

# Conserving Native Vegetation on Private Land: Subsidising Sustainable Use of Biodiversity?

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## Introduction

The Convention on Biological Diversity 1992 (the Biodiversity Convention) has as its primary objective the conservation of biological diversity.<sup>1</sup> Running a close second is the objective of sustainable use of biological diversity.<sup>2</sup> Simultaneous achievement of such objectives often runs contrary to the desires of large land owners in Australia, particularly when such land owners are engaged in primary production industries.

We have seen disastrous effects of land clearing practices by the agricultural sector resulting in millions of acres of destroyed habitats and lost 'biodiversity' (biological diversity)<sup>3</sup>. In the past, these farming practices have been not only condoned by the government but subsidised as well.

Now with the commitment of the Australian Federal Government to the conservation of biodiversity as part of its obligations under the Biodiversity Convention, we see a concerted effort to encourage good management practices. This commitment has manifested itself in various regulatory instruments. However, in economic terms, the Federal Government established the National Heritage Trust providing \$2.5 billion for managing the environment. This was achieved in 1997 with the partial sell-off of the government telecommunications corporation, Telstra, and was extended for a further five years in the 2001/2002 Federal Budget.

One of the economic initiatives funded has been the concessional tax treatment of voluntary conservation covenants entered into by land owners with an authorised government agency. This is available under the *Income Tax Assessment Act 1997 (Cth)* (ITAA97). Although the initiative is a subsidy contrary to the polluter pays principle, the subsidy is limited in effect while the covenant conserving biodiversity is perpetual. The effect seems to reinforce the importance of economic incentives working together with environmental regulations to ensure the necessary investment in environmental measures by industry.<sup>4</sup> There is a 'partnership' established between

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<sup>1</sup> Article 1 of the Convention on Biological Diversity 1992.

<sup>2</sup> Ibid, Article 1.

<sup>3</sup> Biodiversity refers to "the variety of all life forms – the different plants animals and microorganisms, the genes they contain, and the ecosystems of which they form a part": National Strategy for the Conservation of Australia's Biological Diversity, Dept of the Environment, Sport and Territories, 1996, p.1, <http://www.deh.gov.au/biodiversity/publications/strategy/intro.html> (accessed 15/7/04)

<sup>4</sup> The World Commission on Environment and Development, *Our Common Future*, Oxford University Press, 1987, (Brundtland Report), p. 64, 220.

government and private land owners holding environmentally valuable land. The 'partnership' objective is thus the conservation of the biodiversity found on that land.

With such investment encouraged through subsidies there is a shift from the consumer of the product to the taxpayer as the party who ultimately pays for the preventative or restorative measure.<sup>5</sup> This is in line with the Brundtland Report on sustainable development which espoused "[t]he integration of economic and ecological factors into the law and into decision-making systems".<sup>6</sup>

This paper explores the need for and the operation of the concessional tax treatment afforded to conservation covenants since the beginning of this century.

### **Conservation and sustainability**

The Biodiversity Convention was one of four major documents presented at the United Nations Conference on the Environment and Development (UNCED), held at Rio de Janeiro, Brazil, in June 1992.<sup>7</sup> Australia ratified the Biodiversity Convention on 18 June 1993 and has steadily taken steps to implement the obligations found in the Convention. The three main objectives of the Convention are contained in Article 1 with, arguably, the most important objective being the obligation to conserve biological diversity. The remaining objectives of sustainable use of biodiversity and equitable sharing of the benefits derived from access to and the use of such biodiversity cannot be achieved on a continuing basis without active in-situ conservation.

In order to implement Australia's obligations under the Biodiversity Convention it was recognised that a coherent strategy was necessary to bring together the varying initiatives for conservation at all three levels of government, namely, federal, state and local. Accordingly, the *National Strategy for the Conservation of Australia's Biological Diversity* (the *National Strategy*) was issued in 1996 in an attempt to provide an integrated approach to conservation.<sup>8</sup>

The main objectives of the *National Strategy* are:

- the conservation of biological diversity across Australia;<sup>9</sup>
- the integration of biological diversity conservation and natural resource management;<sup>10</sup> and
- the management of threatening processes.<sup>11</sup>

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<sup>5</sup> Ibid, Brundtland Report, p. 221.

<sup>6</sup> Ibid, Brundtland Report, p. 64.

<sup>7</sup> See GA Res 44/228, GAOR, 44<sup>th</sup> Sess. Supp. No. 49 at 151, UN Doc.A/44/49 (1989) as cited in Blakeney, M., *Biodiversity Rights and Traditional Resource Rights of Indigenous Peoples*, [1998] 2 BSLR 52.

<sup>8</sup> National Strategy for the Conservation of Australia's Biological Diversity, Dept of the Environment, Sport and Territories, 1996, p.3, <http://www.deh.gov.au/biodiversity/publications/strategy/intro.html> (accessed 15/7/04)

<sup>9</sup> National Strategy for the Conservation of Australia's Biological Diversity, Dept of the Environment, Sport and Territories, 1996, Ch 1, <http://www.deh.gov.au/biodiversity/publications/strategy/chap1.html> (accessed 15/7/04)

<sup>10</sup> National Strategy for the Conservation of Australia's Biological Diversity, Dept of the Environment, Sport and Territories, 1996, Ch 2, <http://www.deh.gov.au/biodiversity/publications/strategy/chap2.html> (accessed 15/7/04)

Each of these broad objectives has various specific objectives.<sup>12</sup> For example, the establishment of “a system of voluntary or cooperative reserves, or both, and other management schemes on private lands to complement the protection provided by the public estate in protected areas” forms objective 7.1(c) of the *National Strategy*. Figgis notes the embodiment of objective 7.1(c) in the National Reserve System Program which has received funding of up to \$84 million from the National Heritage Trust.<sup>13</sup> Private land purchases or conservation covenants attract 2:1 funding by the National Reserve System Program and are considered a cost-effective way for the Commonwealth to meet biodiversity conservation targets.<sup>14</sup>

Australia has been classified as one of the world’s 17 mega-diverse nations.<sup>15</sup> There are more than 15,000 species of native higher plants (flowering plants) in Australia with approximately 7,500 species in each of the states of Queensland and Western Australia.<sup>16</sup> This botanical diversity is greater than that found in all of Europe, and there are still new species being discovered in Australia.<sup>17</sup> On the relationship between biodiversity and progress the Australian Bureau of Statistics notes:

“Our native plants, animals and ecosystems bring significant economic benefits, are valuable to society and are globally important. Most importantly, the ways in which organisms interact with each other and their environment are important to human survival: we rely on ecosystems that function properly for clean air and water and healthy soil.”<sup>18</sup>

Accordingly, the two main indicators used to describe the state of biodiversity in Australia have been the numbers of extinct and threatened Australian birds and mammals, and the clearing of native vegetation.<sup>19</sup> Conservation covenants are but one form of encouraging the abatement of land clearing practices.

### **Land Clearing Practices**

Since the beginning of European settlement in Australia in 1788, land clearing, predominantly for agricultural purposes, was an accepted practice encouraged by

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<sup>11</sup> National Strategy for the Conservation of Australia’s Biological Diversity, Dept of the Environment, Sport and Territories, 1996, Ch 3,

<http://www.deh.gov.au/biodiversity/publications/strategy/chap3.html>> (accessed 15/7/04)

<sup>12</sup> In 2001, these were revised by the Commonwealth, New South Wales, Western Australian, South Australian, Victorian, and Australian Capital Territory governments in response to a progress report commissioned by ANZECC (The Australian and New Zealand Environment and Conservation Council), *Australian Commonwealth Government, National Objectives and Targets for Biodiversity Conservation 2001 – 2005*, p.5.

<sup>13</sup> Penelope Figgis, *Conservation on Private Lands: the Australian Experience*, IUCN, Gland, Switzerland and Cambridge, UK, 2004, p.6.

<sup>14</sup> *Ibid*, Figgis 2004, p.10.

<sup>15</sup> Australian Bureau of Statistics, *Measures of Australia’s Progress: The measures - The natural landscape*, 2004, p. 10,  
<http://www.abs.gov.au/Ausstats/abs@nsf/0/62C0CCADA5421F81CA256E7D0000264B?Open>> (accessed 15/9/05)

<sup>16</sup> *Ibid*, Australian Bureau of Statistics, 2004, p. 10.

<sup>17</sup> *Ibid*, Australian Bureau of Statistics, 2004, p. 10.

<sup>18</sup> *Ibid*, Australian Bureau of Statistics, 2004, p. 3.

<sup>19</sup> *Ibid*, Australian Bureau of Statistics, 2004, p. 3.

Australian governments through taxation incentives<sup>20</sup> and land purchase agreements, as well as being advised upon by government agricultural departments.<sup>21</sup> It was not until almost 200 years later that concern over the loss of native vegetation led those same governments to enact controls on land clearing practices.<sup>22</sup> However, in those 200 years, the National Land and Water Resources Audit of 2001 found that 20% of woodland and forest have been cleared or thinned, amounting to more than 700,000 square kilometres.<sup>23</sup> That same audit also found that 35% or 130,000 square kilometres of mallee bush was cleared, while 45% of heath and 10% of grasslands were cleared.<sup>24</sup> These statistics take on an even more alarming meaning when it is recognised that the highest levels of clearance have taken place in the most fertile areas in Australia resulting in the removal of 90% of vegetation in the eastern temperate zone.<sup>25</sup>

The impact of land clearing on the environment is significant. In a report of the Australian Bureau of Statistics it was noted:

“Land clearance is a key pressure on biodiversity, and an estimated 1,000 to 2,000 birds permanently lose their habitat for every 100 ha of woodland cleared. About 14% of Australia’s total greenhouse emissions are estimated to arise from land clearance (greenhouse gases are released from the burning and decay of vegetation and from the disturbance of soil which releases carbon). Clearing vegetation plays an important role in the spread of invasive species, land degradation and declining water quality (which are important to the environment and can impose costs upon the economy).”<sup>26</sup>

In the same report, the economic impact of land clearing was also noted such as the “costs associated with reduced flood control, the provision of potable water or increased salinity and soil erosion”.<sup>27</sup> It is no wonder that the 1990s saw the implementation of native vegetation acts in New South Wales, Queensland and South Australia in an attempt to control the clearing of native vegetation.<sup>28</sup>

Despite the steady decline in land clearing since 1991, with 40% less land being cleared in 2001 compared to 1991<sup>29</sup>, the greatest threat to Australia’s biodiversity is still said to be due to habitat destruction through land clearing.<sup>30</sup> Australia fares

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<sup>20</sup> Section 75A of the Income tax Assessment Act 1936 provided a specific incentive allowing for the deduction of costs associated with land clearing activities such as the destruction and removal of timber, scrub or undergrowth indigenous to the land which was to be used for agricultural purposes. This provision was repealed in 1983 removing the special deduction.

<sup>21</sup> Australian Bureau of Statistics, *Measuring Australia’s Progress: 2002*, The headline indicators – Land Clearance, p. 2, <http://www.abs.gov.au/Ausstats/abs@nsf/0/1C36C09104A4765ACA256BDC001223FE?Open> (accessed 15/9/05)

<sup>22</sup> *Ibid*, Australian Bureau of Statistics, 2002, p. 2.

<sup>23</sup> *Op. cit.*, n. 15, Australian Bureau of Statistics 2004, p. 7.

<sup>24</sup> *Ibid*, Australian Bureau of Statistics 2004, p. 7.

<sup>25</sup> *Ibid*, Australian Bureau of Statistics 2004, p. 7.

<sup>26</sup> *Op. cit.*, n. 20, Australian Bureau of Statistics 2002, p. 4.

<sup>27</sup> *Ibid*, Australian Bureau of Statistics 2002, p. 4.

<sup>28</sup> Recently, the New South Wales legislation was replaced by more stringent controls on clearing practices.

<sup>29</sup> *Op. cit.*, n. 15, Australian Bureau of Statistics 2004, p. 10.

<sup>30</sup> *Op. cit.*, n. 13, Figgis 2004, p. 1.

poorly on the world stage when considering deforestation figures. In 2003, figures revealed that Australia was clearing land at the rate of 500,000 hectares per year, comparable to the worst deforestation rates in Asia, South America and Africa.<sup>31</sup>

Figgis notes that “the vast majority of clearing has been occurring on private leasehold or freehold lands”.<sup>32</sup> This is no surprise considering the main reason for the clearing has been for agricultural purposes. When this is combined with the fact that about two thirds of Australia’s land is private leasehold or freehold land,<sup>33</sup> the importance of government and private landholders working together to achieve conservation goals becomes apparent.

## Managing the Environment

The *National Strategy* recognised the importance of conservation on privately held land and the need to provide appropriate incentives for conservation such as “appropriate market instruments and appropriate economic adjustments for owners and managers” of property requiring protection of significant biodiversity.<sup>34</sup> Further, the *National Strategy* specifically targets the issue of clearing native vegetation at Objective 3.2 requiring the establishment of “effective measures ... to retain and manage native vegetation, including controls on clearing”.<sup>35</sup> This objective became the first of the priority actions set in the *National Objectives and Targets for Biodiversity Conservation 2001-2005*.<sup>36</sup> Consequently, the land protected in nature conservation reserves has grown<sup>37</sup> and the participation of communities in redressing the loss of native vegetation has increased with the National Heritage Trust funding 4500 community landcare groups by 2003.<sup>38</sup>

The recognition of the need for government and private landholders to work together for the protection of Australia’s biodiversity is also made quite clearly in the *Environment Protection and Biodiversity Conservation Act 1999* (Cth). Section 3 (2)(g)(ii) of that Act promotes the need for “a partnership approach to environmental protection and biodiversity conservation through...conservation agreements with land-holders” in order for the objects of the Act to be achieved.

However, voluntary conservation agreements with private landholders have been in existence for many years. For example, since 1948, 1,651,839 hectares of land in New South Wales have been gazetted as wildlife refuges.<sup>39</sup> This voluntary scheme

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<sup>31</sup> Derived from United Nations and Australian figures, *ibid*, Figgis 2004, p. 1.

<sup>32</sup> *Ibid*, Figgis 2004, p. 1.

<sup>33</sup> *Op. cit.*, n. 15, Australian Bureau of Statistics 2004, p. 15.

<sup>34</sup> See Objective 1.5 Conservation outside protected areas, Action 1.5.1, National Strategy for the Conservation of Australia’s Biological Diversity, Dept of the Environment, Sport and Territories, 1996, Ch 1, <http://www.deh.gov.au/biodiversity/publications/strategy/chap3.html> > (accessed 15/7/04)

<sup>35</sup> *Ibid*, National Strategy 1996, Ch3, Objective 3.2.

<sup>36</sup> ANZECC (The Australian and New Zealand Environment and Conservation Council), *Australian Commonwealth Government, National Objectives and Targets for Biodiversity Conservation 2001 – 2005*, p.5.

<sup>37</sup> *Op. cit.*, n 15, Australian Bureau of Statistics 2004, p. 12, with the proportion of land in conservation reserves in 2002 being 54% in the Australian Capital Territory; 37 % in Tasmania; 26% in South Australia; 15% in Victoria; then dropping markedly down to 7% in New South Wales; 4% in Queensland; and 5% in the Northern Territory.

<sup>38</sup> *Ibid*, Australian Bureau of Statistics 2004, p. 15.

<sup>39</sup> *Op. cit.*, n 13, Figgis 2004, p. 15.

provides no certainty for conservation objectives as the ‘agreements’ can be changed or even revoked by the landholders.<sup>40</sup> In recent times, the *Land for Wildlife* scheme has developed throughout most states in Australia.<sup>41</sup> This voluntary scheme requires an agreement to be established for a specified period between a landholder and the relevant conservation agency.<sup>42</sup> The landholder is provided with some technical advice and support both through written materials and personal contact with extension officers who go into the field.<sup>43</sup>

Meanwhile, binding conservation agreements have been developing over time with the provision of vegetation management plans incorporating technical and management advice and, in certain circumstances, financial assistance to the land owner.<sup>44</sup> These have been refined and developed into a more sophisticated scheme under the new *Native Vegetation Act 2003* (NSW) providing a binding incentive scheme for the conservation of farm land incorporating access to financial grants for certified plans. Figgis notes the likely extension of this beyond the borders of New South Wales.<sup>45</sup> However, once again there is a fixed timeframe for such management plans.

Heritage Agreements in South Australia were the earliest form of conservation covenant in Australia, providing financial assistance, advice and local government rate relief to landholders in return for retaining and managing the native vegetation on the land in perpetuity.<sup>46</sup> Despite the uptake of various models of this covenant scheme throughout Australia, the South Australian community appears to have been the most committed to conservation on private land having concluded 1050 covenants covering over 550,000 hectares of land by 1998.<sup>47</sup> The remaining states and territories committed significantly less land to private conservation at that time.<sup>48</sup>

However, the conclusion of conservation covenants have been ever increasing throughout the nation allowing for detailed management plans to be established for the designated conservation area specified in the legally enforceable covenant registered on the title of the land.<sup>49</sup> Unlike the conservation agreements mentioned above, these covenants are binding on future owners of the land and so provide a significant contribution to native vegetation and habitat conservation in Australia. Conversely, these covenants also bring with them additional responsibilities and costs to the landholder, not to mention a loss of land use entitlements.<sup>50</sup> Where no financial assistance has been provided in consideration of the grant of the covenant, the landholder has effectively made a donation. This has been said to be akin to a

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<sup>40</sup> Ibid, Figgis 2004.

<sup>41</sup> Ibid, Figgis 2004.

<sup>42</sup> Ibid, Figgis 2004.

<sup>43</sup> Ibid, Figgis 2004, p. 16.

<sup>44</sup> Ibid, Figgis 2004, p. 16.

<sup>45</sup> Ibid, Figgis 2004, p. 16.

<sup>46</sup> See s.34 of the *Heritage Act 1985* (S.A.), see also the *Native Vegetation Act 1991* (S.A.)

<sup>47</sup> Carl Binning and Mike Young, *Talking to the Taxman about Nature Conservation: Proposals for the introduction of tax incentives for the protection of high conservation value native vegetation*, National R&D Program on Rehabilitation, Management and Conservation for Remnant Vegetation, Research Report 4/99, Environment Australia, Canberra, 1999, p. 50.

<sup>48</sup> Ibid, Binning and Young 1999, p. 50.

<sup>49</sup> Op. cit., n 13, Figgis 2004, p.18.

<sup>50</sup> Op. cit., n 45, Binning and Young 1999, p. 34.

charitable gift.<sup>51</sup> It is this analysis that led to the introduction of the conservation covenant tax incentive to be discussed below. However, the land owner does receive assistance in addition to the availability of tax incentives. For example, local government rate relief may be available.<sup>52</sup> Further, covenant scheme providers can provide the land owner with specialist technical advice and even assistance with management costs such as for fencing, or assistance with pest control and revegetation works.<sup>53</sup> The level of assistance will vary between covenant scheme providers depending on the level of services available and the extent of their budgets.<sup>54</sup>

## **Taxation Incentives for Conservation Covenants**

There are two forms of federal taxation relief for conservation covenants that have been introduced in the past 3-4 years in Australia. One is the provision of a taxation deduction equal to the amount by which the land has been devalued by the creation of the covenant and the other is concerned with the impact of such a covenant on the capital gains tax provisions.

The *Supplementary Explanatory Memorandum* to the amending legislation attributes the introduction of the special deduction for conservation covenants to the *Prime Minister's Community-Business Partnership* recommendations of tax incentives to encourage conservation and philanthropy announced by the Prime Minister on 20 August 2001.<sup>55</sup> The capital gains tax (CGT) rules were amended "to ensure that land owners who enter into conservation covenants over their land are not disadvantaged compared with taxpayers who sell their land".<sup>56</sup>

However, such tax concessions for conservation covenants were the subject of a 1999 report to Environment Australia evaluating proposals for the introduction of tax incentives for the conservation of native vegetation.<sup>57</sup> In that report Binning and Young note that

"Well-targeted incentives may have a greater effect on the behaviour of landholders than grants of an equivalent size"<sup>58</sup>

This is due to the availability and certainty of the tax incentive over the grant. With a tax incentive it must be available to all landholders while grants must be applied for and are often at the discretion of a regulatory body.<sup>59</sup> However, the regime recommended does not absorb the entire cost of entering into and maintaining a

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<sup>51</sup> Ibid, Binning and Young 1999, p. 34.

<sup>52</sup> Department of Environment and Heritage, *Covenants for Conservation*, Commonwealth of Australia 2004 (brochure).

<sup>53</sup> Ibid, Department of Environment and Heritage 2004.

<sup>54</sup> Ibid, Department of Environment and Heritage 2004.

<sup>55</sup> Supplementary Explanatory Memorandum to *Taxation Laws Amendment Bill (No. 2) 2001 Taxation Laws Amendment Act (No. 2) 2001*, ¶1.15.

<sup>56</sup> Ibid, Supplementary Explanatory Memorandum, ¶1.27, first announced by the government through the Treasurers Press Release No. 44 of 15 June 2001.

<sup>57</sup> Op. cit., n 45, Binning and Young 1999.

<sup>58</sup> Ibid, Binning and Young 1999, p. 20.

<sup>59</sup> Ibid, Binning and Young 1999, p. 20.

conservation covenant.<sup>60</sup> There is a significant investment on the part of the landholder. The tax incentive provides “an efficient cost-sharing mechanism”, hence the partnership between government and private landholder.<sup>61</sup>

To qualify for the federal tax incentives the conservation covenant over land must comply with three requirements. Firstly, the whole purpose of the covenant is to maintain the environmental value of the land. Accordingly, the covenant must restrict or prohibit certain activities on the land that could degrade that environmental value.<sup>62</sup> Secondly, the covenant must run with the land, hence it should be registered on the title to the land (where possible) to ensure its permanency.<sup>63</sup> Thirdly, the Minister for the Environment and heritage must have either approved in writing the covenant itself or approved in writing the program under which the covenant is entered.<sup>64</sup>

Conservation covenants entered into on or after 1 July 2002 attract a tax deduction under the provisions of Division 31 ITAA97. However, in order for a taxpayer to qualify for this tax deduction, they must be the owner of the land and the conditions in subsection 31-5(2) ITAA97 must be met.<sup>65</sup> The shortcoming of this provision is the restriction to land owners, thereby disadvantaging the large farm leaseholders. However, when one considers the nature of the conditions in subsection 31-5(2) ITAA97 together with the definition of a conservation covenant in subsection 31-5(5) ITAA97, it becomes apparent that the leaseholder cannot meet those conditions.

The conditions to be met under subsection 31-5(2) ITAA97 reinforce the cost-sharing nature of this partnership between the private land owner and the government. The land owner is permanently affecting their land through a perpetual covenant which places restrictions on use of the part of the land subject to the covenant.<sup>66</sup> In addition, no “money, property or other material benefit” must have been received by the land owner for entering into the covenant.<sup>67</sup> Further, the land owner must have sustained a reduction in the market value of the land greater than \$5000 due to entering into the covenant.<sup>68</sup> If a lesser reduction has been sustained, the land owner will not qualify for the deduction unless the covenant was entered into within 12 months of the owner entering into the contract for the purchase of the land.<sup>69</sup> Finally, the covenant must have been entered into with one of the levels of government, an appropriate governmental authority, or “a fund, authority or institution” that qualifies under the rules for deductible gift recipients found in Subdivision 30-B ITAA97.<sup>70</sup>

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<sup>60</sup> Ibid, Binning and Young 1999, p. 20.

<sup>61</sup> Ibid, Binning and Young 1999, p. 20.

<sup>62</sup> Subsection 31-5(5), *Income Tax Assessment Act 1997 (Cth)*.

<sup>63</sup> Subsection 31-5(5), *Income Tax Assessment Act 1997 (Cth)*.

<sup>64</sup> Subsection 31-5(5), *Income Tax Assessment Act 1997 (Cth)*.

<sup>65</sup> Subsection 31-5(1), *Income Tax Assessment Act 1997 (Cth)*.

<sup>66</sup> Subsection 31-5(2)(a), *Income Tax Assessment Act 1997 (Cth)*. Subsection 31-5(4) notes that “For the purposes of paragraph (2)(a), a covenant is treated as being perpetual even if a Minister of a State or Territory has a power to rescind it”.

<sup>67</sup> Subsection 31-5(2)(b), *Income Tax Assessment Act 1997 (Cth)*.

<sup>68</sup> Subsection 31-5(2)(c) & (d), *Income Tax Assessment Act 1997 (Cth)*.

<sup>69</sup> Subsection 31-5(2)(d), *Income Tax Assessment Act 1997 (Cth)*.

<sup>70</sup> Subsection 31-5(2)(e), *Income Tax Assessment Act 1997 (Cth)*. Section 31-10 *Income Tax Assessment Act 1997 (Cth)* sets out the requirements for such funds, authorities and institutions.



The amount available for deduction under section 31-5 ITAA97 is determined by calculating the difference between the market value of the land immediate before entering into the covenant and immediately after.<sup>71</sup> If there is a decrease in the market value and that decrease is attributable to entering into the covenant then a deduction equal to the amount of the decrease is available.<sup>72</sup> The landowner could choose to spread the deductions over up to 5 years electing the percentage to be deductible in each year.<sup>73</sup>

Market value generally needs to be determined independently and by appropriately qualified individuals. In most other circumstances when market value is being determined for taxation purposes, obtaining valuation reports from registered valuers is common practice. For the purposes of the conservation covenant deduction, subsection 31-15(1) ITAA97 requires that the valuation of the change in market value of the land must be sought from the Commissioner of Taxation. This is qualified in an Australia Taxation Office fact sheet to mean that the valuation is arranged through the Australian Valuation Office allowing for an appropriate fee to be charged, which in turn could be claimed as a tax deduction.<sup>74</sup>

Concessional capital gains tax (CGT) treatment may be available to land owners who have received capital proceeds for entering into a conservation covenant.<sup>75</sup> The gain is classified as CGT event D4<sup>76</sup> and the time of the event is the time at which the covenant was entered.<sup>77</sup> As mentioned earlier, the concessions are aimed at providing comparable treatment with land owners who sell part of their land. A capital gain occurs where the proceeds from entering into the covenant exceed that part of the cost base of the land attributable to the covenant. However, if the proceeds are less than the attributable cost base, a capital loss occurs.<sup>78</sup>

Where the land owner complied with the requirements of Division 31 and qualified for the tax deduction under that division, no payment would have been received for the granting of the conservation covenant. In that instance the capital proceeds for the purposes of the concessional CGT treatment are usually the amount allowed as a deduction under sec 31-5 ITAA97.<sup>79</sup> This is an interesting requirement, particularly when one recognises that the value of a deduction to a taxpayer in net terms is less than an actual payment made for the CGT event. However, when combined with the fact that the deduction allowed under Division 31 would not normally be allowed under the general deduction provisions, and certainly not allowed to a taxpayer who is paid for the conservation covenant, the disparity becomes moot.

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<sup>71</sup> Subsection 31-5(3), *Income Tax Assessment Act 1997 (Cth)*.

<sup>72</sup> Provided that the decrease is greater than \$5000 or the covenant was entered into within 12 months of the owner entering into the contract for the purchase of the land.

<sup>73</sup> Section 30-249G & section 30 -249H, *Income Tax Assessment Act 1997 (Cth)*.

<sup>74</sup> This is also in compliance with subsection 31-15(2) *Income Tax Assessment Act 1997 (Cth)*.

<sup>75</sup> Section 104-47, *Income Tax Assessment Act 1997 (Cth)*.

<sup>76</sup> Subsection 104-47(1), *Income Tax Assessment Act 1997 (Cth)*.

<sup>77</sup> Subsection 104-47(2), *Income Tax Assessment Act 1997 (Cth)*.

<sup>78</sup> Subsection 104-47(3), *Income Tax Assessment Act 1997 (Cth)*.

<sup>79</sup> Section 116-105, *Income Tax Assessment Act 1997 (Cth)*. It should be noted that under 104-47(6):

“\*CGT event D4 does not happen if:

- (a) you did not receive any \*capital proceeds for entering into the covenant; and
- (b) you cannot deduct an amount under Division 31 for entering into the covenant.”

However, CGT event D1 is stipulated to apply under those circumstances.

In calculating the capital gains tax applicable to the establishment of the conservation covenant, the cost base for the covenant is determined in accordance with the following provision in ITAA97:

104-47(4) The part of the \*cost base of the land that is apportioned to the covenant is worked out in this way:

$$\begin{array}{r} \text{*Cost base of land} \quad \times \quad \frac{\text{*Capital proceeds from entering into the covenant}}{\text{Those capital proceeds plus the *market value of the land just after you enter into the covenant}} \end{array}$$

The part of the \*reduced cost base of the land that is apportioned to the covenant is worked out similarly.

The capital gain is therefore the difference between the proceeds and the cost base of the covenant. The tax payable depends on whether the land owner is able to take advantage of the CGT discount and the small business CGT concessions. In addition, if the land on which the covenant is placed was acquired by the land owner before 20 September 1985, the land owner can claim the pre-CGT exemption and pay no capital gains tax.<sup>80</sup>

The legislation provides the following example to illustrate the operation of section 104-47 ITAA97:

Lisa receives \$10,000 for entering into a conservation covenant that covers 15% of the land she owns. Lisa uses the following figures in calculating the cost base of the land that is apportioned to the covenant:

The cost base of the entire land is \$200,000.

The market value of the entire land before entering into the covenant is \$300,000, and its market value after entering into the covenant is \$285,000.

Lisa calculates the cost base of the land that is apportioned to the covenant to be:

$$\$200,000 \times 10,000 \div [10,000 + 285,000] = \$6,780$$

This means that the capital gain made by Lisa in the above scenario is \$10,000 less \$6,780 providing a capital gain of \$3,220. However, if Lisa did not receive \$10,000 for entering into the covenant but instead qualified for the deduction under Division 31 ITAA97, that deduction would be calculated using the market value of the land before and after the covenant, that is, \$300,000 less \$285,000, providing a deduction of \$15,000. The capital gain in this scenario would then require a re-calculation of the cost base for the covenant and the new capital gain as follows:

The cost base of the land that is apportioned for the covenant:  
 $\$200,000 \times 15,000 \div [15,000 + 285,000] = \$10,000$

The capital gain in relation to the covenant:  $(\$15,000 - \$10,000) = \$5,000$ .

<sup>80</sup> Subsection 104-47(7), *Income Tax Assessment Act 1997 (Cth)*.

However, Lisa would be entitled to use the CGT discount if she held the land for more than 12 months thereby reducing the capital gain by one half. This capital gain must be brought to tax in the income year that the covenant is entered into. However, Lisa may choose to spread out her deduction under Division 31 for up to 5 years. Clearly, the ability to invoke the operation of Division 31 in conjunction with the capital gains provision for conservation covenants provides a significant incentive to commit to permanent conservation management practices. However, one must keep in mind that the incentive is shortlived while the obligation to conserve the biodiversity on the land affected is perpetual.

### **Conservation Covenanting Programs**

Before a covenant satisfies the requirements of Division 31, an application must be submitted for approval either to the Minister for the Environment and Heritage or to an organisation whose conservation covenanting program has been approved by the Minister.<sup>81</sup> Approvals for conservation covenanting programs are for a three year period and must undergo a review of the operation of the program for the approval to be renewed.<sup>82</sup> When, in turn, providing approvals of conservation covenant applications, the organisation operating the approved program should establish either an advisory board, technical committee or expert panel to assess such applications.<sup>83</sup>

For an organisation to obtain approval for their conservation covenanting program a significant amount of work is required. In their application, the organisation must provide a copy of their “conservation covenanting charter, examples of a conservation covenant, plan of management, and any relevant templates or other supporting documentation...[such as a] stewardship program”.<sup>84</sup> This is in addition to preparing a submission addressing the *Guidelines for approval of a conservation covenanting program* (the Guidelines).<sup>85</sup>

There are eight guidelines to be addressed by an organisation seeking approval of the conservation covenanting program.<sup>86</sup> These guidelines effectively set out the parameters of the conservation covenants. The first is the establishment of the main objectives of the program, namely, “to permanently protect, conserve and manage environmental values, through the use of a conservation covenanting instrument”<sup>87</sup>. Identifying environmental values requires a consideration of current environmental policy in the national and regional context. Specifically, the Guidelines focus on “native vegetation, biodiversity, terrestrial ecosystems, or native habitat with important conservation priority”.<sup>88</sup> Simultaneously, these environmental values must be of high quality or significance.<sup>89</sup> The Guidelines provide a number of factors for

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<sup>81</sup> Subsection 31-5(5), *Income Tax Assessment Act 1997 (Cth)*.

<sup>82</sup> Department of the Environment and Heritage, *Conservation covenanting programs and the Income tax Assessment Act 1997*, Commonwealth of Australia 2005, p.1, <http://www.deh.gov.au/biodiversity/incentives/covenants-guidelines.html>> (accessed, 3/09/2005).

<sup>83</sup> Ibid, Department of the Environment and Heritage 2005, p. 2.

<sup>84</sup> Ibid, Department of the Environment and Heritage 2005, p. 1.

<sup>85</sup> Ibid, Department of the Environment and Heritage 2005, p. 1.

<sup>86</sup> Ibid, Department of the Environment and Heritage 2005, p. 2.

<sup>87</sup> Ibid, Department of the Environment and Heritage 2005, p. 2.

<sup>88</sup> Ibid, Department of the Environment and Heritage 2005, p. 3.

<sup>89</sup> Ibid, Department of the Environment and Heritage 2005, p. 3.

consideration on a case-by-case basis in determining whether the environmental values, the subject of a proposed covenant, attain such standing.<sup>90</sup> This demonstrates the selectiveness of conservation covenanting programs and therefore the potential fastidiousness of the Division 31 tax deduction for conservation covenants.

The second guideline requires the organisation to elaborate on how the permanency of conservation covenants will be arranged within its program including the need to arrange for their registration on title in order to comply with section 31-5 ITAA97.<sup>91</sup> Meanwhile, the third guideline focuses on the administering body, its ability for longevity and its pro-activeness in obtaining conservation covenants from landholders with high conservation value areas on their land.<sup>92</sup> The fourth guideline requires a demonstration of the ability for the conservation covenant instrument to comply with section 31-5(5)(a) ITAA97, namely, “restrict or prohibit ... activities on the land that could degrade the environmental values identified”.<sup>93</sup>

The management of the land the subject of the conservation covenant is dealt with in guidelines five and six. A plan of management is required to be formulated either contemporaneously with the negotiation of the covenant or within six months of having lodged the covenant for approval.<sup>94</sup> Management actions must be set out in the plan and must be binding on the land owner and even the administering body.<sup>95</sup> Allowable non-conservation related activities can also be specified in the management plan.<sup>96</sup> Meanwhile a change in ownership of the land triggers a review of the management plan but at the very least a review must take place every five years.<sup>97</sup> The stewardship program establishes the process under which the administering body will provide ongoing assistance to the land owner.<sup>98</sup> Such assistance may include periodic visits, provision of management and technical assistance, monitoring compliance with the management plan and assisting when management problems arise, including the provision of financial assistance for specific management actions.<sup>99</sup>

Monitoring and compliance strategies are required to be established by the administering body under guideline seven.<sup>100</sup> The purpose is to ensure that the terms and conditions of the conservation covenants and the plan of management are being adhered to and to provide mechanisms to secure compliance or remedy a default.<sup>101</sup> In addition, guideline eight requires the organisation to describe the circumstances in which a conservation covenant may be terminated or varied.<sup>102</sup> However, it is noted that such action should only occur in exceptional circumstances otherwise the

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<sup>90</sup> Ibid, Department of the Environment and Heritage 2005, p. 3.

<sup>91</sup> Ibid, Department of the Environment and Heritage 2005, pp. 3-4.

<sup>92</sup> Ibid, Department of the Environment and Heritage 2005, p. 4.

<sup>93</sup> Ibid, Department of the Environment and Heritage 2005, p. 4.

<sup>94</sup> Ibid, Department of the Environment and Heritage 2005, p. 4, Guideline 5.

<sup>95</sup> Ibid, Department of the Environment and Heritage 2005, p. 4, Guideline 5.

<sup>96</sup> Ibid, Department of the Environment and Heritage 2005, p. 4, Guideline 5.

<sup>97</sup> Ibid, Department of the Environment and Heritage 2005, p. 4, Guideline 5.

<sup>98</sup> Ibid, Department of the Environment and Heritage 2005, p. 4, Guideline 6.

<sup>99</sup> Ibid, Department of the Environment and Heritage 2005, p. 4, Guideline 6.

<sup>100</sup> Ibid, Department of the Environment and Heritage 2005, p. 5, Guideline 7.

<sup>101</sup> Ibid, Department of the Environment and Heritage 2005, p. 5, Guideline 7.

<sup>102</sup> Ibid, Department of the Environment and Heritage 2005, p. 5, Guideline 8.

permanency of the covenant and ultimately the effectiveness of the program come into question.<sup>103</sup>

These eight guidelines clearly demonstrate a positive reinforcement of environmental goals through the interaction between environmental policy and taxation incentives. The command and control measures in place to abate land clearing practices together with the positive schemes developed for the conservation of remaining native vegetation are surely assisted by the carefully targeted tax incentives for conservation covenants. It is a recognition of the important role played by private landholders in conserving what is left of Australia's biodiversity as well as recognising that some form of financial assistance is necessary to this end. The choice of tax concession over a grant scheme is made evident by Binning and Young above who also point out that a philanthropic market requires encouragement through adequate tax incentives.<sup>104</sup>

## **Conclusion**

This paper has demonstrated the need for a partnership between government and private land owners in order for Australia to achieve its international biodiversity obligations under the key instrument, the Convention on Biological Diversity, 1992. This partnership has been assisted by the use of a tax concession or subsidy recognising the philanthropic donation of environmentally valuable land into approved schemes for conservation management. Although the initiative is a subsidy contrary to the polluter pays principle, the subsidy is limited in effect while the covenant scheme conserving biodiversity is perpetual.

The effect seems to reinforce the importance of economic incentives working together with environmental regulations to ensure the necessary investment in environmental measures, in this instance, primarily by the agriculture industry. The operation of the conservation covenant program is a good illustration of the mutual reinforcement that can be achieved when bringing together environmental laws with tax laws.

The question arises as to the success of the program. Conservation covenanting programs predate the tax concessions recently implemented and have displayed a limited uptake in States where they are most needed. The Australian Bureau of Statistics has shown that there is a steady increase in conservation covenants nationally but what is required now is a correlation between the number of covenants entered into and the uptake of the tax concessions available.

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<sup>103</sup> Ibid, Department of the Environment and Heritage 2005, p. 5, Guideline 8.

<sup>104</sup> Op. cit., n 45, Binning and Young 1999, p.20.