

Chapter 1

Introduction

1.1 On 26 June 2008, the Senate referred the following matter to the Senate Standing Committee on Rural and Regional Affairs and Transport for inquiry and report by 22 August 2008:

The implementation, operation and administration of the legislation underpinning Carbon Sink Forests and any related matters.

1.2 The legislation under review is the *Tax Laws Amendment (2008 Measures No. 2) Act 2008* which under Schedule 8 provides for tax deductibility for the cost of establishing carbon sink forests. The bill received Royal Assent on 24 June 2008, and provides for amendments to the *Income Tax Assessment Act 1997* (ITAA), inserted in Subdivision 40-J.

Background

1.3 In 2004 the Australian Taxation Office (ATO) withdrew a non-binding Interpretive Decision which had indicated that year-of-expense deductibility of costs for establishing forests for the purpose of carbon sequestration would be allowed. As a consequence of that action carbon sink forests became treated as capital items, with no deductions available for establishment costs, and created an unequal taxation treatment of carbon sink forests compared with other planted forests.

1.4 Other forms of greenhouse gas emissions reduction activities by industries are tax deductible. For example, capital expenditure on depreciating assets that reduce emissions from oil and gas production may be written off over the effective life of the assets. These considerations provided a case for addressing a change in the tax treatment of carbon sink forests.

1.5 Amendments to the taxation legislation were first proposed in the May 2007 budget by the previous government. They were introduced into Parliament in September 2007 but were not passed prior to the election. The Government reintroduced the amendments in February 2008.

1.6 The new tax arrangements provide a short-term (until 2012) incentive to encourage early establishment of carbon sink forests that will contribute to a medium-term emissions target, while other options for delivering significant emissions reductions are further developed. Carbon sink forests also contribute to the achievement of national policy objectives for sustainable natural resource management.¹

1 *Submission 45*, Department of Climate Change, pp 2-3.

Overview of the legislation

1.7 As noted above, the Act amends the ITAA to allow a tax deduction in respect of capital expenditure incurred in the establishment of trees in carbon sink forests. Subdivision 40-J of the ITAA describes 'carbon sink forests' as forests which are established for the primary and principal purpose of sequestering carbon from the atmosphere. The forests cannot be used for harvest or for commercial horticulture.

1.8 The legislation allows carbon sink forest operators to depreciate the costs of establishing a qualifying carbon sink forest under the horticultural plant provisions, with effect from 1 July 2007. This treatment was applied to recognise that a tree planted as part of a carbon sink forest has the characteristics of a depreciating asset, in that it has a limited 'effective life' and can reasonably be expected to decline in value over time.

1.9 The legislation is structured in two phases. The first phase allows deductibility in the year of expense of eligible establishment costs. This provides an incentive for the establishment of carbon sink forests as a climate change measure for a period of five years from 1 July 2007. The second phase, commencing from 1 July 2012, applies a low rate of deductibility of 7 per cent per annum over 14 years and 105 days which is equivalent to the terms for long lived horticultural plantings.²

1.10 In order to claim a tax deduction for costs associated with establishing a carbon sink forest taxpayers must meet certain conditions including:

- they must be carrying on a business;
- the primary and principal purpose of establishing the trees is carbon sequestration by the trees;
- they did not incur the expenditure under a managed investment scheme or a forestry managed investment scheme; and
- the trees in the carbon sink forest meet certain forest characteristics and adhere to environmental and natural resource management guidelines.³

1.11 As a general approach the ITAA does not lay down specific conditions for deductible activities, for example, regarding species selection or planting location. However the requirement to meet certain forest characteristics and adhere to environmental and natural resource management guidelines have been specifically introduced for carbon sink forest establishment. The forest characteristic conditions provided in the legislation align with the criteria for carbon sink forest activities that can contribute to Australia's greenhouse gas target under the Kyoto Protocol.⁴

2 Tax Laws Amendment (2008 Measures No. 2) Bill 2008, Revised Explanatory Memorandum, pp 51-52.

3 Revised Explanatory Memorandum, pp 52-55.

4 *Submission 45*, Department of Climate Change, p. 4.

1.12 Taxpayers that meet the conditions for a carbon sink forest may only deduct 'eligible' establishment costs. These include the costs of acquiring and planting the trees or seeds, the costs incurred in preparing to plant the trees or seeds and surveying costs. However, taxpayers cannot claim expenditure on land, fencing, water facilities and accessing carbon rights. There is no tax deduction available under Subdivision 40-J of the ITAA for on-going maintenance costs.⁵

1.13 Under the legislation, a landholder who grows a forest for carbon sequestration purposes could claim a tax deduction. Landholders can also offer land to businesses that grow carbon sink forests, in return for payment for use of the land. In this situation the business would obtain the tax deduction.

1.14 Subsection 40-1010(3) of the Act requires the Minister for Climate Change to make guidelines, in the form of a disallowable instrument, about the environmental and natural resource management in relation to the establishment of trees for the purposes of carbon sequestration. The regulations were introduced on 2 July 2008. The guidelines provide that carbon sink forest establishments should be:

- based on regionally applicable best practice approaches for achieving multiple land and water environmental benefits;
- guided by regional natural resource management plans and water sharing plans; and
- recognise and adhere to all government regulatory requirements.⁶

Conduct of the inquiry

1.15 The committee advertised the inquiry in *The Australian* on 2 July 2008. In addition to the relevant government agencies and departments, the committee wrote to a number of key stakeholder groups inviting submissions. Sixty written submissions were received. A list of written submissions is included at Appendix 1.

1.16 The committee held three public hearings in relation to its inquiry: in Canberra on 27 July 2008; in Brisbane on 18 August 2008; and in Canberra on 11 September 2008. The committee heard evidence from a number of witnesses, including representatives from industry organisations, horticultural and grower groups, peak bodies as well as government departments and agencies. For a full list of witnesses see Appendix 2.

1.17 The relevant submissions and the Hansard transcripts of the committee's hearings are available on the parliament's homepage at <http://www.aph.gov.au>

5 Revised Explanatory Memorandum, pp 55-62.

6 Minister for Climate Change and Water, Environmental and Natural Resource Management Guidelines in relation to the establishment of trees for the purposes of carbon sequestration, 2 July 2008.

Acknowledgements

1.18 The committee appreciates the time taken by all of those who provided both written and oral submissions to the inquiry – particularly in view of the short timeframe. Their work has assisted the committee considerably in its inquiry.