Submission to the

Business Tax Working Group
Discussion paper

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Introduction

The NSW Farmers' Association represents the interests of commercial farm operations throughout the farming community in NSW. Through its commercial, policy and apolitical lobbying activities it provides a powerful and positive link between farmers, the Government and the general public. The Association is the key state representative body for both intensive and extensive industries ranging from broadacre, meat, wool and grain producers, to producers in the horticulture, dairy, poultry meat, egg, pork, oyster and goat industries.

The Association welcomes the opportunity to provide a submission to the business tax reform discussion paper. Farmers, as small businesses, are highly exposed to business tax arrangements and in particular some of the advantages that are provided for encouraged investment such as the accelerated depreciation provisions and the research and development tax incentive. However their ability to access any benefits of reduced company tax rates will be limited by the relatively low number of company structures in the farm business sector.

NSW Farmers supports tax reform, indeed we were a strong proponent of the introduction of the GST. However any tax reform must provide the following:
(a) revenue neutrality and provisions for Commonwealth/State accountability;
(b) improved competitiveness of Australian business;
(c) broadening of the tax base without disadvantaging those on low and fluctuating incomes;
(d) a system that is simple, transparent, can be enforced across all taxpayers including foreign investors and reduces wherever possible the costs of compliance;

Corporate tax rate cut

Farming businesses are often set up under a range of business structures including partnerships, trusts, sole traders and companies. The choice of structure is contingent on the owners, the past history, succession planning and a range of other measures including any taxation benefits. It is also the case that there may be more than one structure used as part of the complete farming business given the operating arm of the business, the employment arm of the business, and the land ownership arm of the business.

The prevalence of company structures in farming is estimated to be low. Both ABARES and the Australian Tax Office estimates showed that sole traders and partnerships operate most farm businesses, with companies and trusts being used in less than 10% of instances[1]. Figure 1 outlines the different structures used by farming businesses over the period from 1988-89 to 1996-97. As can be seen in the diagram, sole owners and business partners dominate the industry with small portions utilising company and other structures.

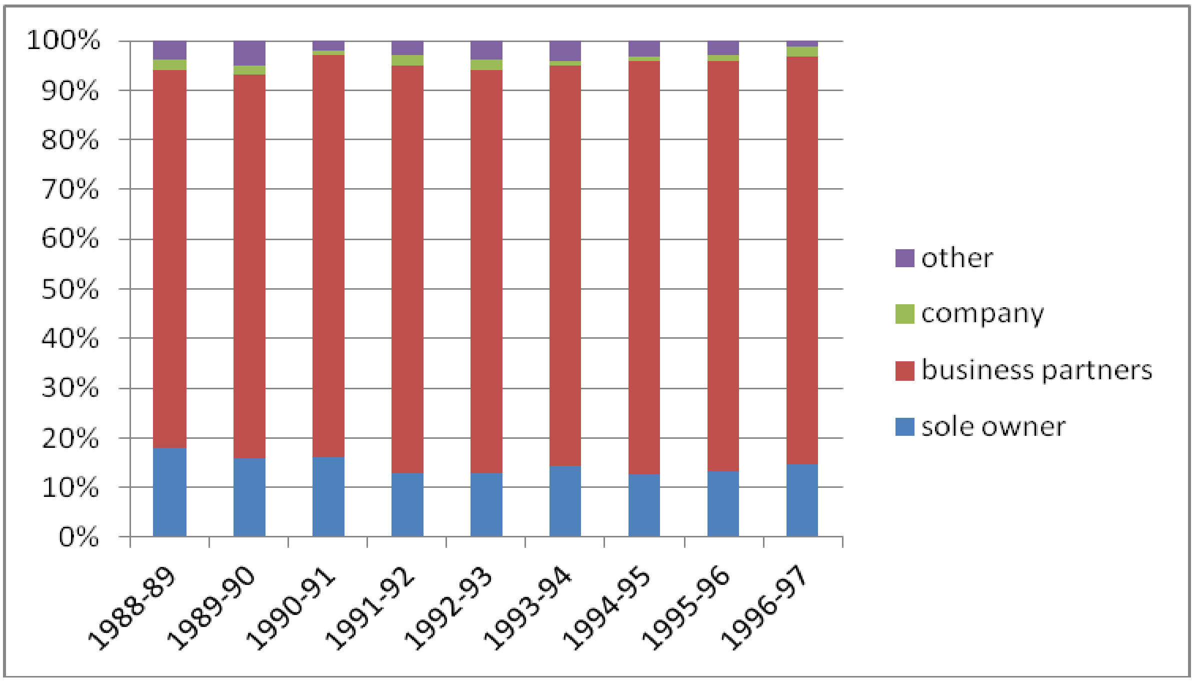
In comparing the agricultural sector to the rest of the economy the prevalence of the company structure is well below other sectors in the economy. According to the Australian Taxation Office Taxation statistics 2009-10, approximately 8% of farming establishments submitted company tax returns. In comparison of the total establishments conducting mining and financial services, 55% and 57% submitted company tax returns respectively. Figure 2 shows the percentage of establishments in each industry submitting company tax returns.

In addition to the low numbers of companies in agricultural businesses are the low levels of taxable companies in the agricultural sector. Of the 16,675 companies in the agricultural

[1] Synapse Research & Consulting & Bob Hudson Consulting 2005, *Australian Farm Sector Demography: Analysis of Current Trends and Future Farm Policy Implications,* Australian farm Institute, Surrey Hills, Australia (p. 18).

forestry and fishing sector in 2009-10 11,565 or 69% were non taxable that is, their trading profit was fully offset by their reconciliation items[2]. This is marginally higher than in other industries where the equivalent figure is about 60%.

Figure 1 Ownership structure of farm businesses[3]



Low prevalence of company structures together with a low level of taxable companies within the agricultural sector suggests that any reduction in the company tax rate will only affect a small proportion of businesses and only affect them in a small way.

In considering what structure to operate under, Synapse and Hudson[4] note a number of reasons for the choice in farm business structure, these are:

- *Partners and sole traders can immediately deduct losses from one business, from taxable income from another business.*
- *Partners and sole traders receive the benefit of any tax preference they receive while, as a rule, tax preferences gained but companies are 'clawed back' on distribution as unfranked dividends.*
- *Changes in business structure are normally treated as a deemed disposal and acquisition for tax purposes.*
- *The tax accounting and compliance costs of companies and trusts are much larger than those of partnerships and sole traders*
- *Company dividends are treated as non-primary production income and cannot be averaged.*
- *The benefits of limited liability associated with companies and trusts are substantially eroded by lenders requiring personal guarantees.*

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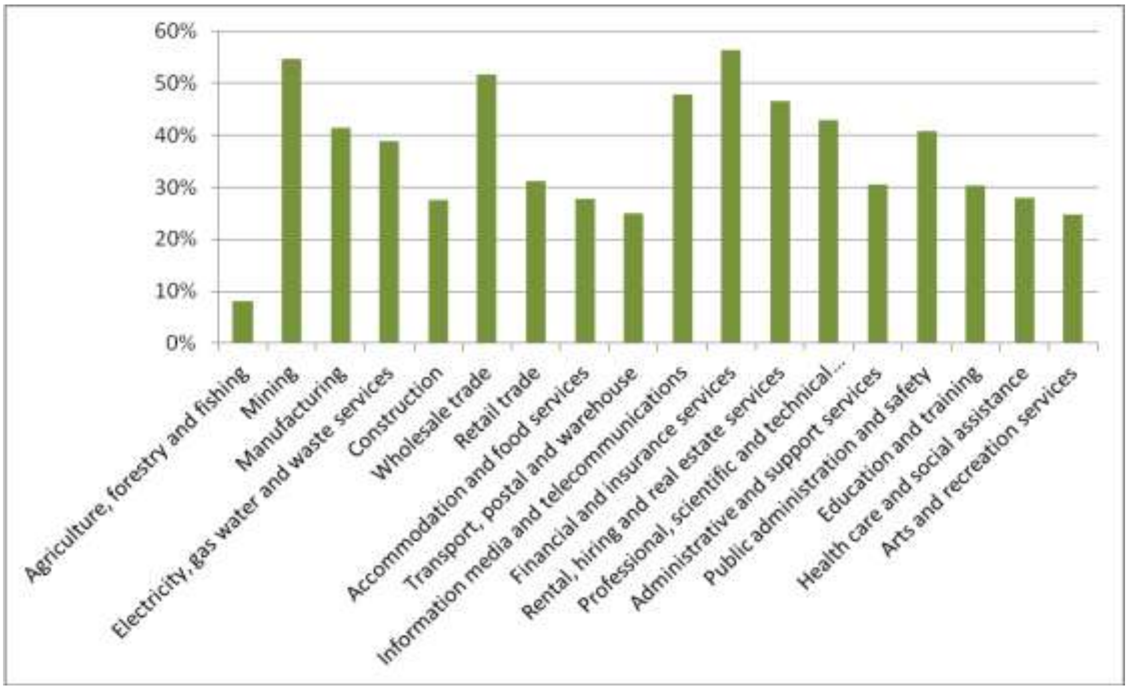
[2] Australian Taxation Office (2012)*Taxation statistics 2009-10*, available from http://www.ato.gov.au/content/00305922.htm?alias=taxstats [accessed on 17 September 2012]
[3] Garnaut, J. And Lim-Applegate, H. 1998, *People in Farming,* ABARE Research Report 98.6, Canberra
[4] Synapse Research & Consulting & Bob Hudson Consulting 2005, *Australian Farm Sector Demography: Analysis of Current Trends and Future Farm Policy Implications,* Australian farm Institute, Surrey Hills, Australia (p. 18).

In recent years we have seen a gradual increase in interest in corporate farms in Australia. This is noted in the report by Tonts et al[5] titled *Rural Communities and Changing Farm Business Structures.* While recognising this increasing presence, does suggest that changes to the company tax rate will have implications, the information in Figure 1 illustrates that for the vast majority of farming businesses it will have no impact.

From the above list of reasons it is expected to be unlikely that there would be any significant change in the number of farming businesses operating under a company structure as a result of a small change in company tax rates.

Figure 2 Percentage of companies by industry[6]



Base broadening options

Depreciating assets and capital expenditure

The current effective life caps applying to the agricultural industry (tractors and harvesters 6 2/3 years and water facilities at 3 years) serve a benefit to the industry encouraging the updating of machinery to be more efficient and environmentally friendly and also improve water infrastructure. As noted in the discussion paper the removal of these effective life caps would reduce after tax returns to investment by unincorporated taxpayers, such as primary producers, who would not benefit from a cut to the company tax rate as illustrated earlier in this submission.

Dumler et al[7], in looking at implications of alternative tractor depreciation methods concluded that making depreciation deductions follow a pattern more consistent with reductions in economic value had the following policy implications:

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[5] Tonts, M. Halpin, D. Collins, J. Black, A (2003), *Rural Communities and Changing Farm Business Structures* A report for the Rural Industries Research and Development Corporation *Publication No. 03/126*
[6] Australian Taxation Office (2012)*Taxation statistics 2009-10*, available from http://www.ato.gov.au/content/00305922.htm?alias=taxstats [accessed on 17 September 2012]

> *The most obvious losers of a change that would reduce deduction in the early years of a depreciable assets useful life would be farmers, because they would not be able to deduct a depreciation expense that often is greater than economic depreciation and, therefore, would lose interest earned on tax savings. Furthermore, farmers who did not use their tractors heavily would have low depreciation deductions, thereby lowering the incentive to purchase new tractors. The demand for new tractors might decrease, and the demand for used tractors might increase. This indicates that farm equipment manufacturers also would lose because of a change in policy.*

Removing the effective life caps and accelerated depreciation arrangements are expected to have a significant impact on farming businesses. When considering the financial costs of accelerated depreciation schedules the additional value beyond the financial costs must be recognised. By encouraging the uptake of modern machinery and infrastructure we are accessing additional benefits such as increasing efficiencies, improvement in health and safety benefits, and providing environmental benefits. Without the depreciation allowances some of the external benefits to the broader public may not be realised.

The R&D tax incentive

The Productivity Commission in 2005 found that for the periods 1975-2004, productivity growth in agriculture outstripped growth in all other 'market' sectors of the economy, with the exception of the communications sector. This productivity growth has been instrumental in maintaining the efficiency and profitability of the agricultural sector. While difficult to attribute this growth to the R&D taxation arrangements, they do play a part in providing incentives for R&D which in turn leads to improvements in productivity.

NSW Farmers would be opposed to reductions in the R&D tax incentive that would potentially lead to a reduction in R&D investment.

Other matters

NSW Farmers is currently considering alternative options for a national drought policy. State and federal agricultural ministers along with a range of farming organisations have identified the need to have a clear focus on preparedness measures. As part of those preparedness measures discussions have been held around accelerated depreciation, income averaging and farm management deposits. Each of these taxation arrangements provide an invaluable tool for farmers to better prepare for droughts and other natural disasters. It is recognised that a forthcoming report by PriceWaterhouseCoopers - *Supporting primary producers under the Australian taxation system* has costed some of the taxation concessions available to farmers. NSW Farmers argues that these costs are outweighed by the benefits of facilitating greater farmer preparedness and would oppose any moves to reduce or remove the ability of farmers to access these tools. We encourage Treasury to consider the full implications beyond just the financial cost of taxation revenues.

In identifying beneficial accelerated depreciation arrangements to support greater drought and income fluctuation preparedness, farming organisations, through National Farmers Federation, is looking for the following:

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[7] Dumler, T. Burton, R. Kastens, T (1998) *Implications of Alternative Farm Tractor Depreciation Methods*, selected paper at the annual meeting of American Agricultural Economics Association, available from http://ageconsearch.umn.edu/bitstream/20913/1/spduml01.pdf [18 September 2012]

- The accelerated depreciation option would preferably offer 30% depreciation in the first and subsequent years for all risk mitigation assets and continue to have the existing instant write-off of $6500.
- Accelerated depreciation should be available to all small and medium farms businesses (as defined by ATO).
- The beginning of the process is a farm plan and the items that are eligible for accelerated depreciation should be identified in that process.
- Items for consideration could include (but not limited to):
  - Environmental netting (permanent and temporary) (horticulture)
  - Netting Applicators
  - Protective structures (glass houses, etc.)
  - Weedmatting
  - Mulchers/mowers
  - Fertigation tanks
  - Water efficiency infrastructure, such as water meters
  - Direct drill seeding equipment
  - Hay sheds
  - Grain Silos
  - Fencing materials
  - Livestock assets such as feeding equipment and hay and foraging production equipment.