

# Federal tax provisions — a comparison of farming and forestry

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In the past eight years, the public debate about the expansion of timber plantations funded and managed as forestry managed investment schemes (MIS) has seen a number of factually wrong or at best misleading assertions made about the tax provisions that apply to these schemes.

Despite being an easy target, tax is not the villain some commentators make it out to be. No proper objective analysis can substantiate the often-repeated assertions of ‘taxpayer funds that would otherwise be spent on roads, schools and hospitals’, or of ‘tax subsidies’ and ‘unfair tax breaks’.

Articles published elsewhere provide detailed explanations of why these assertions misrepresent the real situation. (For example, see *MIS forestry will shape Australia’s future wood potential*, in Australian Farm Journal, March 2009, pp 42-45.)

The **attached** two-page table has been prepared to help demonstrate why it is misleading to claim that MIS forestry enjoys ‘unfair tax breaks’ or ‘special tax advantages not available to other primary production enterprises’. The table compares the tax treatments of private forest growers, MIS forestry investors, MIS forestry companies and non-forestry primary production.

Different tax arrangements are put in place for specific and rational policy reasons, not the least of which are the pursuit of consistency with the fundamental tax policy concepts of efficiency, equity and simplicity, the correction of market failures, and Government determinations to influence consumption and investment patterns throughout the economy. Consequently, knowing the Government’s policy intent is important to understanding the significance of any particular tax provision.

The table indicates that the diverse complex of tax provisions available to different primary production sectors tend to balance each other out and leave no sector with a special overall tax advantage that is not in place for good policy reasons.

An important qualification applies to the ‘Notional farm’ column in the table. Clearly, there is no such thing as a ‘typical farm’ in Australia. Widely diverse business and ownership structures, enterprise combinations and scales of operation mean that not all of the listed tax provisions will apply to all farms, and the table should be read with that in mind.

One example is that income averaging, Farm Management Deposits (FMDs) and the non-commercial loss provisions apply only to sole traders and partnerships, not to company structures, and also have a number of eligibility thresholds. Other examples, which have legitimately been excluded from the table, include the special provisions relating to double wool clips, insurance recoveries for livestock and timber losses, and forced disposal or compulsory destruction of livestock.

One of the terms used in the table warrants some explanation.

**Period inequity** is the term used to describe the different tax impacts of lump-sum income compared to annual income. Period inequity is inherent in a plantation forestry enterprise, which offers one to three income events spread over periods of from ten to 25 years. Because most of the income in large income events (commercial thinning harvests and final clearfall harvest) is taxed at the forest grower’s highest marginal tax rate, it can be seen that, subject to the taxpayer’s individual circumstances, more income tax is likely to be paid on a plantation forestry enterprise than if the same total amount of income was received annually—as with the most livestock, cropping and horticultural enterprises.

Constraints of space prevented more detailed explanations of the various tax arrangements listed in the table. Readers are referred to the relevant parts of the tax laws and rulings, which can be accessed via the ATO website, [www.ato.gov.au](http://www.ato.gov.au).

*Although the table was prepared in consultation with the Treasury and the Australian Taxation Office (ATO), the authors take responsibility for the content and presentation.*

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## Comparative tax treatments for farming, private forestry and investment forestry (2 pp)

<i>Item</i>	<i>'Notional farm'</i>	<i>Private forest grower</i>	<i>Forestry MIS investor</i>	<i>Forestry MIS manager</i>
1. Management, rent & lease costs 100% deductible in the year incurred by farmer, investor or manager?	Yes — General business deduction under section 8-1 of <i>Income Tax Assessment Act 1997</i> (ITAA 1997)	Yes — General business deduction under section 8-1 of <i>ITAA 1997</i>	Yes, but conditional (↓) — Statutory deduction under Div 394 of <i>ITAA 1997</i> — <i>Manager must prove the project passes the '70% DFE test' before investors can claim deduction</i>	Yes — General business deduction under section 8-1 of <i>ITAA 1997</i> — Note the statutory requirement to bring forward company tax (see under #5 below)
2. Income tax paid on profits? (Excl. very specific provisions, eg, double wool clips)	Yes — Tax planning common via family trusts and companies	Yes — Tax planning as for farms	Yes — At personal marginal tax rate — Tax planning through MIS — Family trusts rarely used	Yes — At company tax rate
3. Suffer from 'lumpy returns' and 'period inequity'?	Moderate — Annual returns variable, but lumpiness not 'inherent' — No period inequity (see #4)	High — Lumpiness + period inequity — 1 to 3 income events over 10 to 25 years	High — Lumpiness + period inequity — 1 to 3 income events over 10 to 25 years	Not really — Management of numerous projects is ongoing
4. Can access 'tax smoothing'?	Yes (for eligible farms) — Primary production income averaging — FMDs	Yes (technically, if eligible) No (in practice) — Large tax bill at harvest with no capacity to spread	No — Large tax bill at harvest, with no capacity to spread	No
5. Taxed on gross proceeds?	No — Tax paid on profits	No — Tax paid on profits	No — Tax paid on profits	Yes (section 15-46 of <i>ITAA 1997</i> ) — Manager must bring forward company tax on gross funds collected to match the year investors claim deductions — Only offset in future years
6. Must seek Commissioner's discretion under non-commercial loss law (Div 35)?	No — Small part-time farms only	Yes — Inherent in private forestry	N/a under the new Div 394 — But necessary under section 8-1 arrangements	N/a under the new Div 394 — But necessary under section 8-1 arrangements

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7. Can access CGT small business concessions?	Yes — If pass eligibility tests	Yes — If pass eligibility tests	No — Not 'carrying on a business' under Div 394	No — Not a 'small business'
8. Do prepayment provisions apply?	Yes — 12-month prepayment period if a small business (turnover <\$2m/year) — Or, standard provisions, claimable over the lesser of 10 years or life of prepayment	Yes — As for farm (←)	Yes — Statutory deduction in year investor pays, but limited by tax symmetry (→) — Provides no additional 'incentive'	Yes — Standard provisions only — Investors' prepayment is limited by manager's 'bring-forward' of company tax on gross funds collected (see #5 above)
9. Tax subsidy for land purchase?	No	No	No	No
10. Depreciation of other capital expenditure?	Yes	Yes	N/a — Statutory deduction	Yes
11. Can access landcare and water infrastructure capital write-offs?	Yes — Eligible landcare and water infrastructure	Yes — Eligible landcare and water infrastructure	N/a — Statutory deduction	Yes — Eligible landcare operations — Water conservation unclear
12. Subject to special compliance obligations ? (Excl standard ATO review and audit)	Yes (for some farms) — eg Div 35: Commissioner's discretion — FMDs	Yes — Div 35: Commissioner's discretion (see #6 above)	Yes — Dev 35: Commissioner's discretion — (Also see →)	Yes — Several ATO laws and rulings — Corporations Act and ASIC regulation — Frequent audits