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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (2023 MEASURES NO. 3) BILL 2023

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

This Explanatory Memorandum uses the following abbreviations and acronyms.

Abbreviation	Definition
ITAA 1997	<i>Income Tax Assessment Act 1997</i>

Chapter 1: Tax accounting for primary producer registered emissions units

Outline of chapter

- 1.1 Schedule # to the Bill amends the ITAA 1997 to allow primary producers to treat certain carbon abatement income as primary production income for the purposes of the Farm Management Deposit Scheme and accessing income tax averaging arrangements for primary producers.
- 1.2 All legislative references in this chapter are to the ITAA 1997 unless otherwise stated.

Context of amendments

- 1.3 Australian Carbon Credit Units are issued by the Clean Energy Regulator for carbon abatement activities undertaken as part of the Australian Government's Emissions Reduction Fund.
- 1.4 Currently, primary producers who sell Australian Carbon Credit Units cannot treat the income as primary production income and therefore are ineligible for concessional tax treatment under the Farm Management Deposit Scheme or income tax averaging for such income.
- 1.5 The Farm Management Deposit Scheme allows primary producers to make deposits under the scheme to reduce their taxable income in years of good cash flow and to draw down on that income by making withdrawals in years when they need the income. Similarly, tax averaging allows primary producers to even out their income tax liability from year to year by reducing the effect that fluctuations in their taxable income have on the marginal rates of tax that apply to them from year to year.
- 1.6 Holders of Australian Carbon Credit Units are also currently taxed based on changes in the value of their Australian Carbon Credit Units each income year, which can result in tax liabilities arising prior to sale.
- 1.7 The Government is taking practical steps to move towards net zero emissions and protect the environment by encouraging primary producers to undertake additional carbon abatement activities. In particular, the Government is providing concessional tax treatment for the net proceeds of sale of Australian Carbon Credit Units and income derived from farm abatement activities supporting such units.

- 1.8 Eligible primary producers will be able to treat the net proceeds from the sale of Australian Carbon Credit Units they first held on or after 1 July 2022 as primary production income for the purposes of the Farm Management Deposit Scheme and accessing income tax averaging arrangements. The taxing point for Australian Carbon Credit Units held by eligible primary producers will also be changed to the point of sale. Similarly, income derived from farm abatement activities supporting such units first held on or after 1 July 2022 will be treated as primary production income for the purposes of the Farm Management Deposit Scheme and accessing income tax averaging arrangements.
- 1.9 This new tax incentive will encourage primary producers to diversify their income by generating and selling Australian Carbon Credit Units and supporting the creation of such units, as it helps to balance out other fluctuations in income derived from farming.
- 1.10 Deferring taxation point until point of sale also benefits the cash flow position of the primary producers, encouraging more primary producers to increase their carbon abatement activities.
- 1.11 Targeted support to primary producers will further incentivise more carbon abatement projects in the agricultural sector and drive investment in regional communities, while helping Australia achieve its commitment to net zero emissions by 2050.

Comparison of key features of new law and current law

Table 1.1 Comparison of new law and current law

<i>New law</i>	<i>Current law</i>
Proceeds from selling Australian Carbon Credit Units and income derived from farm abatement activities supporting such units, are treated as primary production income for primary producers’ eligibility for concessional tax treatment under the Farm Management Deposit Scheme and tax averaging.	Proceeds from selling Australian Carbon Credit Units and income derived from farm abatement activities supporting such units are treated as non-primary production income and, accordingly, do not automatically qualify for concessional tax treatment under the Farm Management Deposit Scheme and tax averaging. Eligibility depends on the total amount of non-primary production income.
Holders of Australian Carbon Credit Units that are carrying on a primary production business are taxed based on the net gain from their Australian Carbon Credit Units in the year they are sold.	Holders of Australian Carbon Credit Units are taxed based on changes in the value of their Australian Carbon Credit Units each year.

Detailed explanation of new law

Eligibility for concessional tax treatment

1.12 Concessional tax treatment under the Farm Management Deposit Scheme and tax averaging are available for the net proceeds from the sale of an Australian Carbon Credit Unit or net income derived from another entity that holds such a unit, regardless of the amount of the proceeds or income, when the following conditions are met:

- the Australian Carbon Credit Unit is first held on or after 1 July 2022;
- the unit is issued under the *Carbon Credits (Carbon Farming Initiative) Act 2011* in relation to an ‘eligible offsets project’ (within the meaning of subsection 27(2) of the *Carbon Credits (Carbon Farming Initiative) Act 2011* which provides that an offsets project will be considered an eligible offsets project if the Minister declares it to be);
- at all times while the eligible offsets project is carried on, a primary production business is also carried on in the same area as the offsets project or in an area connected to an area in which the offsets project is carried on; and
- the primary production business mentioned above is carried on by an individual or as a beneficiary of a trust that is carrying on the primary production business or a partner in a partnership that is carrying on the primary production business. Section 420-13 clarifies that an individual’s eligibility could be met under one or more a number of criteria depending on their circumstances (that is, they may meet the conditions of an individual, a beneficiary of a trust, a partner in a partnership or a combination at different times).

[Schedule #, items 3 and 7, section 420-13, note 3 to section 420-13 and subsection 995-1(1)]

1.13 Existing Subdivision 420-D that sets out the tax treatment for registered emissions units is intended to continue to apply unaffected if the above conditions are not met such as for pre-1 July 2022 units or where the required primary production activity is not carried on as required.

[Schedule #, item 4, section 420-62]

Arrangements with carbon service providers

1.14 Australian Carbon Credit Units can be held by carbon service providers, rather than primary producers. Primary producers can enter into a commercial agreement with carbon service providers. Such agreements cover matters including sharing of the proceeds of the units issued or otherwise making regular payments for undertaking the carbon abatement project.

- 1.15 The net proceeds from the sale of units that accrue to the primary producer and net income derived from farm abatement activities supporting such units are eligible for concessional tax treatment (when the above conditions are met).
[Schedule #, item 2, paragraphs 392-80(2)(d) and 392-80(3)(e)]

Exclusions

- 1.16 Concessional tax treatment is only intended to apply to units issued under the *Carbon Credits (Carbon Farming Initiative) Act 2011* in relation to an ‘eligible offsets project’. Concessional tax treatment will not apply to subsequent holdings of units – if a primary producer disposes of a unit, and that unit is later acquired by a new holder or reacquired by the same primary producer, concessional tax treatment is not available for that unit.
[Schedule #, item 3, notes 1 and 2 to section 420-13]
- 1.17 Incorporated farms are excluded. The policy objective of the concessional tax treatment is to encourage individual farmers to undertake additional carbon abatement activities. The tax treatment set out in existing subdivision 420-D is intended to continue to apply for units held by excluded entities.
- 1.18 If the eligible offsets project is carried on in an area over which there is a quasi-ownership right (that is, a lease or rental arrangement for the area) then carbon abatement income derived from that area is excluded. This exclusion does not include land held in the Australian Capital Territory, which is held on leasehold by the primary producer.
[Schedule #, item 2, subparagraphs 392-80(2)(d)(iii) and 392-80(3)(d)(iii)]

Calculating the taxable primary production income

- 1.19 Existing Divisions 392 and 393 set out the rules for the Farm Management Deposit Scheme and tax averaging. These Divisions apply in relation to the net proceeds from the sale of units that meet the eligibility conditions and the net income derived from farm abatement activities supporting such units.
[Schedule #, items 5 and 6, subsections 420-65(7) and 420-70(3)]
- 1.20 Whether the primary producer would have the benefit of income tax averaging or the Farm Management Deposit Scheme will depend on the application of those schemes for the particular income year in which the disposal of Australian Carbon Credit Units occurs or net income is derived from farm abatement activities supporting such units.
- 1.21 Taxable primary production income is taken into account to work out the averaging adjustment for the purposes of averaging of a primary producer’s tax liability. It is also used to determine entitlement to the Farm Management Deposit Scheme.
- 1.22 Taxable primary production income is worked out using assessable primary production income and primary production deductions.

- 1.23 For the income year that the disposal of a unit (that meets the eligibility conditions) occurs, any amount included in assessable income (or the primary producer's basic assessable income that resulted from an amount included in a trust's assessable income) in starting to hold, holding or ceasing to hold the unit is added to the primary producer's assessable primary production income. Similarly, in the income year that income is derived by a primary producer from an arrangement with the holder of a unit in which the primary producer carries on a carbon farm abatement project in relation to the unit, that income is added to assessable primary production income.
[Schedule #, item 2, subsection 392-80(2)]
- 1.24 For the income year that the disposal of a unit (that meets the eligibility conditions) occurs, so much of any deductible amounts in relation to the expenditure incurred in starting to hold, holding or ceasing to hold the unit is included in the primary producer's primary production deductions. Similarly, in the income year that income is derived by a primary producer from an arrangement with the holder of a unit in which the primary producer carries on a carbon farm abatement project in relation to the unit, any expenditure incurred in deriving that income is included in the primary producer's primary production deductions.
[Schedule #, item 2, subsection 392-80(3)]
- 1.25 A note has been included to clarify that primary producers can deduct expenditure incurred in preparing or lodging an application for a 'certificate of entitlement' (within the meaning of section 15 of the *Carbon Credits (Carbon Farming Initiative) Act 2011*) or an 'offsets report' (within the meaning of section 76 of the *Carbon Credits (Carbon Farming Initiative) Act 2011*).
[Schedule #, item 2, note 1 to subsection 392-80(3)]
- 1.26 A further note has been included to clarify that expenditure incurred in ceasing to hold a unit is currently a deduction under existing section 420-42.
[Schedule #, item 2, note 2 to subsection 392-80(3)]
- 1.27 Primary producers and other businesses continue to be entitled to deduct amounts under existing Division 8. For example, businesses can deduct expenditure incurred in establishing a carbon farming project (that is, cost of trees (deducted over a number of income years) and water and fertiliser in establishing and maintaining a tree planting project for carbon sequestration).

Consequential amendments

- 1.28 Schedule # to the Bill also amends the meaning of the expression **basic assessable income** to correct some technical and typographical errors.
[Schedule #, item 1, subsection 392-45(2)]

Commencement, application, and transitional provisions

- 1.29 The amendments commence on the first 1 January, 1 April, 1 July or 1 October to occur after the date the Bill receives Royal Assent.
[Clause 2]
- 1.30 The amendments apply to assessments for the income year that includes 1 July 2022 and later income years Accordingly, the amendments in this Schedule to the Bill have retrospective application.
[Schedule #, item 8]
- 1.31 The amendments apply retrospectively to ensure that primary producers qualify for the concessional tax treatment as announced in the March 2022-23 Budget – that is, if Australian Carbon Credit Units are first held on or after 1 July 2022, concession tax treatment may apply to the units provided they meet the eligibility conditions. The changes are wholly beneficial to persons affected by these amendments because they allow concessional income tax treatment by enabling the smoothing out of income and tax liabilities over income years