

Submission to the Tax White Paper Task Force

Tax Discussion Paper March 2015

from



Australian Land Conservation Alliance

The Australian Land Conservation Alliance was established in 2011 to promote and support the conservation of private land in Australia.

The Australian Land Conservation Alliance (ALCA) brings together The Nature Conservancy (Australia) and Australia's state level Land Trusts, which as a collective represents the vast majority of private landholders engaged in permanent private land conservation. The state level Land Trusts are: Tasmanian Land Conservancy; Trust or Nature Victoria; Nature Conservation Trust of NSW; Trust for Nature Queensland; National Trust and Nature Foundation South Australia.

The state Land Trusts engage in perpetuity private land conservation through the use of covenanting, a permanent, legally binding agreement places on the property's title that is binding on successors in title.

ALCA welcomes the opportunity to make a submission to the Tax White Paper Task Force. The following submission refers to the research and recommendations made by the Victorian Trust for Nature during a review of environmental markets and the law in 2014¹.

ALCA submits that the issues and recommendations in this submission are relevant for all Australian jurisdictions to ensure our tax system supports the sustainable use of the nation's natural capital as well as financial capital. For future generations, our environment and economic well being our recommendations address the importance of increasing the number of landholders engaging in the sustainable management of private land in a way that protects biodiversity, the provision of ecosystem services, and managing private land for conservation and public benefit.

Our recommended reforms would play a part in helping the Australian Government meet its international obligations to build its National Reserve System to achieve minimum levels of protection for Australia's distinct biological communities and species on private land.

The following submission includes excerpts from the Trust for Nature reports and the recommendations therein. Copies of the full reports are attached to this submission.

¹ Trust for Nature (2014) *Land-based environmental markets and the law: the evolving legal landscape underpinning ecosystem services markets in Victoria*; and Trust for Nature (2014) *Shining a Light on law and markets in private land conservation: insights and issues from Victorian landowners*.

Private Land Conservation

In the last two decades, there has been increased emphasis on retaining and restoring ecosystem services on private land and creating innovative mechanisms and schemes to facilitate and achieve those outcomes. This has included mechanisms to create a market-based demand for ecosystem services on private land.²

Private land conservation forms an integral part of Australia's natural resource management and biodiversity conservation efforts. The efforts of private landholders are essential to meet the International Convention of Conservation of Biology (CBD) biodiversity targets referred to as the 'Aichi Biodiversity Targets'.³ The role and importance of private landholders in biodiversity conservation is explicitly recognised in the Australia's Biodiversity Conservation Strategy, which seeks to increase the extent of private land managed for biodiversity conservation.⁴

The National Reserve System has been identified as the single most important asset for the conservation of Australia's unique and globally significant biodiversity⁵. Australia's National Reserve System is Australia's network of recognised protected areas. The goal of the National Reserve System is to develop a comprehensive, adequate and representative system of protected areas, to secure the long-term protection of Australia's terrestrial biodiversity.⁶

In 2011 non-government conservation organisations were identified as the fastest growing sector building the National Reserve System⁷. In 2014, it was estimated that there are ~5,000 properties that can be considered private protected areas covering 8.9 million hectares.⁸ Critically, these private protected areas conserve some of the nations most endangered ecosystems and species⁹ and their protection through private land mechanisms has saved Commonwealth and state governments considerable expenditure through not having to acquire this land themselves. For Australia to meet its obligations for creating a *representative* reserve system under the Convention on Biological Diversity, critical gaps in the reserve network will need to be filled. Most of these gaps occur in regions dominated by private land where voluntary private land conservation mechanism will be the only realistic options for filling the gaps.

Australia's Biodiversity Conservation Strategy identifies the importance of environmental markets and other incentives to achieve an increase in private landholders managing biodiversity and ecosystem services¹⁰ and

² Trust for Nature (2014) *Land-based environmental markets and the law: the evolving legal landscape underpinning ecosystem services markets in Victoria*; p5

³ <http://www.cbd.int/sp/> The twenty Aichi Targets include: By 2020, at least halve and, where feasible, bring close to zero the rate of loss of natural habitats, including forests; By 2020, establish a conservation target of 17% of terrestrial and inland water areas and 10% of marine and coastal areas of ecologically representative, well connected protected areas; By 2020, restore at least 15% of degraded areas through conservation and restoration activities.

⁴ Natural Resources Management Ministerial Council (NRMMC) (2009) *Australia's Strategy for the National Reserve System 2009 – 2030*. Canberra, Australia p44

⁵ Taylor MFJ, Fitzsimons JA, Sattler PS, 2014. *Building Nature's Safety Net 2014: A decade of protected area achievements in Australia*. WWF-Australia, Sydney, p19

⁶ NRMMC (2009) *Australia's Strategy for the National Reserve System 2009 – 2030*. Canberra, Australia: Natural Resources Management Ministerial Council

⁷ State of the Environment 2011 Committee. *Australia state of the environment 2011. Independent report to the Australian Government Minister for Sustainability, Environment, Water, Population and Communities*. Canberra: DSEWPac, 2011; citing Australian Government Department of Sustainability, Environment, Water, Population and Communities. *Conservation organisations*. Canberra: DSEWPac, 2011, viewed 21 July 2011, www.environment.gov.au/parks/nrs/getting-involved/organisations/index.html.

⁸ Fitzsimons J, 2015. Private protected areas in Australia: current status and future directions. *Nature Conservation* 10: 1-23.

⁹ Ibid

¹⁰ Natural Resource Management Ministerial Council 2010, *Australia's Biodiversity Conservation Strategy 2010-2030*, Australian Government, Department of Sustainability, Environment, Water, Population and Communities, Canberra. p3

recognises the need to encourage increasing private investment in biodiversity conservation so that both the costs and the benefits of biodiversity use are distributed across relevant sectors, and seeks to increase private expenditure on biodiversity conservation¹¹.

*Society as a whole benefits, and future generations will also benefit, from protecting biodiversity. However these benefits are not fully reflected in our economic system. To ensure that biodiversity's importance as a public good is fully valued, we need to ensure that there are financial incentives for actions that protect or enhance biodiversity and that the cost of damage to biodiversity is accounted for in economic planning. One way of moving towards such a system is to stimulate the development and expansion of markets for biodiversity and ecosystem services, including initiatives such as the Australian Government's Environmental Stewardship Program, the Victorian Government's BushTender program and the New South Wales Government's BioBanking program.*¹²

The Biodiversity Conservation Strategy sets a goal of doubling the value of complementary markets for ecosystem services by 2015 and seeks to achieve the following outcomes:

- An increase in the use of markets and other incentives for managing biodiversity and ecosystem services
- An increase in private expenditure on biodiversity conservation
- An increase in public-private partnerships for biodiversity conservation¹³.

ALCA submits that a number of financial barriers exist to achieving these goals, and that the national tax review provides an opportunity to address these barriers.

ALCA's submission does not address state jurisdiction land-based taxation issues (e.g. land tax impost or exemption) as they relate to the management of private lands in perpetuity for public benefit, but simply notes the need for consistency and equity in the treatment of such landowners. We also note that such considerations may have relevance to any reform of Commonwealth State taxation transfer arrangements, taxation roles and responsibilities arising from the work of the Task Force.

Barriers for Private Land Conservation in the current tax system

Private landowners who voluntarily establish land under conservation/sustainable management provide an extremely important public service, often at considerable financial cost to themselves. The importance of this is emphasised by the fact that some of Australia's highest priority conservation lands, for example coastal rainforests and inland grassy box woodlands, are now found mostly on private land.

Private conservation landholders are frequently unable to earn significant income from their properties (because it is protected for conservation and any future development rights are forfeited) but must still meet the costs of rates, taxes, pest, weed and fire management and fencing on land that is ultimately held for future and current social benefit.

¹¹ Ibid p 42 and 44

¹² Natural Resource Management Ministerial Council 2010, *Australia's Biodiversity Conservation Strategy 2010-2030*, Australian Government, Department of Sustainability, Environment, Water, Population and Communities, Canberra.p41

¹³ Ibid p42

There is very little financial reward or public recognition for those landowners who choose to protect areas and implement actions beyond their perceived/or legislated level of duty of care, most often without any financial reward. At the same time, our governments and major scientific institutions such as the CSIRO recognise the importance of protecting land with high conservation value for future generations, environmental and economic resilience.

Increasingly the provision of economic incentives is integral to securing biodiversity conservation management, and financial assistance to private landholders, through payments and concessions recognised as an important motivator for private land biodiversity conservation.

There are a number of impediments to landholders who want to manage their land for conservation, and increasing private land participation in biodiversity conservation and environmental markets will require an improved recognition of the public interest character of ecosystem service payments.

Various but limited tax incentives currently exist for landowners who engage in private land conservation initiatives. These include income tax deductions and concessional capital gains tax treatment for entering into conservation covenants or other ATO-recognised permanent protection instrument registered on title¹⁴, as well as deductions or concessions for landcare operations¹⁵. Whilst these measures are intended to provide tax benefits and incentives to land-based environmental activities, they do so in a very limited manner. ALCA submits that reform is required to address limitations and barriers to landholder contributions to maintaining and often restoring the country's biodiversity and natural assets on private land.

Limitations of covenant concessions

At present, deductibility against taxable income for entering into a conservation covenant has 2 significant barriers to a taxpayer's eligibility to claim a deduction for providing a significant public benefit. First, it only applies where land value declines by more than \$5000 (independently assessed by an ATO valuer) as a result ; and secondly, no consideration has been received for doing so¹⁶, regardless of the amount (or proportion) of income or capital co-contribution the landowner may be making. In the case of a landowner voluntarily entering into a covenant as an element of a market-based or incentive scheme participation (such as in the case of some National Landcare Program projects and regulatory native vegetation offsets), the income tax deduction is not available because consideration (in the form of money payments) will be received for doing so, however, landowners may have some eligibility for concessional Capital Gains Tax treatment.

It appears that by comparison with international best practice, current Australian tax policy fails to acknowledge public interest dimensions to these transactions, even though it is reasonable to assume both private and public interest characteristics to them.¹⁷ The public interest character of entering into permanent protection registered on

¹⁴ *Income Tax Assessment Act* (ITAA)(Cth)1997, Division 31.

¹⁵ *Income Tax Assessment Act* (ITAA)(Cth)1997, Subdivision 40-G.

¹⁶ ITAA Division 31

¹⁷ In particular, a private interest is generated and recognisable in the transfer of funds from the funding body to the individual benefit of the landowner. There may also be recognised a private interest to the landowner in improving the environmental qualities of their land. But additionally, there is a benefit to the community as a whole in the environmental values of the land being well managed and/or restored

title is only addressed under these provisions where covenanting occurs entirely as a gift. The establishment of ‘split-receipting’ for charitable ‘ecological gifts’ in jurisdictions such as Canada¹⁸ has been one important method of recognising and accommodating the public interest character of environmentally beneficial transactions¹⁹. In summary, a landowner can receive a payment or incentive for permanently protecting environmentally sensitive land and at the same time receive a tax deduction spread over five years for any unremunerated value of the ‘land use and development rights’ effectively given up (gifted) in establishing permanent protection.

This tax law framework enables the Canadian funding mechanism supporting on-title protection of high conservation value land to complement and work proactively with the tax law incentives for landowners donating ecologically sensitive lands to a qualified land trust. This approach also operates in the United States.

The policy basis of the Canadian approach is to allow for the private benefit of money or property received for entering into conservation protection to be distinguished from the ‘charitable’ (public) benefit of encumbering the land for conservation purposes and reducing its fair market value²⁰.

The tax treatment in the Canadian approach better acknowledges and deals with the private/public benefit distinction actually operating in environmental incentive and market schemes. It would enable all jurisdictions to far more effectively leverage private contributions to the nation’s National Reserve System and natural capital bank. Taking the lead from international best practice in this regard will also help evolve the Australian tax law to take better account of emerging environmental markets and incentive payments.

Recommendation 1

Landowners who receive a payment or incentive for permanently protecting environmentally sensitive land remain eligible to receive a tax deduction spread over five years for any unremunerated value of the ‘land use and development rights’ effectively given up (gifted) in establishing permanent protection.

Recommendation 2

Canadian (and American) approaches to the tax treatment of ecosystem services payments that seek to clarify and distinguish private and public interest dimensions to revenues, as well as allowing for ecological ‘gifting’, be adopted as a means of improving Australia’s ecosystem service protection efforts, and enable a greater level of transparency, fairness and landowner confidence in environmental contracts.²¹

(hence a public interest), including for example improved biodiversity outcomes, water quality outcomes, decreased erosion or salinisation problems, or greater capacity or efficiency in carbon sequestration on that land.

¹⁸ See Canada Customs and Revenue Agency *Income Tax Technical News No. 26 – Proposed Guidelines on Split Receipting* (2002), <http://www.cra-arc.gc.ca/E/pub/tp/itnews-26/itnews-26-e.pdf> (viewed 11 May 2014); for an overview of recent history of the provisions, see Theresa Man ‘Recent Income Tax Amendments that Affect Charities’ (2010) *Charity Law Bulletin* No. 221, <http://www.carters.ca/pub/bulletin/charity/2010/chylb221.pdf> (viewed 11 May 2014). Note: America has very similar provisions and sophisticated instruments and stand and surrounding such concessions, including clear links to public sector funding programs under the Farm Bill 2014.

¹⁹ For a guide to the application of split receipting (and other tax implications) to conservation covenants, see Ann Hillyer and Judy Atkins *Giving it away: tax implications of gifts to protect private land* (West Coast Environmental Law Research Foundation, 2004).

²⁰ That is, making a gift of the value of the land associated with foregone opportunities to sell it at the going market rate or developing it. Under the Canadian approach, the ‘gift’ is the transfer of property and entering into a conservation easement (a conservation covenant) is considered to be a form of transfer of property. For further discussion regarding ‘fair market value’ please refer to Trust for Nature (2014) *Shining a Light on law and markets in private land conservation: insights and issues from Victorian landowners* p 63-64

²¹ Trust for Nature (2014) *Shining a Light on law and markets in private land conservation: insights and issues from Victorian landowners* p64

Clarifying tax treatment of expenditures for nature conservation purposes

Under Commonwealth income tax law, benefits only applying to primary producers are relaxed through deductions for 'landcare operations'. Capital expenditure for landcare operations is deductible. This category of deduction is available to rural landowners using their land to carry on a business for a 'taxable purpose'²², as well as to those using the land for primary production. Taxable purpose includes for 'the purpose of producing assessable income'²³, which, depending on a landowner's individual financial and taxation circumstances, may include income from environmental market schemes and incentives. Whether activities funded under environmental market programs and agreements are 'landcare operations' requires clarification²⁴.

Provisions for 'landcare operations' capital deductions do not appropriately recognise the expenditures of landowners managing permanently protected private land for public benefit without any income or contributions towards the expenditures incurred in so doing. In addition, provisions for 'landcare operations' pre date widespread use of financial incentives and market mechanisms for delivery of ecological management and restoration of private land²⁵. It therefore appears timely and appropriate to revisit the structure and content of these capital allowances to adjust the meaning of 'landcare operations'. Adjustments could include:

- enabling landowners with conservation covenants to claim a 'landcare operations' deduction from assessable income earned, regardless of source of income, and whether or not they are carrying on a business for a 'taxable purpose' on the land;
- shifting the language of these provisions toward 'ecological management and restoration' activities (or alternatively the 'management and restoration of ecosystem goods and services'), as distinct from 'landcare operations'; and
- establishing, as appropriate, the purposes of actions enumerated in section 40.635 as 'ecological management and restoration' (or alternatively the 'management and restoration of ecosystem goods and services'), as distinct from ameliorating land degradation.
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Recommendation 3

Review 'landcare operations' deductions under the Income Tax Assessment Act 1997 with a view to broadening the availability of concession to include 'ecological management and restoration' (or alternatively the 'management and restoration of ecosystem goods and services')

²² *Income Tax Assessment Act 1997* ('ITAA 1997'), subs 40.630(1)(b)

²³ ITAA 1997, subs 40.25(7)(a).

²⁴ For discussion regarding ATO rulings regarding landcare operations please refer to Trust for Nature (2014) *Shining a Light on law and markets in private land conservation: insights and issues from Victorian landowners* 5.6.1pp61-62

²⁵ See *New Business Tax System (Capital Allowances) Act 2001* (Cth), Schedule 1.

Recommendation 4

In reviewing the deduction, include non-capital expenditure and entitlement of all landholders with conservation covenants to a deduction against assessable income for conservation works expenditure (capital and non-capital expenditure) whether funding has been received or not.

Recommendation 5

That the Australian Government exclude payments for conservation activities from taxable income where associated costs are not claimed

Recommendation 6

That further professional development or guidance of tax advisers on the nature and implications of environmental market schemes could be desirable. ATO tax treatment information relevant to land managers undertaking land care and conservation activities on private land could be simplified; made a lot more informative and accessible to support landowners decision-making about participation in environmental incentive and market based schemes²⁶

A stand-alone architecture for 'ecosystem services' payments

Tax provisions relating to carbon offsetting measures are distinctly contained in a stand-alone architecture under Part 3-50 of the *Income Tax Assessment Act 1997*. This approach provides an element of coherence and relative simplicity to the tax treatment of carbon offsetting. There would be value in a similar stand-alone, coherent treatment of revenues from the management of 'ecosystem services' as a category of economic activity. It is a category that might incorporate activities such as participation in conservation tenders, environmental offsets and grant programs with a view to creating a unified scheme for this sector of the land management activities.

Recommendation 7

Consider a stand-alone treatment of revenues from the management of 'ecosystem services' as a category of economic activity to support the overall governance of environmental markets and enhance public sector funding programs' ability to leverage private investment in conservation²⁷.

Goods and Services Tax

At present, the sale of land used for business purposes, primary production or a residence is Goods and Services Tax free if the purchaser intends to continue to use it for those purposes but the sale of land covered by a Conservation Agreement or Trust Agreement and used in-perpetuity for private conservation is not.

²⁶ Ibid p 53

²⁷ Trust for Nature (2014) *Shining a Light on law and markets in private land conservation: insights and issues from Victorian landowners* p61

ALCA submits that policy change to provide equality of treatment under the Goods and Services Tax (GST) between owners of private conservation land and other landowners should be considered if the private conservation market is to become a major part of the solution to biodiversity loss.

Recommendation 8

Land protected by in perpetuity Conservation Agreements registered on the title of land be exempt from GST on future sale/purchase

Recommendation 9

To take account of circumstances where a landowner purchases land which is not protected by a perpetual conservation covenant with the intention of protecting its high conservation values, an amendment to *A New Tax System (Goods and Services Tax) Act* to exempt land purchased for nature conservation from GST on the undertaking of the purchaser to place a perpetual conservation covenant within two years of the date of purchase.

Recommendation 10

That organisations constituted to establish in perpetuity conservation agreements on property title, who purchase and sell properties for that purpose would be GST exempt.

Increasing private investment in biodiversity conservation ALCA members continue to be approached by individual landowners with high conservation value land wishing, for example, to continue to live on the property, but gift part or the entire property to a land trust for assistance with its ongoing management and future utilisation for land conservation purposes. Disincentives and barriers exist within the current taxation system preventing these public benefit 'living bequest' transactions.

Recommendation 11

That the Australian Government encourage 'living bequests' of land with high conservation values able to meet the standards of the National Reserve System by clarifying that they are deductible (or rebatable) under the income tax gift provisions, and ensuring that any taxable capital gain at least excludes the value of retained rights or benefits²⁸.

The future of Private Land Conservation

It has been identified that in-perpetuity conservation covenants on private land, including on farms, could become a significant contributor to meeting Australia's national and international biodiversity obligations if provided with sufficient financial support²⁹. ALCA strongly supports this vision and submits that a tax system that removes financial barriers and provides support to private land conservation managers will assist the Australian Government in fulfilling its objectives.

²⁸ The Allen Consulting Group (2002) *Building a stronger social coalition Summary Report A discussion paper proposing measures to encourage increased philanthropy and a stronger civic culture in Australia*

²⁹ Taylor MFJ, Fitzsimons JA, Sattler PS, 2014. *Building Nature's Safety Net 2014: A decade of protected area achievements in Australia*. WWF-Australia, Sydney, p32

Taxation law, policy and administration have an indirect regulatory role on PES [payments of ecosystem services] and environmental market schemes and private land conservation generally. For instance, not only may recipients of funds under environmental market schemes be liable to have those funds included in assessable income for Federal income tax purposes, but also the complexity and fragmentation of tax treatment of landowners participating in these schemes may have an impact on their capacity or desire to participate in the future³⁰.

Summary of Recommendations

ALCA is grateful for the opportunity to make a submission to the Tax Discussion Paper March 2014 and would like the opportunity to meet with the Tax White Paper Task Force to discuss the information and recommendations in this submission.

Please find a summary of recommendations made within this submission below:

Recommendation 1

Landowners who receive a payment or incentive for permanently protecting environmentally sensitive land remain eligible to receive a tax deduction spread over five years for any unremunerated value of the 'land use and development rights' effectively given up (gifted) in establishing permanent protection.

Recommendation 2

Canadian (and American) approaches to the tax treatment of ecosystem services payments that seek to clarify and distinguish private and public interest dimensions to revenues, as well as allowing for ecological 'gifting', be adopted as a means of improving Australia's ecosystem service protection efforts, and enable a greater level of transparency, fairness and landowner confidence in environmental contracts.

Recommendation 3

Review 'landcare operations' deductions under the Income Tax Assessment Act 1997 with a view to broadening the availability of concession to include 'ecological management and restoration' (or alternatively the 'management and restoration of ecosystem goods and services')

Recommendation 4

In reviewing the deduction, include non-capital expenditure and entitlement of all landholders with conservation covenants to a deduction against assessable income for conservation works expenditure (capital and non-capital expenditure) whether funding has been received or not.

Recommendation 5

That the Australian Government exclude payments for conservation activities from taxable income where associated costs are not claimed

Recommendation 6

³⁰ Trust for Nature (2014) *Shining a Light on law and markets in private land conservation: insights and issues from Victorian landowners* p51
Refer also to landholder feedback regarding the complexity of tax implications for landholders.

That further professional development or guidance of tax advisers on the nature and implications of environmental market schemes could be desirable. ATO tax treatment information relevant to land managers undertaking land care and conservation activities on private land could be simplified; made a lot more informative and accessible to support landowners decision-making about participation in environmental incentive and market based schemes

Recommendation 7

Consider a stand-alone treatment of revenues from the management of 'ecosystem services' as a category of economic activity to support the overall governance of environmental markets and enhance public sector funding programs' ability to leverage private investment in conservation

Recommendation 8

Land protected by in perpetuity Conservation Agreements registered on the title of land be exempt from GST on future sale/purchase

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To take account of circumstances where a landowner purchases land which is not protected by a perpetual conservation covenant with the intention of protecting its high conservation values, an amendment to A New Tax System (Goods and Services Tax) Act to exempt land purchased for nature conservation from GST on the undertaking of the purchaser to place a perpetual conservation covenant within two years of the date of purchase.

Recommendation 10

That organisations constituted to establish in perpetuity conservation agreements on property title, who purchase and sell properties for that purpose would be GST exempt.

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