

13 December 2019

**Online submission:** Future Drought Fund Consultative Committee

Dear Committee Members,

**Submission to: Future Drought Fund Consultative Committee**

I write to you in reference to the Invitation for Public Submissions on the draft Drought Resilience Funding Plan.

**Background to this submission**

The UQ Law School is currently conducting a three-year pilot study in Central West Queensland, focussed on the business structures that primary producers and small family businesses use, and how these relate to their cash position in the context of the environmental impact of the prolonged drought in the region.

The research is a collaborative project between:

- The UQ Law School
- RAPAD (Central Western Remote Area Planning and Development Board) and
- RFCSNQ (Rural Financial Counselling Services North Queensland).

The pilot study is being conducted in what is commonly referred to as the RAPAD region that makes up 23 per cent of the land area of Queensland, and which comprises of the:

- Barcaldine Regional Council
- Barcoo Shire Council
- Blackall-Tambo Regional Council
- Boulia Shire Council
- Diamantina Shire Council
- Longreach Regional Council and
- Winton Shire Council.<sup>1</sup>

The overall population of the RAPAD region stands at approximately 10,500. The region is undoubtedly classified as a 'very remote' area using the Accessibility and Remoteness Index of Australia (ARIA+).

The RAPAD region relies to a large extent on the beef industry, and on sheep and wool production as key economic drivers. These industries, and government and local government, provide the largest number of jobs in the region, as set out in Table 1.

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<sup>1</sup> RAPAD, *RAPAD Annual Report 2018 – 2019* (Report, 2019) 4–5.

	Barcardine Regional Council	Barcoo Shire Council	Blackall- Tambo Regional Council	Boulia Shire Council	Diamantina Shire Council	Longreach Regional Council	Winton Shire Council
<b>Total population = 10,554</b>							
<b>Population size</b>	2,865	272	1,903	429	291	3,660	1,134
<b>Top 5 responses – industry of employment</b>							
Accommodation		4.20%			6.90%		4.20%
Beef Cattle Farming	26.90%	38.20%	25.60%	59.60%	30.50%	6.90%	18.10%
Fuel Retailing					6.10%		
Hospitals (except Psychiatric)	5.80%		5.20%			5.80%	5.50%
Local Government Administration	5.80%	34.70%	10.40%	15.70%	26.70%	5.20%	13.40%
Primary Education		4.90%	3.10%	11.20%		3.10%	
Combined Primary and Secondary Education	4.10%						
Pubs, Taverns and Bars					5.30%		
Road and Bridge Construction	3.90%			4.50%			
Sheep-Beef Cattle Farming		3.50%					4.40%
Supermarket and Grocery Stores			3.10%	2.20%		3.30%	

**Table 1 – RAPAD region population and industry of employment by local government area**

By studying primary production businesses in the RAPAD region, we are able to consider the impact of trends on the wider regional economy, and in reference to the beef, sheep-beef, sheep and wool industries.

In particular, we would like to point out that the size of primary production businesses in the RAPAD region compares well to the size of agriculture, forestry and fishing businesses across the rest of Queensland. As presented in Table 2, more than 90 per cent of all agriculture, forestry and fishing businesses have a turnover of less than \$2 million annually.

<b>Number of agriculture forestry and fishing businesses by turnover:</b>	<b>Zero to less than \$50k</b>	<b>\$50k to less than \$200k</b>	<b>\$200k to less than \$2m</b>	<b>\$2m to less than \$5m</b>	<b>\$5m to less than \$10m</b>	<b>\$10m or more</b>	<b>Total</b>
Barcaldine	53	56	93	6	3	0	211
Barcoo	10	3	6	0	0	0	19
Blackall-Tambo	37	63	80	16	0	0	196
Boulia	0	0	3	0	0	0	3
Diamantina	0	0	4	0	3	0	7
Longreach	62	83	122	3	0	0	270
Winton	9	12	6	0	0	0	27
<b>Total number across the RAPAD region</b>	171	217	314	25	6	0	733
As % of total	23.3%	29.6%	42.8%	3.4%	0.8%	0.0%	100.0%
% with turnover less than \$2 m	95.8%						
<b>Total number of agriculture, Forestry and Fishing businesses in Queensland</b>	9,910	8,031	8,721	696	170	136	27,664
As % of total	35.8%	29.0%	31.5%	2.5%	0.6%	0.5%	100.0%
% with turnover less than \$2 m	96.4%						

**Table 2 – Number of businesses by turnover**

Agriculture in Queensland and in the RAPAD region is thus dominated by small family enterprises.

What is the purpose of the study?

Our study is primarily concerned with the legal business structures used to operate small businesses, starting with primary production businesses in the RAPAD region.

Using a multi-faceted theoretical framework, the project explores four research themes:

1. The factors that drive business structure selection
2. Participants' understanding of the legal nature of their firm participation rights
3. The merging of firm and participant personal finances
4. Tools and strategies to plan for, manage and take advantage of the business structure adopted.

These concepts are undeniably at the core of each firm's operations. However, the interrelationship between these are complex and difficult to navigate.

Why are the preliminary findings of our study important for the Drought Resilience Funding Plan consultation process?

The consultation process is aimed at identifying gaps in the broad framework that will guide funding decisions for the Future Drought Fund.

Strategic priority 1 of the draft funding plan concerns 'Economic resilience for an innovative and profitable agriculture sector'.

In reference to the Objective and Actions associated with strategic priority 1, our study points out that it is **essential to understand what the structure of farms and farming is in Australia, in order to set policy and in order to design effective drought resilience measures.**

While more than 90 per cent of all agriculture businesses are small, based on turnover and employment, they are nevertheless complex in structure.

- The simple truth, is that we do not have a picture of the structure of farms and farming in Australia
- The structure of farms and farming in Australia, and how that relates to land, labour, capital and management is a national research priority for ABARES.<sup>2</sup>

It is on that basis, that we respectfully submit that a key action point that should be added to strategic priority 1 is:

**Support the collection, management, public accessibility and application of data to understand the structure of farms and farming in Australia.**

How do we conduct our pilot study?

The pilot study uses a range of methods for triangulation purposes. But its centrepiece is a document analysis.

What makes the study unique and important in the context of the Future Drought Fund, is the extent to which farming families in the RAPAD region have given our research team access to:

- Their personal income tax returns
- Their business income tax returns
- Business financial statements.

By systematically analysing these records, we are able to compile a picture of the actual consolidated financial position of farming families in the region.

What do our preliminary results say about the structure of farms and farming in Australia that are relevant to drought resilience, drought policy and appropriate on-farm tools to drought proof properties? Why are the structures important?

Perhaps the best way to explain the national relevance of our study to the Drought Resilience Funding Plan is to present a few examples of the richness of our data and preliminary findings.

Example 1:

Our study has revealed that many farming families use more than one legal structure to conduct their business. Oftentimes, the operations and the land are not owned by the same entity. If the land is held in one entity and there is a large mortgage over the property, then the entity that operates the farming operations have to 'transfer cash' to the entity that holds the land so that it can pay off the mortgage.

To do so, the operating entity typically makes a tax deductible lease payment to the entity that holds the land. It may be that this lease payment is sufficiently large to result in a tax loss in that entity, in

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<sup>2</sup> Department of Agriculture, ABARES, 'The structure of farms and farming in Australia' (Web Page, 28 October 2019) <<http://www.agriculture.gov.au/abares/research-topics/surveys/structure-of-farms>>.

what is otherwise a perfectly profitable enterprise, and one suited to invest cash in Farm Management Deposits to protect the business against income volatility. However, because the operating entity has a tax loss, it does not meet the requirements to make the deposit. The result is thus that the overall whole-of-business position plays an insufficient role in the Farm Management Deposit Scheme.

Unless we know how many farm businesses find themselves in this position, we won't know what the potential of, or impediments to measures such as the Farm Management Deposit scheme are.

If a farming family uses more than one legal structure to operate their farm business, each of the structures will have a separate Australian Business Number. There is no national mechanism to connect these to obtain reliable and relevant information about family farm businesses, even in reference to Australian Taxation Office ('ATO') data. The only solution is the type of data collection and analysis that we use in our study.

#### Example 2:

Over the past number of years, a key feature of facilitative small business tax policy has been the accelerated write offs available for the cost of new capital assets. If a small business can write off the cost of a new asset for tax purposes in the year when the asset is purchased, it lowers the effective cost of the asset by the tax rate applicable to the business.

These tax concessions are an important tool in drought proofing. New assets such as fodder stores are entirely tax deductible in the year of purchased.

However, our study has revealed the presence of large accumulated tax losses in many farm businesses that have built up over many years. The purchase of new drought proofing assets reduce these tax losses over time, but do not generate a cash tax saving in that year.

Unless we study farm business structures in reference to income tax and cash, we will not know how many primary producers are caught in the middle of large tax losses that have built up because of the drought, and the fact that they can't afford drought proofing assets because there is no immediate tax saving to them.

#### Example 3:

Over the last eight to ten years, several important concessional loan schemes have been employed as part of drought resilience and support programs. In each of these schemes, as is the case with the Farm Household Allowance, primary producers may fail to qualify based on their overall financial position that takes into account all of the legal structures they use, but which may not appropriately take into account the nature of loans in these legal structures.

Our research has revealed a complex web of loans between structures that may in fact be equity, but equity with little to no value in the context of succession planning or as a retirement income source.

- In designing drought assistance schemes, policy makers do not have access to the type of data that explain the structures and interconnectedness between the legal structures. Without these, it is difficult to design schemes that appropriately consider inter-entity loans and positions.
- Unless we know how many farm businesses use more than legal one entity with assets and loans that are linked, income tax law may continue to be a limitation in generational farming. Generational farming is effective in understanding climate, water and pastures on properties.

We submit that no survey, questionnaire or interview can adequately explain the impact of business structures on drought resilience, drought policy and drought measures. The web of interconnected business structures that many primary producers use, are complex to understand, yet:

- On-farm decisions are taken in the context of a business structure
- Financing is sought in the context of a business structure
- Succession planning is effected in the context of business structures.

It is on that basis, that we respectfully submit that a key action point that should be added to strategic priority 1 is:

**Support the collection, management, public accessibility and application of data to understand the structure of farms and farming in Australia.**

Yours sincerely,



**Dr Thea Voogt**

Chief investigator

Research project: Small Australian firm business structures

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