital gains or losses in relation to the water entitlements are disregarded.

Therefore whilst a loss of [REDACTED] is incurred no tax benefit of the loss will be enjoyed as expenditures made under the program are non tax deductible.

ii) Individual Irrigator – Member of CICL

The PIOP program has a second part to it. Funding would also be provided to CICL on behalf of its members. These moneies would be spent on individual irrigator's irrigation infrastructure assets with the aim of repairing and improving the individual irrigator's infrastructure. The outcome of this would be that the individual irrigator's system will operate more efficiently. The efficiency gains will mean that an individual irrigator will need less water to deliver a similar irrigation outcome as prior to the expenditure.

Therefore at the end of the project an individual irrigator has a similar productive capacity after the project is complete as they had prior to entering the project.

However as part of receiving the funding the individual irrigator will have given up water entitlement to the Commonwealth.

Therefore it is arguable that the irrigator as a standalone organisation is economically worse off having entered into the project – that is their irrigation outcomes has a similar capacity as prior to entering into the agreement but less entitlement.

Therefore in summary:

- The productive capacity of the irrigation infrastructure is substantially the same after the projects have been undertaken as it was before;
- The irrigator would give up an asset with a market value of [REDACTED];
- The irrigator would incur a tax loss of up to [REDACTED];
- The tax loss could be carried forward to be offset against future assessable income

Proposed Remedy

The impact of the proposed change in the legislation is to deny taxpayers the benefit of a tax write-off for the diminution in their asset base as a result of the program. This diminution in the asset base can be seen as the organisation's contribution to the water efficiency program.

We suggest the following no detriment courses of action to consider.

The preferred option is that the present legislation remains with slight amendment. This amendment would allow immediate deductibility status to expenditures under the project similar to expenditure under Subdivision 40G. This would have the benefit of removing the acknowledged timing anomaly whilst allowing taxpayers a tax deduction for their contribution to the project.

An alternate course of action might be that for those organisations that entered into arrangements prior to the announcement of this changed legislation have a choice to use the present legislation or the proposed legislation. Thereby the organisation is not at a disadvantage as a result of the proposed changes.