



Plantations and Tax

The majority (around 90%) of investment in new plantations in Australia each year now comes from private investors. State governments have largely withdrawn from establishing new plantations, and are focussing on re-planting harvested areas. Managed Investment Schemes (MIS) are funding most of the new investment, and are often incorrectly criticised for getting tax advantages not available to other businesses.

Key messages

- Investors in MIS forestry do not receive a tax subsidy or a special tax advantage not available to other enterprises.
- Like all Australian businesses, MIS investors, MIS companies and non-MIS private plantation growers can claim 100% of their eligible expenditure as a tax deduction in the year they incur the expenditure.
- MIS and non-MIS plantation investors alike pay tax on their forestry investment income at their marginal tax rate.
- MIS companies pay tax on their net income at the company tax rate.
- Australian plantation expansion is now largely reliant upon private investment.

The Australian system is unique

All other countries with well-established or expanding plantation estates encourage plantation investment by using some combination of subsidies, grants, bounties, concessionary loans or special tax incentives.

Australia is different. Here, expenditure on plantation establishment is a legitimate tax deduction under the general businesses deductions provisions, contained in section 8-1 of the *Income Tax Assessment Act 1997*.

This situation means that eligible plantation establishment and management costs are tax deductible, in the same way that eligible costs can be deducted from gross income by all Australian businesses – farmers, newsagents, builders, dentists, service stations, shoe shops, accountants, and so on.



Plantation costs such as seedlings are an eligible deductible expense

How are plantation investments made?

There are four main avenues whereby new plantation investments are made in Australia:

1. The Do-it-Yourself (DIY) model, where landowners use their own or borrowed funds to establish plantations. These are typically small scale operations, often farm forestry integrated with other farming operations;
2. Taxpayer investment – state governments use funds from their resources to establish new plantations or to replant recently harvested plantations;
3. Managed investment schemes – the investors pay into a pool of project funds and the MIS company establishes, manages, harvests and markets the wood on behalf of the investors;
4. Non-MIS plantation companies establish plantations (often large-scale) on behalf of other large investors (eg. superannuation companies), or in their own right.



MIS plantations represent 90% of new plantation investment

New tax arrangements for MIS forestry

In June 2007, the Federal Parliament converted this same basic principle under the general business deduction provisions into a specific statutory deduction (Division 394 of *ITAA 1997*) specifically for MIS forestry.



For MIS forestry investors to obtain a tax deduction, at least 70% of their funds must be classified as 'direct forestry expenditure', such as tree pruning

Although the investors no longer need to be carrying on a business under the statutory arrangement, they are still entitled to deduct their expenditure in the MIS project from any other income they make in the year they incur the expenditure over the life of the project. However, three qualifying conditions must now be met for investors to secure and retain the tax deduction under this new arrangement.

1. At least 70% of the pool of investment funds must be spent by the MIS forestry company on 'direct forestry expenditure' – meaning it is spent on plantation establishment, management and harvesting operations. Commissions to financial advisors, marketing costs, and general business overheads are specifically excluded from the '70% test';
2. The trees must be established within 18 months of the end of the financial year in which the investors make their investment;
3. The initial investor must remain in the MIS forestry project for at least four years before selling their interest to another investor.

Farm versus forestry taxation – Is it fair?

Some people wrongly claim that forestry investors, in particular those who invest through an MIS project, receive an unfair tax advantage. The facts of the matter in relation to a number of key taxation issues are as follows:

- Farm businesses, private forest growers, MIS forestry investors and the MIS forestry company can all deduct management, rent and lease costs from their income;
- Farm businesses, private forest growers, MIS forestry investors and the MIS forestry company all pay income tax on any profits;
- Farm businesses have access to tax-smoothing instruments such as Farm Management Deposits and income averaging, which can reduce or even out the tax they pay each year. The MIS forestry investor and MIS forestry company cannot use these instruments, and may face a large tax bill at tree harvest (the investor), or at the start of project when investor funds are received;
- Pre-payment provisions apply to all four groups of taxpayers. The MIS forestry investor can claim a deduction in the year of investment, even though the plantation work may be carried out over future years. The farm business can claim a deduction for the full cost of work (eg. contractor services) if work is carried out in the next 12 months, or a portion of the cost in each year if the work is carried out over several years;
- None of the groups obtain a tax subsidy for land purchase;
- MIS forestry investor funds are largely used to pay company employees, local contractors, and local suppliers of goods and services, and so become taxable income in the hands of these people.

Figure 1 illustrates the tax payable by a grazing farm generating a taxable income of \$50,000 per year, and an MIS investor with taxable income of \$50,000 who purchases a 2 ha woodlot .

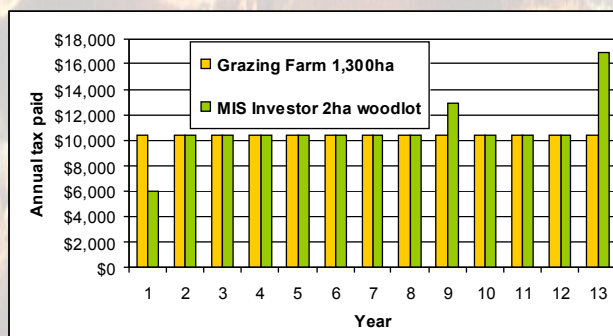
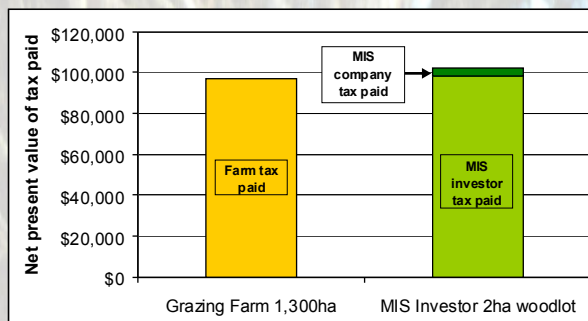


Figure 1. Tax paid comparison – farm and MIS investment



The second chart in Figure 1 shows that over the 13 year period, when the company tax paid by the MIS firm is included, the total tax paid by the MIS investment entity is actually slightly higher than for the grazing farm.

MIS is currently enabling forestry investment and employment to continue

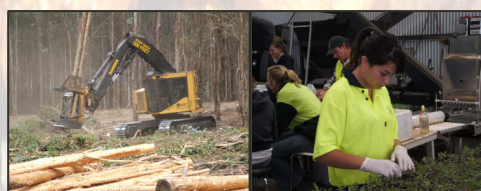
Regional Forest Agreements and the conversion of large areas of production native forest into national parks and reserves have seen a significant contraction of native forestry investment and employment in many parts of regional Australia.

Partly offsetting this has been investment in new plantations, at a rate of about 73,000 ha per annum. Around 90% of this investment comes from MIS forestry, which at the end of 2008 accounted for around 700,000 ha or more than a third of the 1.9 million ha national plantation estate.

Increasingly, new MIS plantations are growing the future wood resource for the undersupplied domestic solid wood market.

Many MIS forestry companies are now vertically integrated, meaning they are investing in downstream wood processing and marketing facilities as well as growing the trees for their investors. Examples include investments in woodchip mill and port facilities in Albany and Bunbury in Western Australia, a new high-tech sawmill in Tasmania and a softwood mill and treatment plant at Bombala in NSW.

Plantation forestry and associated timber processing operations are one of just a very few primary production sectors that are expanding in regional Australia, bringing new investment and jobs.



The plantation industry in Albany is generating new jobs for young people

References.

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