

TIMBER PLANTATIONS AND MANAGED INVESTMENT SCHEMES... ESSENTIAL TAX BASICS

Produced by Australian Forest Growers (AFG)
and its special interest branch, Treefarm Investment Managers Australia (TIMA)

(in consultation with Commonwealth Treasury Business Tax Division, Australian Taxation Office and tax consultants KPMG)

Contact: Alan Cummine, Ph: 02 6162 9000, Fax: 02 6285 3855, Mob: 0407 488 927, email: alan.cummine@afg.asn.au

February 2005

*Timber plantations are sometimes **incorrectly** perceived to be the beneficiaries of 'incentives' or 'subsidies' through the Australian taxation system.*

*Consequently, the tax treatment of plantation forestry is also sometimes **incorrectly** targeted as the direct cause of land use change associated with plantation establishment on cleared agricultural land.*

Such a view misunderstands the application of Australian tax law allowing the deduction of legitimate expenditure incurred in conducting business activity to generate future profit.

Plantation establishment and management does not receive special tax incentives or subsidies. Plantation forestry operates under the same basic tax regime as other agricultural enterprises – that is, deductions are available for claimable business expenditure, and tax is paid on the profit from the enterprise.

This information sheet explains the tax treatment of plantation forestry and the managed investment scheme (MIS) structure through which most new plantation establishment is currently financed. The MIS structure has proven to be the most effective way of attracting private investment into new timber plantations to make up for the reduction in government-funded plantation expansion and the diminishing access to natural forest for harvest.

Essential facts about tax and plantations

- **People involved in growing timber plantations for future profit are carrying on a business of primary production, and expect to pay tax on that profit when it arises.**
- Unless classified as a prepayment (a very specific situation), **all non-capital costs of establishing, managing and harvesting a timber plantation and transporting its produce are business expenses, deductible against a taxpayer's total income in the year they are incurred** (Tax Ruling TR 95/6). This standard business tax measure applies to **all** classes of primary production, not just plantations.
 - In other words, it is the same entitlement that farmers have to claim the expenses of running their grazing, dairying and cropping enterprises.
 - **Growers can never claim capital costs, such as those relating to the purchase of land, as a business tax deduction.**
- Because of the nature of growing a forest crop, **by far the biggest proportion of tax-deductible expenditure in a plantation cycle occurs in the establishment years (i.e. years one and two)**, with much lesser costs also arising at significant intervals over the life of the plantation.
- Establishing and growing timber plantations naturally involves **a substantial time lag between commencing business and realising the profit from harvest**. This is the fundamental difference from other agricultural businesses. After waiting between, say, ten years (pulpwood) and twenty five years (sawlog) to receive income from the final harvest, a plantation grower then receives harvest income which is **taxed according to the grower's individual income status at that time**. For some growers, depending on circumstances, this once-only tax liability may be substantial, and may be somewhat higher than that of a primary producer receiving the equivalent total income but in annual instalments instead.
- Because of the specific eligibility rules applying to income averaging and the Fam Management Deposits scheme, **plantation forest growers without another primary production enterprise have very limited access to the income averaging provisions enjoyed by other classes of primary producer.**

Tax and managed investment scheme plantations

A primary production managed investment scheme is a type of enterprise that allows people who are not 'on-the-land' to carry on an agricultural production business. An offer is made to potential investors to become growers via a Product Disclosure Statement (PDS), which is tightly regulated by the Australian Securities and Investments Commission (ASIC).

People have participated through MISs in a broad range of agricultural businesses, including cattle farming, production of wine and table grapes, vegetables, stone fruit, citrus, almonds, olives, and timber plantations.

- Subject to certain conditions, **a grower participating in one or more woodlots in an MIS plantation project is at law carrying on a business of primary production with a view to securing a future profit**, and thus is entitled to claim the business tax deductions described above in the year the grower incurs those costs, provided that a number of conditions are satisfied as to the commerciality of the activity.
- The deductibility of this expenditure is confirmed when the Australian Taxation Office (ATO) issues a Product Ruling. **A Product Ruling does not provide any new tax deductions; it merely provides the grower with certainty that the ATO recognises and will honour the tax deductions available through the MIS business.**
 - When a proposed timber plantation MIS project is submitted to the ATO, the ATO assesses the project to determine whether the growers will be carrying on a business on a commercial basis. If the project satisfies this and other conditions, the ATO issues a Product Ruling confirming the tax deductibility of the grower's expenditure, provided that the project is carried out in accordance with the 'Arrangement' section of the Product Ruling. A Product Ruling has the same effect as a Private Binding Ruling that may be issued for an individual taxpayer.
- The 12-month prepayment provision that applies to MIS plantations was created to enable plantation managers to better plan their land, contractor and seedling requirements and to establish the plantations in a seasonally appropriate manner. Thus, as explained below, it is no more than a timing mechanism that recognises the complex and unique nature of plantation investment.
- There are two parts to the 12-month prepayment provision. The first is section 82KZMG of the *Income Tax Assessment Act 1936*. This section permits a plantation management company to carry out the plantation establishment work within 12 months of the grower having paid for it, **while the grower's deduction for that expenditure is available in the tax year that the grower commences the business and incurs the expense** (ie, the standard 'year-of-expenditure' deduction), just as it would be without the 12-month rule. **So the grower gets no special tax incentive or subsidy.**
- **The plantation management company also receives no tax incentive or subsidy.** The second part of the 12-month rule legislation is section 15-45 of the *Income Tax Assessment Act 1997*, which specifically prevents a mismatch of growers' tax deductions and companies' related income. **This highly irregular provision requires the plantation manager to 'bring forward' its company tax liability on the gross revenue received from growers for the plantation establishment work into the same year the growers claim their deductions.** So any public revenue loss occurs only where there are differences between personal and company income tax rates.

The plantation timber industry contributes substantially to long-term employment, business investment and environmental enhancement in regional Australia, and is but one small part of the change occurring in rural landscapes and communities. As the margins of agricultural commodity prices have become tighter, family farms have had to diversify, operate at a larger scale, and become more efficient to survive. New enterprises based on cropping or other intensification of farming have also become part of the land use options.

Neither the 'year-of-expenditure' tax deductibility for establishing plantations (available to all businesses) nor the 12-month prepayment rule (a timing mechanism for MIS plantations) are the direct cause of perceived landscape or catchment problems associated with the increase in investment in new timber plantations.

To the degree that governments may seek to influence where and how timber plantations are grown in the landscape, governments have no need to interfere with standard business tax provisions or corrective measures, but rather should implement and rely upon relevant land use and landscape planning policies, codes of practice, and targeted tax incentives where appropriate.

More information?... www.afg.asn.au/tima, www.afg.asn.au/publications, www.plantations2020.com.au, www.ato.gov.au

On the ATO website, useful references include the tax rulings... **TR 95/6**: Primary production and forestry; **TR 97/11**: Am I carrying on a business of primary production?; **TR 2000/8**: Investment schemes; **TR 2001/14**: Div 35 – non-commercial business losses; **PR 99/95**: Income tax and fringe benefits: the Product Rulings system.