SUBMISSION TO THE CONSULTATION ON THE DRAFT LEGISLATION: Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Tax accounting for primary producer registered emissions units

Submission by

The Institute of Foresters of Australia trading as **Forestry Australia.**

Website: www.forestry.org.au
Telephone: 03 7065 4250
Email: admin@forestry.org.au

Forestry Australia input to the Consultation on the Concessional treatment of Australian Carbon Credits for Primary Producers

Provided to:
Indirect and Industry Tax Policy Unit
Personal and Indirect Tax and Charities Division
Treasury
Langton Cres
Parkes ACT 2600
Email: industrytax@treasury.gov.au

Prepared by:
Dr Kevin Harding (member of Forestry Australia Growers Committee, Chair of Forestry Australia Growers Special Interest Group, Former Director Forestry Australia 2019-2022, Former Chair, Australian Forest Growers 2014-2019), and

Ms Jacquie Martin (CEO, Forestry Australia),

incorporating inputs from Forestry Australia members.

Forestry Australia – who we are:

Forestry Australia is an independent professional association of forest scientists, managers and growers who work in native forests, plantations and provision of environmental services. Its members are committed to the principles of sustainable forest management and applying these principles to generate environmental, economic and social outcomes in all types of forests and tenures.

Consultation on the Concessional treatment of Australian Carbon Credits for Primary Producers

Support for the proposed change:

Forestry Australia welcomes the opportunity to provide input into this consultation. Forestry Australia has been a strong advocate of both federal and state government initiatives to increase Australia's forest resources, decrease Australia's reliance on forest imports and, of particular significance in this context, to make real contributions to carbon sequestration and mitigating the negative impact of climate change.

We commend the Treasury for proposing the draft amendments to provide concessional tax treatment of ACCUs to primary producers who integrate tree plantings into their rural holdings that qualify for ACCUs issued by the Clean Energy Regulator. We note that this is a sensible extension of the current legislation to encourage primary producers to include ACCUs as part of their rural business plans.

Recommendation:

Forestry Australia recommends:

- ***that the Indirect and Industry Tax Policy Unit, Personal and Indirect Tax and Charities Division of Treasury, move with priority to support small forest growers by addressing tax and superannuation treatment of small-scale private forest grower investors.***
- ***That the Indirect and Industry Tax Policy Unit, Personal and Indirect Tax and Charities Division of Treasury considers the intent of the Government's National Forest Industries Plan (2018) to review "legislation, policies and processes that may be unintentionally restricting plantation expansion" and "work with states and industry to help farmers explore opportunities for expanding farm forestry, creating future wood and fibre supplies, improving increasing economic returns for farmers".***

Forestry Australia (and its predecessor organisations) provided detailed arguments for the need for changed treatment of small-scale private forest growers in submissions to:

- The 2021 Department of Agriculture, Water and the Environment Farm Management Deposits Scheme Evaluation, and
- The 2020 Australian Government's House Standing Committee on Agriculture and Water Resources "Inquiry into timber supply chain constraints in the Australian plantation sector".

Without further targeted concessional treatment of plantation tree investors, whether farmers and primary producers who integrate tree plantings into mixed farming businesses or small-scale stand-alone plantation tree investments, **the Government's policy objectives to expand the national commercial plantation tree estate** as an important part of 2050 net-zero Carbon goals **will not be achieved.**

NOTE: Forestry Australia will be pleased to provide expert members for further consultation to assist the Indirect and Industry Tax Policy Unit to develop policy in these areas that will encourage farmers, primary producers and small-scale private forestry investors to plant more trees.

1. Rationale provided by *the Indirect and Industry Tax Policy Unit* for the proposed Concessional Treatment of ACCUs

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.

Tax accounting for primary producer registered emissions 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.

Forestry Australia welcomes the intent of this proposed concessional treatment of ACCUs. However, Forestry Australia contends the anticipated impact is over-stated, and we do not expect it will achieve the scale of investment in tree growing that the Parliament is hoping to deliver. This is because very few of our Forestry Australia Grower members (mostly previously members of Australian Forest Growers) currently qualify to use the Farm Management Deposit Scheme. Forestry Australia highlighted this in our 2021 Submission to the Farm Management Deposits Scheme Evaluation for the Department of Agriculture, Water and the Environment in 2021.

We also highlighted the previously communicated deficiencies in tax and superannuation law that have inhibited investment in private forestry in our submission to the 2020 Australian Government's House Standing Committee on Agriculture and Water Resources "Inquiry into timber supply chain constraints in the Australian plantation sector". In terms of generating Australian Carbon Credit Units (ACCUs), small-scale farm foresters face other significant hurdles. Specifically, there is the need for a retail AFSL for any third-party professional advice regarding analysing forward ACCU price forecasts for farmers with less than $10M in assets. This means that farmers who wish to explore carbon farming have less access to the business advice necessary to undertake their proposed activity, thus compounding the poor net return on top of the FMD issues.

Carbon policy development for forestry-related projects tends to be fragmented, inconsistent and often contradictory. There is a need for the development of an integrated forestry-carbon national policy that addresses the obstacles to the deployment of sufficient natural capital to this sector to generate ACCUs.

Treasury needs to be aware that tree planting for carbon is a tiny fraction of the current ACCU market - because it is often just too hard to make the business case for it. The current policy framework is not achieving its goals and recently publicised carbon market integrity concerns will only worsen if previous Forestry Australia advice is not acted upon putting our Paris Agreement targets at risk of non-delivery. There is an opportunity for these matters to be raised and considered again via the emerging ERF Integrated Farm Method.

2. Policy Environment – The National Forest Industries Plan 2018:

"GROWING A BETTER AUSTRALIA…A billion trees for jobs and growth" was adopted by the Government in 2018.

The plan commits the government to range of actions to deliver its key goal of increasing forest plantation establishment in Australia including (page 11):

The Australian Government will support a goal of adding a billion new plantation trees by:

- undertaking a review of the water requirements in the Emissions Reduction Fund (ERF) farm forestry and plantation methodologies to enable forestry to fully participate in the ERF
- working with industry and state governments to allow Regional Forestry Hubs to maximise their capacity to accommodate plantation expansion in the right places
- **reviewing other legislation, policies and processes that may be unintentionally restricting plantation expansion**.

The plan also emphasises the important role of Farm Forestry (page 9):

The government committed to

- working with states and industry to **help farmers explore opportunities for expanding farm forestry**, creating future wood and fibre supplies, improving linkages with the forestry industries, and **increasing economic returns for farmers.**

It is clear from this politically bi-partisan supported plan that the Government supports the amendment and/or elimination of legislation, policies and processes that may be unintentionally restricting plantation expansion and to help farmers explore opportunities for expanding farm forestry and increasing their economic returns.

The current proposal legislative changes to provide concessional treatment of ACCUs for Primary Producers is a small but positive step. However, to achieve the Government's goals much more work is needed to encourage many more farmers to integrate tree plantings into their rural business plans.

3. Highlights from previous Forestry Australia submissions to 2020 and 2021 inquiries

Forestry Australia encourages officers of the Indirect and Industry Tax Policy Unit, Personal and Indirect Tax and Charities Division of Treasury, to review the arguments we put to the Department (DAWE) and the House of Representatives Standing Committee in 2021 and 2020 respectively in these Evaluation and Inquiry submissions.

Some highlights of key points from these submissions are provided next below:

3.1 2021 Department of Agriculture, Water and the Environment Farm Management Deposits Scheme Evaluation

In our submission to the 2021 DAWE Evaluation, we noted:

> *Conceptually, the FMDS is a sensible policy – following on from its forebear, the Income Equalisation Deposits scheme – and deserves to be retained. We expect others will have plenty to say about how successful the FMDS has been in aiding the intended target users, achieving its program objectives, meeting its budgetary requirements, and so on.*
>
> *Our primary concern is that, in its original formulation, the FMDS did not embrace forestry as a form of primary production, and subsequently, despite years of advice and representations from AFG, the scheme has not been adapted in any way to accommodate private forestry.*

Our submission provided the following explanation of our position:

> ***Private forestry is primary production***
>
> *Attracting large-scale private investment into plantation forestry to replace what used to be financed directly through State government forestry commissions (with Commonwealth-subsidised loans) faces different and peculiar challenges stemming from the unique nature of forestry enterprises and assets.*
>
> *Although plantation forestry has features not shared by annual agricultural crops (for example, flexible harvest dates, within reason), it still faces the same general agricultural risks – rainfall variability, flood, fire, severe and extreme weather events, pest and disease outbreaks, commodity market variability, and more.*

But forestry is different in that it is a much longer-term enterprise. with high establishment costs, illiquid assets subject to the risks noted above, very few income events, returns coming in large 'lumps', and (for private growers) a large tax liability at final harvest.

Planting long-rotation softwood plantations for a large sawlog final harvest looks 25–35 years ahead. Hence the repeated government and industry policy and program initiatives – particularly since World War 2 – to establish new plantations well in advance of an anticipated industry to process the intermediate and final plantation products.

Many hardwood forests, both in plantations and in managed native forest, can have rotations up to double that period, depending on the target purpose and product and the management regime.

Private forest growers can range from farmers who have integrated a forestry enterprise into their mixed farming operations – as diverse as can be imagined – to those who choose to practise forestry as their sole primary production enterprise. This can range, in turn, from managing a privately owned native forest to planting and tending a plantation, with or without the help of a professional forest manager.

In the latter case, many private forest owners have the intention of growing their forest as a form of self-funded superannuation, and don't plan to replant or to continue primary production after final harvest.

Our submission went on to explain our position thus:

120 days – the primary focus of our interest in this evaluation

The conditions of use of the Farm Management Deposit Scheme (FMDS) and its predecessor, Income Equalisation Deposits (IED), have always discriminated against primary producers whose only enterprise is self-funded private forestry.

This discrimination is a consequence of the condition that all payments made into a Farm Management Deposit must be withdrawn within 120 days once the grower ceases to carry on a primary production enterprise.

***Farmers with forestry as one of several enterprises can be reasonably flexible in managing their costs and income streams among their enterprises, and tend to be able to use FMDs effectively**. By contrast, the cohort of private forest owners whose forests are their only primary production can be especially badly affected, and their stories of unexpectedly high tax liabilities and of the unfairness of having grown their own superannuation investment only for it to go unrecognised, including by the FMDS, have been known to discourage other potential private growers.*

The restrictive access to the FMDS adds insult to the injury suffered by a grower's (hopefully) high harvest return being taxed at the grower's highest marginal tax rate, despite having waited decades for that return. This is the problem of lumpy returns – or period inequity – inherent in a very long-term primary production enterprise with only* *one or two intermediate returns (from thinnings, if fortunate to have access to a market like pulp for small log thinnings) and one much larger final harvest return.*

> *****Period inequity is the term for the different tax impacts of lump-sum income compared to annual income****.* ***Period inequity is inherent in a plantation forestry enterprise****, which offers one to three income events spread over periods from 10 to 40 years. Because most of the income in large income events (commercial thinning harvests and final clearfall harvest) is taxed at the forest grower's highest marginal tax rate, it can be seen that, subject to the taxpayer's individual circumstances,* ***more income tax is likely to be paid on a plantation forestry enterprise than if the same total amount of income had been received and taxed annually over the equivalent period*** *—as is the case with most livestock, cropping and horticultural enterprises.*

Although some plantation critics like to claim that the deferral of tax liabilities for many years until harvest constitutes some form of special treatment, such a claim ignores the simple fact that the plantation growers are waiting many years to receive the income on which that tax is to be paid. Furthermore, this investment is usually financed by after-tax earnings, so the forest grower has already contributed to the Government's revenue base for many years while waiting for the forest to mature and bear dividends. This long-term deferral of income then incurs an inequitably large tax liability that reduces the after-tax return on investment to uneconomic levels. This acts to discourage plantation investment by private growers.

…….. it is fundamental that the tax treatment of an annual income stream from livestock, cropping or horticultural crops over 30–40 years will almost certainly be considerably less than that from a single very large return from a mature plantation harvest.

It is therefore reasonable to seek to extend beyond 120 days the period over which a private forest owner may retain a legitimate Farm Management Deposit after having ceased primary production. IFA/AFG (Forestry Australia) *recommends that this period be extended to at least a minimum of three years.*

Over many years, Australian Forest Growers has advocated a small number of policy and program changes to remove disincentives to the uptake of on-farm plantations – at any scale and configuration. IFA has often actively supported the AFG's position. Some of these changes have been adopted. But this restrictive condition of the FMDS has yet to be amended in a way that recognises and accommodates the inherent characteristics of this long-term form of primary production to address the inherent discrimination against it.

3.2 2020 Australian Government House Standing Committee on Agriculture and Water Resources "Inquiry into timber supply chain constraints in the Australian plantation sector".

Forestry Australia (then operating under our interim merged name of Institute of Foresters of Australia/Australian Forest Growers or IFA/AFG) also made a submission to the Australian Government's House Standing Committee on Agriculture and Water Resources "Inquiry into timber supply chain constraints in the Australian plantation sector" and Dr Kevin Harding and Mr Alan Cummine appeared at Committee hearings representing IFA/AFG (now Forestry Australia). Much of our **key testimony was reported in the Standing Committee's final report – "Aussie logs for Aussie jobs: Inquiry into timber supply chain constraints in the Australian plantation sector" (March 2021).**

Our submission to this Standing Committee Enquiry focussed on the Inquiry terms of reference, "Opportunities to increase Australia's wood supply, including identifying and addressing barriers to plantation establishment".

IFA/AFG (now Forestry Australia) recommended:

> *That tax and superannuation regimes, policies and rulings that apply to private forestry need urgent government attention to:*
>
> > *• provide a stable, predictable and neutral tax environment that encourages private investment in forestry by any participant at any scale*
> > *• recognise and account for the 'period inequity' inherent in long-term private forestry **
> > *• enhance the liquidity of long-term private forestry investment.*
> > *(NOTE: * 'Period inequity' is defined above)*

We provided the Context for these recommendations as follows:

> *The IFA & AFG advocate for our grower members (previously members of Australian Forest Growers until our merger with IFA in 2019). Our submission is focussed principally on issues of importance to our Forest Grower members – mostly small-scale private forest growers.*
>
> *The IFA & AFG considers **that the lack of significant new farm forestry plantings over the last decade reflects in large part an urgent need for improved tax and superannuation regimes, policies and rulings that apply to private forestry**. These constitute a significant barrier to farm forestry investment when the intermittent returns from plantation establishment are weighed up against alternative options offered by annual cropping or livestock management**. If these concerns are not addressed, the Government's National Forest Industries Plan will fall well short of its planned target for an increase of 400,000 hectares of new plantation establishment** to meet the expected shortfall in national total wood fibre demand. **This will in turn be a missed opportunity to contribute to meeting government climate change targets for carbon sequestration**.*

4. Further Inputs

As the independent professional association of forest scientists, managers and growers who work in plantations, Forestry Australia members are committed to the principles of sustainable forest management and applying these principles to generate environmental, economic and social outcomes in all types of forests and tenures.

Forestry Australia requests dialogue with the Indirect and Industry Tax Policy Unit, Personal and Indirect Tax and Charities Division of Treasury to discuss the issues raised above. Such informed discussions would aim to further develop policies that will assist Treasury to deliver the Government's goals of taking practical steps to move towards net zero emissions and to protect the environment by encouraging primary producers to undertake additional carbon abatement activities.

Please contact Forestry Australia CEO, Ms Jacquie Martin, to schedule discussions at
ceo@forestry.org.au
03 7065 4250

Forestry Australia will be pleased to make available a panel of our most experienced members with expertise in this area to ensure such discussions are productive and assist Treasury to deliver useful policies in line with Government goals and appropriate fiscal controls.