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Your submission for this review:

Biodiversity Market Monitoring team, Please find attached our submission on the performance of the Biodiversity credits market. Our submission is in response to the published Discussion Paper, and in light of IPART's 'credit sellers' Stakeholder workshop. In this submission we wish to bring to IPART's attention the importance of allowing the Total Deposit Fund (TDF) to accommodate 100% of the proceeds from the sale / retirement of credits. The change required is relatively easily achieved as the level of funds on the TDF is governed by regulation, the Minister's decision and a gazette process. This outcome would allow a credit seller to produce a net zero D4 CGT event, requiring no capital gains tax to be paid (as the CGT tax will be converted to income tax). For your consideration.



07 October 2024

IPART Biodiversity Review Team

Submission via upload to IPART online portal

RE: Discussion Paper – Performance of NSW Biodiversity Credits Market

Further to our Company's submissions of 4 August 2023 and 10 January 2024, we wish to update the Biodiversity Review Team ('the Team') on progress made with the ATO on our Private Ruling submission and offer our suggestion to the Team on a way forward to improve the performance of the NSW Biodiversity Credits Market. In this submission we focus on two matters arising from interaction with the ATO.

Context of ATO submission

The ATO offers an 'early engagement' process for Private Ruling submissions, which we accepted. This process was smooth and efficient but focused only on what the tax law states, and the protocols adopted by the ATO when interpreting that law. Consequently, our suggestions for variation of those protocols were overlooked in the ATO's response to our submission. The ATO recognized this impact on our submission and advised that we could escalate our submission to an 'objection in paying Capital Gains Tax (CGT)', with the possibility of a further escalation to an external authority (most likely the Administrative Appeals Board) for a final determination of the matters we are seeking to have modified. The Company is currently considering objecting to the design of the ATO's D4 CGT event ruling.

Outcome of the ATO submission

Two very clear and hugely important messages arose from the ATO's early engagement response.

- First, the principle that the ATO used to formulate tax on biodiversity conservation was based solely on property. A summary of their foundational view as stated in the response is that "the Company, as the landowner, has created rights in the Minister for the Environment of the State of NSW and this is considered the giving of property in respect of acquiring the biodiversity credits". Note that this principle applies at the time the credits were created (meaning 'entering into', or execution, of the Biodiversity Stewardship Agreement, BSA), and not at the later time of actually receiving capital proceeds. The phrase 'giving of property' implies that the Company has effectively 'sold' the land to the Minister (as it is an in-perpetuity event) and received credits in return for that transaction (a one-off event). It is the Company's view that the focus of the BSA execution event on property detracts enormously from the economic endeavours that should be encouraged to improve the welfare of native plants and animals, in accordance with the obligations placed on the landholder by the BSA and the overarching intent of the biodiversity market design.
- Second, the notional capital proceeds created in the first point above can be reduced by placing a proportion of those notional proceeds, to the extent specified in the BSA, in the Company's Total Deposit Fund held by the Biodiversity Conservation Trust. Specifically, the ATO stated in their response that "the total deposit fund (sic) is an 'incidental cost' as described in section 110-35 of the ITAA 1997, incurred by the Company that can be included in the cost base of each biodiversity credit generated from entering into the BSA". The Company notes that, from an ATO perspective, there is no restriction on the extent of the notional proceeds that can be included in the cost base of each biodiversity credit, up to the maximum of 100%. At 100% reduction in the cost base, the net capital gain is zero and no CGT tax would be payable – rather, the tax would be paid on the income stream arising from the annual payment of funds from the TDF to the Landowner in accordance with the BSA. This would commence at the time the credits were sold or retired, as the case may be.

Improving the performance of the NSW Biodiversity Credits Market

Point 2 above provides a relatively simple way forward to move from the focus on property (as if the event were simply a sale of the land) to a focus on the economic endeavour of a long-term business, with business activities occurring regularly across the year. Importantly, it provides NSW, rather than the ATO, with control of the economic performance of the Biodiversity Credits Market. This is even more relevant due to the tax law principle of 'Base Rate Entity Passive Income, BREPI', as will be explained.

The benefits of point 2 can be explained by referring to the current version of the Biodiversity Conservation Act 2016 No.63 (NSW). Part 6, Division 4, Section 6.21 'Payment to Fund on first transfer of biodiversity credit or on retirement without first transfer', provides the flexibility to vary the amount contained in the TDF to the maximum of the gross capital proceeds assigned to the total quantity of Biodiversity credits specified in the BSA.

This flexibility is contained in paragraph (6) of that Section by virtue of assigning the role of variation to the regulations: "The regulations may amend this section to vary the operation of this section (including to vary the calculation of the amount to be paid into the Fund under this section or to provide for the deferral of the payment of the amount until a subsequent transfer of the biodiversity credit)". This flexibility would allow the regulation to accept a request from the landowner to increase the amount contained by TDF to the maximum level available from the sale (or retirement) of the Biodiversity credits. If all notional capital proceeds are to be placed in the TDF, the net impact on the D4 and A1 capital gain events will be zero. The income stream flowing annually from the TDF to the landowner will be classified as ordinary income and subject to income tax, payable by the landowner.

In this regard, Part 6, Division 6.1, Sections 6.12 and 6.13 of the Biodiversity Conservation Regulation 2017 [NSW] are relevant. There appears to be nothing limiting a change to the Regulation as suggested above. As this change is under the direct control of the Minister, the changes appear to be relatively easily implemented and within the current design of the Biodiversity Offset Scheme.

Ordinary income arising from the TDF to manage Biodiversity stewardship obligations is classified as Base Rate Entity income (as it is not listed in the Subsection 23AB(1) of the ITAA 1986). Subject to other minor conditions, this income stream attracts a lower tax rate for the Company, which is an important business consideration. The D4 capital gains event, as well as any subsequent A1 capital gains event are classified as providing Base Rate Entity Passive Income and attract a higher company tax rate. Consequently, the complete conversion of capital proceeds to a net zero capital gain is an important consideration for BSA entities.

We note that the changes proposed in this submission concern the seller rather than the buyer. Whilst not immediately obvious, we consider that the matters raised above fit into questions 2 and 6, page 2, as outlined in the IPART Discussion Paper. In question 2, the Company considers that treating Biodiversity credits as property carries a demotivating stigma for the long-term upkeep of the products on that property. Those products are represented by the credits, and hence the credits should be classified as products that produce an income stream, not a capital gain. In question 6, the Company considers that information on how to convert D4 and A1 capital gain events into an ordinary income stream, such that it looks and feels like the maintenance of a Biodiversity Stewardship Site, is missing. From a motivational perspective, we would like to regard Biodiversity Stewardship credits as representing 'products' that are either in the ground or roaming on or near its surface. Those products produce an annual income stream, like any other product.

We are happy to provide details of our suggestion should you consider that helpful. For further information on this submission, please contact Peter Egger (E: peter.egger@peggerco.com.au; M: 0419713780).

I wish to advise that in light of the outcome of the ATO early engagement response, we now consider it appropriate to have all our Biodiversity submissions to IPART (Aug2023; Jan2024 and this document) made public, if IPART so determines.

Yours faithfully,



Eda Egger
Chairman.