VFF SUBMISSION
ON
RALPH REVIEW OF BUSINESS TAXATION DISCUSSION PAPER
A PLATFORM FOR CONSULTATION

Introduction

The Victorian Farmers Federation (VFF) is the largest single farm organisation in Australia.

This submission is made on behalf of the VFF's 17,500 members.

The submission does not discuss all areas of concern as the National Farmers Federation (NFF) is providing a more detailed submission.

Instead, it provides a brief analysis of four of five key areas of concern to Victorian farmers.

The Review of Business Taxation and other Government objectives

The VFF believes the Review of Business Taxation final report should take into account other current Government objectives.

Victorian Government targets call for a tripling of food exports from Victoria by 2010 to a total of $12 billion per annum. Rural Victoria is also a crucial part of the Federal Government's `Supermarket to Asia' program, which seeks to make Australia (particularly its southern regions) the foodbowl of Asia.

In line with this Government-backed push, processed produce from dairying is now the single largest item exported from the Port of Melbourne (the largest container port in Australia). Australian wine exports (originating mainly from the southern States of Victoria, South Australia and New South Wales) are tipped to reach $1 billion per annum shortly.

A wrong decision in terms of tax treatment of farmers, particularly with accelerated depreciation and capital gains tax indexation, could endanger farm viability, long-term agricultural investment and the $12 billion target.

Accelerated Depreciation

Under Review of Business Taxation options, powered machinery moves from 30% to 22.5% diminishing value, non-powered machinery moves from 25% diminishing value to 15%, while fences drop from 10% diminishing value back to 4.5%.

The Review also has an impact on machinery trade-in. Any surplus of trade-in value above the depreciated value could be taxed rather than rolling over, as is the current practice.

Any diminution in accelerated depreciation would undermine farmers' ability to re-invest and adopt new technologies needed to maintain a competitive advantage in international markets.

Low commodity prices and a high level of international competitiveness are forcing farm operations to become larger and more productive.

Much of the recent productivity improvement on Australian farms can be attributed to farmers investing in new plant and equipment that includes the latest world class technologies. Tractors, combine harvesters, sprayers and seeding and tillage equipment all include sophisticated computer-based programs which allow access to global positioning systems and other precision technology.

This allows farmers to adopt the Precision Agricultural (PA) practices which result in the productivity improvements they require to stay competitive in the global market.

It was observed recently by John Harvey, Grains Research and Development Corporation program manager, that while PA technology was still in its infancy at farm level, those who had used it were surprised at the large yield variations within a paddock.[1]

Four or five fold variations in crop yields over short distances had been detected using PA technology.[2]

With tractors equipped with yield monitors, farmers can do a range of experiments without interrupting harvest. Similarly the use of variable rate seeders can also be used to make experimentation easier.[3]

GPS systems can ensure that a paddock of grain will be done in fewer laps, saving a farmer around 5% or 10% of their time, plus fertiliser and seed.

In 1997, the average tractor sold was 85kW, up from 51.4kW in 1991.[4] A new model tractor such as the Fastrac, with power take off in the 100 to 150 kW range have been specifically designed to boost farm productivity.[5]

Spraying is a major cost for vineyard operators. It is common for vines to be sprayed up to 11 times in any one season. With vines, timeliness of spraying is critical. When mildew occurs, spraying has to be done immediately, with severe consequences for delays.[6]

Gil McDonald, Maintenance Manager of Southcorp Wines, has estimated that up to 65 per cent of the chemical applied by a conventional sprayer completely misses the target canopy and much of the 35 per cent that hits the target does not adhere.[7]

It has been estimated that using a new technology sprayer such as the Green Tech model can deliver cost savings of $102,000 per annum for a 200 ha vineyard and $444,000 pa in a 800 ha vineyard. The main cost savings occur in chemical reduction, minimising production loss and labour productivity.[8]

A typical application of copper oxychloride and sulphur to control downy mildew would be 2.5 litres per ha at a cost of $20.45 per ha. The Green Tech system can achieve the same coverage with just one litre of each, costing just $12.27 per ha.[9]

New technology and machinery is vital in the dairy industry, too. Since 1991, milk yields per cow have increased at a faster rate than earlier trends as dairy farmers increased their adoption of new technologies (as well as farm management practices such as the use of supplementary feeding, improved dairy cattle genetics and better pasture management).[10]

The average productivity of milk-shed labour for farms with rotary dairies in Australia was estimated in 1996 to be 154 cows milked per hour, as opposed to farms with herringbone and walkthrough dairies, with 59 and 35 cows per hour respectively.[11]

An estimated 7% of all dairy farms operated a rotary milking shed in 1995-96, compared to only 2% of dairies in 1991-92. This trend is indicative of both the need for farms to increase their productivity by increasing the numbers of cows milked per operator and the changing structure of the industry.[12]

There is a desire on the part of dairy farmers to increase productivity. The proportion of dairy farmers wanting to change their dairy shed and dairy equipment in 1995-96 was 41% and 34% respectively. Of those wishing to change their shed or equipment, approximately 66% of them listed cost as the main prohibitive factor. Removing accelerated depreciation would not assist here.[13]

The VFF in fact believes accelerated depreciation provisions should be extended to items of capital expenditure such as cattle underpasses. Herd sizes of 500 cows are bot uncommon nowadays in Victoria and many farmers have boosted land holdings to graze their larger herds. Many farmers own land holdings on both sides of major highways such as the Murray Valley and Midland Highways and cross stock twice daily. This endangers stock, motorists and the farmer and also holds up traffic.

Cattle underpasses can cost up to $60-70,000 to build and the depreciation rate offered is 2.5%, a fairly inadequate incentive to make such a capital expenditure.

Finally, with COAG principles advocating cost recovery in relation to water, it has become very important from an environmental and business perspective to use water more wisely. State of the art irrigation equipment plays an enormous role in saving water through better-targeted waterings - cutting costs to farmers and boosting productivity.

Overall, accelerated depreciation enables farmers to finance such large capital outlays.

This is especially so because farmers generally have a low cash income. For example, farm business profit for broadacre farm industries has declined from $9,979 in 1995-96 to $2,000 in 1997-98.

Furthermore, agriculture is very capital intensive - farmers invest over $4 billion a year in new capital.

Depreciation was estimated to cost farmers about $3.4 billion in 1997-98, more than half of farm net cash income of $6.2 billion.

Some farmers have had to postpone investment decisions because of low commodity prices and poor climactic conditions. The plant on many farms is already in need of urgent replacement.

Ageing or obsolete machinery leads to increased repair costs and less time effectiveness. If farming areas or practices have changed, machinery which is too small for the job can mean it takes longer to complete, resulting in lower yields or quality. Delayed sowing of wheat can cost $1 per hectare per day given normal conditions. [14]

Trading Stock (including livestock)

The Review paper states that the current choice of methods of valuing trading stock (cost, market and replacement value) "allow excessive flexibility".

A Platform for Consultation contains an option which advocates the revaluation of all trading stock, including livestock, at net realisable value rather than the statutory livestock valuation used by most producers currently. This would result on the taxation of unrealised gains and would thus be detrimental to many farmers' cashflow.

The Review also suggests an option whereby deductions not be allowed for growing crops until the value of the crop is realised. This would be completely disastrous for industries such as apples, oranges and stoned fruits, which take more than one year to grow.

There is also the potential requirement of valuing fuel and other consumables as trading stock. This would result in a significant one-off revenue grab and increased compliance costs to farmers.

All three options represent significant one-off Treasury revenue grab. There will be no sustainable increase in government revenue arising from these options - the major effect will be that Treasury gains a cashflow advantage at the expense of farmers, who will be significantly cashflow-disadvantaged.

Entities Taxation of Partnerships

The Government has already advocated the entities taxation of trusts whereby the trust would pay tax rather than the beneficiary, causing a significant cashflow problem to farmers who operate their businesses via trusts.

Farming families often use trusts as a means of succession planning - as a convenient means of keeping the family farm in the family.

The VFF understands that certain big businesses have used trusts as a means of avoiding paying their fair share of tax and does not oppose moves to crack down on rorting - this can be solved largely by measures to identify beneficiaries.

However, the proposed changes to the taxation of trusts could catch ordinary farming operations in the net; causing farmers liquidity problems and threatening farm succession planning.

The payment of tax for many distributions will be brought forward, causing possible cashflow problems

This will particularly affect trusts, as they will have to pay tax when the distribution is made, rather than the current system of tax being paid by the beneficiary after the end of the financial year. In many cases, tax will be paid at least nine months before it is due now, severely affecting cashflow. For low-income farmers, the tax paid on distributions may be more than the final tax liability.

This measure also means that for new trusts, and new assets of existing trusts, the benefit of tax preferences will no longer flow to beneficiaries (with some exceptions). The main tax preference is the indexation of capital gains tax for inflation.

The VFF understands these provisions will not apply to the existing assets of existing trusts and also understands that primary production income of trusts will still be eligible for averaging, and income splitting will still be permitted.

The VFF requests that closely held farm family trusts should be exempt from entities taxation.

More disturbingly, one Review option seeks to extend entities taxation to partnerships. With 82% of farmers using partnerships as their operating entity, this could cause cashflow problems for farmers, particularly those with fluctuating incomes.

The removal of the balancing adjustment rollover when a partnership is reformed could also have a detrimental effect on the intergenerational transfer of the family farm.

The option which suggests that partners maintain their own depreciation records for their share of partnership assets would add to compliance costs for no gain in taxation revenue and is inconsistent with the Review's goal of simplifying the taxation system.

Capital Gains Tax

The current CGT system is patently ineffective - Australian agricultural research has led the world in terms of scientific advances, particularly in terms of biotechnology. Far too often, Australia's CGT regime has forced these advances to be developed offshore and sold back to Australia at a higher price.

The Review of Business Taxation makes a suggestion that indexation for capital gains be abolished in favour of a 30% capped rate. Such a proposal favours speculation and discriminates against long-term investment. This would be totally unacceptable for agriculture, as most investment in agriculture is long term and thus more subject to the effects of inflation.

The VFF supports a Speculative Gains Tax, which progressively reduces taxes on gains from long-term ventures, rewarding patient capital whilst taxing speculation.

Fairness

Over 90% of farm businesses in Australia operate as partnerships or sole traders and thus would not benefit from any drop in the company tax rate from 36% to 30%.

The VFF is concerned about a situation whereby its members do not gain benefits from the recommendations contained in the final Review Report but incur much of the costs associated with benefiting other sectors of the Australian economy.

The only beneficiaries from such a reduction in the corporate tax rate are in fact international investors and those companies which retain their profits.

Furthermore, the Prime Minister has commented that no Australian will be worse off under tax reform. However, it is conceivable that some farmers may be worse after tax reform (even taking into account all of the benefits in A New Taxation System) if proposals to introduce entities taxation and abolish CGT indexation are introduced.

Conclusion

Many of the options outlined in *A Platform for Consultation* could be a disaster for farmers. The paper addresses some concerns of large corporations but many of the options in this discussion paper will leave farmers significantly worse off.

Furthermore, many proposals in *A Platform for Consultation* contradict other Government policy objectives which depend on an increase in farm productivity and output.

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