

18 March, 1999

Ref: CC:hp:cf

The Secretary,  
Review of Business Taxation,  
Department of the Treasury,  
Parkes Place,  
Canberra. ACT 2600

Dear Sir,

Please find attached a submission of behalf of the Grower Owned Sugar Mills Group which includes the following:

GOSMG (Grower Owned Sugar Mills Group)response to the Ralph Committee latest discussion papers and recommendations. (A Platform for Consultation)

GOSMG and position paper on the Business Tax Review and principals involved.

A background paper on GOSMG

Thank you for the opportunity to comment.

Yours sincerely,

Chris Connors  
Company Secretary

***SUBMISSION TO THE RALPH COMMITTEE***

***FROM THE GROWER OWNED SUGAR MILLS GROUP***

***on the BUSINESS TAX REVIEW and RALPH ENQUIRY***

**GOSMG**  
**RESPONSE TO RALPH COMMITTEE SECOND PAPER**  
**"A PLATFORM FOR CONSULTATION"**

**PREAMBLE**

GOSMG is pleased with the opportunity to respond to the Ralph Committee's second discussion paper on the Review of Business Taxation - "A Platform for Consultation". This paper limits its response to those issues dealt with within chapter 23 of the report and is a further development of the GOSMG's original submission which is attached.

**HOW WOULD THE DEDUCTION TO TAX CO-OPERATIVES FOR THE REPAYMENT OF GOVERNMENT LOANS BE AFFECTED? (SECTION 120(1)(C))**

*"Taxing tax co-operatives like companies under a new entity tax system is a separate issue from the deduction that some tax co-operatives receive for capital repayments of certain government loans." (page 510, 23.12)*

**CURRENT TREATMENT**

*"Division 9 allows eligible tax co-operatives a tax deduction for repayments of loans made by a government. That is, it is an outright deduction for principal repayments of borrowings.*

*An eligible tax co-operative must have as its primary object the acquisition of commodities or animals from its shareholders for disposal or distribution. Members who supply the company with the commodities or animals must hold not less than 90 per cent of the company's paid up capital." (page 513, 23.23)*

**ABOLITION OF DEDUCTION NOT ESSENTIAL**

*"Although the Review considers that the deduction has limited practical applicability or justification, the continuation of the deduction is a separate issue from extending a new entity tax system to tax co-operatives. The deduction could therefore be maintained even if tax co-operatives were otherwise taxed like companies." (page 514, 23.33)*

**GOSMG POSITION**

GOSMG recommends that the section should not be abolished. Whilst GOSMG does not agree with much of the comment of the Ralph Committee report on this section, we would refer to our submission which is attached and would recommend the retention of this particular section which is so critical to the continued development of cooperative enterprises in the rural sector.

The review has noted that the section has been subject to many reviews in the past. The most recent review before a Senate enquiry led to the section being retained and GOSMG would question the validity of any move for its abolition.

It is important to recognise that the deduction only applies to those cooperatives which meet an extremely strict criteria.

. 90% of the cooperatives business must be done with its members and

. 90% of the value of the cooperative must be held by the members who supply the cooperative.

These restrictions mean that cooperative is owned by its suppliers and are extensions of the farm gate principle and clearly results in the retention of ownership by Australian owned small business.

The retention of the section will be critical to the continued viability and competitiveness (international and domestic) of these farmer owned organisations.

### **HOW WOULD REBATES AND BONUSES PROVIDED BY TAX CO-OPERATIVES BE AFFECTED?**

In summary the Ralph discussion paper recommends the distribution of surpluses from cooperatives be treated as either a business expense if the distribution is made based on business done or as a normal dividend if the distribution is related to shareholding.

### **DISTRIBUTION BASED ON MEMBERS ACTIVITIES**

Any distribution which is made by the cooperative to its members based on business done with the cooperative is treated as a normal business expense for taxation purposes.

*"If the amount of the rebate or credit is calculated by reference to that member's actual activities with the tax co-operative, where the rebate or bonus is provided on a 'commercial basis' having regard to the overall circumstances, the amount would not be treated as a distribution of profits. It would also not be subject to the FBT rules. In these circumstances, the general deductibility provisions would apply." (page 513, 23.22)*

### **GOSMG POSITION**

The GOSMG agrees with the proposed treatment provided the deduction for the distribution is allowed in the same year in which the business was done which created the distribution. The Taxation Department have treated distributions in this manner in the past provided the distribution is actually paid within a reasonable period after it is declared.

The interpretation of "where the rebate or bonus is provided on a commercial basis having regard to the overall circumstances" is of concern because it is unclear in its intent. GOSMG would vehemently oppose any wording which would endanger the treatment of distributions to their members based on their normal business activities as being a normal business expense. eg additional payments based on cane supplied.

Distributions provided solely due to capacity as a shareholder

*"If the rebates or bonuses are provided solely due to capacity as a shareholder, rather than by reference to actual business activities conducted with the co-operative, the amount could be treated as a distribution. The first two options for the definition of distribution under the new entity regime discussed in Chapter 18, for example, would treat these rebates or bonuses as distributions. Under those two options the amount of the distribution would be the amount of the rebate or bonus. Under the third option discussed in Chapter 18, the rebate or bonus might be subject to the FBT rules, rather than be treated as a distribution. Under each option, no deduction would be available to the tax co-operative." (Page 512, 23.20)*

### **GOSMG POSITION**

GOSMG would suggest that for the most part cooperatives within the group would have no concerns with the above recommendation.

We would however recommend that where the shareholding of a cooperative is directly linked to business done ie the shares have been issued on the basis of business activities undertaken with the cooperative then the distribution based on such shareholding should be considered as a business expense.

We would also recommend further that where such distribution is made in the form of shares that such distribution also be considered as a normal tax deductible expense.

Cooperatives are very different to companies in the way in which their shares are issued. Some cooperatives issue shares as a bonus payment and the share issue is based on the business done with the cooperative. The shareholder base is therefore established on the basis of actual business activity with the cooperative. This unusual relationship should be recognised and the distributions which are based on this relationship (provided 90% of the value of the cooperative is retained by the members) should be acknowledged as being in the same category as distributions made on the basis of business done with the cooperative and should be treated as a business expense.

# *Grower Owned Sugar Mills Group*

## *Cooperative and Australian-owned enterprises producing over 40 % of Australia's Raw Sugar Exports*

*Submission on the  
Review of Business Taxation*

*from the  
Grower Owned Sugar Mills Group*

*Mackay Sugar, Proserpine Sugar, Tully Sugar,  
Mulgrave Central Sugar Mill, Isis Central Sugar,  
South Johnstone Sugar, Mossman Central Sugar Mill and New  
South Wales Cooperative Sugar Mills*

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## FOREWORD

### GROWER OWNED SUGAR MILLS

The Grower Owned Sugar Mills Group (GOSMG) represents over 40% of the Sugar industry in Australia and is an exemplary and successful model of a **cooperative** business system which :

- . is stable
- . makes robust investment decisions
- . supports improved competitiveness
- . encourages greater productivity
- . exhibits high gross domestic product growth
- . creates employment
- . contributes substantially to taxation revenue through its membership and operations

The group with productive capacity strategically placed along the east coast of Australia has as its membership , seven large sugar milling companies in Queensland (10 sugar mills) and one large milling company in New South Wales (3 mills).

Members of GOSMG operate on the principle of cooperation. They represent over 5,000 member shareholders who provide the raw material (sugar cane) to their own member owned mills. Their cooperative performance and level of innovation in line with the government's objectives is proof that a superior level of competitiveness and efficiency is being achieved.

The group is a stable and significant employer in the cane growing regions of both Queensland and New South Wales. The group employs over 3,000 people on a full time basis and generates in excess of \$1.2 billion annually. A large proportion of those earnings are export based.

Members have a strong influence over the prosperity of their respective cane growing regions. Much of the income generated is invested within the region, contributing to the stability, balanced growth, sustainability and diversity of the regions.

A more detailed description of the group's membership and operations is attached as appendix 1.

### CO-OPERATIVES AND THE PRIMARY INDUSTRY SECTOR

Whilst this submission is made on behalf of the sugar industry cooperatives it is important to recognise Co-operatives are extremely diverse and successful in many industries particularly in the Primary Producer Sector.



Co-operatives (farmer owned businesses) are major players in many diverse industries, including dairy, fruit processing, sugar, cotton, fishing, nut, meat and pork processing and many others and are prevalent amongst Australia's major exporters.

### **DIVISION 9 OF THE INCOME TAX ASSESSMENT ACT 1997**

This area of the current Australian Income Tax Legislation is specifically aimed at and addresses Co-operatives as they operate. It recognises that enterprises formed under the principle of cooperation are different in their operating principles to those that are simply profit based.

### **A NEW TAX SYSTEM**

The government's review of the business tax system is based on the white paper "**Tax reform not a new tax a new tax system**".

The principle of the review is that the same tax arrangements should apply to co-operatives as applies to all business entities that offer limited liability to their owner's.

**This principle does not recognise that co-operatives do not operate on the same basis as profit motivated companies. The impact of the implementation of this principle on Grower Owned Sugar Mills will be particularly severe and will either see the curtailment of development of the mills or will see the cooperative ownership lost to outside interests. The impact on employment in the regional areas in which the mills are situated will be significant with both the long term and short term employment numbers being threatened.**

This submission proposes that Division 9 should not only be retained but should be enhanced so that co-operatives are supported as a means whereby Australian owned enterprises can flourish in the world economy.

## **Executive summary**

The Government intends to abolish Division 9 of the Australian Income Tax Legislation under the principle that the same tax arrangements should apply to co-operatives as applies to companies.

The Grower Owned Sugar Mills Group submits that the principle on which the review is based is flawed in that it does not recognise the principles under which co-operatives operate.

Co-operatives should continue to be recognised as distinctly different business entities under the new tax system.

The provisions in Division 9 of the Australian Income Tax Legislation do not convey special privileges to co-operatives. The provisions are in place because of the recognition of the distinct manner and restrictions under which cooperatives operate. Section 120(1)(c) was put in place and confirmed in recent legislation because of these restrictions which limit the ability of cooperatives to raise development capital.

Similar co-operative taxation provisions to that found in Division 9 are found in the Income Tax Acts of nearly all the countries that are Australia's trading competitors and recognise the co-operative enterprise.

The tax system would not be able to achieve the objectives of the government unless it recognises co-operatives as distinct Australian owned entities that contribute to the economy and to the taxation revenue base and are vital to the stability and continued growth of the rural community. Division 9 of the Australian Taxation Legislation and in particular Section 120(1)(c) has allowed primary producer cooperatives and Grower Owned Sugar Mills to develop and compete as major players in the world market. Grower Owned Sugar Mills produce over 40 % of Australia's Raw Sugar which is subsequently shipped to world markets.

Co-operatives are a viable alternative to avoid major overseas ownership of Australian industry keeping Australian owned and operated enterprises in Australian hands. The majority of the balance of the Australian Sugar Milling Industry is owned by multinational companies or major public companies whose major purpose is to make a return on investments to often remote investors with no direct interest in the farmers or local communities in which they operate.

## RECOMMENDATIONS

That Division 9 of the *Income Tax Assessment Act* be retained, with the following improvements:

- Section 120(1)(c) should be enhanced to allow all co-operatives the deduction, not only those which comply with Section 117(1)(b).
- the Taxation Department should work with the co-operative movement to determine a set of guidelines as to the operation of Division 9 and subsequently release a public ruling which supports the guideline.
- Section 120(1)(c) should be enhanced by withdrawing the requirement for the loan repayments to be made to government and allowing a deduction for all repayments of loans for acquisition of assets.

## SUBMISSION

### TAX REFORM NOT A NEW TAX A NEW TAX SYSTEM

Treasurer Peter Costello released a briefing paper on the GST and Tax Reform - "Tax Reform not a new tax a new tax system" which indicated that there will be changes to the company tax system.

The paper has identified under the heading of "Taxation of business entities is inconsistent" three areas which will be targeted (page 109):

- (a) inconsistent entity treatment,*
- (b) inappropriate taxation of company groups and*
- (c) inconsistent treatment of distributions*

Co-operatives are specifically referred to in the following areas within the above identified targets

### BUSINESS TAX SYSTEM

The paper indicates that the government intends to redesign the company tax arrangements and has specifically identified trusts as the target area, however within the plan the following appears on page 115:

*The government intends to broaden the benefits of these redesigned tax arrangements by applying them to other business entities offering limited liability to their owners: limited partnerships, co-operatives and life insurers. This would mean that life insurers' income would be taxed uniformly at the company tax rate (with imputation credits for investment policyholders). **Co-operatives are already taxed like other companies if less than 90 percent of their business is with their members.***

## **REVIEW OF BUSINESS TAXATION**

The Review of Business Taxation group within Treasury was asked to comment on the impact of the "The new Tax System" and the Ralph enquiry on co-operatives, and their response is clear on the impact and principles which the review will adopt. The Secretary of the Review of Business Taxation replied:

*"A New Tax System' indicated that the Government intended to apply the same redesigned company tax arrangements to co-operatives as to other entities offering limited liability to their owners, such as other companies, trusts and limited partnerships. Those redesigned arrangements would supersede unique tax rules for co-operatives."*

## **AIM OF THIS SUBMISSION**

The GOSMG submits that co-operatives should be more positively encouraged (by means of the taxation system) to ensure that they are in a position to develop in the global economy and retain ownership of Australian business by Australians.

The GOSMG submits that the retention and improvement of Division 9 in the new tax system will assist the Government to achieve its objectives, in particular, by improving the competitiveness and efficiency of Australian business, and thereby the competitiveness of the Australian economy.

The Sugar Mills which form the GOSMG are a typical example of small businesses (cane farmers) who have through the formation of a cooperative been able to compete with larger corporations and gain access to overseas markets. The co-operative model is an ideal vehicle to promote Australian ownership .

There are many examples in Australia where co-operatives play a vital role in enabling small business to be a player in the market and the success of many major Australian Primary Producer Co-operatives - The Grower Owned Sugar Mills Group, Golden Circle, Bega, UMT, Australian Cooperative Foods (The Dairy Farmers Group), Fremantle Fishermans Coop, Banana Growers Coop and many more, shows the viability and resilience of co-operatives as business entities.

## **WHAT IS THE DIFFERENCE BETWEEN A CO-OPERATIVE AND A PUBLICLY LISTED COMPANY?**

The GOSMG is a typical example of the number of ways under which a cooperative can be formed. Mackay Sugar and Proserpine Sugar are registered under The Cooperative Act 1997 Qld and their rules are specifically approved under this Act. Similarly the New South Wales Sugar Cooperative is registered under The Cooperative Act 1992 in New South Wales. The other Mills (Mossman, Mulgrave, Tully, South Johnstone and Isis) are formed under The Corporations Law and have articles which specifically comply with the definition of a cooperative under Division 9 of the Australian Income Tax Legislation.

These Acts, rules and articles define the structure of the co-operatives and govern how they operate. The main features of the legislation for the purposes of this review relate to the purpose of a co-operative, its ownership, capital formation and distribution of surplus. Division 9 of the Australian Income Tax Legislation, in particular Sections 117 and 118, reinforce these features and place specific restrictions on the type of entity that can qualify for tax purposes as a co-operative.

The GOSMG co-operatives are extensions of the cane growers' businesses. Their primary purpose is to provide services to assist members (cane growers) and their operations by transporting and crushing their cane, producing and transporting the processed product, gaining access to previously inaccessible markets, achieving savings on inputs to the members' businesses, and providing services that are not available from other sources.

The owners of the co-operatives are those farmers that use its services. The Co-operatives Act requires that any grower who ceases to use a co-operative's services, ceases to be an owner (member) of a co-operative. Section 118 of the Income Tax Act requires that 90% of the business done by the cooperative must be with its members or it ceases to be a cooperative for tax purposes.

**The GOSMG cooperatives are specifically formed and operated to service their owners who are the Australian cane farmers who supply the mills.**

**This is a totally different objective to other mills within the industry whose main objective is to reward the remote investors who own the companies.** These investors and owners in many cases are not Australians who have an interest in the local community but are overseas or remote investors driven by profit and returns on their investment.

While recipients of distributions of surpluses from sugar milling co-operatives are invariably based in rural Australia and are necessarily part of the local community within which the co-operative sugar mill operates, the recipients of dividends on profits from publicly listed sugar milling companies can be, and quite often are, off-shore and are not necessarily either rural based or part of the community within which the sugar mill operates.

Multinational companies also have the added advantage of being able to raise funds at much lower margins than are available in Australia and quite often pay no or little income tax in Australia.

## **THE CURRENT LEGISLATION**

The existing taxation legislation recognises the need to differentiate between entities set up for profit purposes and entities that are set up as cooperatives.

The provisions in the current Australian Income Tax Legislation do not convey special privileges.

## **DIVISION 9 OF THE INCOME TAX ASSESSMENT**

Division 9 had its origins in 1918, when the Commonwealth Income Tax Act first recognised a co-operative as a distinct business entity. After a series of amendments during the 1920's, the present Division 9 was part of a number of recommendations of the Ferguson Royal Commission 1932- 34.

Section 117 defines a cooperative for the purpose of the Australian Income Tax Legislation. It limits the number of shares held by any one shareholder, prohibits the quotation of shares for sale or purchase on a stock exchange or in any public manner. It also requires that the primary object/s of the cooperative must be to acquire, dispose, store, market, pack and process the commodities of its shareholders or to render services to its shareholders. These objects and limitations differentiate a cooperative from a company whose principles are profit driven.

Section 118 reinforces the principle of supplier ownership by requiring that 90% of the services provided or storage, marketing, packing, or processing of commodities by the cooperative must be provided to the members or shareholders. (Some cooperatives have no shares).

Section 119 separates a cooperative from the basic tenet " that a person's income consists of only monies derived from sources other than himself or herself", by requiring the cooperative to declare as assessable income all sums received by the cooperative for the rendering of services or storage, marketing, packing or processing of commodities from all sources including its members.

Section 120 however then establishes the basic deductions because of the cooperative ownership principle under which a cooperative operates.

The first Sub section allows those cooperatives who meet the primary objects defined in Section 117 and Section 118 of the Australian Income Tax Legislation, a deduction for all distributions amongst its shareholders or members in the form of - rebates or bonuses based on the business done with its shareholders; or interest or dividends on shares. Clearly the deduction recognises that the rebates bonuses etc are an extension of the payments for the products which have been supplied by the farmer owners.

The second Sub section allows cooperatives that comply with Section 117(b) the deductibility of the repayment of certain loans under Section 120 (1)(c).

There is a further requirement for the allowance of this deduction which requires that 90% of the value of the cooperative must be held by the persons who supply the commodities or animals which the cooperative requires for the purpose of its business.

Section 120(1)(c) is principally in place because of the restrictions which cooperatives have in place from a fund raising point of view. The deduction enables cooperatives to direct retained earnings back into development which in turn has a direct benefit to the economy and the tax base.

**Cooperatives again are clearly different to publicly listed companies who have the ability to raise funds from external sources as investment capital or equity. The other players in the Australian Sugar Industry have sources of capital from the international market. Cooperatives however must draw from their members (farmers) or raise development capital by way of debt finance. The implementation of Section 120(1)(c) and its subsequent improvement in 1997 clearly recognised the need to ensure that Australian owned farmer cooperatives had the ability to continue in their development whilst retaining their identities as Australian owned businesses.**

## **IMPROVEMENTS TO DIVISION 9**

The GOSMG submits that any revision of the Australian Income Tax Legislation should



promote cooperatives as a means of retaining Australian ownership of businesses particularly within the Primary Producer sector and continue to recognise the principle of cooperation in accordance with the current Division 9.

The GOSMG submits that Division 9 of the Australian Income Legislation be retained, with the following improvements:

- **Section 120(1)(c) should be enhanced to allow all co-operatives the deduction not only those which comply with Section 117(1)(b)**

The current legislation only allows those cooperatives who comply with Section 117(1)(b) the deduction under Section 120(1)(c). GOSMG would argue that since the whole of Division 9 defines a cooperative and places specific restrictions on its formation that the deduction should be allowed to all entities who comply with section 117 not just sub section 1(b) of the section.

- **Section 120(1)(c) should be enhanced by withdrawing the requirement for the loan repayments to be made to government and allowing all repayments of loans for acquisition of assets.**

GOSMG submits that the need to have the loans come from government is an unnecessary restriction from both the cooperative and finance sector perspective.

- **the Taxation Department should work with the co-operative movement to detail a set of guidelines for the operation of Division 9 and subsequently release a public ruling which supports the guidelines.**

GOSMG believes that it is necessary for the Taxation Department to work closely with the Cooperative Movement in establishing a set of guidelines supported by a public ruling which clearly establishes the manner in which the Section should be used.

Members of the group have had discussions with Taxation Department officials over the past two years aimed at establishing guidelines and GOSMG believe that the matter should be progressed to its completion.

Further attachment detailing who are the members of this co-operative, details of how much sugar is produced etc – available in hard copy only.