The Senate

Standing Committee on Rural and Regional Affairs and Transport

Implementation, operation and administration of the legislation underpinning Carbon Sink Forests

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ABBREVIATIONS

ATO	Australian Tax Office
ITAA	Income Tax Assessment Act 1997.
QFF	Queensland Farmers Federation
DCC	Department of Climate Change
ABARE	Australian Bureau of Agricultural and Resource Economics
NAFI	National Association of Forest Industries
VFF	Victorian Farmers' Federation
ANEDO	Australian Network of Environmental Defenders' Offices
CSIRO	Commonwealth Scientific and Industrial Research Organisation.
NFF	National Farmers Federation
MIS	Managed Investment Schemes
ASCAS	Australian Soil Carbon Scheme
CCX	Chicago Climate Exchange
GRDC	Grains Research and Development Corporation
NWI	National Water Initiative
NWC	National Water Commission
COAG	Council of Australian Governments
DOW	Department of Water (WA)

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]

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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]

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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

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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.

Chapter 2

Major issues raised during the inquiry

Introduction

2.1 A number of broad issues relating to the impact of taxation incentives for the establishment carbon sink forests were examined during the committee's consideration of this legislation. These included

(a) the impact on prime agricultural land;

(b) the impact on rural communities and industries;

(c) enforceability of carbon sequestration property rights over consecutive landowners;

(d) the permanency of new plantings;

(e) the requirement that plantings be contiguous;

(f) incentives for biodiverse planting;

(g) the potential for undesirable taxation outcomes;

(h) the need for the tax incentives;

(i) Managed Investment Schemes; and

(j) recognition of other forms of carbon stores.

2.2 These issues are discussed in the following chapter. Issues relating to the *Environmental and Natural Resource Management Guidelines* are discussed in Chapter 3.

Impact on prime agricultural land

2.3 Submissions expressed concerns at the potential for the permanent loss of large tracts of prime productive agricultural land to carbon sink forests. This could occur either by a landowner ceasing production and planting a forest or by an investment group buying prime agricultural land and planting a carbon sink forest on that property.

2.4 The Queensland Farmers' Federation stated that:

> …we would have to be worried about any scheme that saw arable land which was being farmed productively for food and fibre being taken out of production. Climate change and increasing climate variability have the potential to limit Australia's capacity to produce food and fibre for both domestic and export consumption. Food security and food pricing should be seen as part of a national food policy. The removal of 85 000 Ha of land from agricultural production by 2011 is not good policy unless there is a requirement to assess the social, economic and environmental impacts of

> these tree plantings. This becomes even more significant when most of these plantings are likely to be in the higher rainfall areas.[1]

2.5 However some submissions questioned the extent to which prime agricultural land will be threatened. The Department of Climate Change (DCC) stated that carbon sink forests are generally established as small plantings integrated within existing agricultural land uses in less productive regions and on low productivity land units in the landscape.[2]

2.6 DCC commissioned the Australian Bureau of Agricultural and Resource Economics (ABARE) to conduct a study to assess the circumstances in which it may be financially attractive to replace agricultural land uses with carbon sink forests. The study analysed the threshold carbon prices required to equate the net present value of returns from carbon sink forests with a range of representative land values. The analysis covered a range of agricultural land uses and different rainfall zones, including examples representing highly productive agricultural regions. The methodology allowed assessment of the potential for replacement of a current agricultural land use with carbon sink forests, rather than the common practice of establishing carbon sink forests on smaller areas within existing land uses.

2.7 The study found that for all scenarios, carbon prices in excess of $100 per tonne of carbon dioxide equivalent would be required to make it attractive to replace agriculture with carbon sink forests. These findings apply across the different study regions. While carbon sequestration rates (and therefore returns) will generally rise with land productivity, highly productive land also has a high value for agricultural production.[3]

2.8 DCC stated the findings align with the evidence of current practice, where carbon sink forests are being established in regions that are marginal for agriculture, or in low productivity sites.[4]

2.9 The National Association of Forest Industries (NAFI) also noted that:

> Existing carbon sink projects are typically sited in areas with access to affordable land and low to medium rainfall such as the wheat-belts of Western Australia and Central- West New South Wales...
>
> When a mature market for carbon is established it is likely that the area suitable for carbon sink forests could expand. However, it is unlikely that

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1 *Submission* 51, p. 2. See also *Submission* 23, p.1; *Submission* 39, p.1; *Submission* 24, p. 1; *Submission* 49, p. 2.

2 *Submission* 45, pp 6 - 8.

3 ABARE, *Estimated Threshold Carbon Prices for Investment in Carbon Sink Forests*, August 2008, pp 1-9.

4 DCC, Additional Information, dated 5 September 2008. See also *Committee Hansard*, Mr Ken Matthews, National Water Commission, 11 September 2008, p. 41; *Committee Hansard*, Mr Paul Ryan, DCC, p. 56.

> under a Carbon Pollution Reduction Scheme the price of carbon would rise to a level where the economic returns from carbon sink forests would exceed returns from agricultural activities on high value land.[5]

2.10 NAFI stated that the legislation facilitates the integration of carbon sinks forests with existing land uses.

> This legislation sets up arrangements for farmers, landowners and investors from other sectors to invest in rural and regional Australia in order to increase the sequestration capability of our landscape through the establishment of carbon sink forests. But it does this in a way that recognises the fact that increasing trees in our landscape needs to be achieved in a way that integrates carbon sink forests with existing land uses, and it recognises the economic, social and environmental benefits in doing so.[6]

2.11 Carbon Conscious Ltd provided an example of a successful venture. The company identifies optimal sites within the wheat belt areas and integrates planting of trees with existing agricultural activities.

> Farmers are rewarded for the use of their land, with cash consideration and, at their option, a share of the carbon credits generated from the plantings. In addition, farmers will reap significant environmental benefit from the surrounding land due to the presence of the native trees. Carbon Conscious believe there is no net loss of food production from the plantings, due to the environmental benefits associated with the trees. The capital cost associated with the use of the land and the planting of the trees will, in the majority, be met by third-party carbon emitters.[7]

Committee view

2.12 The committee questions the extent to which prime agricultural land will be threatened by the establishment of carbon sink forests. It notes that the ABARE study found that carbon prices in excess of $100 per tonne of carbon dioxide equivalent would be required to make it attractive to replace agriculture with carbon sink forests.

2.13 The committee further notes that carbon sink forests do not appear to be activities that offer high returns over a short period of time. The committee therefore believes that it is unlikely that the availability of a tax deduction for a limited range of expenses would be sufficient incentive to cause the large scale planting of these forests. The requirement that these forests meet natural resource guidelines and not interfere with existing patterns of water use, together with the likely increasing price of water, suggest that the planting of these forests will most likely be limited to less productive or marginal land.

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5 *Submission* 50, pp 1-2.

6 *Committee Hansard,* 24 July 2008, p. 2.

7 *Committee Hansard*, 24 July 2008, p. 90.

2.14 The committee also notes that, importantly, unlike other forestry tax deductions, not all the costs involved in the establishment and management of a forest carbon sink are tax deductible. The land component, for example, which represents a significant proportion of the total cost of establishing a carbon sink, is not tax deductible under the legislation.

Impact on rural communities and industries

2.15 The inquiry received differing views on the impact on rural communities and industries of the establishment of carbon sink forests. It was argued that if enough rural properties in a particular area are diverted to use for a carbon sink forest then the critical mass of an industry will be lost. This may lead to the closure of the remaining farms in that area. It was also argued that the disturbance of established patterns of rural production may destroy the social make-up of the area and eventually lead to its de-population over time.

2.16 Some potential negative impact on rural businesses and communities was noted by industry, farming and environmental groups.[8] The Environment Association noted the undesirable impacts in rural Tasmania.

> Australia's attempts to sequester carbon to mitigate global climate warming are likely to promote a mass expansion of artificial plantations in Tasmania. A great social concern for Tasmania is that farming activity is being replaced by artificial plantations which employ very few. The reduction in farming activity, the local production of food and associated employment is a long-term loss that may well have severe impacts for the viability of our community.[9]

2.17 The Victorian Farmers' Federation (VFF) stated that the change of land use from production agriculture to carbon sink forestry will result in a transfer of economic activity from rural areas to businesses requiring the carbon offset. The VFF noted that rural areas are already facing considerable economic and social challenges from changes in climate and reductions in water availability.[10]

2.18 However, a number of submissions argued that the encouragement of carbon sinks projects will provide benefits to regional areas, including large increases in regional employment and direct investment in regional communities and services.[11]

2.19 NAFI stated that:

> The recognition and encouragement of carbon sink forest establishment is another positive step towards regional job creation and enhanced

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8 *Submission* 39, p.2; *Submission* 59, p.5; *Submission* 52, p. 2; *Submission* 33, p. 4.

9 *Submission* 56, p. 10.

10 *Submission* 46, p. 3. See also *Submission* 44, pp 6-7.

11 *Submission* 10, p. 4; *Submission* 36, p.1.

> community prosperity through the investment of city-based capital spent on agribusiness investment in rural Australia.
>
> Combined with the environmental benefits of carbon abatement, salinity and erosion control as well as increased biodiversity, carbon sink forests are a good investment for those parts of rural and regional Australia that are mainly reliant on agriculture.[12]

2.20 Mr Cosier of the Wentworth Group also noted benefits for rural communities:

> At $70 a tonne you are looking at a massive injection of money into farming systems that would not otherwise be injected. It also brings with it some risks if there is not a sensibly planned transition to this significant economic change.[13]

Committee view

2.21 The committee notes the concerns expressed in relation to carbon sink projects on rural communities and industries. It also recognises that the development of carbon sinks will provide benefits to many rural communities, including investments and job opportunities.

2.22 The committee notes that if the relative returns from land given over to carbon sink forests are relatively low, as has been suggested in evidence, then the disruption to rural communities will be minimised. If the returns from carbon sink forestry are higher than exiting uses of such land, this will provide an opportunity for existing landholders to convert land use to carbon sink forestry. Alternatively, if the returns from carbon sink forestry are high enough, this activity may provide an alternative activity for those in rural communities whose current farming activities are no longer viable.

Land title

2.23 Some submissions raised issues related to state government legislation providing for establishment of property rights for carbon sequestered in forests, including the specific issue of registering rights on title. Registering such rights on title may, depending on the nature of the legislation, allow enforceability of carbon sequestration property rights over consecutive landowners, as well as helping to inform property purchasers of the existence of rights over the land.

2.24 Mr Curnow, Partner, Baker and McKenzie outlined the situation in the states and territories in respect of carbon sequestration rights legislation.

> ….all states and territories, except the Northern Territory and the Australian Capital Territory, have some form of carbon sequestration rights legislation in place. Those different pieces of legislation confer different rights. In New

12 *Submission* 50, p. 4. See also *Committee Hansard*, 24 July 2008, pp 2-3.

13 *Committee Hansard*, 18 August 2008, p. 28.

> South Wales, Western Australia and South Australia, they confer an interest in land. In the other states, on our analysis, they confer only a personal right and have some restrictions with respect to being able to register an interest on title. If we look at those states where there is, in fact, the ability to register a CSR on title, in our experience from having been involved in a number of these projects, the reality is that it is very difficult to get the commercial backing for these projects without holding a carbon sequestration right. In practice, the reality is that all of these sorts of projects that may take benefit from the deduction that is allowed under the Income Tax Assessment Act would seek to have some form of carbon sequestration right registered on title. I think, in that sense, it is important to remember that, practically, what we see as being likely to happen in most instances is that people developing these projects would get the carbon sequestration right registered on title.
>
> …at the moment not all states and territories have the same approach. I think there is a need to make the nature of that carbon sequestration right and the way in which it can be registered on title uniform across the states and territories. At the moment, in some states and territories, you do not get the ability to register an interest on title. So, if there is a change in ownership of the land, that carbon sequestration right does not run with the land, because you have a mere personal right as opposed to something that is registrable on title. There is definitely an issue at the state and territory level about the nature of carbon sequestration rights and what protection they confer when there is a change of ownership of the land.[14]

2.25 Mr Curnow indicated, however, that despite the carbon right issue being unclear, it has not presented an impediment to people engaging in the process.

> In our experience, notwithstanding those restrictions, the reality has been that a lot of projects are still happening in those states and territories. So I think it is not so much a case of things which are preventing or discouraging investment but more about how we can improve the overall system and make it more robust, particularly in the context of potentially a lot of these projects opting into an emissions trading scheme down the track.[15]

2.26 DCC stated that the state governments (Victoria, New South Wales, South Australia, Tasmania, Western Australia and Queensland) have enacted specific legislation to recognise ownership of carbon sequestration property rights from forest sink projects separately to ownership of vegetation and land. The legislation allows parties to register on title a legally binding agreement stipulating arrangements such as the particular land unit to which the agreement applies (e.g. through land surveys), and the rights and duties of each party. In most states the legislation includes provisions

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14 *Committee Hansard*, 24 July 2008, p. 106. See also Mr Gilbert, NAFI, *Committee Hansard*, 24 July 2008, p. 12; Mr Cosier, Director, Wentworth Group, *Committee Hansard*, 18 August 2008, p. 33.

15 *Committee Hansard*, 24 July 2008, p. 107.

protecting carbon sequestration property rights in the event of a change in land ownership.[16]

2.27 DCC noted that there is a range of other differences in carbon property rights legislation between states. Furthermore, the practical application of the legislation in some states has been limited to date.[17]

2.28 Mr Balsarini, Executive Director, Carbon Conscious Ltd, indicated that the state legislation would provide sufficient surety that the registration on the property title is secure.

> I guess it would be fair to say that that state legislation has been in for a few years over here but it has not necessarily been tested because it is a fairly fledgling industry, as I guess you would appreciate...And I guess if we could get some further clarification about how the carbon reduction scheme will operate that would help us. But at the moment I am relatively comfortable with the way the WA title system works—albeit that it will obviously need to be tested over the next few years.[18]

2.29 Carbon Conscious Ltd also operates a carbon covenant.

> In addition to the carbon right that we lodge on title, we also take what is called a carbon covenant. The carbon covenant is a registered document. It outlines the relationship between the landowner and the carbon rights holder, particularly in relation to the permanency of the trees and the things they need to do on an annual basis, such as to certify that the trees are there and are growing and that they are getting managed. We have a management protocol, so a number of the farmers actually provide management services and get a cash return for that. It is a little bit wait-and-see.[19]

2.30 The committee notes that the issue of the transfer of land title was raised as a potential problem during the inquiry. The committee notes, however, the advice of DCC which indicated that in most states the relevant legislation includes provisions protecting carbon sequestration property rights in the event of a change in land ownership. The committee further notes that a number of companies currently operating in the carbon sink market have adopted best practice in relation to property rights.

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16 *Submission* 45, p. 5. See also DCC, Additional Information, dated 5 September 2008; DCC, *Committee Hansard*, 11 September 2008, p. xx [6.17 pm].

17 DCC, Additional Information, dated 5 September 2008.

18 *Committee Hansard*, 24 July 2008, p. 96.

19 *Committee Hansard*, 24 July 2008, p. 96.

Permanency of new plantings

2.31 Concerns were expressed in relation to the permanency of the new plantations, and whether the carbon is sequestered permanently. The Australian Network of Environmental Defender's Offices (ANEDO) stated that:

> Neither the Bill, the Explanatory Memorandum, nor the Guidelines provide that any trees planted under the scheme are to remain a 'carbon sink forest' for any sustained period of time. There is no requirement that the trees planted to establish a carbon sink forest reach an age (ie, at least 10-20 years) to significantly contribute to the purpose for which they were supposedly planted – to provide a carbon store.
>
> The "establishment expenditure will be immediately deductible for trees established in carbon sink forests in the 2007-08 to 2011-12 income years (inclusive)". It is therefore currently possible for an entity to plant trees, immediately obtain the tax deduction and not be concerned whether they succeed in growing or not. Additionally, there are no provisions preventing the land set aside for carbon sink forests to be sold on at a later stage and cleared.[20]

2.32 Some witnesses questioned the usefulness of the concept of 'permanence' in relation to forests. Dr Polglase, Research Program Leader with the Commonwealth Scientific and Industrial Research Organisation (CSIRO), argued that:

> …when we talk about permanence and we say, about a forest, that you must have it for 100 years, that is a nonsense at a tree level. Every tree cannot live for 100 years. So what you get is an average.[21]

2.33 Evidence suggested that certain factors will ensure that sinks are maintained for the long-term. The CO2 Group Ltd argued that given the level of expenditure involved in establishing and maintaining a forest carbon sink, investments will not be made in forest carbon sinks for the sole purpose of realising a tax deduction.

> …it would make no commercial sense to incur a large expenditure and realise only a part of that expenditure as a tax deduction. It beggars belief that a corporate, or private investor, would establish a carbon sink in order to realise only a 20-25% tax deduction for every dollar invested. Instead, investors will inevitably seek to recoup investment expenditure through realising revenue from the forest carbon sinks through, for example, trade of carbon permits generated from the forest carbon sink under an emissions trading scheme, or reducing costs through acquittal of such permits.[22]

2.34 The CO2 Group argued, however, that accreditation of forest carbon sinks under a recognised emissions reduction scheme might be a sensible pre-requisite to

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20 *Submission* 48, pp 4-5. See also *Submission* 32, p. 2; *Submission* 35, p. 3; Mr Williams, Greening Australia, *Committee Hansard*, 24 July 2008, p. 40.

21 *Committee Hansard*, 24 July 2008, p. 15.

22 *Submission* 9, p. 2.

tax deductibility. Such an approach would ensure the retention of forest carbon sinks in the long-term since such schemes institute stringent eligibility requirements around permanence of a forest carbon sink.[23]

2.35 The CO2 Group is accredited both under the New South Wales Greenhouse Gas Abatement Scheme and the Commonwealth Government's Greenhouse Friendly scheme.

> So one of the accreditation requirements is that you have to demonstrate and address the question of permanence. Under the New South Wales scheme, we do that by undertaking a forestry right and a carbon sequestration right which is registered on title, runs with the land, cannot be removed and is for 150 years.
>
> Furthermore, under that scheme the trees are protected by a restriction on use which is administered by the Crown. If those trees are damaged or removed or you have not fulfilled your accreditation responsibilities, there is civil liability as a director of a company. So the responsibilities are incredibly onerous and significant. To meet them it is critical that you have substantive legal documentation and points of proof that are maintained.[24]

2.36 Two other submitters to this inquiry are similarly accredited. AusCarbon Pty Ltd is accredited under the Greenhouse Friendly Certification Program as an abatement provider.[25] Carbon Conscious Ltd has an application for accreditation with DCC under the same program.[26]

2.37 Mr Grant of the CO2 Group indicated that accreditation should be within the Guidelines and ideally be under the Commonwealth scheme.

> …now that we know the green paper is out, the Carbon Pollution Reduction Scheme would be the most appropriate measure because it will be a national scheme and it will supplant any existing initiatives. The New South Wales government has stated that it will fold the Greenhouse Gas Reduction Scheme into the federal scheme. It is arguable whether the Greenhouse Friendly scheme will prevail, whether it needs to prevail, when it could be overtaken by the Carbon Pollution Reduction Scheme.[27]

2.38 The committee considers that, while permanency of new plantings is not specifically addressed in the legislation, certain factors such as the level of expenditure involved in establishing a forest carbon sink would mitigate against short-term plantings. In addition, if trees, in respect of which a carbon sink forest deduction had been claimed, were later removed, this may be grounds for the Commissioner of

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23 *Submission* 9, p. 3.

24 *Committee Hansard*, 24 July 2008, p.68.

25 *Submission* 10, p. 1.

26 *Submission* 20, p. 4.

27 *Committee Hansard*, 24 July 2008, p. 74.

Taxation to review the taxpayer's eligibility for that deduction. The concept of 'permanence' in relation to trees is also open to question. The committee also notes the possible benefits of the accreditation scheme as outlined by the CO2 Group Ltd above.

Contiguous plantings

2.39 Concerns were also raised that the proposed arrangements would not allow a landholder to make a claim on the capital expenditure on non-contiguous plantings.

2.40 The NFF argued that this condition places a limitation on primary producers claiming the tax provisions for on-farm forestry practices that deliver carbon sink benefits. The NFF stated that on-farm forestry practices by agricultural producers will often involve multiple patches of small lots of trees in order to optimise the broader environmental and productivity benefits of such practices.[28]

2.41 The NFF also argued that this same condition may instead lead to the perverse outcome of providing an incentive to farmers to plant trees in areas which deliver a poor environmental outcome, purely in order to maximise the potential claim. Continuous areas may not suit particular landscape planning and may therefore lead to inappropriate land use decisions on-farm.[29]

2.42 The committee, while noting the concerns expressed in relation to the requirement to have in place contiguous plantings, believes that extending the tax deduction to non-contiguous plantings would add to the administrative complexity of the scheme.

Incentives for biodiversity/environmental planting

2.43 Concerns were raised that the legislation does not require that plantations be biodiverse plantings. Some submissions also argued there is a lack of incentives for environmental planting.

2.44 Mr David Williams of Greening Australia stated that:

> Whilst the environment and natural resource management guidelines in relation to the establishment of trees for the purposes of carbon sequestration do go some way to delivering a balanced mixed land use, they fall short of driving biodiverse plantings as the guidelines rely on ambiguous regional natural resource plans.[30]

2.45 Mr Williams also noted that it costs approximately twice as much to plant a 40-odd species biodiverse planting than a single-species planting – 'therefore investors seeking lowest cost abatement will direct their funds towards monoculture plantings.

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28 *Submission* 44, p. 4.

29 *Submission* 44, pp 4-5. See also *Submission* 46, p. 2; *Submission* 52, p. 1.

30 *Committee Hansard*, 24 July 2008, p. 34.

To see the first ecosystem service market fail to maximise environmental benefits would be a perverse outcome'.[31]

2.46 Mr Paul Ryan, Director, Land Sector Policy in DCC stated that biodiversity considerations were considered in the development of the Guidelines which were the subject of wide consultation.

> In terms of biodiversity considerations specifically, the guidelines were developed within the Australian government and in consultation with our colleagues in Environment. There was also consultation conducted consistent with all tax measures with interested parties, including organisations like Greening Australia, which obviously have a close interest in biodiversity.[32]

2.47 Evidence indicated that companies involved in the carbon market are focussing on the need to facilitate biodiversity. AusCarbon Pty Ltd noted that the company is building biodiversity through its plantings.

> …we are planting a variety of locally-sourced, endemic, mixed species, which is helping to build biodiversity back into the region. Our vision statement is: 'Building the community carbon cycle.' By this, we mean that, by increasing the vegetative biomass and thus increasing the amount of carbon stored, there will be a significant flow-on of benefits, economically, environmentally and socially, and this gives a win-win-win result for the community…
>
> All our plantings are biodiverse. Our particular economic modelling only allows for these marginal areas. The way we do our biodiversity projects will not allow us to encroach into the higher rainfall areas…. That is part of our vision statement: to rebuild these communities from which…people have been moving to the cities because they have just become unviable.[33]

2.48 Mr Balsarini of Carbon Conscious Ltd stated that:

> Our business proposition is the creation of stakeholder value through the sequestration of carbon from the atmosphere by the planting of native mallee eucalyptus trees in the wheat belt areas of Australia. The business identifies optimal sites within wheat belt farms of Australia and integrates planting of these trees with existing agricultural activities. This integration involves working in conjunction with farmers to ensure that plantings can coexist within existing cropping rotations.[34]

2.49 Mr Cosier of the Wentworth Group cautioned against direct intervention in the market, noting that many farmers are already planting biodiverse forests.

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31 *Committee Hansard*, 24 July 2008, p. 34.

32 *Committee Hansard*, 11 September 2008, p. 58. See also, Dr Charlie Zammit, DEWHA, *Committee Hansard*, 11 September 2008, p. 37.

33 *Committee Hansard*, 24 July 2008, pp 84-85.

34 *Committee Hansard*, 24 July 2008, p. 90.

> Plantation forestry is a market asset like any other agricultural commodity. …we would not seek to intervene into that market. So if the market was operating fairly and transparently we would say that is fine. If a farmer wants to grow plantation forests against, say, grazing sheep, and all the other externalities are addressed, it would not concern us from a conservation perspective—if you have land clearing legislation still in place, and that is pretty well secured on the mainland of Australia. What we are saying about the biodiverse forests is that they are a public good. Certainly many farmers in Australia are voluntarily planting biodiverse forests for their own self-benefit and for the public good and we would be very pleased to see them rewarded with the price of carbon for doing so. But whichever it is, if it is plantation or conservation forestry, and someone is to secure a financial benefit from the carbon market, it has to be absolutely locked in as a guaranteed secure source of carbon.[35]

2.50 Some submissions raised the issue of environmental planting. The Green Institute argued that:

> Environmental planting will benefit minimally from the tax deductions. Only businesses are eligible, not voluntary or tax exempt organisations. The deductions are confined to expenditure on establishing 'trees': natural regeneration costs little and will benefit little (fencing costs are excluded for example); and non-trees do not qualify.[36]

2.51 Witnesses noted however that tax incentives already exist to assist with environmental issues, such as regeneration of degraded vegetation. Mr Andrew Grant of CO2 Australia stated that:

> …section 40 of the tax act, which deals with the environmental provisions, particularly environmental improvement by a primary producer, is a more effective section of the tax act for that. There already are taxation incentives detailed in there and, if it were your view that they were incomplete or inadequate, that would be a more appropriate place. For example, if a farmer undertakes fencing to keep stock off degraded vegetation so you can let the natural restoration processes occur, those costs are totally deductible in the year of expenditure.[37]

Committee view

2.52 The committee notes that the Environmental and Natural Resource Guidelines provided for under subsection 40-1010(3) of the ITAA reinforce that carbon sink forests are to be established in a manner that is consistent with existing good practice environmental and natural resource management frameworks. The committee also notes that while the tax deduction is for the primary purpose of carbon sequestration

35 *Committee Hansard*, 18 August 2008, pp 29-30.

36 *Submission* 38, p.1. See also *Submission* 31, p. 2; *Submission* 27, p. 2.

37 *Committee Hansard*, 24 July 2008, p. 81.

this does not prevent the taxpayer from having a secondary purpose in planting of trees, such as improving the biodiversity of the property in question.

Taxation outcomes

2.53 Some submissions argued that forest carbon sinks may lead to undesirable taxation or investment outcomes.[38]

2.54 The CO2 Group argued however that the establishment of forest carbon sinks requires significant up-front, and often trailing, investment and that realisation of a tax deduction is unlikely to act as a primary driver for forest carbon sink establishment.

> … not all of the costs involved in the establishment and management of a forest carbon sink are tax deductible. The land component, for example, which represents a significant proportion of the total cost of establishing a carbon sink, is not tax deductible under the Bill. Furthermore, deductions for the establishment of forest carbon sinks post 2012 will be delivered over a 14 year period and not during the first year of project establishment.[39]

2.55 While forest carbon sinks will not be established purely for tax avoidance reasons, the CO2 Group argued that the tax deduction will be helpful in defraying some of the significant costs involved in investing in long-term forest carbon sink projects and, therefore, is an important policy instrument with respect to providing some support for private investment into projects addressing climate change issues.[40]

Managed Investment Schemes

2.56 A number of submissions drew upon the negative impact of Managed Investment Schemes (MIS) in diverting significant areas of agricultural land into forestry arguing that similar impacts may occur under the tax concessions for carbon sink forests.[41] The Treefarm Investment Managers Association however refuted these assertions noting that MIS forestry is specifically excluded from the scope of the legislation.[42]

2.57 The committee notes that under the legislation, in order to claim a tax deduction for costs associated with establishing a carbon sink forest, taxpayers must meet certain conditions including that they did not incur the expenditure under a MIS or a forestry managed investment scheme.

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38 *Submission* 35, p. 1-2; *Submission* 60, pp 1-3.

39 *Submission* 9, p. 1.

40 *Submission* 9, p. 1.

41 *Submission* 52, p. 2. See also Mr Bernard Milford, Canegrowers Australia, *Committee Hansard*, 18 August 208, pp 1-2.

42 *Submission* 62, p. 1.

2.58 Submissions also emphasised key differences in the operation of the different schemes. NAFI stated that:

> This legislation prohibits the provision of a tax deduction if the investment is made through an MIS or if there is an intention to fell the trees or use them for commercial horticulture. Carbon sink forests and forestry MIS are unrelated and should be treated as such by this inquiry.[43]

2.59 Given the concerns raised in relation to MIS schemes, the committee sought clarification of the relationship between this scheme and MIS, particularly in terms of the way investors could become involved and make use of the upfront deduction at least for the first three years. The Treasury advised that:

> An indirect investor in a carbon sink forest cannot claim a deduction under this measure. The taxpayer claiming this deduction must have incurred the capital expenditure and must have met the other conditions for deductibility. Therefore a shareholder of a company cannot claim a deduction if the company establishes a carbon sink forest. Furthermore, under paragraph 40-1010(1)(f) of the legislation a deduction cannot be claimed if the taxpayer incurred the expenditure under a managed investment scheme (MIS) or a forestry MIS.[44]

2.60 Mr Matthew Flavel, Acting General Manager, Business Tax Division, Treasury, told the committee that MIS investment and investment in carbon sink forests are based on fundamentally different structures. He said

> I think it is important because the concern in MISs was essentially raised in some quarters about the fees going to third parties-planners and those involved in the process of raising capital that was then ultimately fed through to MIS investment. This tax deduction goes directly to a business which is in the business of carbon sequestration, so it is a fundamentally different structure-[45]

2.61 The Treasury also clarified for the committee how investors get involved in agricultural investments:

> Under a company structure, an investor purchases a share in the company. As a shareholder, this investor becomes an owner of the company and receives returns via dividends and capital gains from the share's increase in value. The shareholder is unable to claim a tax deduction for expenditure incurred by the company to establish an agricultural plant. The company retains ownership of that planting.

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43 *Submission* 50, p. 2. See also *Submission* 9, p. 1.

44 Department of Climate Change, answer to question on notice, 11 September 2008, (received 19 September 2008).

45 *Committee Hansard*, 24 July 2008, p. 47.

> Under a MIS there are two entities which need to be considered (an investor and a manager). Generally, the investor contributes money and receives a bundle of rights in relation to a parcel of land.[46]

2.62 Some submissions, while acknowledging that the deductions under the forest carbon sink legislation would not be available to MIS operators, expressed concerns about the impact of MIS in regional areas.[47] This is however outside the committee's terms of reference.

Emissions trading scheme

2.63 The committee raised the issue of why it was necessary to provide tax deductions given that the Government has included plantation establishments under the Carbon Pollution Reduction Scheme.

2.64 Mr Curnow, Partner, Baker and McKenzie stated the need for complementary measures to operate in the early years of an emissions trading scheme.

> …it is important to remember that the emissions trading scheme—
>
> —is one policy, although it is going to have broad coverage—at least as far as what the green paper proposes—covering most sectors, including a voluntary, opt-in arrangement for the forestry sector. The reality is that, in our view, there will be a reasonably low carbon price in the early years, because you are going to have a transition arrangement from having no scheme to introducing the scheme and then ratcheting the caps down over time. So I think, in that context, complementary measures in the early years of introducing the emissions trading scheme will still be very important. We have seen, for example, that renewable energy projects will not get up purely on the basis of the introduction of a carbon price because it is likely to be too low in the early years. So you need a complementary measure like the national renewable energy target. I think this really falls into a similar category, because with forestry you have very long lead times before you get substantial levels of sequestration...you need complementary measures, like the ability to claim tax deductions on aspects of that, to help in that transition period.[48]

Recognition of other forms of carbon stores

2.65 The committee heard evidence from a number of witnesses that the government should examine options for recognising all forms of carbon sinks in terrestrial ecosystems, including carbon stores in existing native forests. [49] Submitters

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46 Department of Climate Change, answer to question on notice, 11 September 2008, (received 19 September 2008).

47 *Submission* 44, p. 7.

48 *Committee Hansard*, 24 July 2008, pp 110-11.

49 See for example *Submissions* 22, 29 and 48.

stressed that environmental stewardship over remnant vegetation should also be recognised.[50] The committee heard that a higher value should be placed on the carbon sequestration contribution of natural systems as these provide more resilient and long term carbon stores.[51]

2.66 The committee received evidence regarding the potential capacity of perennial pasture to sequester carbon. Submitters noted the wider benefits in farm productivity, soil erosion and weed management, as well as soil carbon sequestration that could be achieved by encouraging the conversion of annual pasture to perennial pasture.[52]

2.67 Dr Christine Jones, Founder of the Australian Soil Carbon Scheme (ASCAS) outlined for the committee the approach adopted by the ASCAS to combine the benefits of perennial pasture systems with the benefits of direct drilling to achieve grassland carbon sinks.[53] The ASCAS is a stand alone voluntary incentive scheme. Through the scheme annual payments are made to landholders based on annual measured increases in soil carbon above baseline levels.[54] Dr Jones stated that the intention of the scheme is to act as a stepping stone for farmers to move into the carbon market.

2.68 Dr Jones told the committee that it would require only a 0.5% increase in soil carbon on two percent of agricultural land to sequester all Australia's annual carbon dioxide emissions.[55] Dr Jones also outlined a range of additional advantages of the establishment of grasses as carbon sinks. These include the ability of grasses to sequester carbon more quickly, particularly in the initial stages of establishment, compared to trees and the long term resilience of perennial pastures if managed correctly. Dr Jones claimed that as ninety percent of the biomass of a perennial pasture is below ground there was less risk to the carbon store in the event of fire as grass has the potential to regenerate from the crown.[56]

2.69 Through its inquiry into Climate Change in the Australian Agricultural Sector the committee is aware of similar perennial pasture trials in the Northern Agriculture Region of Western Australia which have compared the soil carbon under perennial pasture with that under tradition annual crops and pastures. Such trials have suggested 'sequestration rates of between 5 to 10 tonnes of carbon dioxide equivalents per hectare per year' for soil under perennial pasture.[57] The committee notes that the trial

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50 See *Submissions* 23 and 27.

51 See *Submissions* 32 and 47.

52 See *Submissions* 24 and 58.

53 *Committee Hansard*, 11 September 2008, p. 4.

54 *Submission* 42 to RRAT Inquiry into Climate Change in the Australian Agricultural Sector.

55 *Submission* 58, p. 9.

56 *Committee Hansard*, 11 September 2008, p.6

57 *Submission* 41, Rural and Regional Affairs and Transport Committee Inquiry into Climate Change in the Australian Agricultural Sector, p. 14

samples are small and that more rigorous scientific examination of the results is required.

2.70 In her submission to the committee Dr Jones recommended that the 0-110 centimetre soil profile beneath appropriately managed perennial grasslands be included as an eligible carbon sink under paragraphs 40-1010(2)(a) to (c) of Division 40 of the ITAA. Dr Jones states that the granting of equal status for carbon sink perennial grasslands would enable landholders to designate areas of their land for soil carbon sequestration purposes. Farmers could then choose to abate their own greenhouse gas emissions and/or generate tradeable offset credits.[58]

2.71 Both Dr Jones and Mr David Sykes advocated the establishment of a project-based soil carbon offsets scheme, similar to that currently operating for agricultural soils in the northern hemisphere through the Chicago Climate Exchange (CCX) to expand the range of financial incentives for farmers to adopt improved land management systems. The CCX is an international rules-based greenhouse gas emission reduction audit, registry and trading program based in the United States. Under the CCX landholders have access to a range of qualifying projects for offsetting green house gas emissions.[59]

2.72 DCC explained to the committee that this legislation is targeted specifically at activities that directly contribute to Australia's current Kyoto protocol targets, which include the establishment of new forests since 1990. DCC explained that grassland activities do not contribute to these targets.[60]

2.73 However, DCC told the committee that the government has an interest in soil carbon sequestration and is supporting work in this area. Through its investment in a new measure called Australia's Farming Future, the government is starting to look at other ways in which the agriculture and land sectors can contribute to Australia's overall greenhouse objectives. DCC noted that while the benefits of forests as carbon stores and the ability to account for their growth and carbon sequestration is well established, similar knowledge regarding grassland systems is still emerging.[61] Mr Ryan told the committee:

> The government has done some work to inform some of the decisions already taken in accordance with the Kyoto protocol rules about the potential benefits in grassland systems but also the potential risks in terms of losses. With our variable climate, as well as particular aspects of the accounting rules, there are risk issues in terms of loss as well as gains that need to be taken into account. [62]

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58 *Submission* 58, p. 2.

59 *Committee Hansard*, 11 September 2008, pp. 17 – 18.

60 *Committee Hansard*, 11 September 2008, p. 54

61 *Committee Hansard*, 11 September 2008, p. 53.

62 *Committee Hansard*, 11 September 2008, p. 53.

2.74 The committee's attention was drawn to statements by CSIRO and the Grains Research and Development Corporation (GRDC) that are more cautious about the viability of trading soil carbon. GRDC has said that while carbon inputs can be influenced by management and land use, there are constraints to the amounts of carbon that can be fixed by photosynthesis. GRDC considers that as 40-80% of carbon in plant residues and stubble is lost as carbon dioxide it may take decades to achieve a significant change in soil carbon. GRDC also believes that it is difficult to quantify change in soil carbon.[63]

2.75 CSIRO has stated that carbon credits from carbon stored in the soil on farms may not be as valuable as to farmers as hoped. In its Spring Plant Industry Newsletter CSIOR states

> Carbon trading will generate extra costs for agriculture, including increased fuel and fertiliser costs. Soil carbon credits have been seen as a possible way to offset these costs.
>
> Carbon is locked up in soil in humus, a stable form of organic matter. However humus also locks up nitrogen (N), phosphorus (P) and sulphur (S) – elements essential for healthy plant growth.
>
> Using relevant research done over 50 years ago Dr Mark Peoples and other CSIRO scientists determined the value of N, P and S locked up in humus.
>
> They estimate that to replace nutrients stored in a tonne of humus farmers would have to add about 60kg of N, 12kg of P and 9kg of S – about $200 worth of fertiliser.
>
> If an estimated 2.2 tonnes of carbon dioxide is stored in each tonne of humus and if carbon dioxide is valued at $20 a tonne, the value of carbon dioxide stored in a tonne of humus is therefore about $44.
>
> Thus the overall cost of additional fertiliser, $200, will outweigh the value of the soil carbon credits, $44.[64]

2.76 However, the committee notes that CSIRO is undertaking work to improve soil productivity through the development of conservation farming systems. CSIRO is also studying plant roots and their association with soil and plant productivity to boost sustainable crop and pasture production.[65]

Committee view

2.77 The committee notes that soil carbon is not currently recognised in the Kyoto Protocol arrangements for carbon sinks. However, the committee notes that soil

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63 Dr Christine Jones, Answer to Question on Notice

64 CSIRO Plant Industry Newsletter, Issue 23, Spring 2008, http://www.pi.csiro.au/enewsletter/previousEditions/023story4.htm , accessed 16 September 2008.

65 CSIRO Plant Industry, Farming: roots and soil, CSIRO website, http://www.csiro.au/science/RootSoil.html accessed 16 September 2008

carbon may be recognised in future treaties. Therefore, improving soil carbon through the establishment of perennial pasture is a 'no regrets' policy, particularly given its potential to improve soil productivity in the face of climate change and more extreme drought. The adoption of such management practices now will improve Australia's readiness for future agreements.

2.78 The committee notes the apparent disconnect between the claims of the Soil Carbon Accreditation Scheme and recent statements by CSIRO regarding the value of soil carbon credits. The committee considers that the government should request CSIRO to assess the data being accumulated by the Soil Carbon Accreditation Scheme.

Chapter 3

Environmental and Natural Resource Management Guidelines

Introduction

3.1 Eligibility for the carbon sink forest tax deduction requires adherence to a set of environmental and natural resource management guidelines. Subsection 40-1010(3) of the *Income Tax Assessment Act 1997* (ITAA) requires the Minister for Climate Change to make guidelines about environmental and natural resource management in relation to the planting of carbon sink forests. The Environmental and Natural Resource Management Guidelines in relation to the establishment of trees for the purposes of carbon sequestration (the Guidelines) were introduced on 2 July 2008 and were tabled in the Parliament on 26 August 2008. A copy of the Guidelines is provided at Appendix 4 to this report.

3.2 The committee was told that the purpose of the Guidelines is to reinforce that carbon sink forests are to be established in a manner that is consistent with existing good practice environmental and natural resource management frameworks and regulations. The committee was also told that the Guidelines do not apply any new regulatory arrangement by any level of government and have been developed to avoid negative environmental outcomes, and provide realistic compliance and administration costs for government and taxpayers.[1]

3.3 The Guidelines set out three areas for achieving climate change and natural resource management outcomes and provide examples for how each of these outcomes can be met. The Department of Climate Change (DCC) states that the guidelines align with relevant established good practice environmental and natural resource management.[2]

3.4 Guideline 1 aims to ensure that carbon sink forests are established using regionally applicable best practices approaches for achieving multiple land and water benefits. The committee notes that the expectation underlying this guideline is that carbon sink forests should be established in ways that enhance, or limit significant negative impacts on, water availability and salinity mitigation.

3.5 Guideline 2 aims to ensure that carbon sink forest activities are consistent with regional natural resource management plans and that potential cumulative environmental impacts are assessed at a catchment scale. Guideline 3 aims to ensure

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1 *Submission* 45, pp. 9 – 10.

2 Department of Climate Change website, http://www.climatechange.gov.au/land/tax-deduction.html, accessed on 28 August 2008.

compliance with Commonwealth, state and territory legislation, and local and regional regulations.[3]

Flexible nature of the guidelines

3.6 The committee received a number of submissions which commented on the manner in which the Guidelines have been drafted. A number of submissions expressed concern that the Guidelines provided only examples and guidance and do not employ more prescriptive language.[4] Some submitters consider that the requirements in the Guidelines should be mandatory and preferably set out in the primary legislation.[5]

3.7 Other submitters expressed concern that the Guidelines are not sufficiently comprehensive. For example, Greening Australia expressed concern that the Guidelines do not provide specific direction on a range of environmental impacts including water quality, restoration and protection of carbon stocks, impacts on habitat, permanence or perverse outcomes associated with inappropriate plantings.[6] The Green Institute expressed concern about the adequacy of environmental planning requirements in the Guidelines, noting that there is no specific mention of the *Environment Protection and Biodiversity Conservation Act 1999* in the Guidelines. Similarly, Greenpeace Australia Pacific considers that the guidelines should include conditions to safeguard the social, cultural and environmental integrity of areas proposed for Carbon Sink Forest establishment.[7]

3.8 The committee notes that the Guidelines are drafted in particularly generic and simple terms. The committee heard that the Guidelines have deliberately been drafted in this way to take account of future legislative and regulatory changes. Mr Ian Carruthers, First Assistant Secretary, Adaptation and Land Management Division, DCC, told the committee that if there were a change in environmental and natural resource guidelines brought in by the Commonwealth or state governments then these Guidelines would automatically adopt it.[8] Mr Carruthers told the committee:

> There is added focus and pressure through this legislation to declare that all the applicable public policy at all levels of government and all the industry codes and whatever are complied with in making a tax deductibility provision. If governments, through public policy, choose to strengthen or change requirements to do with conservation or other matters over time, then these guidelines have built into them the flexibility to require that the

3 Department of Climate Change website, http://www.climatechange.gov.au/land/tax-deduction.html, accessed on 28 August 2008.

4 *Submission* 56, p. 7.

5 See for example *Submission* 41 and 56

6 *Submission* 35, p. 3.

7 *Submission* 41, p. 3.

8 *Committee Transcript*, 24 July 2008, p. 57.

> standards of the day are met in making an application for establishment costs.[9]

3.9 The committee heard that the intent of the legislation is to achieve an integrated outcome in terms of climate change objectives, natural resource management objectives and environmental objectives.

Reliance on state and territory regulatory structures

3.10 The committee notes there is also some concern that relying on regionally applicable best practice approaches and State and Territory regulation may not be effective. For example, Greening Australia expressed concern that the Guidelines rely on standards prescribed under, what it describes as, variable and often ambiguous regional natural resource management plans. The Australian Network of Environmental Defender's Offices (ANEDO) perceives problems with the current state regulation of plantations in NSW and is concerned that such problems are exacerbated by poor monitoring and enforcement of legislation by relevant government authorities. ANEDO would prefer that a comprehensive national framework is established to ensure that carbon sinks fulfil their intended purposes and do not cause ancillary environmental harm.[10]

3.11 The committee also notes that the various legislative instruments relied upon in the Guidelines are different in each state and territory. For example, Mr Andrew Grant, CO2 Group Limited, explained that his company needs to comply with a range of environmental regulatory requirements from state to state.

> part of our site assessment and due diligence in planning application requires securing all of the appropriate approvals before the sink is established. New South Wales has a discrete piece of legislation called the Plantation and Reafforestation Act, and it stipulates all the environmental approval assessments and the regulatory approvals that are critical. There is a government department that administers that, so every planting on every property has to go through that approval. In Victoria, South Australia and Western Australia it will vary, but it is a variation on a common theme. In the case of New South Wales, the landholder has to undertake that application.[11]

3.12 The committee notes that there may be some benefit in companies seeking to invest in carbon sink forests across states if there were a greater degree of regulatory consistency between jurisdictions.[12] However, the committee notes that the Guidelines have been drafted so as to accommodate such variations.

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9 *Committee Transcript*, 24 July 2008, p. 53.

10 *Submission* 48, p. 6.

11 *Committee Transcript*, 24 July 2008, p. 70.

12 Mr Andrew Grant, *Committee Transcript,* 24 July 2008, p. 70.

3.13 The committee was also cautioned against seeking to make the guidelines more specific. Mr Andrew Grant, CO2, told the committee that he did not think it would be possible to improve the guidelines given the degree of variation between legislation and regulations in each State and territory. In Mr Grant's opinion the inclusion of greater detail in the guidelines may render them unworkable.[13]

3.14 The committee notes that there is some support for the current reliance on state and territory legislation.[14] In particular the committee notes the endorsement of the Western Australian Departments of Environment and Conservation and Water.[15]

Management of water resource impacts

3.15 The committee was particularly concerned to understand how the impact of carbon sink forests on water resources would be managed under the Guidelines. In particular, the committee examined how the issue of water interception by carbon sink forests would be dealt with under the Guidelines and the implications of the National Water Initiative (NWI) for carbon sink forests.

3.16 The committee notes that under the NWI governments have committed to:

- prepare water plans with provision for the environment;
- deal with overallocated or stressed water systems;
- introduce registers of water rights and standards for water accounting;
- expand the trade in water;
- improve pricing for water storage and delivery; and
- meet and manage urban water demands.

3.17 Under the NWI each state and territory government is required to prepare a NWI implementation plan. These plans, which are accredited by the National Water Commission (NWC), include actions and timelines for implementation of key actions under the NWI. Nine implementation plans have been accredited by the NWC to date.[16]

3.18 Mr Russell James, Water Policy Branch, Department of the Environment, Water, Heritage and the Arts told the committee that the legislation is compliant with the NWI.[17] Mr James also clarified that that while the NWI does not specifically deal

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13 Mr Andrew Grant, *Committee Transcript*, 24 July 2008, p. 70.

14 See *Submission* 11, *Submission* 30 and *Submission* 50.

15 *Submission* 53 and *Submission* 54.

16 National Water Commission website, http://www.nwc.gov.au/www/html/117-national-water-initiative.asp?intSiteID=1 , accessed on 28 August 2008.

17 Mr Russell James, Assistant Secretary, Water Policy Branch, Department of the Environment, Water, Heritage and the Arts, *Committee Transcript*, 24 July 2008 p. 101.

with the implications of plantation forests, including plantations for the purpose of carbon sinks, it commits states and territories to having in place, by no later than 2011, arrangements to ensure that such water intercepting activities are considered in the water planning process. In cases where such activities are expected to intercept significant volumes of water, the NWI ensures that they are managed appropriately. Mr James explained to the committee that:

> The basic approach of the National Water Initiative is that commercial water use should be limited so as to ensure environmental objectives can be met and that the allocation of water for commercial use should be through the market. While much water use is regulated in the form of water access entitlements, the NWI recognises that a number of water-using activities, such as farm dams, bores and plantation forests, have potentially significant water use. If this is not taken into account in the water planning process, there is a risk that the environment will get less water than intended and that the water access entitlement system will be eroded.[18]

3.19 The committee heard that if comprehensive water planning arrangements are in place, proposals for carbon sink forests would need to be assessed within the context of these arrangements. In systems that are overallocated, fully allocated or approaching full allocation, the NWI indicates that proposals above a certain threshold size should be required to obtain a water access entitlement and that a suitable monitoring regime is put in place.[19]

3.20 The committee notes that most states are actively addressing the development of water sharing plans. Under the NWI this work is to be completed by 2011. However, the committee notes that the Council of Australian Governments (COAG) Working Group on Climate Change and Water is currently preparing advice on a forward work program for water reform. One of the issues to be addressed as part of this forward work program is the acceleration of the NWI commitments on interception in recognition of the potentially significant impact of growth-intercepting activities. The Working Group is expected to report to COAG in October 2008.[20] Mr James explained to the committee

> Regarding concern about intercepting activities broadly, carbon sink forests are only one possible form of those activities. For example, in the Murray-Darling Basin there are estimates that in the next 10 years something like an additional 1,500 gigalitres of water might be taken out of the system by growth in activities like farm dams or plantations. There is nothing specific about carbon sink forests in that estimate. In a sense, that is why COAG has asked us to look at this issue more closely. There is already a commitment

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18 Mr Russell James, Assistant Secretary, Water Policy Branch, Department of the Environment, Water, Heritage and the Arts, *Committee Transcript*, 24 July 2008, p.

19 Mr Russell James, Assistant Secretary, Water Policy Branch, Department of the Environment, Water, Heritage and the Arts, *Committee Transcript*, 24 July 2008, p. 98.

20 Mr Russell James, Assistant Secretary, Water Policy Branch, Department of the Environment, Water, Heritage and the Arts, *Committee Transcript*, 24 July 2008, p. 99.

> in the NWI to ramp up the regulation of these activities by 2011, and COAG has asked us to make that happen even faster.[21]

3.21 In its Report to COAG in February 2008, the NWC noted that significant progress has been made across a broad range of areas of water reform. The NWC reports that almost all states and territories have made good progress in developing water access entitlement and planning frameworks as prescribed by the NWI, particularly in high priority water systems. The report notes that almost all states have made statutory provision for environmental and public benefit outcomes within water plans to protect water sources and their dependent ecosystems.[22]

3.22 The NWC provided the committee with a summary of the processes and practices for water planning in each state and territory and an updated report on the current status of water planning for each water system, including both surface water catchment and groundwater systems. The committee notes that water plans have been commenced in relation to most water systems, but that a significant amount of work remains to be completed in most states.[23]

3.23 The committee also notes that all water plans have a statutory review period. While this review period varies significantly from state to state, ranging from 5 years to 15 years, the committee considers that this provision for review is important in ensuring that each water plan is responsive to changes within the water system to which it applies. Such changes will include climatic changes as well as changes in the availability of information and knowledge in relation to water usage, environmental water needs and the impact of adaptive management practices.

3.24 In evidence to the committee, the NWC clarified that it has previously observed a need for more concerted action by the states and territories on interception and has expressed some concerns in relation to the slow rate of rollout of completed plans across Australia. The NWC has also expressed concern in relation to the lack of a shared national definition of sustainable levels of extraction. However, the NWC does not consider that the provisions of this legislation on their own will lead to large-scale land use change and large-scale interception of water.[24]

3.25 Mr Matthews explained to the committee that the basis for this view is that within each state the development of water plans has been subject to a prioritisation process. He told the committee that the water plans across Australia have been

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21 Mr Russell James, Assistant Secretary, Water Policy Branch, Department of the Environment, Water, Heritage and the Arts, *Committee Transcript*, 24 July 2008, p. 99.

22 National Water Commission, Update of progress in water reform: input into the water sub group (WSG) stocktake report, 15 February 2008, pp. 3-4

23 National Water Commission, answer to question on notice, 11 September 2008, (received 22 September 2008).

24 *Committee Transcript*, 11 September 2008, p. 40

sequenced by the state governments according to those catchments where the water systems are under the greatest pressure. Mr Matthews said

> … for a long time now the most stressed areas—water systems—have had intensive planning activity across them. That gives me some confidence that, if there are water systems that are approaching full allocation or are overallocated, they are under notice now. Where the systems are not approaching overallocation, and given what I have said about our expectation that this will not be an additional major demand on water, I am confident that the sequencing and the timing can be accommodated.[25]

3.26 While the committee notes that the Guidelines appear to be compliant with the NWI, it also notes the improvements to the Guidelines suggested by the Department of Water WA (DOW). While DOW agrees with the basic principles which underly each guideline, it suggests that the Guidelines should also include a requirement to avoid the establishment of carbon sink forests in areas of shallow groundwater where there is a potential for acid sulphate soil generation.[26] DOW goes on to suggest that 'catchment' should be replaced by 'water system' throughout the Guidelines to account for both surface water and groundwater systems.[27] DOW also suggests that it would be beneficial for the legislation underpinning Carbon Sink Forests to include a guideline that 'other legislation pertinent to tree plantations for the purpose of carbon sequestration must take into consideration water interception activities.[28]

3.27 The committee notes from the status report of water plans prepared by the NWC that most states and territories are considering the interrelationship between ground water and surface water, including overland flow, in the development of water plans. Water sharing plans are also being developed specifically for groundwater systems in most states.[29]

3.28 The committee explored the suggestion that the Guidelines could be amended to limit tax deductions to carbon sink forests in catchments where there is a signed off water plan and catchment management plan. Mr Matthews told the committee that because the NWI has prioritised the development of plans in fully allocated systems or those approaching full allocation, such an amendment to the Guidelines could have a perverse outcome.

> I think that could run the risk of having a perverse outcome—that is, it might direct these forests to the most overallocated systems because the most overallocated systems are where the planning has been. The least overallocated systems often have not yet finished their planning. I suggest

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25 *Committee Transcript*, 11 September 2008, p. 43.

26 *Submission* 54, p. 1.

27 *Submission* 54, p. 2.

28 *Submission* 54, p. 2.

29 National Water Commission, answer to question on notice, 11 September 2008, (received 22 September 2008).

> to the committee that you have a think about making that condition, because it might have a perverse outcome.[30]

Land clearance

3.29 The committee received a range of evidence expressing concern that these provisions could lead to the clearance of remnant vegetation. The committee notes that all mainland jurisdictions have some form of control on the large scale removal of native vegetation.[31]However, the committee recognises that as with other legislative structures there is some variation between land clearance requirements between the various jurisdictions.

3.30 The committee was disappointed that DCC appeared unable to allay concerns that a lack of enforceable legislation in some jurisdictions may result in clearance of remnant native vegetation. In particular, the committee sought clarification of the status of land clearance legislation in the Northern Territory and Tasmania. Mr Paul Ryan told the committee

> I do not think we are able to comment specifically on state legislation. Our understanding is that there is clearing legislation in place in all jurisdictions.[32]

Compliance with the Guidelines

3.31 Under Sub-section 40-1010(h) of the ITAA the owner of the trees must give a notice to the Commissioner of Taxation providing all information necessary to determine whether all of the conditions in subsection 40-1010(2) are met. One of these conditions is that the establishment of the trees meets the requirements of the Guidelines. In addition to this requirement, Subsection 40-1010(6) requires the Secretary of DCC to establish whether there are reasonable grounds for believing that the environmental and natural resource requirements set out in the Guidelines have been fulfilled.[33] Where the Secretary is satisfied that one or more of the conditions in subsection 40-1010(2) has not been met, the Secretary must give notice of this to the Commissioner for Taxation and no tax deduction can be claimed in these circumstances.

3.32 To receive the carbon sink forest tax deduction, tax payers must complete a Notice of Establishment of Trees in a Carbon Sink Forest Form. The notice requires the taxpayer to declare the locations where trees have been established, the species planted and that the trees meet the forest characteristic requirements and comply with the environmental and natural resource management Guidelines. These claims will be

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30 Mr Ken Matthews, CEO, National Water Commission, *Committee Transcript*, p. 44.

31 Mr Peter Cosier, Wentworth Group, *Committee Transcript*, 18 August 2008, p. 29.

32 Mr Paul Ryan, *Committee Transcript*, 11 September 2008, p. 59.

33 *Committee Transcript*, 24 July 2008, p. 54.

assessed by the Department of Climate Change, taking into account the information submitted by the taxpayer.[34]

3.33 Mr Carruthers also explained to the committee that DCC would be assisted in its assessment of a taxpayers claim by satellite records developed under the National Carbon Accounting System. Mr Carruthers said:

> Through the National Carbon Accounting System we have a record of the tree cover of Australia at the subhectare scale over more than 30 years, so we know what is happening out there in the landscape in terms of cluster of trees. It is a very simple matter to check the GPS coordinates on somebody's claim against what satellite records show at the point from establishment out in time.[35]

3.34 Mr Carruthers told the committee that, as these satellite records are publicly available, taxpayers would be able to use them to demonstrate their claim that they are planting on non-forested lands.[36] Mr Carruthers also told the committee that

> Given the keen public interest in these matters, I am sure that it would not just be the Department of Climate Change that would have its eyes and ears open in determining and assessing conformity with the legislative provisions to see whether there may be nonconformity. I am sure that there will be many interested parties, including the buyers of the carbon credits and organisations like Greening Australia and other public voices.[37]

Committee view

3.35 The committee notes the concerns raised in relation to the simple and generic nature of the Guidelines. The committee recognises that many submitters would like to see greater clarity in relation to how specific environmental and natural resource implications of carbon sink forests will be managed. At the same time the committee recognises that the reliance on existing state and territory regulatory structures will provide realistic compliance and administration costs for both government and taxpayers.

3.36 More significantly, the committee recognises that establishment of uniformity across the states and territories in relation to the full range of relevant legislative instruments would be no small undertaking. The committee also accepts the proposition that the inclusion of a greater level of detail within the regulations may render them unworkable or result in perverse outcomes. The committee notes that the Guidelines appear to be consistent with other government initiatives at both a state

34 *Submission* 45, p. 11.

35 *Committee Transcript*, 24 July 2008, p. 57.

36 *Committee Transcript*, 24 July 2008, p. 57

37 *Committee Transcript*, 24 July 2008, p. 54.

and Commonwealth level and appear to be capable of responding to changes in regulatory requirements over time.

3.37 However, the committee also notes the concerns raised in relation to the consideration of ground water in hydrological analysis within water systems. This committee is aware of the complex interrelationship between ground water and surface water. The committee's predecessor registered its concerns in relation to the regulation of ground water extraction and the need for state and territory governments to undertake reviews of ground water allocations in its inquiry into Water Policy Initiatives.[38] In this context, the committee supports the inclusion of specific reference to ground water in the Guidelines.

38 Rural and Regional Affairs and Transport References Committee, Water policy initiatives, Final Report, December 2006.

Chapter 4

Committee conclusions

4.1 The committee considers that the tax deductions for carbon sink forests under the *Income Tax Assessment Act 1997* (ITAA) represent a valuable policy addition that will promote greenhouse gas reductions. The structures and processes outlined in the Act provide for a sensible legislative and administrative framework relating to the tax treatment around the establishment of forest carbon sinks.

4.2 The committee notes that other forms of greenhouse gas emissions reduction activities by industries are tax deductible. The change in the tax treatment of carbon sink forests addresses this anomaly in the tax system.

4.3 The committee believes that the tax deductions will provide incentives for corporate investment into greenhouse gas abatement activities which represents an ideal opportunity to direct necessary capital to achieve positive environmental outcomes.

4.4 The new tax arrangements provide a short-term 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.

4.5 The committee considers that if Australia is to meet its carbon pollution reduction goals at least cost, the support of a viable carbon sink industry is important. Appropriate taxation arrangements are one part of a range of measures needed to encourage the role of carbon sink forests in Australia's carbon pollution reduction effort.

4.6 The committee recognises the benefits of relying on existing state and territory regulatory structures for the management of the impacts of carbon sink forests on the environment. The committee has some concerns that in certain key areas, such as land clearance legislation, natural resource management and water sharing, some states and regions may not currently have in place appropriate regulations or plans to manage the impacts of carbon sink forests. The committee notes that through the National Water Initiative, states and territories are committed to completing comprehensive water planning arrangements by 2011 and that COAG is currently seeking to accelerate the pace of this planning. The committee also notes that under this process steps have been taken to ensure that those water systems under the greatest pressure receive early attention. The committee considers that it would be desirable if a similar focus could be directed to regulation of land clearance and natural resource management.

4.7 More specifically, the committee notes the concerns raised in relation to the need to include ground water within water sharing plans. The committee supports the inclusion of specific reference to ground water in the Guidelines.

4.8 The committee notes the significant support expressed during this inquiry for specific incentives to encourage the establishment of biodiverse forests. The legislation as drafted does not distinguish between the type of forest planted and the committee is satisfied that it provides no disincentive for the plantation of biodiverse carbon sink forests. The committee also notes that biodiversity considerations have been taken into account in the development of the Guidelines and that these should contribute to the establishment of carbon sink forests in conformity with good practice environmental and natural resource management frameworks. The committee considers that any proposal to offer specific incentives for the establishment of biodiverse plantings must be considered within the context of existing environmentally focussed taxation incentives.

4.9 Finally, the committee welcomes the evidence received in relation to alternative options for terrestrial carbon stores, particularly in relation to perennial pasture cropping. While there clearly is some work to be done to demonstrate the benefits of such an approach within a carbon trading scheme, the committee considers that the wider benefits of improved soil structures and the potential increases in productivity of such systems warrant further examination. The committee considers that the government should request CSIRO to assess the data being accumulated from pasture cropping trials in Western Australia and New South Wales.

Senator Glenn Sterle
Chair

Dissenting Report

Senator Christine Milne, Australian Greens, Senator Barnaby Joyce, Senator Fiona Nash, and Senator the Hon Ronald Boswell, The Nationals Senator the Hon Bill Heffernan, Liberal Party of Australia

The Senate Standing Committee on Rural and Regional Affairs and Transport works hard to achieve consensus reports. It is a serious step for such a high level of dissent.

The report representing the views of the Government Senators does not reflect the evidence provided to the Committee at several hearings. It is clear that the intention of this legislation was to give the same tax deduction for planting trees for carbon as has been given for planting them for harvest under MIS arrangements. The environmental guidelines are just that, guidelines. They are flexible and not prescriptive or mandatory. They are clearly an afterthought. No social and economic analysis was done to anticipate the impacts on rural and regional Australia.

By the conclusion of the hearings it was confirmed that:

- There is no requirement that a carbon sink forest for which a tax deduction has been granted has to be registered on the title of a property.
- There is nothing in the legislation or the Guidelines that prevents prime agricultural land being planted as carbon sinks thus displacing food crops and destroying rural communities as the Managed Investment Schemes have done. The best land with the best rainfall will grow trees fastest and therefore bulk up the carbon fastest and so maximise profits. The Government's arguments, that the low price of carbon will prevent the best land from being planted, does not stack up. Why is it that MIS schemes have encroached on cropping land if the price argument is valid? Many witnesses told of the adverse impact of the MIS schemes in rural Queensland.
- The government and ABARE have not taken into account the fact that there will be a forward market in carbon permits and there will be a strong incentive for companies to buy early and cheaply to shield themselves from later rises in the carbon price. This will drive land acquisition.
- Furthermore, if ABARE is wrong about a low price of carbon and it rises rapidly then not only will prime land be turned over to carbon sinks but existing MIS scheme forests will not be harvested but kept instead to grow on to maximize carbon credits. This perverse outcome will drive the logging industry further into native forests because emissions from these forests are currently ignored. The loss of biodiversity and carbon stores will be a disaster.

- The claim that there will be benefits including large increases in rural employment and direct investment in services is unjustified and not borne out by the evidence from MIS schemes. The National Association of Forest Industries made the same claims then but the evidence is to the contrary with many areas losing services such as schools and bus runs and employment.
- There is nothing to prevent the conversion of native vegetation to plantations, nothing to require mixed species plantings or the forest to be in the ground for any length of time. An area of land covered in native vegetation that is not a Kyoto forest, savannah or Brigalow for example, can be cleared unless state legislation prohibits it.
- Given the lack of consistent land clearance legislation across the nation and the uneven compliance and enforcement regimes, this legislation will provide a perverse incentive to clear native vegetation resulting in a loss of biodiversity and the release of the carbon contained therein. The Biodiversity Unit in the Department of the Environment was not consulted in the development of the Guidelines.
- There is nothing to prevent a plantation company from benefiting from a tax deduction to establish a carbon sink forest and then if the fibre price is higher than the carbon price, cutting it down. Who will recoup the deduction for the tax payer 15 years down the track?
- There is no requirement that hydrological studies including interception, be completed before a planting occurs. Compliance with the National Water Initiative means that water plans need to be in place by 2011. All the National Water Initiative does is to commit states and territories to having in place by no later than 2011 arrangements to ensure that such water interception activities are considered in the planning process. Considering a matter in a planning process is not the same as a mandatory outcome. By 2011 many hectares of carbon sink forests will be in the ground with no guarantee of sustainability in the catchment. The majority report claim that this initiative 'will contribute to sustainable land management' is an unsubstantiated claim.
- Who in the Federal Dept of Climate Change will check to make certain that carbon sink forests 'meet natural resource guidelines and not interfere with existing patterns of water use'? Compliance will be deemed to occur if a State or Territory has no such guidelines because compliance with the legislation only requires adherence to what a state or territory has in place and if they have none then compliance will have been achieved. At no stage did the Government outline how the Federal Department will assess the applications as to their compliance with state or territory guidelines.
- In dissenting to this report I do not believe that there was any evidence presented to prove that the legislation represents 'a valuable policy addition that will promote greenhouse gas reductions'. The government has made no claims about the volume of CO2 sequestered or hectares to be planted. Furthermore, there is no proposal or ability for anyone protecting or rehabilitating a standing

forest or protecting natural vegetation to benefit from tax deductions or any other financial incentives.

- The claim for 'the benefits of relying on existing state and territory regulatory structures for the management of the impacts of carbon sink forests on the environment' was unsubstantiated. Tasmania is a case in point where there are no land clearance or water plans that have any rigour and there is certainly no compliance or enforcement of guidelines to protect the environment.

Recommendations

1. **The Guidelines should be mandatory regulations.**
2. **There should be incorporated into the regulations conditions which must be met before the tax deductions would apply, namely;**
   - **The carbon sink forests must be registered on the property title.**
   - **No native vegetation can be cleared for or converted to carbon sink forests.**
   - **Carbon sink forests should be biodiverse and cannot be harvested or cleared, and**
   - **No carbon sink forest can be established in the absence of a hydrological analysis including ground water and interception, of the proposed area to be planted.**
3. **To avoid the destruction of rural communities and the displacement of food crops, prime agricultural land must be excluded from carbon sink plantings.**

Senator Christine Milne
Senator for Tasmania

Senator Barnaby Joyce
Senator for Queensland

Senator Fiona Nash
Senator for New South Wales

Senator the Hon Ronald Boswell
Senator for Queensland

Senator the Hon Bill Heffernan
Senator for New South Wales

Dissenting Report

Senator McGauran, Liberal Party of Australia

Introduction

The legislation and guidelines do not represent a valuable policy addition to the national objective of reducing greenhouse gas emissions.

The evidence received at the Committee hearings strongly supported this proposition.

The obvious result of providing a tax incentive to one sector of the market, in this case the carbon sink forest investors will be to raise the rate of return on investment. Consequently the value of land increases, marginal and prime, for the purposes of carbon sink investment.

In contrast, traditional agricultural land void of an equivalent tax incentive suffers a similar decline in the rate of return. Consequently, rural land will lose its value as a food producing resource.

In short it is not a level playing field.

The added downside to this tax incentive, as distinct to the tax incentives given to Managed Investment Schemes, is the carbon sink forest is permanent and therefore the market for food producing land cannot make a comeback if returns should improve for food producers over and above the distortion the tax incentive has created.

The Committee heard the permanency was envisaged to be some 100 years!

The tax incentive and accompanying guidelines are a clear case of distorting the market and creating an unfair advantage that will inevitably lead to a misallocation and inefficient use of resources including capital.

The importance of food producing land in Australia is being devalued by these tax incentive guidelines.

The effect of this is threefold

1. In a time of anxiety regarding world food shortages the long-term effect from a major food producing country like Australia lowering its food production will further exacerbate the situation. Equally Australia will lose valuable export income.

2. Given the majority of the farming sector is made up of family farms, this efficient social and economic unit will be undermined by the distortions that will be produced by the tax incentive.

3. Farming families are a foundation stone of the economic and social life of small towns and regional cities. The Small businesses, schools, hospitals, etc of these small

> towns and regional cities are primarily reliant on a viable farming sector for their own economic viability. These economic regions will be detrimentally affected by the loss of productive farming land.

The proposition that certain land can be quarantined from the legislation is not convincing. At best, a bureaucratic and subjective nightmare is created, at worst, it is unworkable. This is due to the variable factors of farming, such as drought and prices. Such variables occur across farming regions, affecting the returns in so-called prime land and marginal land.

A practical example is the cattle station of the Northern Territory specialising in the live cattle export trade yet the successful operations are being undertaken on so – called marginal land compared to the family dairy farm in Victoria that is struggling with prices yet being farmed on so – called prime agricultural land. At differing times the cattle station and the dairy farm's rate of return on capital and profit fluctuate. Further the rates of return and profit are in the eye of the beholder. For example the family farmer will likely take the factor of lifestyle into account over maximizing return whilst the corporate operation focuses more on maximising profit.

It is a perilous role for the Federal Parliament to direct the market as to what land is classified as marginal agricultural land and what land is classified as prime agricultural. It should be principally the market that drives the choice of agricultural land production in Australia together with the economic decisions made every day by the farmer.

Impact on prime agricultural land.

The evidence submitted to the Committee was compelling in regard to the potential impact of the tax incentive on the food producing sector.

The Queensland Farmers Federation (QFF) stated that:

> "…we would have to be worried about any scheme that saw arable land which was being farmed productively for food and fibre being taken out of production. Climate change and increasing climate variability have the potential to limit Australia's capacity to produce food and fibre for both domestic and export consumption. Food security and food pricing should be seen as part of a national food policy. The removal of 85 000 Ha of land from agricultural production by 2011 is not good policy unless there is a requirement to assess the social, economic and environmental impacts of these tree plantings, This becomes even more significant when most of these plantings are likely to be in the higher rainfall areas."[1]

Impact on rural communities and industries

The Environment Association noted the undesirable impacts in rural Tasmania, stating:

> "Australia's attempts to sequester carbon to mitigate global climate warming are likely to promote a mass expansion of artificial plantings in

1 *Submission* 51, p.2 sell also *Submission* 23, p.1, *Submission* 39, p.1, *Submission* 24, p.1, *Submission* 49, p.2

> Tasmania. A great social concern for Tasmania is that farming activity is being replaced by artificial plantations which employ very few. The reduction in farming activity, the local production of food and associated employment is a long-term loss that may well have severe impacts for the viability of our community."[2]

The Victorian Farmers Federation (VFF) stated that the change of land use from production agriculture to carbon sink forestry will result in a transfer of economic activity from rural areas to businesses requiring the carbon offset. The VFF noted that rural areas are already facing considerable economic and social challenges from changes in climate and reductions in water availability.[3]

Other aspects of the Legislation and guidelines

The Committee heard evidences that even in its administration and operation the legislation and guidelines are flawed. The intent of the legislation, to introduce a tax incentive to establish carbon sink forests that will contribute to natural greenhouse gas emission targets, will not be fully realised.

Permanancy of new plantings

Concerns were expressed in relation to the permanency of the new plantations, and whether the carbon is sequestered permanently. Australian Network of Environmental Defenders Officers (ANEDO) stated that:

> "neither the Bill, the Explanatory Memorandum, nor the Guidelines provide that any trees planted under the scheme are to remain a 'carbon sink forest' for any sustained period of time. There is no requirement that the trees planted to establish a carbon sink forest reach an age (ie, at least 10-20 years) to significantly contribute to the purpose for which they were supposedly planted – to provide a carbon store.
>
> The "establishment expenditure will be immediately deductible for trees established in carbon sink forests in the 2007 – 2008 to 2011 – 12 income years (inclusive)". It is therefore currently possible for an entity to plant trees immediately obtain the tax deduction and not be concerned whether they succeed in growing or not. Additionally, there are no provisions preventing the land set aside for carbon sink forests to be sold at a later date or cleared."[4]

2 *Submission* 56, p.10.

3 *Submission* 46, p.3. See also *Submission* 44, pp 6-7

4 *Submission* 48, pp 4-5. See also *Submission* 32, p.2; *Submission* 35, p.3; Mr Williams, Greening Australia, *Committee Hansard*, 24 July 2008, p.40.

Flexible nature of the guidelines

Other submitters expressed concern that the Guidelines are not sufficiently comprehensive. For example, greening Australia expressed concern that the Guidelines do not provide specific direction on a range of environmental impacts including water quality, restoration and protection of carbon stocks, impacts on habitat, permanence or perverse outcomes with inappropriate plantings.[5]

Carbon Price

The Library economics section when writing on the legislation's possible effect on prime agricultural land being taken out of production highlighted the price carbon is set under the Governments Emission Trading Scheme as being a determining factor.

> "The major uncertainty in the above argument (agricultural land production lost to carbon sink forest) is the impact of any Australian emissions trading scheme. In particular, what the price per tonne of CO_2 will be and whether emissions credits generated by forestry will be included in this scheme. If the price of one tonne of CO_2 is sufficiently high, the emission credits generated by forestry are of the same value and are included in an Australian Emissions Trading Scheme (ETS), then the potential gains to a firm that makes significant emissions may be sufficiently large for it to purchase significant areas of agricultural land for the purposes of planting a carbon sink forest."[6]

Senator Julian McGauran
Senator for Victoria

5 *Submission* 35, p.3

6 *Nielson, Leslie, Parliamentary Library, Background Note, Draft, Tax deductions for Carbon Sink Forests p.12.*

Appendix 1

List of Submissions

1. Ms Diana Nunn

2. Matthew and Catherine Allison

3. Deep Southern Pty Ltd

4. Pelion Consulting & Metanoia Learning and Design

5. Supersonic

6. Leaman Geophysics

7. Mr Tom Street

8. Mr Phill Parsons

9. CO2 Australia Ltd

10. AusCarbon Pty Ltd

11. Institute of Foresters of Australia

12. James and Diane Ingles

13. AgroEco Systems Pty Ltd

14. South West Enviro Centre Inc.

15. Iris Farm Private Nature Reserve

16. Mr Peter Sims OAM

17. Seaview Farm

18. Australian Sugar Milling Council

19. **CONFIDENTIAL**

20. Carbon Conscious Limited

21. Mr Michael Sobb

22. The Wilderness Society Inc.

23. The Western Australian Farmers Federation (Inc)

24. Evergreen Farming Inc.

24A. Evergreen Farming Inc

25. Allan & Lyndall Reardon

26. CSR Limited

27. Mr Jeff Short

28. Mr T Digwood

29. CHIPSTOP campaign against woodchipping the south east forests

30. Nursery & Garden Industry, Australia

31. Sunshine Coast Environment Council

32. Environment Tasmania Inc.

33. Australian Banana Growers' Council Inc.

34. Mr Chris Hilder

35. Greening Australia Limited T

36. CSIRO

37. Ms Sharon Moore

38. Green Institute

39. Tully Sugar Limited

40. Still Wild Still Threatened

41. Greenpeace Australia Pacific Ltd

42. Ms Colleen Dibley

43. Ms Prue Acton

44. National Farmers' Federation

45. Adaptation and Land Management Division

46. Victorian Farmers Federation

47. Huon Valley Environment Centre

48. Australian Network of Environmental Defender's Offices

49. Growcom

50. National Association of Forest Industries

51. Queensland Farmers' Federation

52. CANEGROWERS Australia

53. Department of Environment and Conservation

54. Department of Water Government of Western Australia

55. Clarence Environment Centre

56. The Environment Association (TEA) Inc.

57. Australian Manufacturing Workers' Union

58. Australian Soil Carbon Accreditation Scheme

59. Bundaberg Sugar Ltd

60. Property Rights Australia

61. Department of Water & Energy and the NSW Department of Primary Industries

62. Treefarm Investment Managers Association

Appendix 2

Witnesses who appeared before the Committee at the Public Hearings

Thursday, 24 July 2008
Parliament House
CANBERRA

National Association of Forest Industries
Mr Allan Hansard, Chief Executive Officer
Mr David de Jongh, Senior Forest Policy Adviser
Mr Shane Gilbert, Strategic Adviser

CSIRO
Dr Philip Polglase, Research Program Leader

Horticulture Australia Council
Mr Stuart Swaddling, Chair
Ms Kris Newton, Chief Executive Officer

Greening Australia
Mr David Williams, Chief Executive Officer
Ms Dianne Dibley, Director, Policy and Program Development

Treasury
Mr Matthew Flavel, Acting General Manager, Business Tax Division

Department of Climate Change
Mr Ian Carruthers, First Assistant Secretary, Adaptation and Land Management Division
Mr Paul Ryan, Director, Land Sector Policy

Baker and McKenzie
Mr Paul Curnow, Partner
Mr John Walker, Partner

Carbon Conscious Ltd
Mr Peter Balsarini, Executive Director
Mr Michael Shields, Non-Executive Director

CO2 Australia
Mr Andrew Grant, Chief Executive Officer
Mr James Bulinski, Manager, Carbon and Innovation Services

AusCarbon Pty Ltd
Mr Kent Broad, Director

South Australian Farmers Federation
Mr Kent Martin, Natural Resources Committee

Department of athe Environment, Water, Heritage and the Arts
Mr Russell James, Assistant Secretary, Water Policy Branch

Monday, 18 August 2008
Premier's Hall, Parliamentary Annexe
BRISBANE

CANEGROWERS Australia
Mr Bernard Milford, Senior Manager, Policy

Tully Sugar Limited
Mr Dick Camilleri, Chairman of Directors
Mr John King, General Manager

Australian Sugar Milling Council
Mr Max Craigie, Chief Executive Officer
Mr Jim Crane, Senior Executive Officer

CSR
Mr John Pratt, General Manager, Grower and Community Relations

Wentworth Group of Concerned Scientists
Mr Peter Cosier

Property Rights Australia
Mr John Purcell, Chairman
Mr Phillip Sheridan

Thursday, 11 September 2008
Parliament House
CANBERRA

Australian Soil Carbon Accreditation Scheme
Dr Christine Jones, Founder

Mr Peter Sykes, Private capacity

Pew Environment Group
Dr Barry Traill, Australian Director

Department of the Environment, Water, Heritage and the Arts
Mr Russell James, Assistant Secretary, Water Policy Branch
Dr Charlie Zammit, Assistant Secretary
Ms Carey Robinson, Director, Conservation Policy Section

National Water Commission
Mr Ken Matthews, Chair
Mr Murray Radcliffe, Manager, Water Planning and Management

Department of Climate Change
Ms Josephine Mummery, Acting First Assistant Secretary, Adaptation and Land Management Division
Mr Paul Ryan, Director, Land Sector Policy

Appendix 3

List of Tabled Documents

Index of Documents Tabled at Canberra Hearing
Thursday, 24 July 2008

Date	Lodged By	Title/Subject	No of Pages
24/7/08	Mr Shane Gilbert, National Association of Forest Industries (NAFI)	Two-page document titled "Salinity Abatement" – features a coloured map of *Target areas for plantations to address salinity in the Murrumbidgee and Murray River Catchments*	2
24/7/08	Mr Allan Hansard, National Association of Forest Industries (NAFI)	Productivity Commission 2008, *Trade & Assistance Review 2006-07,* Annual Report Series, Productivity Commission, Canberra, March	147

Index of Documents Tabled at Brisbane Hearing
Monday, 18 August 2008

Date	Lodged By	Title/Subject	No of Pages
18/8/08	Mr Dick Camilleri, Tully Sugar Limited	Document titled *Submission by Tully Sugar Limited*: cover page plus 24 A4 photographs of sugar cane area and land surrounding Tully – showing cane fields and initial plantings of trees	25
18/8/08	Australian Sugar Milling Council	Document titled *Carbon Sink Forest Inquiry – August 2008*, opening statement and key points.	9

Appendix 4

Environmental and Natural Resource Management Guidelines in relation to the establishment of trees for the purposes of carbon sequestration

1. Carbon sink forest establishment should be based on regionally applicable best practice approaches for achieving multiple land and water environmental benefits.

Compliance with this guideline may be achieved by, for example:

- avoiding clearing land of remnant native vegetation as determined by the relevant state or territory legislation; and
- taking into account features of plantation and forestry best practice guides (e.g. state and territory codes of practice) relevant to carbon sink forests; and
- establishing carbon sink forests in ways to avoid any significant negative impacts on water availability; and
- establishing carbon sink forests in ways to enhance potential salinity mitigation benefits and prevent potential increases to in-stream salinity; and
- developing a weed and feral animal management plan and fire management plan as applicable to the state or territory jurisdiction.

2. Carbon sink forest establishment activities should be guided by regional natural resource management plans and water sharing plans, and environmental impacts at a catchment scale should be considered.

Compliance with this guideline may be achieved by ensuring that establishment activities are consistent with regional natural resource management plans, for example by identifying:

- strategies for ensuring that individual carbon sink forest plantings account for natural resource management priorities at a larger regional scale; and
- potential cumulative environmental impacts of carbon sink forest activities at a catchment scale.

In cases where establishment of carbon sink forests would represent a significant interception activity in a catchment that has been identified as fully allocated, over-allocated or approaching full allocation, water access entitlements must be obtained.

3. Carbon sink forest establishment activities should recognise and adhere to all government regulatory requirements.

Compliance with this guideline may be achieved by meeting any applicable Commonwealth, state and territory legislation, and local and regional regulations, when establishing carbon sink forests.

In cases where establishment of carbon sink forests would represent a significant interception activity in a catchment that has been identified as fully allocated, over-allocated or approaching full allocation, water access entitlements must be obtained.