Advanced Income Tax Law

Chapter 5

Primary Producers

What is Primary Production?

s.995-1(1) states that a primary production business is carried on where a taxpayer is engaged in:

the cultivation or propagation of plants, fungi or their produce or parts

the maintenance of animals or poultry for the purpose of selling them or their bodily produce, including natural increase

fishing operations

forest operations

manufacturing dairy produce from raw materials that the taxpayer has produced

Primary Production Income

For tax purposes income from primary production includes the following receipts:

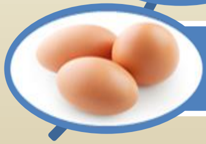
proceeds from the sale of produce

proceeds from the sale of livestock

stud fees, prize monies

insurance recoveries for loss of profits

agistment fees



value of primary produce taken by the owner for domestic use

Averaging of Income

Often a primary producer's income may vary greatly from year to year due to seasonal, climatic factors or commodity prices.

Averaging provisions ensure that taxpayers who are engaged in the business of primary production, do not pay greater tax over a number of years than those taxpayers on comparable but non-fluctuating incomes.

Tax averaging enables primary producers to even out their income and tax payable over a maximum of five years, to allow for good and bad years.

Averaging of Income

Eligibility for averaging

An eligible primary producer may be:

- an individual
- a partner
- a trustee

provided that the main or sole purpose is carrying on the business of primary production for a period of at least 2 years.

Averaging of Income

Averaging involves the granting to the taxpayer of a *tax offset* or imposition of *extra income tax* in the calculation of tax payable.

Tax offset

- occurs when taxable income exceeds average income.

Calculated as the difference between tax on taxable income at ordinary tax rates and tax on taxable income at the average tax rate.

Averaging of Income

Extra income tax

- occurs when taxable income is less than average income.

- also calculated as the difference between tax on taxable income at ordinary tax rates and tax on taxable income at the average tax rate.

Averaging of Income

Calculation of average income

Average income is calculated by dividing the sum of *basic taxable incomes* of the years from and including the first eligible year for averaging purposes by the number of years.

Basic taxable income is taxable income excluding certain items specifically excluded such as net capital gains.

Averaging of Income

Calculation of average income

Averaging will not apply until the taxpayer's basic taxable income in the current year is greater than or equal to the basic taxable income from the tear before.

A year in which a loss occurs is counted as a NIL amount in the calculation of average income

The tax loss can be carried forward for deduction in a following year(s).

Averaging Component

Where a primary producer derives both primary production income (PPY) and non-primary production income (non-PPY), then the averaging scheme applies only to the taxpayer's averaging component.

Averaging Component

The Averaging Component is calculated as follows:

- Averaging component consists of all the basic taxable income where the taxpayer's non-PPY is less than $5,000.
- If non-PPY is between $5,000 and $10,000, then the averaging component consists of all PPY plus an allowance of $5,000, reduced by $1 for every $1 by which the non-PPY exceeds $5,000.
- If non-PPY is greater than $10,000, then only the PPY comprises the averaging component.

Calculating Tax Payable under Averaging

The steps involved are:

1) Calculate taxable income

2) Calculate comparison rate of tax
   a) calculate average income
   b) calculate comparison rate of tax as follows:

$$\frac{\text{tax on average income}}{\text{average income}} \times \frac{100}{1}$$

3) Calculate the averaging component

4) Compare tax on taxable income at ordinary rates with tax on taxable income at comparison rate to determine the Gross Averaging amount.

5) Calculate the Averaging Adjustment
   The Averaging adjustment is:

$$\text{Gross Averaging amount} \times \frac{\text{Averaging component}}{\text{Taxable income}}$$

6) Calculate tax payable

Special Deductions

A number of special tax concessions are available as an encouragement to primary production for various *capital costs* incurred.

These include:

- Telephone Lines
- Water Facilities and Fencing Assets
- Landcare Operations

Special Deductions

Telephone Lines

s.40-645 allows a deduction in ten equal annual instalments for capital expenditure incurred in extending a telephone line to a primary producer.

Special Deductions

Water Facilities and Fencing

s.40-515 allows an immediate (100%) deduction for expenditure incurred from 7.30pm (AEST) 12 May 2015 on eligible water facilities (i.e. in conserving and conveying water) and fencing.

e.g. dams, tanks, tank stands, bores, wells, irrigation channels, pipes, pumps, water towers, windmills and extensions or improvements to any of these items.

Special Deductions

Landcare Operations

s.40-630 allows an outright (100%) deduction for capital costs incurred on landcare operations.

e.g. soil conservation measures, the eradication and extermination of animal or vegetable pests, and the destruction of weeds and plants detrimental to land.

Special Deductions

Fodder Storage assets

A fodder storage asset is an asset that is primarily and principally for the purpose of storing fodder such as silos, hay sheds and tanks used to store grain or other animal feed.

Expenditure incurred on eligible fodder storage assets from 7:30pm (AEST) 12 May 2015 is deductible over three years in three equal annual instalments.

Farm Management Deposits Scheme (FMD)

The FMD scheme is designed to provide a means whereby primary producers (except companies) can reduce the tax effects caused by fluctuating incomes.

Features of the FMD scheme include:

- deposits into the FMD scheme are deductible in the year of deposit provided that the primary producer did not derive more than $100,000 in non-primary production income (excluding capital gains)
- the minimum deposit and withdrawal is $1,000
- the total of all deposits cannot exceed $800,000
- interest is payable on deposits and is assessable
- withdrawals from an FMD are assessable in the year of withdrawal

Horticultural Plants

A horticultural plant is defined as:

"a live plant or fungus that is cultivated or propagated for any of its products or parts".

Horticultural Plants

A depreciation deduction is available for capital costs incurred in:

- Acquiring the plants or seeds
- Planting
- Preparation for planting
- Grafting trees
- Maintaining until planting
- Pots and potting mixture

Horticultural Plants

The annual write-off rate is determined by the effective life of the horticultural plant.

Effective Life (years)	Annual write-off rate %
3 to fewer than 5	40
5 to fewer than $6^2/_3$	27
$6^2/_3$ to fewer than 10	20
10 to fewer than 13	17
13 to fewer than 30	13
30 or more	7

Trading Stock

Trading stock of primary producers includes:

- Livestock
- Harvested crops of grain or fruit
- Wool once shorn from the sheep

Livestock Valuation

Under s.70-45, the closing value of livestock is calculated, at the taxpayer's option, using of any one of the following valuation options:

- Cost (average cost)
- Market Selling Value
- Replacement Price

Valuation of Natural Increase

When cost price is used for valuing livestock, then in calculating the average cost to be used for valuing closing stock, a cost must be assigned to any natural increase during the year.

When any natural increase of a taxpayer's livestock is first brought to account, any value may be selected provided it is not less than the minimum prescribed value given by ITR97 reg 70-55.01.

Natural Increase Valuation

The minimum prescribed values for the year ended 30 June 2020 are:

Livestock	Cost per head
Sheep	$4
Cattle	$20
Horses	$20
Pigs	$12
Deer	$20
Goats	$4
Poultry	$0.35
Emus	$8

Killed for Rations

The value of livestock killed for rations will depend on whether it was:

i. <u>on hand at the beginning of the year</u>

   - value using the same method as was used to value the opening stock.

ii. <u>purchased during the year</u>

   - value using its purchase price.

iii. <u>from natural increase</u>

   - value using the elected value for natural increase

If unable to identify the source of livestock killed for rations, then use the average cost of stock to calculate the value.

Double Wool Clips

Under s.385-135, if receipts from two wool clips are included in assessable income in a single year due to an advanced shearing because of drought, fire or flood, then the wool grower may elect to defer the **net income received for the second wool clip** to the following year.

Insurance Recoveries for Loss of Livestock

Insurance recoveries received by a primary producer for loss of livestock due to a natural disaster such as flood, fire, disease, drought, or any other disaster may be spread in equal instalments over a five year period.

Insurance Recoveries for Loss Timber

Insurance recoveries received by a primary producer for loss of trees by fire may also be spread in equal instalments over a five year period.

Profit from Death or Forced Disposal

If livestock is disposed of as a result of:

- the compulsory acquisition of land,
- a cattle tick eradication program by the State, or
- the loss or destruction of pastures or fodder due to fire, flood or drought,
- the receipt of a statutory notification regarding the contamination of property,

then any *profit on disposal* forms part of a taxpayers' assessable income.

However, there are two alternative forms of concessional tax treatment available by election to the taxpayer.

Profit from Death or Forced Disposal

Spreading the tax profit

An election can be made by that taxpayer to spread the assessment of the profit over five years – s.385-105.

All profit is included as assessable income in the current year, but $^4/_5$ is deferred to the succeeding four years.

For the election to apply, the taxpayer must satisfy the Commissioner that the profit has or will be applied to the purchase of breeding or replacement stock.

Profit from Death or Forced Disposal

Deferring the tax profit

s.385-110 provides an alternative to the election made under s.385-105.

The taxpayer may elect to have any profit offset against the cost of replacement stock purchased during the year of disposal or any of the next five years following the year of forced disposal.

Any profit not brought to account at the end of five years is included in the assessable income of the fifth year.

Summary of Sections

Receipts

s.385-135	**Double Wool clips**	Net income on 2nd clip is deferred.
s.385-130	**Insurance recoveries for loss of livestock/timber**	Defer $^4/_5$ of the insurance recovery.
s.385-105	**Profit on Forced Disposal or Death**	Defer $^4/_5$ of the tax profit. (i.e. "spread the profit").
or		
s.385-110	**Profit on Forced Disposal or Death**	Defer all of the tax profit. (i.e. "defer the profit").

Summary of Sections

Expenditure

s.40-645	**Telephone lines**	$^{1}/_{10}$ written off in the year of expenditure and in each of the subsequent 9 years.
s.40-515	**Water facilities**	Immediately deductible where expenditure is incurred from 7:30pm (AEST) 12 May 2015. $^{1}/_{3}$ written off in the year of expenditure and in each of the subsequent 2 years where the expenditure was incurred up to 7.30pm (AEST) 12 May 2015.
s.40-630	**Landcare operations**	Immediate write-off.
s.40-515	**Fencing**	Immediately deductible where expenditure is incurred from 7:30pm (AEST) 12 May 2015.
s.40-515	**Fodder Storage assets**	Immediate write-off where the expenditure is incurred on or after 19 August 2018.