

CARBON SINK FOREST LEGISLATION

What is the carbon sink forest legislation?

The new carbon sink forest legislation allows a tax deduction for the costs for establishing forests for the purpose of carbon sequestration, by treating the carbon sink forests as a capital item for tax purposes.

The legislation allows the separation of the ownership of the trees from the land, allowing landowners to lease land to businesses to grow carbon forest sinks. The landowner would receive an income from the lease of the land with the business obtaining the tax deduction and the revenue from the carbon credits.

The recognition of carbon as a saleable product for tax purposes is long overdue. A tree planted as part of a carbon sink has the characteristics of a depreciating asset, with a limited effective life and can reasonably be expected to decline in value over time, therefore should be treated as a depreciating asset for tax purposes.

The new legislation removes the unequal treatment of carbon sink forests relative to other planted forests and agricultural crops. It also brings carbon sink forests in line with other forms of tax deductible emission reduction activities, such as capital expenditure on depreciating assets to reduce emissions from oil and gas production.

What is the impact on agriculture?

Concerns have been raised that the new legislation will lead to the permanent loss of large tracts of prime agricultural land to carbon sinks. However there is little evidence to support this. While carbon sequestration rates rise with land productivity, highly productive land also has a high land value for agricultural production.

An ABARE study analysed the threshold carbon prices that would drive large scale replacement of a current agricultural land use with carbon sink forests, across a wide range of regions and land values.

The study found that for all scenarios, carbon prices in excess of \$100 per tonne of CO₂e would be required to make it attractive to replace agriculture with carbon sink forests. With the recent Treasury modelling predicting a carbon price at the beginning of the Carbon Pollution Reduction scheme in 2010 of \$20.88 per tonne of CO₂e under the CPRS -5 scenario and \$29.10 per tonne of CO₂e under the CPRS -15 scenario, it is very unlikely that there will be large scale replacement of prime agricultural land with carbon sinks.

The cost of land, which represents a significant component of the total cost of establishing a carbon sink forest, is not deductible under the new legislation. Typically, the costs related to the establishment of a carbon sink forest that are eligible for tax deductibility equate to no more than 20% to 25% of the total investment in a carbon sink project.

To date, carbon sink forests have been established mainly as small plantings integrated with existing agricultural land uses in less productive regions and on low productivity land. Plantations established in these less productive regions typically complement the agricultural activity, providing added benefits of salinity and erosion control, as well as increased biodiversity. In addition, carbon sink forests offer landowners an opportunity for to offset emission from their agricultural activity.

The requirement that forests meet natural resource guidelines and not interfere with existing patterns of water use, together with the likely increasing price of water, will continue to limit carbon sink forests to less productive marginal land.

While the permanency of carbon sink forests plantings is not specifically addressed in the legislation, the level of expenditure involved would mitigate against short term plantings. An investor will need to maintain the forest for the long term to gain a return on investment through the carbon permits.

How is the legislation structured?

The legislation is structured in two phases.

The first– from 1 July 2007 until 2012 – allows tax deductibility in the year of expense for eligible establishment costs. These include:

- the cost of acquiring and planting trees or seeds;
- the costs in preparing to plant the trees or seeds; and
- surveying costs.

However they specifically exclude the cost of:

- land;
- fencing;
- water facilities; and,
- accessing the carbon rights.

The aim of the first phase is to encourage early establishment of carbon forest sinks that will contribute to a medium emissions target while other options for delivering significant reductions are further developed.

The second phase – commencing 1 July 2012 – allows the cost of establishing a carbon forest to be depreciated at 7% per annum over 14 years and 105 days. This is equivalent to the depreciation allowance for long lived horticultural plantings.

What are the conditions for claiming a deduction?

In order to claim a deduction for costs associated with establishing a carbon sink forest taxpayers must meet the following conditions:

- They must be carrying-on a business
- The primary and principle purpose of establishing the trees is carbon sequestration by the trees
- They did not incur the expenditure under a managed investment scheme or forestry managed investment scheme
- The trees in the carbon forest meet certain forest characteristics and adhere to environmental and natural resource management guidelines. The guidelines provide that carbon sink forest establishments should be:
 - Based on regionally applicable best practice approaches to 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.