

# The Australian Government's proposed taxation arrangements for plantation forestry

## SUBMISSION

On behalf of the Australian Plantation Timber Industry

By

Australian Plantation Products and Paper Industry Council (A3P),

Australian Forest Growers (AFG) and  
Treefarm Investment Managers Australia (TIMA),

National Association of Forest Industries (NAFI) and  
Tree Plantations Australia (TPA)



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**The industry associations that are signatories to this submission represent among them the following members of Australia's plantation timber industry**

AKD Softwoods Pty Ltd	Highland Pine Products
Albany Plantation Forest Company of Australia Pty Ltd	Hyne Timber
Allied Timber Products Pty Ltd	Integrated Forest Products Pty Ltd
Amcor Australasia	ITC Limited
Australian Forestry Management	CA Joseph & Sons Pty Ltd
Australian Paper Pty Ltd	Kimberly-Clark Australia Pty Ltd
Australian Solar Timbers	Lignor Pty Ltd
Auswest Timbers Pty Ltd	Logform Industries Pty Ltd
The Australian Sawmilling Company Pty Ltd	Macquarie Bank
Boral Timber Division	McCormack Timber Group
Carter Holt Harvey Pty Ltd	Midway Pty Ltd
Conservation and Land Management ACT	Norske Skog Australasia Pty Ltd
Environinvest Limited	Northern Tropical Timbers Pty Ltd
Forest Enterprises Australia Limited	Pentarch Forest Products Pty Ltd
Forest Industries Association of Tasmania	Pinetec Limited
Forest Industries Federation (WA)	Queensland Paulownia Forests Limited
Forest Products Commission	Rewards Group Limited
Forestry Plantations Queensland	South-East Fibre Exports Pty Ltd
Forestry SA	Taswood Growers
Forestry Tasmania	Timbercorp Limited
Forests NSW	Tropical Forestry Services Limited
Grand Ridge Plantations Pty Ltd	Victorian Association of Forest Industries
Great Southern Plantations Limited	Visy Industries
Green Triangle Forest Products	WA Blue Gum Limited
Gunnersens Timbermark	WA Plantation Resources Pty Ltd (WAPRES)
Gunns Ltd	Wespine Industries Pty Ltd
Gunns Plantations Limited	Weyerhaeuser Australia Pty Ltd
Hancock Victorian Plantations	Whiteheads Timber Sales Pty Ltd
Hansol Australia Pty Ltd	Willmott Forests Limited

...as well as private plantation growers and about 50,000 growers in retail forestry projects.

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## Submission on behalf of Australia's plantation industry

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## Executive Summary

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The plantation timber industry welcomes the Australian Government's continued support and its stated intention to reduce uncertainty and administrative and compliance burdens. While some aspects of the proposed tax arrangements are welcome and will help industry to achieve the Government's stated forest policy objectives, other aspects are likely to be detrimental to the plantation industry and to the Government's broader policy objectives.

The existing tax arrangements for growers in forestry managed investment schemes ('retail forestry projects') – entitlement to year-of-expenditure business deductions plus the '12-month prepayment rule' – have the confidence of the industry and provide certainty for growers. The arrangements have been effective in attracting much needed funds into plantation development in regional Australia. The benefits of the prevailing tax arrangements are being realised in the form of increasing employment and wood processing opportunities in rural communities, as well as clearly meeting the Government's broader forestry and regional development objectives.

Rather than implementing a different and unproven tax arrangement, industry recommends that the Government focus on enhancing the policy delivery of the existing arrangements. This could be achieved by taking elements of the proposal and building them into the existing arrangements. Positive elements of the proposal, such as the extension of the activity period to 18 months, development of secondary trading markets, and simplifying the treatment of the goods and services tax (GST) for retail forestry projects, can be incorporated within the existing taxation structure.

Timber processing is a very long-term industry, heavily dependent on a secure, consistent flow of high quality wood resource of the right specification over a long period. These factors are susceptible to sovereign risk – that is, to changes in government policy. The industry has only now recovered from the 70 per cent reduction in plantation establishment precipitated by the removal of the 13-month rule in 1999. The return of a prepayment rule (the 12-month rule) in 2002 stimulated a recovery that has taken four years from 2003 to 2006.

However, the retail forestry projects sector is far from being 'overheated', as the recovery trend of the sector might imply. As anticipated, and as evidenced by the 2005-06 retail woodlot sales, plantation establishment is now settling down to oscillate around its long-term sustainable trend of about 80,000 hectares of new plantations per year. This is consistent with the rate required to create a national plantation estate of about 3 million hectares by 2020, the target of the Plantations 2020 Vision.

Although the proposed new tax arrangements have been presented as a 'package' of measures, industry believes there is little interdependence among most of the individual elements, each of which can be considered and dealt with separately.

### Comments on specific elements of the Government's proposal

#### 1. Replacing the 'general business deduction' and the 12-month prepayment rule with a new tax arrangement

The proposal is that "*the 12-month prepayment rule for forestry MIS investors and its associated requirement that investors be carrying on a business would be replaced with new rules in the income tax law governing the deductibility of investment in MIS*".

- There is no need for a special hybrid treatment to be introduced in a new section of the Tax Act governing deductibility, as all the specific proposals could be effected without changing the general rules regarding deductibility.
- There is no uncertainty about whether retail forestry project fees are deductible under the prevailing law. Court findings and overwhelming legal and tax opinion exist (including specifically for this submission) that unequivocally support the deductibility of growers' costs under both 'limbs' of the general business deduction provisions of the *Income Tax Assessment*

*Act 1997*. That is, section 8-1(a) (the 'first limb') – expenses incurred in producing assessable income; and section 8-1(b) (the 'second limb') – expenses incurred in carrying on a business.

- So there is no legal requirement for investors to be carrying on a business to receive a deduction for project fees.
- Regardless of s8-1(a) deductibility, there is no doubt that growers in retail forestry projects are carrying on a business, as required by of *ITAA 1997*. The legal opinion has been consistently held over a long period of time. Further, the Australian Taxation Office (ATO) has issued public rulings and product rulings confirming this over many years.
- The proposed taxation structure is inconsistent with the three key principles of tax policy – simplicity, efficiency and equity.
  - The proposed arrangements are not simple to legislate and will be costly to implement.
  - They will be less efficient than existing arrangements, as they will create investor uncertainty where none exists today, and are likely to jeopardise the Government's desired forest policy outcomes.
  - The proposed arrangements create inequity in tax treatment between taxpayers in retail forestry projects, and other individual and corporate taxpayers who grow plantations outside managed investments arrangements. No such inequity exists currently.
- If a new rule were to be introduced, the industry would not support (and would strongly oppose) any move to specifically deny deductibility under Section 8-1 of the Act, or the deeming of investors not to be carrying on a business. Such denial or deeming would be a legal fiction, and would create different rules for different classes of taxpayers.
- If for any reason a new section was introduced, there is legislative precedent for such a section to stand alone but still allow deductibility under Section 8-1. Examples already exist in the Tax Act in respect of many expenditures, including superannuation and legal fees, among others.

### ***Industry Position***

***No change in legislation is required, as fees of a non-capital nature paid by growers in retail forestry projects are already clearly deductible under the existing provisions of the Tax Act. All other elements of the proposal can be achieved within the current taxation structure.***

## **2. Setting a cap on first-year deductions of \$6,500 per hectare**

The proposal is that “forestry investors would be able to deduct the full cost of their investment, subject to a cap of \$6,500 per hectare in the year of expenditure, with the balance (if any) of the investor's contribution being deductible in the following year”.

- Applying caps to prices or deduction levels creates market distortions and results in inefficient economic and policy outcomes. Industry sees little rationale or legal precedent to create an artificial and arbitrary cap to limit deductibility. A cap would:
  - create confusion and uncertainty, particularly in respect of what constitutes a speciality or 'boutique' forestry project, as there is considerable variation among retail forestry projects with regard to locations, tree species, types of products, duration, management intensity, marketing arrangements, and project structure (such as projects offered at a cost 'per production unit' not 'per hectare');
  - unfairly and unnecessarily disadvantage higher-cost operations, particularly long-rotation sawlog and high-value speciality timber projects, effectively contravening one of the Government's stated policy objectives of facilitating development of long-rotation plantations;
  - disadvantage higher-cost remote operations, such as the Tiwi Islands, which is more costly than mainland operations, but provides significant social and economic benefits where significant government expenditure has already been outlaid;

- discourage managers' innovation, research and development, or high-cost improvement options;
  - create a focus on cost minimisation rather than profit maximisation to growers, to the detriment of the growers and of the industry more broadly;
  - not limit commissions paid to advisers relative to the total project costs, because commissions are determined in competitive financial markets, where retail forest project managers are regarded as price-takers.
- Capping deductibility is unnecessary, as retail forestry projects operate in a competitive, arms-length environment and are thoroughly scrutinised by independent market research. This provides a market constraint on costs, because uncompetitive fees would make it virtually impossible for a retail forestry project to receive an acceptable research rating.
  - Without fair and proper indexation, the value of first-year deductibility will diminish over time, and plantation forestry will become less attractive in the market place. For this reason alone, a dollar-value cap is seen as onerous and uncertain in terms of its administration.
  - Establishing a robust secondary trading market in plantations would provide clear price signals on the value of plantations at various ages, including at the initial establishment phase. The use of secondary market values as a basis of keeping establishment costs competitive would not distort the market, nor would it disadvantage long-rotation or high-value projects or stifle product innovation, whereas an artificial and arbitrary cap would do so. (See #4 below.)

### *Industry Position*

***An arbitrary dollar-value cap on first year deductions is not necessary because market-based mechanisms, including the early introduction of secondary market trading, would provide the necessary constraints on costs.***

### 3. Extending the establishment activity period from 12 to 18 months

The proposal is that “*the period within which planting must occur as a condition of deductibility should be extended from 12 month to 18 months*”.

- The plantation forestry industry welcomes the Government's recognition of the complexity of plantation establishment, particularly variable climatic and seasonal conditions and their effect on the optimum planting period, as well as the complex nursery and site preparation activities over many months preceding planting. Therefore the industry supports the proposal to extend the establishment activity period from 12 to 18 months. This issue has previously been raised by industry, noting the need for timing of establishment activities to be driven by silvicultural considerations rather than the artificial constraints of the financial year.
- The industry notes that the length of the establishment period is immaterial for tax purposes, given that the 12-month prepayment rule legislation has a special provision requiring the retail forestry project manager to bring forward its company tax liability on gross receipts from growers into the same year the growers pay fees and claim their business tax deductions.
- The industry also notes that this aspect of the proposal can easily and clearly be achieved within the current taxation structure and could be implemented immediately for the long term benefit of the forest industry.

### *Industry Position*

***Industry supports the further facilitation of best-practice forestry through the extension of the eligible plantation establishment period from 12 months to 18 months, by appropriate amendments to the relevant subsections of ITAA 1936.***

#### 4. Secondary market trading in retail forestry projects

The proposal is that “trading in forestry MIS investments acquired after 30 June 2008 would be allowed such that:

- interests are required to be held by initial investors for a period of four years from the date of entering the arrangement for deductions to be maintained;
  - all returns to an investor treated as assessable income; and
  - the cost of acquiring a MIS interest on the secondary market to be deductible against income received at disposal or harvest”.
- Industry welcomes the Government’s recognition of the importance of creating a secondary trading market for immature plantations as a means to attract more investment in longer-rotation solid wood plantations.
  - Industry believes that policy delivery would be improved by adapting the proposal in the following manner.
    - Allow the potential trading of all standing interests in retail forestry projects (without jeopardising initial deductions) that meet the initial holding period after 30 June 2008. This would increase the volume of plantations potentially traded, resulting in stronger and more immediate market signals to growers considering establishing plantations and to investors considering purchasing an established plantation (a policy outcome sought by the Government).
    - Set the initial holding period for plantations at eight years – to more closely equate the liquidity of the investment between short- and long-rotation plantations, and to provide a sound basis for commercially assessing immature plantations. This will increase the likelihood of plantations being valued accurately, which is in the best interests of all parties involved, including the Government.
    - Confirm that the tax arrangements applying to a purchaser of a secondary market interest are consistent with the policy intent and do not discourage an active secondary market.
  - Industry notes that this element could be implemented by modifying existing arrangements.

#### *Industry Position*

***As soon as possible, the Government should take steps, through appropriate legislative or administrative mechanisms, to permit retail forestry project managers to offer trading of standing plantations no younger than eight years old at the time of sale, without loss of tax deductibility for the original growers.***

#### 5. Certification of retail forestry project managers

The proposal is that “deductibility would also be conditional on the certification of the MIS company to ensure best practice in forestry, regional planning, land use and natural resource management, under arrangements to be developed by the Department of Agriculture, Fisheries and Forestry”.

- Retail forestry projects are highly regulated, being a combination of a financial product and a land use activity.
- Continuous improvement to the regulation and requirements of retail forestry projects and managers is beneficial, as long as it does not duplicate the extensive regulatory processes that managers currently comply with, and does not add unnecessary costs that would ultimately be borne by investors. These existing arrangements include state-based codes of forest practice, independent forest management certification options (eg, Australian Forestry Standard and Forest Stewardship Council), and community consultation processes.
- The retail forestry project sector considers that it already conducts best practice in establishing plantations and that it would be more appropriate to strengthen existing arrangements, if and where necessary, rather than superimpose an additional layer of regulation and compliance.

- The industry sees this as an opportunity to review the operational requirements of retail forestry projects, as these requirements impose substantial costs on the management companies and their growers. Possible streamlining of these requirements would assist in reducing compliance costs and improving overall policy delivery. Industry would welcome the opportunity to work with the Government on these issues.

#### *Industry Position*

***The Department of Agriculture, Fisheries and Forestry, in consultation with industry, should develop an arrangement that documents, acknowledges and, where practical, streamlines existing arrangements.***

***Industry is committed to working with the Department of Agriculture, Fisheries and Forestry on how industry can continue to improve consultation and communications with local communities.***

## 6. Capping first-year deductibility for 'boutique' forestry projects

The proposal is that *“in recognition that there are higher costs associated with boutique forestry schemes, such as sandalwood, an appropriate treatment for such schemes is to be considered in consultation”*.

- 'Boutique' forestry projects are more accurately described as 'specialty, higher value' forestry projects. They include, so far, sandalwood, paulownia, teak, African mahogany and red mahogany, but also encompass Australian tropical cabinet timbers and other native species intensively managed for high-value end-products.
- A trend is emerging towards offering retail forestry projects using a variety of timber species and a combination of short- and long-rotation management regimes to produce a number of different end-value products. This creates uncertainty in the definition of a so-called 'boutique' forestry project.
- Difficulty in defining and differentiating a specialty 'boutique' project from a mixed species project, as well as from the wide variation in so-called 'commodity' projects in diverse climatic zones, will make this proposal unworkable in practice.

#### *Industry Position*

***Any arrangement developed with respect to the deductibility for specialty high-value projects must be considered in the context of the full continuum of retail forestry projects. Thus, this proposal has been addressed as part of proposal #2 above.***

## 7. Administration of the goods and services tax

The proposal is that *“the administration of the goods and services tax (GST) for MIS arrangements would be simplified, by ensuring that individual investors in an MIS are treated as passive investors for GST purposes (thereby removing them from the GST system), subject to the agreement of the States and Territories”*

- Industry welcomes the Government's intention to reduce the administrative and compliance burden associated with GST issues.
- The Government proposes that arrangements be simplified by ensuring individual investors in retail forestry projects are treated as passive investors for GST purposes. However, the legal form of these projects is that they comprise growers 'carrying on a business'. To classify them as passive investors would be a legal fiction and create confusion and uncertainty.
- Rather, there are alternative approaches to simplifying GST treatment for retail forestry projects within the current overall tax arrangements. These include appointment of the retail forestry project manager as the entity for GST collection purposes, application of existing joint venture principles, statutory deeming options, or other legislative or administrative solutions that could effect these changes in a clearer and more consistent manner.

- Industry has been working with the ATO on the issue of simplifying the GST arrangements on retail forestry projects and would welcome the opportunity to continue to work with Treasury and the ATO to resolve this issue without needing to treat investors as passive.

#### *Industry Position*

***The Government, through either a legislative or an administrative solution, should simplify the treatment of GST within retail forestry projects in a way that is consistent with the prevailing legal form of the participants carrying on a business.***

### 8. Review of tax arrangements for retail forestry projects

The proposal is that “*the proposed taxation arrangements would be fully reviewed in 2011 to examine the appropriateness of the arrangements in the context of the Government’s forestry and broader policy objectives*”.

- While industry acknowledges the importance and value of periodically reviewing public policy, the review period must be relevant to the nature and intent of the policy being reviewed.
- The proposed review date is only three years after the ‘12-month rule’ sunset clause date of 30 June 2008, which, in turn, is only two years after a year-long review that is just coming to an end. Such frequent reviews increase the sovereign risk for an industry that relies on long-term stable policy settings.
- It is noted that if the proposal for secondary market trading were to be implemented as is, the earliest the first trades would occur could be in 2012-13, one year after the proposed review date.
- A review date of 2013 and an implementation date of 2015 would allow appropriate time for the existing or revised arrangements to be assessed against the Government’s forestry and broader policy objectives, including the Plantations 2020 Vision. This would lessen the risk of unnecessarily destabilising the plantation industry with new uncertainty about the policy settings affecting investment flows that provide the wood resource for domestic and export processing industries.

#### *Industry Position*

***Any new arrangements put in place as of July 2008 should be reviewed no sooner than 2013, with any subsequent new arrangements to be applied no earlier than 1 July 2015, and the review must be conducted jointly by the Department of the Prime Minister and Cabinet, the Treasury, and the Department of Agriculture, Fisheries and Forestry.***

### Plantation industry performance

The forest and timber industry provides economic, social and environmental benefit to Australia, and particularly for rural communities. Over the last five years, the retail forest projects sector has injected over \$2.0 billion into rural communities for plantation expansion.

#### Industry profile

- A large proportion of the \$18 billion turnover in the industry is produced by plantations in regional areas of Australia.
- Plantations provide jobs for many of the 135,000 people employed in the timber growing, harvesting and processing sectors of the forest and timber industry.
- Retail forestry projects are currently establishing most of Australia’s new plantation resource.
- The sector has developed significant export markets and links to domestic processing.

- The forest and timber industry is on the verge of realising a \$4 billion increase in domestic value-added processing capacity, underpinned by an expanding plantation resource, increasingly provided by retail forestry projects. This investment in increased domestic processing capacity is highly dependent upon the continuation of consistent ongoing planting levels.
- Current and proposed industry developments could deliver an additional 4,600 jobs to regional Australia.

### Trade deficit

Australia has historically shown a trade deficit in forest products. The current deficit is around \$2.0 billion per annum.

- Further development of the plantation resource and proposed industry developments have the potential to reverse this trade deficit, with Australia becoming a net exporter of forest products.

### Benefits for rural communities

Plantation development has helped stem the underlying decline of many rural communities, providing diversity and long-term stability to local economies.

- Research shows that continued development of the resource and further processing can result in positive population and employment growth in these communities.
- Plantation development is assisting to offset some of the regional impacts of removing areas of native forests from timber production.

### Positive environmental benefits

Plantations provide positive environmental benefits through biodiversity, erosion control and salinity control, land rehabilitation, water quality and carbon sequestration.

- Private sector investment and commercial tree planting – the essential elements of retail forestry projects – make a vital contribution to more sustainable land management.
- Although trees do use water, research has shown that in the general range of rainfall (500–800mm/yr), this use is similar to water use by pasture.
- Climate change, irrigation and farm dams have been identified as greater risks to water availability than broadscale plantation development.
- Plantations established by retail forestry projects have made and continue to make a significant contribution to Australia's ability to meet the Kyoto emissions target.

### What happens if the current arrangements are removed?

History tells us that change to the taxation arrangements for plantations can result in serious economic consequences for the forest industry and for regional communities.

- Removal of the 13-month prepayment rule in 1999 precipitated a 70 per cent decline of investment in plantations, with serious effects on the industry and on rural businesses and communities.
- Economic modelling by Econtech reveals that a similar change to the taxation arrangements could result in:
  - a \$1.2 billion reduction in the industry's annual gross value of production;
  - a deterioration in our forest products trade deficit of over \$500 million per year based on increase in imports – potentially from countries with unsustainable or illegal forest practices; and
  - up to 10,000 direct and indirect jobs lost in rural communities in the long term.

## Introduction

The plantation forestry industry grows two distinct types of plantations – short-rotation plantations (principally hardwood) grown for pulpwood to manufacture paper, and long-rotation plantations (principally softwood, but which may involve hardwood) grown mainly for sawlogs. Long-rotation plantations are harvested after at least 15 years from the date of establishment and milled to create high-value products, including structural timber and boutique or specialty timbers such as sandalwood, teak, mahogany, and paulownia.

The plantation industry is also characterised by a number of different ownership sizes and structures, including: State government business enterprises; integrated plantation growing and wood processing companies; Australian and institutional investors and superannuation funds; large and small private growers and farm foresters; and private growers participating in plantation forestry managed investment schemes (retail forestry projects). Retail forestry projects currently account for over half of the hardwood plantations and around 2 per cent of softwood plantations in Australia.

A progress report on the *Plantations 2020 Vision* undertaken in 2005 concluded that "...the program is making good progress and the *Vision* is well within the bounds of realisation providing the appropriate policy settings are in place". It went on to say that a key challenge in meeting the expansion targets is the need to "maintain appropriate and stable taxation policy frameworks". With around 80 per cent of all new plantations funded by private investment, the continued expansion of Australia's plantation estate is heavily dependent upon the maintenance of prevailing taxation arrangements.

## Background

In November 1999, responding to the Ralph Review of Business Taxation, the Australian Government removed the prepayment provision which had been in place since May 1988 for a wide range of prepaid investments and business expenses. This sudden policy change precipitated a dramatic decline in the flow of funds into retail forestry projects – around 70 per cent over the next two financial years – in association with a severe loss of investor confidence. This change also resulted, at least in part, in one large plantation manager going into liquidation and significant negative economic and employment implications for rural Australia. The industry and Government's major plantation policy, to build Australia's forest plantation resource to 3 million hectares by 2020, was also jeopardised (*Plantations for Australia: The 2020 Vision*).

Fulfilling a 2001 election commitment, the Government introduced the 12-month prepayment rule specifically for retail forestry projects in 2002, to restore investor confidence in the industry, to address regional economic and employment impacts, and to re-establish progress toward the 2020 Vision target. A sunset clause of 30 June 2006 on the 12-month rule was accepted by the Government as a condition of passing the Senate, and this was subsequently extended to 30 June 2008 in the 2005-06 Budget. Since 2002, the establishment of plantations has steadily recovered, and is now stabilising at a level that is consistent with the pre-1999 long-term forecast trend of around 80,000 hectares a year.

In the 2005-06 Budget, the Government announced and sought submissions to a review of the taxation arrangements for plantation forestry. The Government received submissions from the National Association of Forest Industries, Australian Plantation Products and Paper Industry Council, Treefarm Investment Managers Australia and Australian Forest Growers, as well as a number of individual submissions from Australia's forestry companies.

The Government has not revealed any findings for most of the terms of reference of the Review. However, at the time of the 2006-07 Budget, the Government announced that it was considering a proposal for an alternative taxation arrangement to the 12-month rule, and asked for submissions from interested parties to assist the government in making a decision on taxation arrangements for forestry investments. Industry representatives sought additional detail on the proposal, and met with Government officials on 24 May and 12 July 2006.

This submission to the consultation has been prepared by the A3P, AFG/TIMA and NAFI/TPA as a whole-of-industry response. We ask that it be given appropriate weight in the Government's consideration of the issues, as the positions have the support of the vast majority of the plantation industry.

## **Policy context to assessing the Government's proposal**

A meaningful assessment of the Government's proposed taxation arrangements for plantation forestry must include an understanding of the linkages to and implications for industry and Government policy objectives relating to forestry, regional development, and natural resource management. The plantation forestry industry plays an important role in overall Government policy, and the forestry managed investments schemes ('retail forestry projects') sector in turn plays an important role within the broader forest and timber industry. Any changes to the current taxation arrangements therefore must not be viewed in isolation, but rather in the context of what the implications may be for the Government's broader policy objectives.

A key issue is the diversity of participants in the retail forestry sector, from the large mainstream companies managing projects that produce commodity products such as hardwood pulpwood and softwood, to the smaller companies managing projects that produce specialty high-value 'boutique' or niche market products, such as sandalwood, teak, mahogany, paulownia and Australian cabinet timbers.

### ***National Forest Policy Statement***

Faced with competing pressures over the use of public native forests, Australian Governments in consultation with the forest industry developed the National Forest Policy Statement (NFPS). It was recognised by governments that if they removed areas of native forests from wood production, they would also need to build an alternative plantation-based resource to offset the economic impacts on rural Australia and address adverse effects on Australia's trade in wood products. This would require a long-term and sustained commitment to plantation development and a plantation-based wood processing industry. One key goal of the NFPS is to "expand Australia's commercial plantations of softwood and hardwoods so as to provide an additional, economically viable, reliable, and high quality wood resource for industry". The Regional Forest Agreement (RFAs) process was initiated to fulfil the objectives of the NFPS.

### ***Plantations for Australia: The 2020 Vision***

The national plantations strategy, known as *Plantations for Australia: the 2020 Vision*, and endorsed by industry and all governments, has been the main policy initiative guiding the development and direction of the plantation industry for the past ten years. The key principle of the policy is to "enhance regional wealth creation and international competitiveness through a sustainable increase in plantation resources". The 2020 Vision sets a target of achieving 3 million hectares of plantations by 2020.

Since 1990, over 11 million hectares of public native forests have been removed from wood production and placed in conservation reserves, largely through the RFAs. By contrast, less than 700,000 hectares of new plantations have been established. There are concerns that, unless sufficient additional plantations are developed, Australia will continue to face a shortage in wood products and will have to increase its reliance on imported products, many of which could be sourced from countries with unsustainable or illegal forestry practices.

### ***Plantations and regional development***

The Australian Government has stated its commitment to regional development through the policy, *Stronger Regions, A Stronger Australia Statement* in 2001. Plantation development has been a key driver of economic growth and development in many regions and has assisted in meeting government objectives of "diversifying the economic base and building comparative advantage and boosting employment in regional areas by stimulating business growth". Economic studies reveal that two

additional (new) jobs are created in regional Australia for every thousand hectares of plantations established. More jobs are created when the trees are harvested and processed or marketed<sup>1</sup>. Plantations, therefore, promote regional development and help to stem rural decline, in periods when other regional farming enterprises are struggling to remain profitable.

### *Plantations and climate change policy*

The Australian Government has stated that it is committed to developing a long-term, low greenhouse gas emissions strategy for Australia, and the development of plantations is a part of that strategy. One milestone is to meet the greenhouse emissions target negotiated at the Kyoto Conference in 1997. This commitment is to maintain emissions at no more than 8 per cent above 1990 levels over a measurement period between 2008 and 2012.

The 700,000 hectares of plantations established since 1990 will deliver significant carbon sink offsets to reduce Australia's emissions. However, this important and potentially increasing contribution to Australia's long-term greenhouse strategy will only be maintained if plantations can continue to be replanted and expanded at or at better than the average planting rate experienced over the past ten years of around 80,000 hectares a year.

### *Plantations and natural resource management*

The Government's natural resource management policies have an objective of "advancing the sustainable use and management of Australia's natural resources – land, water, vegetation and fisheries". Promoting the revegetation of Australia's landscape through plantation development is an essential element in delivering a national response to sustainable natural resource management issues including salinity, water quality, soil erosion and biodiversity. Private sector investment and commercial tree planting – the essential elements of retail forestry projects – make a vital contribution to sustainable land management.

Strategically placed plantations have a minimal impact on water availability while providing significant benefits by addressing erosion, soil amelioration, salinity, water quality and biodiversity objectives.

### *What has been achieved?*

Prior to 1990, plantation development was largely undertaken by State governments with plantation expansion rates reflecting diminishing budget allocations from State governments and the availability of loans from the Australian Government.

The accelerated use of managed investment arrangements in the mid-1990s, supported by prepayment taxation arrangements, saw increases in the level of private investment in plantation development. Over the past ten years, less than 25 per cent of total new plantation establishment has been by state governments, while over 65 per cent of plantations has been established by managed investment schemes. This latter proportion has been increasing, and is now more like 90 per cent.

The prevailing tax arrangements now have Australia on target to achieve the 2020 Vision target of trebling the plantation resource to 3 million hectares by 2020, at an average long-term rate of 75,000 to 85,000 hectares of new plantings per year. See **Attachment A**.

Australia is now seeing the benefits of an expanding plantation estate. Many previously declining rural communities are growing, and industry is on the cusp of investing around \$4 billion in new domestic processing and capacity expansions in rural Australia. These include:

- the Australian Paper pulp mill replacement and expansion at Maryvale in Gippsland, Victoria;
- the proposed Gunns pulp mill in northern Tasmania;
- likely expansion of the Visy Industries pulp and paper mill at Tumut;

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<sup>1</sup> Centre for International Economics (2005). *Plantations, Jobs & Investment in Regional NSW*.

- the proposed Heywood pulp mill in south west Victoria;
- the proposed Penola pulp mill in south east South Australia; and
- the Lignor engineered lumber plant in the Great Southern of Western Australia.

These proposed mills are in addition to a number of sawmill and veneer mill developments in various rural centres. In total, these plantation-based industry developments are estimated to employ potentially an additional 5,000 people in rural Australia. More details on these wood processing investments and resource and industry developments are presented in **Attachment B**.

### *What can be achieved?*

It is important to continue plantation expansion to complete the plantation estates established in the 1980s and 1990s. This will provide opportunities for new processing and marketing opportunities, and will enable existing industry to expand and maintain competitiveness, both domestically and overseas.

Continued plantation development will:

- enable existing mills, in regions where there is currently insufficient resource, to operate at full capacity or even expand to improve their international competitiveness;
- support future industry rationalisation by providing the critical mass of resource to support world scale production facilities in some regions; and
- support the current round of new industry developments and create opportunities for 'greenfield' developments in new regions.

Given the long lead-times in plantation development, it is also important now to be looking beyond the current round of industry developments (which are reliant on plantation expansion that began 10 to 25 years earlier), and to begin planting the resource for future industry developments in 10 to 25 years time.

A long term commitment to the plantation industry will deliver significant benefits to rural economies as well as to the broader economy. For example, the continued development of pulp mill and sawmill processing in Australia has the potential to turn Australia from a net importer to a net exporter of forest products, reversing the \$2.0 billion trade deficit in forest products.

## **Policy settings required for sustainable plantation development**

The industry requires a stable and supportive taxation policy environment to continue developing the plantation resource to a sufficient size to support an internationally competitive wood processing industry.

The industry has identified a number of characteristics that are essential when considering policy settings to underpin the sustainable, long term development of the plantation resource.

### *Recognition of the nature of plantation development.*

There are a number of characteristics that make plantation development unique in comparison to other land use and investment. The first is that plantations are a long-term crop. Even growers of short-rotation plantations typically have to wait at least 10 or more years before they receive a return. The second is the scale of planting required to create sufficient resource for competitive processing and marketing of commodity products such as structural timber, wood panels, paper and packaging.

Domestic and international wood processors require resource of sufficient quantity and quality consistently over a long period of time to underpin internationally competitive processing developments. For example, a world-scale softwood sawmill may require a plantation resource of some 80,000 hectares, developed over a 25 to 35 year period, to supply its needs. The capital required to develop this

resource would be around \$500 million. A world-scale bleached hardwood kraft pulp mill might require some 200,000 hectares of plantation developed over a 10 to 20 year period, to supply its needs. The capital requirement to establish this resource would be in excess of \$1 billion. The scale and the long-term commitment required creates a significant problem for the industry and Australia's broader economy in terms of where the funds for plantation development will be derived.

As is the case for most countries that have significant plantation resource, the majority of Australia's plantations were established by governments or facilitated by government assistance. **Attachment C** provides an overview of plantation development in selected countries. Increasingly, governments are declining to allocate additional direct funds for plantation development. The retail forestry sector, underpinned by the current taxation arrangements, has provided an efficient funding mechanism that can deliver sufficient levels of private sector investment to the plantation sector over a long period of time. The retail forestry sector is increasingly integrating its operations with the wood processing sector, resulting in plantation resources that are specifically developed to meet the needs of domestic processors and/or international markets.

### *The nature of the investment market*

The success of the retail forestry arrangement in underpinning the government's and industry's long-term forest policy objectives is reliant on the ability to attract sufficient investment funds. Competition for funds in the managed investment market is strong, with retail forestry projects, attracting an insignificant proportion of total investment funds. The managed investment market is also highly sensitive to policy change and investor confidence. This was evident when the 13-month rule was removed in 1999, and investment levels fell by around 70 per cent over the next two years.

Independent research analysts confirm that investor confidence in retail forestry projects has only now returned. However, they warn that policy changes that affect investor confidence or the competitiveness of retail forestry projects in relation to other investments could result in a similar reduction in investment and confidence experienced with the removal of the 13-month rule. An assessment of the economic impacts of removing the 12-month rule on rural Australia is provided in **Attachment D**.

### *Long term commitment and a stable policy environment*

Industry analysts concur that sections of Australia's plantation industry, particularly the hardwood sector, is at a critical stage in its development. Although the scale of the plantation resource is increasing, in many regions it is still not of sufficient size to support a new or expanded domestic processing facility or to effectively sell in an international market. Short-term government commitment to the plantation industry reflected in periodic changes to taxation policy can interrupt the sustainable development of the plantation resource and jeopardise the achievement of the Government's and industry's forest policy objectives.

These changes, such as the removal of the 13-month rule, have immediate impacts on the industry and local communities through lower levels of investment and employment. However, there are long-term implications as well, as low levels of plantation development create unwelcome supply gaps in the flow of plantation wood resource for the future. This can make the sale of the available wood less attractive, and would deter or delay investment in, and development of, wood processing facilities.

## **Comments on the proposed arrangements and alternative approaches**

To provide a constructive and informed assessment of the Government's proposed arrangements for the retail forestry sector, the industry sought further information on the policy intent behind the specific elements of the proposal from Government officials. In understanding the reasons why the Government wishes to change the nature of the existing taxation arrangements, the Government's proposal can be assessed in terms of its ability to meet policy intent as well as creating the desired policy settings to facilitate the sustainable long-term development of the plantation resource.

It is noted that a key policy objective of the Government is to remove perceived uncertainty surrounding whether retail forestry investments are deductible and to reduce the administrative and compliance burden on investors and plantation managers. In discussions with Government officials, a number of other policy objectives were identified, many of which aim to address issues identified by the forest industry.

The forestry industry does not share the Government's view that there is uncertainty about whether an investor in a retail forestry project is 'carrying on a business', and therefore can see no need to remove the general business deduction and the '12-month rule' and replace them with a new and unproven tax structure. The proposed new tax structure would in itself create uncertainty about the tax treatment of forestry investments, and is likely to have significant negative impacts on confidence and investment in plantations, resulting in adverse outcomes on employment and longer term industry development in regional Australia.

Rather than implementing different and unproven tax arrangement in what is a competitive market environment, the industry recommends that the Government focus its efforts on enhancing the policy delivery of the prevailing tax arrangements. This could be achieved by taking elements of the proposal and building them into the existing arrangements. Positive elements of the proposal, such as the extension of the activity period to 18 months, development of secondary markets, and simplifying the treatment of the goods and services tax (GST) for retail forestry projects, can easily be incorporated in the existing business deductions and 12-month rule structure.

The forest industry acknowledges that there are a number of negative perceptions about the effect of retail forestry projects on rural communities. These perceptions are often based on anecdotal evidence and reflect a resistance to the inevitable changes occurring in rural landscapes and economies. The industry is working with rural communities to respond to all concerns expressed and will continue to ensure the rural and wider community are kept informed on this issue through the provision of verifiable and/or independent evidence. **See Attachment E.**

The specific elements of the Government's proposal are assessed in the sections below.

### ***1. Replacing the 'general business deduction' and the 12-month prepayment rule with a new tax arrangement***

The proposal is that "*the 12-month prepayment rule for forestry MIS investors and its associated requirement that investors be carrying on a business would be replaced with new rules in the income tax law governing the deductibility of investments in MIS*".

Two key issues need to be considered when assessing this element of the proposal. The first is whether there is uncertainty surrounding retail forestry investors 'carrying on a business', as stated by Government officials. The second is whether replacing the 12-month rule with a new tax arrangement to address deductibility for retail forestry projects will result in greater certainty and an efficient policy outcome.

#### **Is there uncertainty surrounding retail forestry investors 'carrying on a business'?**

No. From the perspective of the plantation managers and investors, the forest industry contends that there is no legal uncertainty that investors' expenses incurred in retail forestry investments are deductible in respect of the requirement that investors are 'carrying on a business'.

In fact, there is no legal requirement for retail forestry investors to be classified as 'carrying on a business' for them to obtain a deduction for their investment, as the expenditure is deductible in any event under the 'first limb' of the general business deduction provisions (Section 8-1(a) of *ITAA 1997* – expenses incurred in producing assessable income).

But regardless of the section 8-1(a) deductibility, the Australian Taxation Office (ATO), in the many product rulings it has issued since 1998, has confirmed that retail forestry investors entitled to the general deduction provisions are incurring expenses in 'carrying on a business', as required under the 'second limb', section 8-1(b). These product rulings contain three important and unequivocal statements.

- (i) The participants in these projects comply with the necessary criteria for, and are therefore classified as, carrying on a business of primary production.
- (ii) The primary purpose of the business activity is commercial, not tax avoidance.
- (iii) The business activities being carried on by participants in these projects meet the criteria necessary to be given the Commissioner's discretion under the non-commercial business loss provisions (*ITAA 1997* Div 35).

These views have been confirmed through legal opinions from Freehills; Mallesons Stephen Jacques; Clayton Utz; Allens Arthur Robinson; PriceWaterhouseCoopers; KPMG; and Pitcher Partners. These opinions draw upon three decades of case law and ATO rulings relating to the issue of 'carrying on a business' and can be summarized as follows.

- (i) Initial management fees payable by investors are an allowable deduction under Section 8-1(b) of *ITAA 1997*.
- (ii) Irrespective of whether or not the investor is considered to be carrying on a business of afforestation, initial management fees are an allowable deduction under Section 8-1(a) of *ITAA 1997*.
- (iii) The management fees are not a capital outgoing, nor would they fall within any of the other categories of outgoing under Section 8-1(2) to preclude deductibility.
- (iv) The management fees do not fall and will not fall within the scope of sections 82KZM, 82KZMA to 82KZMD and 82KZME and 82KZMF of *ITAA 1997*.
- (v) Sections 82KH and 82KJ to KL of *ITAA 1997* will not apply to deny the deductions otherwise allowable.
- (vi) The provisions of Part IV(A) should not apply to the project arrangements.

**Is it necessary to replace the 12-month rule and general business deductions with an alternative taxation arrangement?**

No. Government officials indicated the new arrangements would require the construction of a separate section or part of the Tax Act. It would need to provide a 'special hybrid treatment' by classifying retail forestry investors as 'not carrying on a business' for the purposes of obtaining a deduction for initial investment. An assessment of information provided by Government officials indicates that the proposed arrangements would be inconsistent with the three key principles of tax policy – simplicity, efficiency and equity.

***Simplicity***

The Government's proposed alternative taxation arrangements are likely to be complex. By their very nature, the arrangements will require significant and detailed legislative changes to the Act to ensure that the new category of retail forestry 'investors' are 'quarantined' and are denied access to other parts of the Act, such as the capital gains tax provisions.

By placing retail forestry 'investors' under a special hybrid treatment whereby they are classified 'not to be carrying on a business', the legislation will create a legal fiction and is likely to be subject to legal and interpretive challenge. This will create significant uncertainty for plantation managers and 'investors' where, under existing arrangements, this uncertainty is not currently present. This is likely to add significantly to the administrative costs of the Government and to compliance costs for plantation managers and investors. These outcomes would appear to be at odds with the Government's stated policy intent.

### ***Equity***

The creation of a special hybrid treatment for retail forestry 'investors' within the Tax Act will also create inequity in the tax treatment between taxpayers who invest through a retail forestry arrangement and taxpayers who invest outside the retail forestry arrangements.

For example, 1,000 small 'retail' investors who pay \$10,000 each into a retail forestry project (using a contracted management company and pooled harvesting arrangements) will be taxed differently to 10 very wealthy professional investors who invest \$1 million each in forestry establishment outside a retail forestry project (using the same contracted management company and pooled harvesting arrangements). Similar inequities will also exist between retail forestry growers and individual and corporate plantation growers establishing plantations directly (eg, a farmer) or through a forest management firm or consulting forester.

### ***Efficiency***

After assessing the complexity, uncertainty, added costs and inequity that could be created by developing a special hybrid treatment for retail forestry 'investors', the efficiency of this approach in delivering the Government's intended policy outcome is questionable. In particular, the Government's administrative costs are likely to increase significantly due to the legislative costs of developing, implementing and addressing the uncertainty created by the new arrangements. The compliance costs to plantation managers and investors are also likely to significantly increase as they deal with the complexity and uncertainty of the arrangements.

This approach may also jeopardise the Government's broader policy objectives, including the Plantations 2020 Vision. The removal of the 13-month rule in 1999 represented a smaller, less complex change to the taxation structure than this proposed change, yet resulted in plantation investment falling dramatically and investor confidence being severely affected.

### **Conclusion**

If the Government wishes to increase investor certainty and reduce compliance costs, it is not necessary to replace the 12-month rule with a special hybrid treatment for retail forestry 'investors'. The Government's policy intentions could be achieved more simply, equitably and efficiently by maintaining the 12-month rule structure, which has the confidence of industry and provides certainty for growers. Legal certainty relating to retail forestry growers 'carrying on a business' could be addressed through alternative approaches such as issuing a general product ruling. Alternatively, if legislative certainty is required, this could be achieved by legislating that retail forestry growers are 'carrying on a business' within the 12-month rule arrangement. These alternative approaches are simpler to implement, would reduce administrative and compliance costs, and do not distort the integrity or equity principles of the taxation system.

### ***Industry Position***

***No change in legislation is required, as fees of a non-capital nature that are paid by growers in retail forestry projects are already clearly deductible under the existing provisions of the Tax Act. All other elements of the proposal can be effected within the current taxation structure.***

## ***2. Setting a cap on first-year deductions of \$6,500 per hectare***

The proposal is that "forestry investors would be able to deduct the full cost of their investment, subject to a cap of \$6,500 per hectare in the year of expenditure, with the balance (if any) of the investor's contribution being deductible in the following year".

A related proposal is that “*in recognition that there are higher costs associated with boutique forestry schemes, such as sandalwood, an appropriate treatment for such schemes is to be considered in consultation*”.

In discussions, Government officials revealed that the Government's policy intent in placing a cap on the tax deductibility of a grower's expenditure is twofold. The first reason is to address a perception that the industry is expanding too rapidly, or overheating, placing inappropriate upward pressure on land prices. The second reason offered is to address a perception that the fees charged for retail forestry projects may be too high. No explanation was provided for setting the level of the cap on the tax deductibility of the grower's first-year expenditure in a retail forestry project at \$6,500 per hectare.

### **Is the industry overheating?**

The concept of ‘overheating’ relates to a situation where an industry is expanding contrary to the fundamental market signals. To determine whether the plantation industry is ‘overheating’, an assessment of these fundamental market signals is required. The first market to assess is the investment market, as retail forestry projects compete for investment funds against a range of other financial products.

In reality, retail forestry projects are not a big player in the managed investment market, with retail forestry projects making up an insignificant proportion – perhaps less than 1 per cent – of the managed investment market, as illustrated in **Attachment F**. As became evident when the 13-month rule was removed in 1999, the managed investment market is highly competitive, and any changes to the competitiveness of products can result in dramatic reductions in the levels of investment made. The rise in investment over the past three years since the 12-month rule was introduced reflects the adjustment of retail forestry projects to a sustainable level in the investment market, and is based on the relative competitiveness of retail forestry projects against the other investment products on offer.

This view is supported by the fact that woodlot sales in 2005-06 are around 8 per cent lower than in 2004-05. The retail forestry sector is now planting at average long-term levels consistent with the Plantations 2020 Vision. From a forest policy perspective, there is a strong argument to maintain plantation investment at current levels. See **Attachment G**.

The next market requiring assessment is the land market. Land purchased to establish plantations makes up less than 3 per cent of total rural land sales, and is not likely to have a significant impact on land prices. This conclusion is supported through recent research by the Bureau of Rural Sciences (BRS), which reports an overall increase in land prices over the past decade.<sup>2</sup> Although the price of land in regions suitable for plantations has risen, the increase has paralleled increases in regions not suitable for plantations. See **Attachment H**.

In addition, BRS found that other factors, including ‘lifestylers’ and restructuring within the agricultural sector, are having a far greater impact on regional land values than plantation development. A number of retail forestry managers have stated that in some regions they cannot compete in land markets, and are often outbid by farmers who are expanding their operations, or by agricultural companies or overseas investors. It should also be noted that plantations make up only a small proportion of land use in Australia. BRS research shows that in catchments where plantations are most prominent, they generally make up less than 6 per cent of the land cover throughout the catchment.

The final market to be assessed is the wood products market. Statistics produced by ABARE show that the prices of major wood product categories have remained relatively stable or have increased in recent times.<sup>3</sup> See **Attachment D**. These prices reflect the aggregate supply and demand of forest products globally. As with analysis of any market commodity, there is often a divergence of views as to what the long-term market conditions will be. However, there are some clear facts that indicate that

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<sup>2</sup> Bureau of Rural Sciences (2005). Socioeconomic Impacts of Plantation Forestry.

<sup>3</sup> ABARE (2006). Australian Commodity Prices 2005.

Australia is not facing an oversupply of forest products due to the continued growth in the plantation sector. First, domestic demand for plantation-based pulpwood is growing with a number of industry developments, such as the Gunns and Australian Paper pulp mill developments, which will require existing and additional plantation resource. Significant shortages of softwood sawn timber are also emerging, as the softwood industry expands into the next phase of development. These shortages will worsen dramatically in the next decade without a rapid increase in the establishment of new softwood plantation.

There is strong growth in wood product markets emerging in Asia with the economic recovery in Japan and the continued economic development in China.<sup>3</sup> Australia is well positioned to supply the growing demand for pulpwood in these markets. Continued development of plantations, coupled with the proximity to market, will assure Australia has a comparative advantage over competing supplies in these markets. It should also be remembered that Australia still faces a \$2.0 billion trade deficit in forest products.

In conclusion, there is not a strong economic case that the plantation industry is overheating, and measures introduced to dampen investor behaviour could result in significant negative impacts on the development of the industry and on regional Australia. This also raises the question of why retail forestry projects should be singled out for restriction. No such constraint is imposed on other tax-efficient investments that make up a far greater share of the investment market, such as prepaid interest and highly geared financial products. See **Attachment F**.

### **Are fees charged by forestry projects too high?**

Government officials expressed concern that the fees charged by retail forestry projects were much higher than a quoted cost of establishing a hectare of plantations, and that taxpayers and investors may not be receiving value for money from retail forestry projects.

It must be recognised that a retail forestry project does a lot more than simply put trees in the ground; it provides a full professional service that allows individual growers to undertake the business of afforestation in an industry where economies of scale are paramount to the economic viability of the activity. To achieve this, retail forestry projects combine a land use activity – establishing, growing and managing a plantation, and marketing the wood from it – and a financial product that enables the generation of sufficient investment to meet the scale requirements for plantations, and ensures investors are protected.

The cost of establishing and maintaining a plantation and marketing the wood depends on a range of factors, which include the nature of the plantation, species used, location, preparation of the land, access to the site, scale of the planting, distance to the processing site, and product produced.

These costs, associated with managing the establishment and ongoing maintenance include: site inspection; organising appropriate land-use planning approvals; meeting other land-use regulations such as codes of practice; soil testing; plantation design; organisation of seedling order and delivery; organisation of contractors for site preparation and planting; supervision of establishment activities and quality control; and follow up treatment, including replanting, fertilising and weed control and in some cases thinning and pruning.

Costs associated with the financial nature of the product include: developing and obtaining approvals for a product disclosure statement (PDS), obtaining a taxation product ruling, to commission independent research analysis; to market the project; to pay commissions; and to have in place the extensive company infrastructure and qualified personnel to manage a project in various locations on behalf of hundreds/thousands of growers with identifiable title to woodlots.

These cost components vary from project to project, resulting in a wide range of total costs for retail forestry projects. See **Attachment I**.

There has been some focus on the level of commissions paid by retail forestry companies to financial planners and advisers. These commissions are determined in a competitive financial market, where retail forest project managers are regarded as price-takers.

There is an existing market-based mechanism that ensures fees charged by retail forestry companies are competitive. Retail forestry projects are assessed by the independent investment research houses and rated on performance, including their projected return on investment. High, uncompetitive costs result in lower returns to growers and a lower performance rating. These ratings are used by financial planners to advise their clients where to place their funds, resulting in a direct and significant effect on the investment market. It is therefore in the interests of the retail forestry companies to keep costs competitive against other retail forestry projects and against alternative financial investments.

### **Will a cap on grower deductions deliver value for money to growers and taxpayers?**

There is little basis for the perception that retail forestry projects are high-priced. However, if it is a concern of Government that taxpayers and investors receive value for their money from retail forestry projects, is a cap on grower deductions in the first year an appropriate mechanism?

Applying caps to prices, or deduction levels, creates market distortions and results in inefficient economic and policy outcomes. A fundamental problem with setting a deduction cap is that there is a wide product range for retail forestry projects, reflecting differences in location, type of product, duration of investment, management intensity, marketing arrangements, and scheme structure.

These differences are reflected in the prices charged by the retail forestry project managers and the projected income from the project. For example, the price of an irrigated sandalwood project can range from \$60,000 to \$80,000 a hectare, a high-value mahogany project from \$20,000 to \$30,000 a hectare, and a commodity hardwood and softwood plantation from \$6,000 to \$10,000 a hectare. As the managed investment market is highly competitive – with retail forestry projects competing for funds against tax-effective highly-g geared share and property investments – setting a deduction level will disadvantage those products that have total costs exceeding that amount. It will also provide an incentive for those retail forestry projects with costs less than the cap to increase their project costs.

A cap would also not be effective in controlling the cost of commissions to planners and advisers, as these fees are set as a percentage of the value of the project.

Another fundamental problem with setting a dollar-value deduction cap is how to deal with indexation. The \$6,500 per hectare cap proposed would effectively commence in FY2009 and would not be worth the same amount in two to three years time as it is in today's dollars. Costs continue to increase, and in turn, so will prices. For example, fuel prices are a significant component of the operational cost of plantation establishment and of harvesting and haulage. Without fair and proper indexation, the first-year deductibility will diminish over time and plantation forestry will become less and less attractive in the market place. For this reason alone, a dollar-value cap is seen as onerous in terms of its administration.

Economic literature abounds with examples where capping prices or costs in an industry results in sub-optimal and distortionary outcomes, including the stifling of product innovation. The retail forestry sector has successfully brought private investment into plantations and rural communities through the innovative development of products, including specialty timbers, long-rotation sawlog and short-rotation pulpwood projects. The capping of deductions will stifle this innovation, and result in a reduction in the variety of products available. This could have significant implications for Australia's broader forestry and industry policy, which is based on the development of a diversified wood resource base.

## Conclusion

The forest industry does not see the need for a deduction cap, because the investment ratings process conducted by the independent investment research houses provides an effective market mechanism that keeps the price of retail forestry projects on a competitive basis with other retail forestry projects and with alternative investment products.

However, if it is the policy intent of Government to ensure retail forestry projects provide value for money for growers and taxpayers, and additional policy measures are considered necessary, this can be achieved by increasing the transparency of the market. The establishment of a robust secondary market in immature plantations would provide clear price signals on the value of plantations at various ages, including the initial establishment phase. This would keep initial establishment costs competitive, without distorting the market, disadvantaging long-rotation plantations, or stifling product innovation and product variety (see #4).

If the Government were to choose to proceed with a cap, questions remain as to the additional deductibility for 'boutique' timber projects, as proposed in the Government's statement. These projects, by their specialised nature and scale, have significantly different business, resourcing and operational requirements, compared to the larger 'commodity' projects. Some are also offered on a 'production unit' and not a 'per hectare' basis. The Government must further consult with industry at the earliest opportunity to fully consider these structural adjustment aspects prior to putting such arrangements in place.

### *Industry Position*

***An arbitrary dollar-value cap on first year deductions is not necessary because market-based mechanisms, including the immediate introduction of secondary market trading as soon as possible, provide the necessary constraints on costs.***

### ***3. Extending the establishment activity period from 12 months to 18 months***

Although proposing to remove the 12-month prepayment rule *per se*, the Government has also proposed that "*the period within which planting must occur as a condition of deductibility should be extended from 12 months to 18 months*".

The forest industry acknowledges the Government's policy intent of enabling the timing of plantation establishment operations to be driven by silvicultural considerations rather the artificial constraints of the financial year. In its submissions to the plantation taxation review, the forest industry raised the issue of variable climatic conditions and the effect on the planting season for plantations, and therefore would support this proposal to extend the establishment activity period from 12 months to 18 months.

This can easily be achieved within the existing 12-month rule tax arrangements applying to retail forestry projects.

## Conclusion

An extension of the period for plantation establishment activity is a recognition of the complex and unique nature of broad-acre plantation establishment across a wide range of climatic zones in a large continent – assessing and acquiring suitable land (by lease or purchase); growing nursery stock over the several months prior to planting out; preparing sites (cultivation and weed control) many months before planting; planting and fertilising the seedlings in the right conditions for early growth; and follow-up in-fill where some early plant mortality may have occurred.

The length of the establishment period is immaterial for tax purposes, because the 12-month rule legislation has a special provision to offset the inherent lag between tax expenditure (the growers,

deductions) and tax revenue (company tax paid), to provide 'tax symmetry'. Section 15-45 of the *ITAA 1997* requires that the project manager must bring forward its tax liability on gross receipts from growers into the same income year that the growers pay their fees and claim their deductions – whereas the managers would not otherwise have to bring that tax liability to account until the contracted services had been carried out.

### ***Industry Position***

***Industry supports the further facilitation of best-practice forestry through the extension of the eligible plantation establishment period from 12 months to 18 months, by appropriate amendments to the relevant subsections of ITAA 1936.***

## **4. Secondary market trading in retail forestry projects**

In submissions to the plantation taxation review, industry asked the Government to remove tax impediments to the development of a trading market for immature retail plantations. The current ATO interpretation (Tax Ruling TR 2000/8) threatens the loss of deduction benefits for establishment costs if there is intentional trading of retail plantations.

The plantation industry acknowledges the Government's recognition of the role that 'secondary markets' can play in attracting a greater proportion of retail forestry investment flows towards longer-rotation sawlog plantations. Government officials confirmed that the policy intent of establishing secondary market trading in plantations was twofold:

- (i) to facilitate investment in long-rotation plantations; and
- (ii) to allow greater market transparency and liquidity of investment between the establishment and the final harvest of plantations and the sale of logs produced.

The proposal is that "*trading in forestry MIS investments acquired after 30 June 2008 would be allowed such that:*

- *interests are required to be held by initial investors for a period of four years from the date of entering the arrangement for deductions to be maintained;*
- *all returns to an investor treated as assessable income; and*
- *the cost of acquiring a MIS interest on the secondary market to be deductible against income received at disposal or harvest*".

A significant impediment to investment in long-rotation sawlog plantations is the long and illiquid investment cycle that they represent. The plantation industry considers the introduction of secondary market trading to be a major element of reform that will stimulate investment in such plantations.

The proposal to allow trading after four years in retail forestry enterprises acquired after 30 June 2008 is a positive initiative. However, it could be modified to more effectively deliver the intended policy outcomes.

### **Improving policy delivery**

Within the existing retail forestry project market, there is a bias toward projects that offer a shorter period before a return is obtained – generally about ten years. Plantation managers offering long-rotation plantations (generally from 15 to 25 years) have worked hard to develop competitive products, and have claimed an increasing share of the retail forestry project market. However, a majority share of investment is still directed toward short-rotation plantations.

The proposal to allow trading of plantations after four years should change investor perception about long rotation investments, but investors may still be likely to favour short-rotation plantations. This is because short-rotation plantation investments will hold less risk than long-rotation plantations, particularly where the secondary market is not well established and has a limited potential turnover. Under the proposal, trades will be restricted to retail plantations established after 2008. Therefore, the first potential trade can take place no earlier than 2012-13.

The plantation industry believes that the policy delivery of this measure can be improved by allowing all plantations to be traded, irrespective of when they were established, and extending the holding period to eight years. These changes would do two things to improve policy delivery.

- Allowing trading of all plantations would increase the potential volume of plantation trades significantly, and allow greater market and price transparency between establishment and harvesting of plantations.
- From an investor perspective, the relative benefit of being able to trade a plantation after eight years would be greater for long-rotation plantations, placing them on a more equitable investor footing with short rotation plantations.

It should be noted that, although this alternative proposal would allow the sale of retail plantations at any time after eight years, this does not mean that significant trading would occur in that time period. The actual plantation age at which the majority of secondary market transactions takes place would depend on the interests of the various parties. That is, the initial investor may well be looking to retain the investment for ten years, as in a short rotation pulpwood plantation, or the purchaser may be a wood processing company that wishes to secure its wood supply some three to five years in advance of an initial harvest (thinning) or final harvest.

Allowing trading after a holding period of eight years would allow a more accurate valuation of the plantation to occur, as the potential volume of merchantable timber can be more accurately assessed, and the trees are closer to the age when the plantation can produce a commercial return from thinning or harvesting.

## **Conclusion**

Additional benefits in favour of enabling immediate trading of immature eight-year old plantations are:

- an immediate market-based price-discovery mechanism that would inevitably flow back to the initial woodlot price to the growers, and put additional competitive pressure on retail forestry project companies. This issue was raised in the #2 above;
- a bringing forward of significant tax revenue from plantation trades that, under existing arrangements, would only be realised when the plantation is harvested.

Trading of interests in immature retail forestry projects can easily be facilitated under the prevailing general business deduction and 12-month rule taxation structure.

## ***Industry Position***

***As soon as possible, the Government should take steps, through appropriate legislative or administrative mechanisms, to permit retail forestry project managers to offer trading of standing plantations no younger than eight years old at the time of sale, without loss of tax deductibility for the original growers.***

## **5. Certification of retail forestry project managers**

The proposal is that “*deductibility would also be conditional on the certification of the MIS company to ensure best practice in forestry, regional planning, land use and natural resource management, under arrangements to be developed by the Department of Agriculture, Fisheries and Forestry*”.

The Government's policy intent in developing this element of the proposal is to ensure best practice for plantations established through retail forestry projects.

The retail forestry sector considers that it already conducts best practice in establishing plantations and that it would be more appropriate to strengthen existing arrangements, if and where necessary, rather than superimpose an additional layer of regulation and compliance. Any such certification process

will involve significant costs, which will ultimately be borne by the plantation grower. This would contradict the Government's policy objective of reducing costs and providing greater certainty. It is vital that the Government is aware of, and takes account of, the diverse array of mandatory and voluntary regulation and certification currently complied with by plantation managers, illustrated in the following paragraphs.

- (i) With particular regard to the areas of interest covered by the proposed arrangement – “best practice in forestry, regional planning, land use and natural resource management” – plantation managers must comply with the same planning and environmental regulations as all large-scale private plantations. These regulations can be at the level of the Commonwealth (eg, under the Environmental Protection and Biodiversity Conservation Act), but especially at the State level (under various environmental, water and vegetation management, threatened species, and (in some States) planning regulations), and local government level (eg, planning and zoning). In addition, all large-scale plantation forestry activities are carried out in accordance with State codes of forestry practice or equivalent regulations.

For all States except Queensland, the Commonwealth itself has formally endorsed plantation codes of practice or equivalent regulations, following a thorough review by CSIRO, in the context of the export of unprocessed wood.

- (ii) In particular, all retail forestry projects engage the services of an independent forester, who acts in accordance with codes of conduct overseen by the Association of Consulting Foresters of Australia (ACFA) and Australian Forest Growers (AFG). The independent forester assesses the operations of the retail forestry project; in particular, species suitability, land selection, forest management, market outlook, and harvesting and marketing operations. The independent forester's report is always embodied in the product disclosure statement, and thus becomes an integral part of the legal commitments made by the manager with ASIC and the ATO. Most independent foresters are also engaged to monitor the growth and health of the plantations and provide a periodic report to the growers.

If the Government wishes to strengthen the regulatory framework, one option would be to find ways to make better use – as external independent assessors – of the expanding pool of foresters who are formally accredited as Registered Professional Foresters (RPF) by the Institute of Foresters of Australia.

- (iii) Most retail forestry managers have received certification for quality assurance and environmental management systems under appropriate ISO standards.
- (iv) All retail forestry managers have achieved or are considering accreditation under one or both of the two internationally recognized sustainable forest management certification standards – the Australian Forestry Standard (AFS), and the Forest Stewardship Council (FSC). Both of these standards require strict compliance (and maintenance of that compliance) with comprehensive environmental, economic, and community consultation criteria.
- (v) Although it is voluntary, compliance with the Australian Forest Growers' (AFG) *Disclosure Code for Afforestation Managed Investment Schemes* and the promotion of the companion AFG *Investors' Guide to Afforestation Investment* is another way in which the retail forestry managers demonstrate their commitment to high standards of disclosure and conduct.
- (vi) Also, all retail forestry managers have in place company-specific codes of practice and codes of conduct for implementation by employees and contractors.

- (vii) Plantation companies and retail forestry managers operating in Tasmania have adopted a *Good Neighbour Charter*, which is a voluntary code of conduct for plantation managers in their relations with neighbouring rural properties. The industry is in the process of expanding this 'charter' for adoption by retail forestry managers Australia-wide.
- (viii) Retail forestry managers employ various other measures to ensure and maintain high quality and value in their operations and service delivery. Companies receive research reports from independent research analysts, which thoroughly assess projects and then assign ratings of investment value to assist financial advisers in the advice they offer to potential investors.

Further information on regulation of the retail forestry sector and steps in setting up a retail forestry project is in **Attachment J** and **Attachment K**.

### **Conclusion**

The proposal does not explain how it envisages deductibility and 'certification' being linked. Should the proposal proceed, the plantation industry looks forward to being consulted on the mechanisms the Department develops for a workable framework for certification of retail forestry managers and for linking that certification to deductibility for participating growers.

### *Industry Position*

*The Department of Agriculture, Fisheries and Forestry, in consultation with industry, should develop an arrangement that documents, acknowledges and, where practical, streamlines existing arrangements.*

*Industry is committed to working with the Department of Agriculture, Fisheries and Forestry on how industry can improve consultation and communications with local communities.*

## **6. Capping first-year deductibility for 'boutique' forestry projects**

The proposal is that "in recognition that there are higher costs associated with boutique forestry schemes, such as sandalwood, an appropriate treatment for such schemes is to be considered in consultation".

- Many of the issues surrounding setting a cap for 'boutique' forestry projects were addressed in #2.
- 'Boutique' forestry projects are more accurately described as 'specialty, higher value' forestry projects. They include, so far, sandalwood, paulownia, teak, African mahogany and red mahogany, but also encompass Australian tropical cabinet timbers and other native species intensively managed for high-value end-products.
- A trend is emerging towards offering retail forestry projects using a variety of timber species and a combination of short- and long-rotation management regimes to produce a number of different end-value products. This creates uncertainty in the definition of a so-called 'boutique' forestry project.

### **Conclusion**

Difficulty in defining a specialty 'boutique' project, and differentiating it from a mixed species project, as well as from the wide variation in so-called 'commodity' projects in diverse climatic zones, will make this proposal unworkable in practice. Specialty 'boutique' projects may also be offered on a 'production unit' rather than 'per hectare' basis.

## ***Industry Position***

***Any arrangement developed with respect to the deductibility for specialty high-value projects must be considered in the context of the full continuum of retail forestry projects. Thus, this proposal has been addressed as part of proposal #2 above.***

### **7. Administration of the goods and services tax**

The proposal is that “*the administration of the goods and services tax (GST) for MIS arrangements would be simplified, by ensuring that individual investors in an MIS are treated as passive investors for GST purposes (thereby removing them from the GST system, subject to the agreement of the States and Territories)*”.

The plantation industry welcomes the Government's recognition that collection and payment of GST within retail forestry projects is administratively complex under the existing arrangements and onerous for both the ATO and the retail forestry sector, which acknowledges the Government's intention to simplify these arrangements.

The Government's proposed solution is to remove retail forestry investors from the GST system altogether by classifying them as ‘passive investors’.

However, while apparently simple and straightforward, such a solution relies entirely on creating a legal fiction by overturning the long-standing legal form of retail forestry projects whereby investors are growers ‘carrying on a business’.

The Government's proposal doesn't canvass alternative ways to simplify the treatment of GST while remaining consistent with the legal form of the current business structure. These include:

- (i) the ATO's own proposed ‘snapshot method’, whereby the managed investment scheme Responsibility Entity (RE) takes a ‘snapshot’ (an estimate) at a point in time of the number or percentage of growers in the project that are registered for GST, and then uses that estimate to calculate and remit GST on sales of pooled scheme produce (eg, felled timber), where the sales are made through the RE acting as the agent for each grower;
- (ii) ‘deeming’ all growers to be GST-registered and appointing the Responsible Entity as a single transaction centre for all GST-related transactions;
- (iii) application of joint venture principles; and
- (iv) enabling the use of ‘receiver-created tax invoices’.

The ATO itself has previously discussed the first two of these options with industry representatives.

## ***Industry Position***

***The Government, through either a legislative or an administrative solution, should simplify the treatment of GST within retail forestry projects in a way that is consistent with the prevailing legal form of the participants carrying on a business.***

### **8. Review of tax arrangements for retail forestry projects**

The Government has proposed that “*the proposed taxation arrangements would be fully reviewed in 2011 to examine the appropriateness of the arrangements in the context of the Government's forestry and broader policy objectives*”.

The plantation industry acknowledges the importance and value of periodically reviewing various elements of public policy. However, we believe the ‘period’ must be relevant to the nature and intent of the policy being reviewed.

Timber processing and value-adding requires secure, consistent, long-term, large-scale flows of harvested wood of the required specifications at competitive prices. Stable wood flows in turn require long-term stable policy settings, including taxation. Policy changes can even threaten the marketability of existing plantations, if the regional estates don't continue to expand to the size of the critical mass needed to supply new processing facilities.

It is difficult and expensive for processors to manage large fluctuations in wood flows, as will occur in 5–15 years time from the policy-induced peaks and troughs from 2000 to 2003. It is vital that there be a substantial period of policy stability to avoid a recurrence of that upheaval. If, as a result of this present consultation, another change in tax arrangements were to be implemented in 2008, a review period as short as the three years proposed (in 2011), would exacerbate a climate of instability and uncertainty, contrary to the Government's stated intention of these proposals. Furthermore, a three year period is inconsistent with the four-year holding period proposed for the secondary trading provision (2012-13).

### **Conclusion**

A review date of 2013 and an implementation date of 2015 would allow appropriate time for the existing or revised arrangements to be assessed against the Government's forestry and broader policy objectives, including the Plantations 2020 Vision. This would lessen the risk of unnecessarily destabilising the plantation industry with the uncertainty about the policy settings affecting investment flows that provide the wood resource for domestic and export processing industries.

If the review is to be done in "in the context of the Government's forestry and broader policy objectives", it should be conducted jointly between the Department of Prime Minister and Cabinet, the Treasury, and the Department of Agriculture, Fisheries and Forestry.

### *Industry Position*

*Any new arrangements put in place as of July 2008 should be reviewed no sooner than 2013, with any new arrangements to be applied no earlier than 1 July 2015, and the review must be conducted jointly by the Department of the Prime Minister and Cabinet, the Treasury, and the Department of Agriculture, Fisheries and Forestry.*

## **Other issues not dealt with in the Government's proposal**

The Government's 'Review of the taxation of plantation forestry' had five terms of reference dealing with commercial viability, the role of State and Territory Governments in the plantation industry, the integration of plantation development and natural resource management, and the relative effectiveness of tax and expenditure measures to deliver assistance to the industry.

Industry notes that the proposed taxation arrangements released by the Government do not address all concerns raised in submissions to the review. In particular, the issues of **profit a prendre** and **period inequity** are not addressed. The industry would welcome the Government's findings on these issues in the near future.

Another issue that warrants close attention is that of **comprehensive, independent industry performance information**, referred to by industry submissions to the Government's Review in 2005. Those submissions expressed concern that there is insufficient reliable and independent public information about the whole of the forest growing and wood and paper processing industry, transparently showing the performance of the various sectors and the trends in the markets in which they operate.

Collecting and publishing such data requires co-operation between plantation growers and processors – providing basic data – and the independent agency/ies (ABARE, BRS) – collating, analysing and publishing the information so as to be valuable without breaching commercial confidentiality. There also must be a commitment by both government and industry to continue the process as an ongoing core activity for the benefit of policy makers, the industry, its investors and the public.

Members of the plantation industry are prepared to work with the Government to develop the system for collecting, analysing and reporting the information, and are willing to co-operate by providing basic data in the appropriate form, once agreed.

*Industry Position (derived from previous industry submissions)*

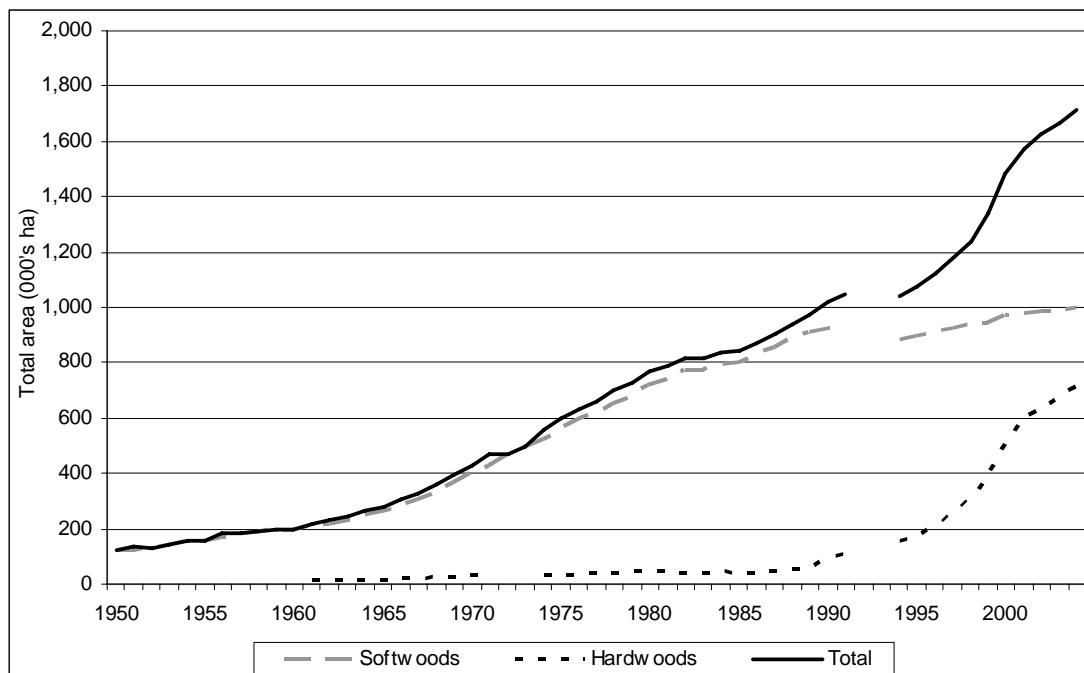
***The Government should commit adequate and ongoing core funding for ABARE and BRS to conduct and publish periodic surveys, inventories and analyses of the supply and demand conditions facing the forest growing and wood and paper processing industry, of the performance of the components of the industry, and of trends in key financial and socio-economic indicators.***

***The plantation industry is committed to working with the Government in compiling this information.***

## History of forest policy and government assistance in Australia

From the 1960s to the 1980s, Australia's plantation estate expanded at a relatively steady rate, driven mainly by the softwood sector, with around 90 per cent of establishment carried out by state government agencies (see Figure A1). Over this period, plantation establishment was largely supported by loans from the Australian Government to state governments through the Softwood Agreement Acts (SAA) of the 1960s and 1970s.

**Figure A1: Plantation development phases (1950 to present)**



**Notes: 1880s to 1960:** low establishment rate; mainly State Government funded plantations.

**1960s to 1980s:** higher establishment rate; Australian Government loans, mainly pine plantations.

**1990 onwards:** high establishment rate; mainly privately funded hardwood plantations.

Even after the SAA had finished in the early 1980s, the softwood plantation estate continued to expand with continued investment by state governments and by 1990, the softwood plantation estate had reached 943,000 hectares. As shown in Figure A1, since 1990, the rate of new softwood plantation establishment has slowed to less than 10,000 hectares per annum, due to a fall in investment in new plantations by state governments and a shift in investment to new hardwood plantations and replanting harvested areas.

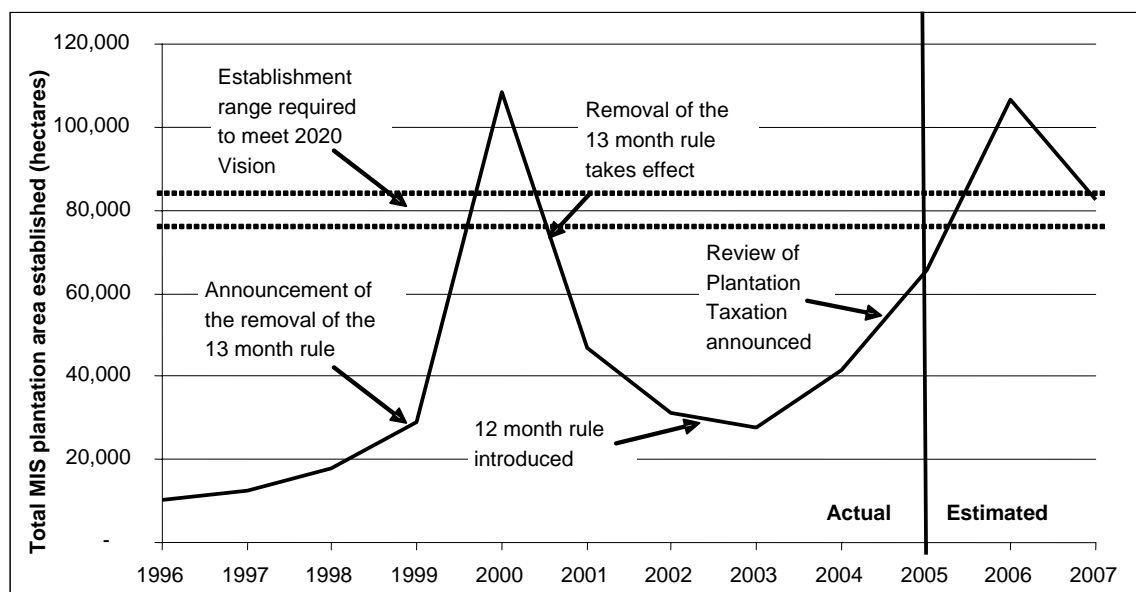
While a range of 'tax-efficient' investment schemes arose during the 1980s, they stimulated little investment in private plantation resources. The extent of hardwood plantation establishment prior to 1990 was minimal. However, the past ten years has seen hardwood plantations make up 84 per cent of new plantation areas. Strong investment has seen the hardwood plantation establishment rate increase to 74,000 hectares per annum since 1997, with the hardwood plantation estate reaching 714,000 hectares in 2004.

Hardwood plantation establishment has been driven mostly by the private sector, as over the past 10 years, an average of 65 per cent of the plantation area established has been by the forestry managed investment schemes ('retail forestry projects'). That proportion has been increasing, and may now be as high as 90 per cent. In comparison, over the same period, less than 25 per cent of the total plantation area has been established by state government agencies.

The acceleration in private plantation establishment, particularly short-rotation blue gum plantations, was supported by the release of the government-industry strategy for plantations (*Plantations for Australia: The 2020 Vision*), the application of the 13-month prepayment rule, and the introduction of the product ruling system by the Australian Taxation Office.

The abolition of the 13-month rule and uncertainty surrounding the investment and tax rules applying to retail forestry projects, resulted in a dramatic fall in the level of investment, until the introduction of the 12-month prepayment rule in 2002 (see Figure A2). Under the 12-month prepayment rule, there is a one-year delay between the collection of immediately deductible investment funds and the establishment of new plantations.

**Figure A2: The effect of tax policy changes on MIS plantation establishment**



The area of new plantation establishment has been increasing since 2003. However, the retail forestry sector is far from being 'overheated', as the recovery trend of the sector might imply. As evidenced by the 2005-06 retail woodlot sales (shown in **Attachment G**), plantation establishment is now settling down to oscillate around its long-term sustainable trend of about 80,000 hectares of new plantations per year. This is consistent with the rate required to create a national plantation estate of about 3 million hectares by 2020, the target of the *Plantations 2020 Vision*.

## Resource and Industry Development

Expansion of Australia's plantation resource is directly linked to industry development. Opportunities to increase the capacity of the processing industry will depend on plantations reaching maturity and having the critical mass to support the resource requirements of processing facilities.

The expansion of the softwood plantation resource, mostly between 1960 and 1990, has supported industry development which now provides an annual turnover in excess of \$13 billion. This resource also supports over 50 sawmills, nearly 20 wood-based panel production facilities, and 6 pulp mills.

The second phase of the softwood industry's development is currently in progress with over \$1.5 billion invested in new, and upgrading existing, production facilities over the past 5 years. Further developments and mill upgrades are planned, with a potential investment of almost \$1 billion over the next 5 years.

The recent rapid growth in hardwood pulpwood plantations has also stimulated considerable interest in industry development to utilise this resource. There are currently 13 proposed new mill developments, at various stages of planning and development, to utilise the hardwood pulpwood resource. The developments include 6 pulp mills, 3 sawmills, 3 woodchip and export facilities and an engineered wood product (EWP) mill. The total of current industry development proposals, as outlined in Table B1 below, will add over \$4 billion worth of new capacity to the industry.

**Table B1: Current and proposed new industry development**

Company	Location	State	Investment Type	Year Complete	Value (\$million)	Direct employment	Indirect employment
Pinetec	Collie	WA	Softwood Sawmill and Pallet Plant	2006	16	10	25
IFP/Timbermans Group	Bombala	NSW	New Sawmill	2006	35	20	50
Willmott Forests	Bombala	NSW	Sawmill / Preservation Plant Upgrade	2006	60	40	100
Norske Skog Aust	Albury	NSW	Paper Mill Upgrade	2006	130	50	130
Weyerhaeuser	Tumut	NSW	Sawmill Upgrade	2006	60	30	80
Western Australian Plantation Resources	Bunbury	WA	Woodchip Mill	2007	35	25	60
Green Triangle Forest Products	Mt Gambier	SA	Sawmill Upgrade	2007	30	30	80
Lignor	Albany	WA	Engineered Strand Lumber	2008	200	143	650
Gunns	Bell Bay	TAS	Pulp Mill	2008	1,500	300	780
Ta Ann Holdings	Huonville	TAS	Plywood & Rotary Veneer Mill	2008	30	100	260
Ta Ann Holdings	Smithton	TAS	Plywood & Rotary Veneer Mill	2008	30	100	260
Timbercorp/ITC	Millicent	SA	Woodchip Export Facility	2008	30	60	156
Heywood	Heywood	VIC	SCTM Pulp Mill	2008	400	120	300
Australian Paper/Paperlinx	Maryvale	VIC	New/replacement Pulp Mill	2008	258	200	520
Forest Enterprises	Northern NSW	NSW	New Sawmill	2008	25	40	100
Swanbank Paper	Ipswich	QLD	Printing and Writing Paper	2008	50	120	300
Penola	Penola	SA	SCTM Pulp Mill	2009	650	120	300
VISY	Tumut	NSW	2nd Paper Machine & Increase Pulping Capacity	2009	450	200	520
				<b>Total</b>	<b>3,989</b>	<b>1708</b>	<b>4671</b>

Of the current hardwood pulp mill proposals, which are at various stages of development, the Gunns and PaperlinX proposals are both expected to commence production in 2008. These two mills would together increase Australia's Bleached Hardwood Kraft Pulp (BHKP) production capacity by 1.15 million tonnes per year and consume over 4.5 million cubic metres of pulpwood

per annum. Two other proposals for pulp mills, in western Victoria (Heywood) and southeast South Australia (Penola), have the potential to double this should they proceed, increasing Australia's domestic processing of hardwood pulpwood to almost 10 million cubic metres per year.

**Wood production** - Australia's softwood plantation resource of 1 million hectares provides over 14.7 million cubic metres of timber each year, of which 9.2 million cubic metres is sawlog and 5.2 million cubic metres is pulp log. From this, 3.5 million cubic metres of sawn timber, 1.9 million cubic metres of wood-based panels, and almost 1 million tonnes of softwood based pulp, is produced.

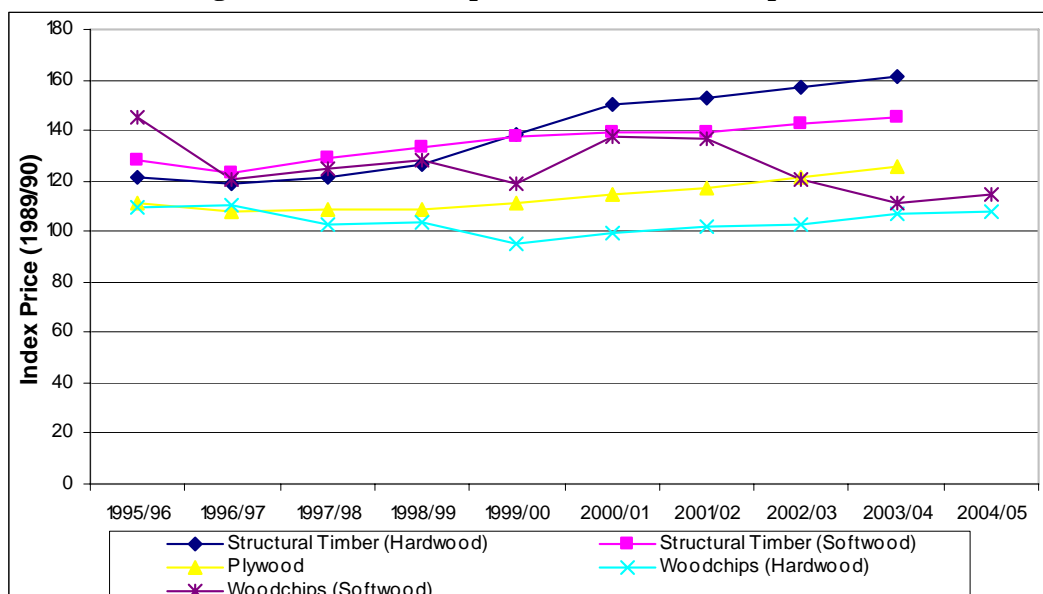
With the decline in softwood plantation establishment rates in recent years, to less than 10,000 cubic metres per annum, softwood log supply is only expected to increase by 3 per cent by 2020. While softwood sawn timber and pulp production has grown strongly over the past 20 years, over 440,000 cubic metres of radiata pine sawn timber and 243,000 tonnes of softwood pulp were imported in 2004.

Most of the hardwood plantation resource has been planted over the past 10 years, with the hardwood plantation area increasing from 175,000 hectares in 1995 to 715,000 hectares in 2004. The supply of hardwood pulpwood from plantations is expected to increase from 1.2 million cubic metres in 2004 to almost 12 million cubic metres by 2010, and 18 million cubic metres by 2020. This represents more than double Australia's current hardwood pulpwood supply of around 8 million cubic metres, the bulk of which is presently sourced from native forests. While the supply from native forests is expected to fall steadily over the next 15 years, it is likely to remain at around 5 million cubic metres by 2020.

**Commodity prices in the forest industry** – As shown below in Figure B1, the commodity prices for some selected forest products in Australia have been relatively stable over the past 10 years. There has been a gradual trend towards stabilisation of prices, and in most cases, a steady increase in these commodity prices.

The prices for softwood and hardwood woodchips have remained relatively stable over the past 10 years, with only minimal variations in prices from year to year. Hardwood and softwood structural timber and plywood prices on the other hand, have showed a fairly steady increase over the 10-year period.

**Figure B1: Australian prices of selected forest products**

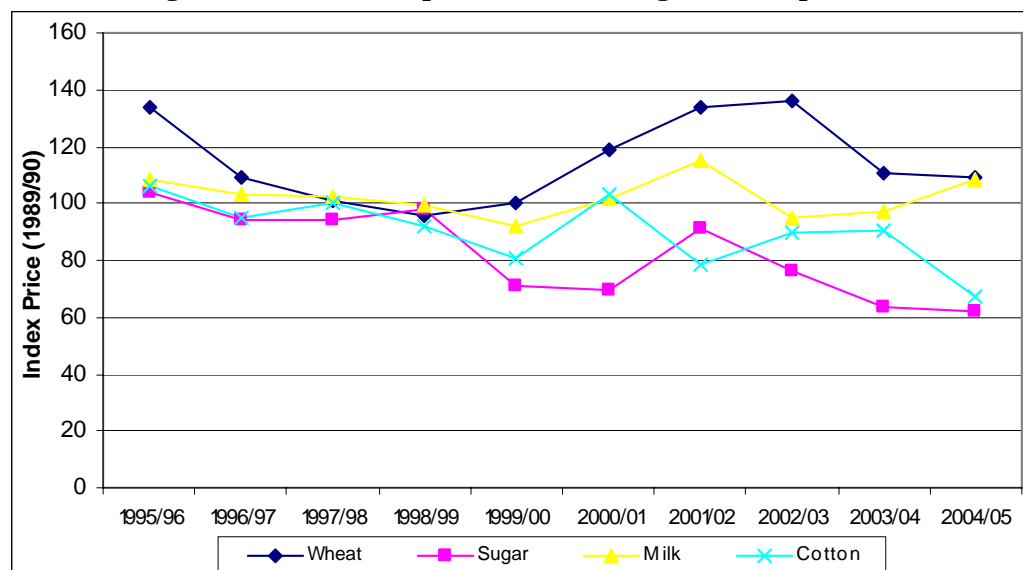


Source: ABARE. Australian Commodity Statistics 2005

In comparison, the commodity prices for some selected agricultural products in Figure B2, show a much greater degree of fluctuation in the prices from year to year and over the 10-year period, when compared with the forest products. Also, the prices of all selected agricultural products are lower in 2003/04 compared with 1995/96, reflecting a downward trend in agricultural commodity prices.

It is claimed by some commentators that the commodity prices of Australia's forest products are unstable and are falling over time, which leads to questions over the future viability of the forest industry. These claims are contrary to the evidence provided above, and in fact, it is shown that the stability of Australia's forest product prices is superior to that for agricultural products, which show a considerable degree of fluctuation over time. Therefore, if stable and rising commodity prices are anything to go by, it would appear that the long term future viability of the forest industry is looking fairly bright.

**Figure B2: Australian prices of selected agricultural products**



Source: ABARE. *Australian Commodity Statistics 2005*

It should also be noted that the stability and gradual rise in Australia's prices for forest products reflects the long-term nature of forestry both domestically and abroad. It also reflects the increasing global demand in forest and wood products, resulting in part from the intensive utilisation of forests in certain parts of the world. As access to timber resources becomes increasingly constrained, due to environmental pressures on logging native forests and decreasing land availability for plantation development, countries such as Australia, with a high quality plantation resource, will experience a sustained level of demand for its forest products, resulting in a continuation of the stable and gradually increasing commodity prices over time.

## Overseas Experience

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### Global support options for plantations

Wherever plantations have been established around the world on a significant scale, governments have implemented major programs to encourage investment into those commercial tree crops. This is a reflection of the investment climate that surrounds plantation forestry. Independent of the rotation length applying to plantations or the potential returns available from the timber that is harvested, the requirement for significant up-front cash outlays to establish the plantations followed by lengthy periods before any returns are realised, presents a number of risks for investors.

The following summary outlines some of the program options introduced in overseas countries that are highly reliant on plantation timber resources. In many cases, the timber-producing companies in those countries are competing with Australian companies for a share of the world's timber markets. Each of the programs have been shown to drive investment into plantation forestry and when those programs are removed, plantation investment falls away quite sharply.

**New Zealand** – The plantation programs have been quite variable over the past 45 years. Grant programs operating from 1970 and again from 1980, provided a cash grant of up to 50% of the costs of afforestation. Plantation establishment rates increased almost immediately after the programs were introduced. Even though the companies could access immediately deductibility allowances for their expenditure on plantations, once these programs finished, the expansion of the plantation estate was markedly reduced.

When the immediate deductibility provisions were removed in 1987 (so that the projects were treated like capital investments), there was a further decline in the annual plantation establishment rates. A return to immediate deductibility, in combination with a range of events that provided investors with greater certainty of the taxation treatment applying to these activities, led to an increase in the plantation establishment rate from 15,000ha in 1991 to approximately 80,000ha per annum through the middle of the decade.

**Chile** – In 1974, the national Government passed Decree Law 701, which provided a 75% subsidy for plantation establishment and tending costs of exotic tree species, combined with tax exemptions for foreign investment. Plantation establishment rates increased from 30,000ha per annum in 1970 to 80,000ha in 1975. When this law was repealed in 1995, establishment rates fell to between 5,000 and 6,000 hectares per annum.

**United Kingdom** – In the period between 1960 and the late 1980s, plantation forestry expenses were immediately deductible against other sources of income, where the top marginal tax rate was 83% between 1975-1980 and 60% until 1989. Overall, these taxation conditions supported a significant amount of new investment into plantation forestry projects.

In 1989, the Government removed the immediate deductibility provisions, although the profits on later logs sales became tax free. These changes led to an immediate reduction in plantation establishment. To retain any significant level of investment in plantations, the Government introduced a range of incentive schemes.

**Brazil** – The Fiscal Incentive Law (1966) was an incentive (establishment subsidy) program for expanding the plantation estate with fast-growing timber species. Between 1974 and 1982, the program supported an average increase in the plantation estate of about 400,000ha per annum. Due to domestic financial troubles and the misuse of the incentive program, it was reduced in 1983. After it finished in 1988, plantation establishment rates fell sharply and have remained low ever since.

Almost twenty years later, that sudden reduction in plantation investment has led to a reduction in wood supply for the growing domestic economy. The greatest impact is in their softwood sector, where the rapidly rising log prices and the limited availability of wood have reduced the international competitiveness of at least this sector of their industry. This is a good example of why it is essential to retain some consistency in the approaches to support plantation development (and the subsequent establishment of plantation resources).

**Uruguay** – Forestry Law No. 15.939 was passed in 1990, outlining a program of credits and fiscal incentives to promote investment in plantation forestry. The program included a 50% subsidy for the estimated planting costs of reforestation, exemptions from land taxes, and low interest rate loans to cover the costs of establishment. Establishment rates fell away during the Argentinian-Uruguayan financial crisis around 2000 and in early 2005, as the national Government removed the plantation investment subsidies.

**Argentina** – Forestry Law No. 25.080 was introduced at the end of 1998 to encourage the establishment of new plantations. Grants are paid to cover part of the establishment costs. In general, the grants are 80% of the plantation establishment costs for areas less than 300ha and 20% of the establishment costs for areas greater than 300ha. Additional benefits provided under the forestry law include accelerated depreciation allowances on capital equipment used for timber milling. Although the plantation establishment rate increased after the forestry law was introduced, the collapse of the Argentinean economy and lengthy delays in the payment of the grants led to a significant loss of confidence in the plantation sector.

**Indonesia** – A re-forestation levy of approximately \$20 per cubic metre on harvested native forest timber was used to finance that country's plantation establishment program. These funds were used to provide an interest-free loan worth 32.5% of the cost of plantation establishment and management. It was combined with government financing for 14% of the plantation costs (in return for the Government having 14% equity in the resources) and the companies providing 21% of the costs. Commercial loans were taken out to fund the remainder of the total plantation costs.

**China** – A major program is in place to raise the total area of forest coverage through the establishment of plantations and limiting the access to native forests. The plantation activities are supported by low-cost seedlings, land grants, grants to growers, and concessionary loans (through the Development Bank and the Agriculture Bank).

**India** – Social forestry programs were used to support the expansion of plantations. With these donor programs finishing in the early 1990s, plantation investment has been assisted through the provision of grants to growers, land grants, the provision of seedlings, and concessionary loans.

**Malaysia** – Tax incentives alone did not act as the catalyst for new plantation investment. As a result the establishment rate for new plantations has remained relatively low.

**United States** – High timber prices, technological advances and favourable tax policies were responsible for the increase in private investment in plantations between 1945 and 1976. During that time, 11.7 million hectares of the current total of 16.2 million hectares of plantations were established. Between 1977 and 1997, there was a more conservative rate of plantation growth.

**European Union** – The EU has had a significant plantation subsidisation program in place since 1979. In 1992, Regulation 2080/92 was introduced, with a budgeted cost of approximately \$1.5bn to refund a significant proportion of the plantation establishment and management costs. In areas where the per capita GDP is less than 75% of the EU average, the maximum refund rate is three-quarters of the plantation costs. In all other areas, up to half of the plantation costs may be refunded. Regulation 2080/92 sets out the maximum payments to plantation growers and is a mandatory requirement in each of the EU member countries. Maximum payments are approximately \$3,200, \$4,000 and \$6,250 per ha for the establishment of short rotation tree crops, conifers and hardwood plantations, respectively. Annual maintenance costs of between \$150-\$500

per hectare are provided together with income compensation to farmers of more than \$600 (per hectare per year for 20 years), a woodland improvement payment, payments for forest roads, and contributions towards firebreaks and dams are all available to plantation growers.

As a result of these programs, private plantation establishment has increased and there is a declining interest in short-rotation plantation (where there are no maintenance or income support programs for trees grown under rotations of 16 years or less). One of the primary motivating forces behind the program is to retire land from agricultural production. It is important to note that the Regulation provides an excessive emphasis on establishing new tree farms, rather than encouraging good (and improved silviculture) in existing plantations.

There are many interesting outcomes from the introduction of Regulation 2080/92. For example, in Ireland, some 75% of the agricultural land converted to plantations with the aid of the subsidies, has been sold off to other investors.

## **Conclusion**

From a whole range of countries, there is considerable evidence to demonstrate plantation expansion will only proceed on a scale that can supply a critical mass of resources where there are long-term programs of government incentives or beneficial taxation arrangements. As a result, all of our international competitors are reliant on these support programs to build their forest industries. The loss of these favourable treatments led to an almost immediate loss in private sector investment in plantation forestry and the potential introduction of other programs to help retain their competitiveness.

Of all the incentives that have been investigated, not one has emerged as being definitely perverse (FAO, 2004). The impacts of these plantation programs have varied considerably, depending on when they are used during the development of a country's plantation estate. However, the greatest gains arise when the policies create a favourable and attractive investment climate that reduces the risks of investment and is designed to remove the structural impediments to investment (FAO, 2004).

## **References**

Note: the information contained in this attachment represents a summary of material provided in a consultants report prepared for NAFI by Jaakko Poyry and Dana Limited, supplemented with details from the following FAO report:

FAO (2004). *What does it take? The role of incentives in forest plantation development in Asia and the Pacific*. Executive Summary (RAP Publication 2004/28). Asia-Pacific Forestry Commission, Food and Agriculture Organisation of the United Nations. Edited by Thomas Enters, Patrick B. Durst, Chris Brown, Jim Carle and Philip McKenzie.

## The regional impact of changing the taxation arrangements for plantation forests

In the event of a major reduction in the plantation industry's production, through the removal of the 12-month rule, the following economy and region-wide consequences, are predicted<sup>4,5</sup>:

- 35% decrease in the annual production of the plantation industry;
- \$1.2 billion reduction in the industry's gross value of production;
- declines in the exchange rate, GDP and housing construction;
- imports increasing by \$523 million per annum (25%);
- substitution away from domestically produced wood and paper products, towards imported wood and paper products;
- fall in employment of around 35% within the plantation industry;

**Table B1: Long term regional employment impact of removing the 12 month rule**

Region	Job Losses
Southern and Eastern South Australia (Mount Gambier)	1600
Barwon-Western (Southwest Victoria)	1100
South Eastern NSW (Eden-Bombala, Tumut)	1100
Northern Tasmania (Northeast Tasmania)	900
Goulburn-Ovens-Murray (Myrtleford-Albury)	1300
Inland Northern and Central NSW (Oberon)	1400
Lower Western WA (Albany)	1900
Wide Bay-Burnett (Gympie)	700

- movement of resources out of the main plantation timber-dependent regions such as Northern Tasmania and Lower Western WA and into mining-dependent regions such as the Northern Territory;
- very little of the \$4.5 billion (see Table A1) of industry investment in value-adding will proceed; and,
- potential to reduce the ability of the Plantation Industry to reach the critical mass that is required to sustain harvesting and processing facilities in each region over the long-term.

It is essential to have a stable investment regime for new plantations to address the changing nature of Australia's wood resource base. This will encourage investment on the scale required to build the plantation timber resources required by industry.

Removing the 12-month prepayment rule will make it difficult to collect sufficient funds for new plantations to fill the supply gaps currently facing the industry.

<sup>4</sup> Econtech (2006). *The significance of the Plantation Forestry Industry to the Australian and Specific Regional Economies*.

<sup>5</sup> Estimates of the economy-wide impacts are conservative because the analysis is based on the size of the Plantation Forestry Industry in 1998/99.

## Attachment E

# Plantation industries enhance regional economies, communities and environments – Responding to claims about the impact of forestry managed investment schemes

*See also [www.plantationfacts.com](http://www.plantationfacts.com)*

1. Forestry managed investment schemes (retail forestry projects) comprise a maturing, long-term industry, supplying wood to regional timber industries, providing social and environmental benefits to regional Australia, and generating taxable returns to growers.
2. The future depends on long-term stable, predictable policy settings, including taxation, especially retention of year-of-expenditure deductibility, a workable prepayment rule, and trading in immature plantations.
3. Plantation industries enhance regional economies, communities and environments. Facts are presented here about:
  - land use change;
  - land values and financing;
  - population, employment and services;
  - chemicals;
  - water;
  - fire management;
  - roads;
  - government regulation; and
  - environmental benefits.

Widespread establishment of new plantations on cleared agricultural land has been recommended by conservation groups and by numerous Government and Parliamentary inquiries for more than two decades. Nevertheless, the inevitable change in land use and landscapes that is now occurring in selected regions has attracted criticism from some in the communities who do not wish for change.

Criticism of retail forestry projects has largely been localised and based on anecdotal perception rather than on verifiable factual information and empirical evidence. (Sources of data and evidence used in this attachment are provided. Abbreviations are listed at the end of this attachment)

### Land-use change

- Broad-acre cropping, farm consolidation and other factors, not plantations, have been the main drivers of land-use change in the past decade (*Ref: ABS; BRS; ABARE*)
  - Between 1994 and 2004, the total area of land used for cropping and grazing fell by 29 mill ha, compared with an increase in the area of plantations of <0.7 mill ha (2%).
  - In that decade, cropping specialists doubled (from 10% to 20% of total agriculture).
  - Total number of dairy farms fell 27% from 1994 to 2004, but dairy cow numbers rose 14%.
  - Land degradation, urban development and rural residential development are having a far greater impact on land use change than plantation expansion is.
- Although timber plantations are very obvious and do change the appearance of local landscapes, the total amount of rural land being planted is very small. (*Ref: ABS; BRS*)
  - In the five regions that in 2000 accounted for about 70% of total plantations as well as having major timber processing industries, no more than 6% of the land was under plantations.
  - Even in Local Government Areas with the highest concentrations of plantations, maximums of 5% to 20% of agricultural land is used for plantations. (Great Southern, WA)

### Land values and sources of finance (See Attachment H for more details)

- Competition for suitable land between competing land users increases land values. Demand for land from plantations and other land uses contributes to increasing land values during periods of rapid expansion, and has done so in the major plantation regions. (Ref: BRS) This has been welcomed by 'retiring' farmers, many having had properties on the market for some years.
  - However, retail forestry project companies, on average, purchase less than a third of the properties initially considered, often because the price is too expensive, and they frequently lose to other farmers at auctions. (Ref: TIMA)
- Retail forestry companies cannot use growers' lease and management fees to buy land, a non-deductible capital expense. ATO will not issue a Product Ruling if there is evidence to that effect, and conducts 'integrity checks' every year that would discover such evidence. These companies fund land purchases as other businesses do – from loans (debt), from capital raisings (equity), and from their own after-tax working capital (retained earnings). (Ref: ATO; TIMA)

### Population, employment and services

- Recent independent studies of socio-economic impacts clearly show that, except in isolated cases, plantation expansion does not cause decline in rural populations or services. Contrary to some popular misconceptions, plantations tend to slow or reverse rural decline, by attracting more working-age families, creating new jobs and businesses, expanding off-farm work opportunities, and increasing the demand that justifies maintaining and improving community services. (Ref: BRS, 2005)
  - Eg, in Bombala (NSW), the hospital is due to be upgraded and the Westpac bank has re-opened full-time after six years at three days a week, because of the expansion of the plantation industry.
- Plantation forestry is more labour-intensive than local agriculture, providing 2.5 jobs for every 1,000 ha of plantation, cf 1.8 jobs per 1,000 ha used by other agriculture. (Ref: CIE, 2005)
- Plantations have a multiplier of ~2.5 (ie, an extra 1.5 indirect jobs for every direct job), and milling operations have a multiplier of >3 (ie, an extra 2 indirect jobs for every direct job in the mill. (Ref: ABS)

### Use of chemicals

- Plantation managers only use chemical pesticides that are registered or permitted by the Commonwealth regulator – the Australian Pesticides and Veterinary Medicines Authority (APVMA). These same chemicals are used throughout Australian society in agriculture, urban parks and gardens, etc, to control weeds, pest insects and plant diseases.
- Chemicals are applied in accordance with state government regulations and codes of practice, and mostly during the plantation establishment phase. The total amounts used are fractions of those used annually in cropping, horticulture, and livestock pasture management.
- Beyond complying with the law, plantation companies pass stringent tests to secure and retain independent accreditation under the international sustainable forest management standards (Australian Forest Standard and Forest Stewardship Council).
- Claimed links between the few commonly used plantation herbicides and cancer have been discounted by world and Australian authorities. (WHO Drinking Water Guidelines; IARC; APVMA). "Following a detailed investigation, the national regulator of pesticides and veterinary medicines ...[APVMA]...has cleared the herbicide, atrazine, of links to cancer and other health concerns." (APVMA media release #8, December 2004).

## Water

- Plantations, like all forms of agricultural crops, intercept and use water. Trees have a longer growing season, more foliage and deeper roots than pasture or crops.
- Some plantations in some parts of some catchments in some soil and rainfall conditions have the potential to reduce environmental flows. (Ref: 'Plantations and Water Use Review', BRS, 2006)
- Plantations improve water quality, and assist in reversing salinity and erosion.
- The effect on streamflow of converting agricultural land to timber plantation is related to the catchment area affected. In smaller catchments, it is difficult to detect an impact when less than 20% of the catchment is planted.
- In major plantation regions, plantations occupy between 1% and 6% of large catchments.
- No irrigation is used in mainstream plantation forestry. Instead, plantation managers mostly utilise land in higher rainfall areas.
- The retail forestry project sector strongly supports and contributes to research that will enable plantations to be more strategically located in different catchments, in the context of the impacts of all land uses on water yield and quality.

## Fire management

- Well managed plantations are the best insurance against the ignition and spread of fire. All MIS and other large plantation managers protect their valuable plantations against fire by maintaining fire trails, managing fuel loads, and having on hand well-trained and well-equipped personnel capable of responding quickly to outbreaks.
  - In some states, plantation fire-fighting teams can be registered rural fire (industry) brigades.
- Plantation managers enhance the fire-fighting capacity in their regions, and are often the first or only crews available to fight fires on neighbouring rural properties and national parks.

## Roads

- In all areas where timber harvesting has commenced, plantation companies are making a significant contribution to road upgrading and repairs.
  - In all major plantation regions, the plantation industry is working co-operatively with State and local governments to plan future road usage and priorities for upgrading and maintenance of infrastructure (eg, Timber Industry Road Evaluation Study, TIRES).
- Community safety is a priority issue. Wood haulage routes and the timing of truck movements are designed to avoid conflicts with school buses and other regular road users.

## State and local planning and regulatory controls

- Plantation forestry is the most regulated and scrutinised of all broad-acre primary production.
- All aspects of plantation establishment, management and harvesting are regulated through the Commonwealth-approved State Codes of Practice, which are supported by an extensive array of legislation and regulations.
- A number of Local Governments have prepared their own Town Planning Schemes that apply wholly to plantations and to no other land use. In some States (eg WA), plantation forestry is excluded from the intensive agricultural zones.

## Other environmental benefits

- Large-scale broad-acre plantations confer substantial natural resource management benefits from the various set-asides and reserves within and alongside plantations – riparian areas and drainage lines, swamps and wetlands, rocky ridges and steep slopes, and patches of remnant native vegetation, used for various conservation purposes, such as erosion control, enhanced water quality or provision of habitat.
- Plantations themselves are recognised as helping control the level of atmospheric carbon dioxide concentrations (*Ref: IPCC*) by absorbing carbon dioxide during photosynthesis.
- Far from being 'biological deserts', plantations (including pine) support a greater diversity of bird species than the pasture or crop land on which they were established. (*Ref: Lindenmayer et al*)
- Strategic location of commercial plantations in catchments has long been recognised as a partial solution to the problem of dryland salinity. (*Ref: CSIRO; MDBC*)

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## REFERENCE ABBREVIATIONS

ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
APVMA	Australian Pesticides and Veterinary Medicines Authority
ATO	Australian Taxation Office
BRS	Bureau of Rural Sciences
CIE	Centre for International Economics
IARC	International Agency for Research on Cancer
IPCC	Intergovernmental Panel on Climate Change
MDBC	Murray Darling Basin Commission
WHO	World Health Organisation

**Specific references can be provided if necessary.**

## Attachment F

### Retail forestry projects in the managed investment schemes market

The scale of the total 'investment market' in Australia was around one trillion dollars in 2005 – comprising equities, direct and indirect property, infrastructure, structured products, hedge funds, superannuation, and so on.

A great many investment opportunities are structured as managed investment schemes, which can thus span categories in the total investment market.

In a managed investment scheme – which must be registered with ASIC under the Corporations Act – contributions/subscriptions from diverse individual members are pooled together or used in some common enterprise to produce financial benefits for members of the scheme.

Common managed investment schemes include cash management trusts, property trusts, equity (share) trusts, and primary production schemes.

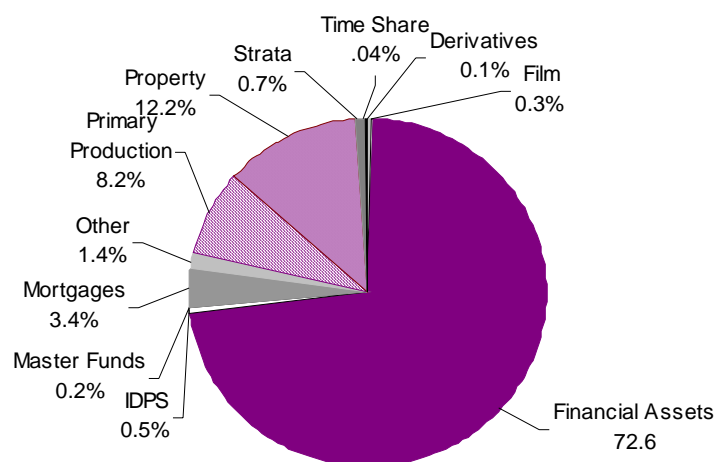
A forestry managed investment scheme ('retail forestry project') allows a group of small forestry enterprises to be pooled and operated by a manager on behalf of the participating growers, who have separate interests in the land and trees and share the harvest returns in proportion to their shares in the total number of woodlots.

Figure F1 below illustrates that in 2001, primary production schemes comprised around 8% of the total number of registered schemes, of which forestry would have been about one tenth of the 230 that made up the 8% - ie, less than 1% of the total. The pie-chart also illustrates the dominance of financial products in the MIS market.

In 2006, this number of primary production schemes was 68, of which forestry represented less than a third.

A total level of investment in retail forestry projects of around \$700 million in 2005-06 would therefore represent but a fraction of the total managed investment scheme turnover.

**Figure F1: Industry profile of registered schemes as at 16 August 2001**



Source: Review of the *Managed Investments Act 1998* Report. Commonwealth of Australia 2001

## Retail forestry project fund-raising and plantation establishment ...recent and future trends

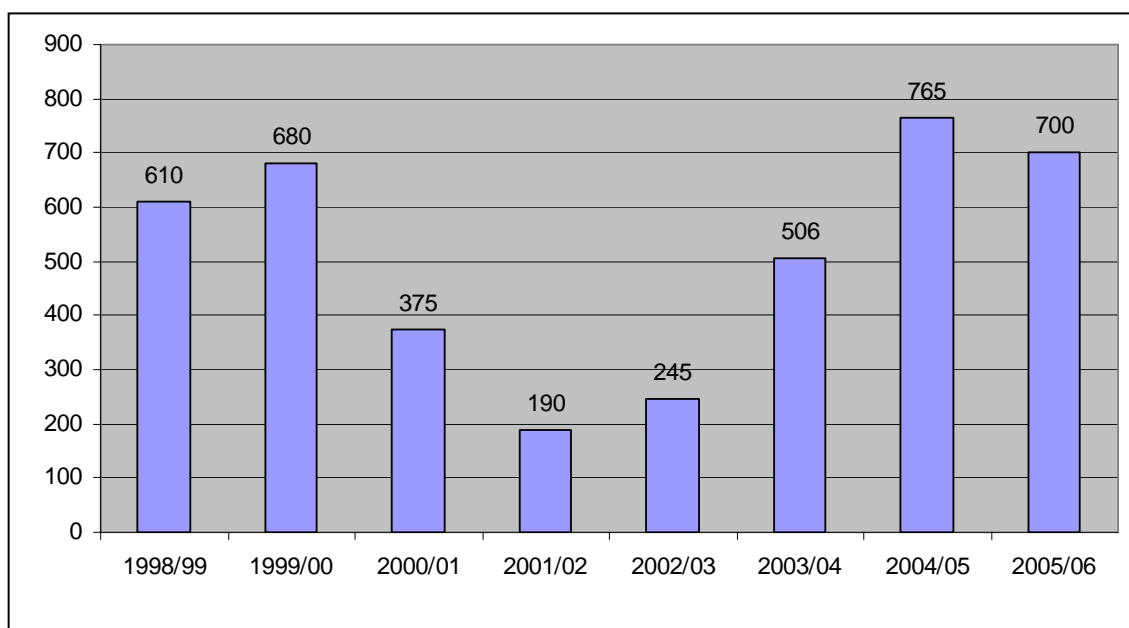
The rapid increase in retail forestry project woodlot sales since the re-introduction of a prepayment rule for plantation forestry (the '12-month rule') in 2001-02 has led some commentators to suggest that the sector is becoming 'overheated' and 'out of control'.

However, the evidence indicates that this is not the case. By contrast, the sector has merely been recovering from the decline precipitated by the removal of the previous prepayment rule in 1999-2000, and is returning to the long-term trend of fund-raising and planting that predated the 1999 reforms, the unintended consequences of which the Government repaired with the 12-month rule.

In other words, it was the decline in sales, not the recovery, that was the aberration in the trend.

The expected flattening out of retail forestry project sales in 2005-06 is shown in Figure G1.

**Figure G1: Retail forestry project sales (\$ millions)**



The 12-month prepayment rule was a clear indication of the Government's continued support for forestry managed investment schemes, underpinning a recovery of confidence in plantation projects as attractive investments for those seeking tax-efficient financial products. The rule allowed retail forestry projects to 'stay open' until 30 June, thus enabling them to compete more effectively with the financial institutions' highly geared, highly structured financial products that have no requirements for contracted services to be carried out in the same income year.

Sales of woodlots in retail forestry projects are now expected to continue to oscillate around the long-term trend of about 80,000 hectares of new plantations per year, consistent with the rate required to create a national plantation estate of about 3 million hectares by 2020, the target of the Plantations 2020 Vision, which will underpin a viable, sustainable plantation-based domestic and export wood and paper industry in regional Australia.

Factors influencing this future trend include:

- The long-term strategies of the managers;
- Managers' targets for a land base and for critical mass of manageable resource;
- The focus of some of the larger managers on replanting existing sites; and
- The domestic and export wood supply agreements being made on behalf of their growers to meet the projected resource needs of the wood and paper products processors.

Market behaviour of the retail forestry project managers is an important indicator. Most set woodlot sales targets each year, based on the alignment of the targets with the factors noted above, as well as with the real-world constraints on acquiring land and carrying out the site preparation and planting within the required times.

- It is common practice for managers to close their projects (ie, accept no more applications) as soon as grower subscriptions have reached the target levels for that year.

Long-term targets for the major retail forestry project managers are being reached.

Related to the concern about growth in woodlot sales is a fear that this will lead to uncontrolled expansion of broad-acre plantations in the landscape. There are two main reasons why such fear is misplaced.

The first is the natural limitation on available land that is: (a) suited to plantation forestry, (b) not constrained by other factors (eg, State and/or local regulation of native vegetation, catchment management, activity zoning, etc), and (c) can be bought or leased at affordable prices.

The second is that land under plantations and owned by the retail forestry project managers (and in some cases by the growers) will be replanted with another plantation (ie, a second 'rotation', and perhaps a third). Harvesting of the first 10-year pulpwood retail projects has commenced, and will now increase rapidly, directly consistent with the rapid expansion of pulpwood plantings in the late-1990s following the launch of the Plantations 2020 Vision. The availability of 'second rotation' land in the managed investment plantation estate will over time reduce the overall demand for new plantation land.

## Land for retail forestry projects

### Land use change; rural land values; land purchase; sources of finance

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Higher rural land values result from, among other things, increased demand and competition for the same land, whatever the land use may be.

There is an uninformed perception that the expansion of managed investment scheme plantations (retail forestry projects) is responsible for driving up rural land prices, and contributing to the declining number of family farms and area of available agricultural land. However, these are well-established trends that arose long before retail forestry companies began expanding their operations.

#### *Land use change*

- Broad-acre cropping, farm consolidation, declining profitability, rural residential development and lifestyle farms, not plantations, have been the main drivers of land-use change in the past decade.
  - The number of 'family farms' in Australia has fallen by 25% in the past twenty years.
  - Between 1994 and 2004, the total area of land used for cropping and grazing fell by 29 million ha, compared to an increase in the area of plantations of <0.7 million ha (2%). In that decade, cropping specialists doubled (from 10% to 20% of total agriculture).
  - In that decade, the number of dairy farms fell 27%, but the number of cows milked rose 14%.
- Although timber plantations are very obvious and do change the appearance of local landscapes, the total amount of rural land being planted is very small. In most catchments where plantations are a suitable land use, less than 10% of the total area has been planted.

#### *Land values*

- Rising values of rural land have been driven by a combination of factors that include low interest rates, high commodity prices, strong international demand for Australian farm products, rationalisation in the rural sector with farm amalgamations, competition for farms from overseas buyers, and multiple changes in land use.
- Plantations are only one of several competing land uses putting upward pressure on rural land prices in recent years. Where plantation companies have been able to buy properties, it has been welcomed by 'retiring' farmers, many having had their properties on the market for some years.
- Other strong competitors for land include: broadacre cropping (a major land-use change); dairying and beef cattle expansion; intensive agriculture; rural subdivision and lifestyle farms (especially in popular 'sea-change' and 'tree change' regions, such as Denmark, WA and Oberon, NSW); and urban encroachment (such as in Wynyard, Tas).
- BRS recently confirmed that WA's Great Southern region saw a steeper increase in land prices since 2002 in non-plantation regions because farmers had experienced "a couple of good seasons".
- Nationally, average prices of broadacre farms sold in Australia rose by 34% in 2004-05, following an average increase of 19% in 2003-04 (Elders Rural Property Index). Forestry companies have purchased around 3% of the total of around 10,000 broadacre properties sold in each of the last four years.
  - It is simply not possible that 3% of sales could drive a 34% increase in land values.
- A rural property forum convened by National Australia Bank Agribusiness presented comparative land values and capital growth in eleven NSW regions from 1978 to 2006. Most notably, "values for most classes of property are shown as having at least doubled since 2002, and in some cases (like Mudgee) nearly trebling or even quadrupling (Yass)". (*The Land* 22 June 2006.)
  - There are very few plantations in either of the Mudgee and Yass districts.

### *Land purchase statistics*

- Retail forestry project companies have purchased only several hundred of the '000s of properties they have inspected over the past five years. Averaged over the total estates of the major retail forestry companies, 12% to 35% of all properties inspected are purchased. The average is less than 20%.
- Many a property is offered to a retail forest project manager but not inspected, because the manager already knows the property to be unsuitable (eg, too far from existing or future processing or port facilities, or fails an initial desk-top analysis). However, for properties that have been inspected, the main reasons for not purchasing, in order of importance, are:
  - property was too expensive (in one-to-one sales);
  - percentage of net plantable area was too small (a sub-set of 'too expensive');
  - soils were unsuitable;
  - company was the losing bidder at auction or tender, mostly to farmers;
  - vendor was not serious, and withdrew once commitment was required;
  - property was too controversial (eg, near a town or a tourist feature).
- Contrary to some local 'stories', the majority of houses on farms purchased or leased by retail forestry companies remain occupied, being let to company employees, contractors, or external tenants (including the previous owners, in some cases).
- As an illustration, in Colac-Otway and Corangamite Shires in Victoria, contrary to the claim that blue gum companies have bought 68 farms and "displaced 68 farming families", an informal survey of the major operators revealed the following statistics:
  - 56 properties have been purchased and 3 leased;
  - 47 were complete farms, and 12 were 'out paddocks';
  - of 43 houses, 35 are still occupied;
  - at least 31 former owners are still in the district.

### *Financing land purchase*

- Retail forestry companies cannot use growers' lease and management fees to buy land, which is a non-deductible capital purchase. ATO will not issue a Product Ruling if there is evidence to the contrary, and conducts 'integrity checks' each year that would discover such evidence.
- Retail forest project companies behave as all other businesses do when funding capital purchases – ie, from commercial borrowings (debt); from capital raisings (equity); and from their after-tax retained earnings (working capital). In the past three years, five ASX-listed retail forestry companies have raised capital through prospectuses or share placements issued specifically for the purpose of land acquisition.

### *Dairy farms*

- According to Elders (December 2005), several dairy farms in Tasmania were purchased in 2005 by forestry companies at prices of \$3,000 to \$6,500 per hectare, while interstate and international dairy farmers had pushed the price for established dairies in prime areas up to \$14,000 per hectare.
- According to the Commonwealth Bank (15 Dec 2005), dairy farmers seeking to expand their holdings in western Victoria are meeting stiff competition from overseas farming interests – particularly from NZ (where dairy land is about \$25,000 per hectare), but also from Europe and Canada. At least 100 overseas families have invested in SW Victorian dairy farms since 1996.
- In March 2006, 164 dairy properties were advertised for sale in Victoria, at an average asking price of \$11,500 per hectare. Advertised prices for dairy farms currently on the market in SW Victoria range from \$12,000 to \$15,000 per hectare.
- Because of these very prices, the three retail forestry companies operating in Corangamite and Colac Otway Shires in SW Victoria are no longer actively seeking land in that region, and have not been a force in the market since mid-2005. But a year later, local detractors still claim the plantation companies are forcing up land prices.

## Fees and profits of retail forestry project companies, and the cost of woodlot establishment

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It must be recognised that a professionally managed retail forestry project does a lot more than simply plant trees; it provides a quality, professional, complete service that allows individual investors to undertake the business of afforestation in an industry where economies of scale are paramount to the economic viability of the activity. To achieve this, retail forestry projects combine a land use activity – establishing, growing and harvesting a plantation and marketing its produce – and a financial product that allows the generation of sufficient investment to meet the scale requirements for plantations, and ensures growers are protected.

Perceptions about high costs and profits in retail forestry projects are addressed here under four headings.

- (i) ATO's periodic reviews and continued issuing of product rulings indicate that retail forestry project managers' fees and profits are not excessive.
- (ii) Per hectare planting cost alone is an invalid benchmark.
- (iii) Returns On Equity (ROEs) for listed plantation managers are on par with or below the relevant ASX indices.
- (iv) Woodlot fees are set in a highly competitive market, and appraisals and ratings of projects by independent research houses demonstrate that fees and profits are not excessive and that grower returns are within acceptable ranges.

**(i) ATO's periodic reviews and continued issuing of product rulings indicate that retail forestry project managers' fees and profits are not excessive.**

Since the introduction of the Product Rulings program in 1998, whenever the ATO has periodically considered the levels of fees charged by promoters, it has qualified its interest with assurances to the industry that:

- (a) the ATO has no authority to dictate fees or charges or profit margins, and is not embarking on a 'tracing' exercise; and
- (b) the ATO's only interest is in determining whether the service being charged for is what's being delivered, and whether the fee being charged is legitimately deductible by the grower (ie, is not 'capital' in nature and is not an ineligible prepayment).

In late 2003, ATO conducted a high-level internal investigation with the working title 'Excessive Fees Review', involving a number of agricultural MIS projects. All plantation projects embraced by the review were then issued with product rulings, having not been found to be charging fees that were inappropriate or excessive.

ATO has continued issuing product rulings for all retail forestry projects each year since.

Although a product ruling does not 'warrant' the commercial viability of a project, the ruling nonetheless indicates that ATO believes there is likely to be a commercial and assessable return to the grower. First, every product ruling contains a statement of the ATO's conclusion that investment in the project is for a commercial purpose, and not for the purpose of tax avoidance under Part IVA of the Tax Act. Second, by exercising the 'Commissioner's discretion' under the non-commercial business loss provisions to allow intermediate losses during long-term business activity, ATO is satisfied by independent evidence that the business activity will pass one of the threshold tests of commerciality or make a tax profit "within a period that is commercially viable for the industry concerned".

**(ii) 'Per hectare planting cost' alone is an invalid benchmark**

It is inappropriate to benchmark the deductible fees charged in retail forestry projects against a quoted cost for planting a hectare of trees.

The cost of establishing, maintaining and marketing a plantation is dependent on a range of factors, which include the nature of the plantation, species used, location, preparation of the land required, access to the site, the scale of the planting, distance to the processing site, and product produced.

There are costs associated with the establishment of the plantation and its ongoing management. Costs of establishment alone include:

- site inspection, survey and assessment, and soil testing;
- organising appropriate land use planning approvals;
- meeting other land use regulations such as codes of practice;
- plantation design and layout;
- organisation of seedling order;
- growing, fertilising, and monitoring of seedlings in nurseries;
- organisation of contractors for site preparation and planting at various locations;
- site preparation works (eg, deep ripping, weed control);
- transport and delivery of seedlings to planting locations;
- planting;
- supervision and quality control of nursery deliveries and planting; and
- follow up treatment including survival surveys, replanting, fertilising and weed control.

Per hectare planting costs can vary widely and are subject to diverse factors. An individual farmer may be able to establish a few hectares of plantations on his/her own property at a very nominal cost (say \$1,500 to \$2,000 per hectare – an amount frequently quoted). But a private grower engaging a consulting forester or forest management firm to do everything will pay professional fees of around to \$4,500 per hectare for establishment alone, rising to around \$5,000 and more if the consulting forester is also engaged to assess candidate properties for suitability before purchase (as is done in retail forestry projects). Because some costs are fixed regardless of the size of the plantation, the per hectare cost would rise still further if the number of hectares is less than, say, ten hectares (perhaps up to \$5,500, or more – if, indeed, the consulting forester could be persuaded at all to do the job for such a small estate).

There are also costs associated with the financial nature of the product – unavoidable costs resulting from the retail forestry manager's obligations to:

- comply with corporations law and tax law, (especially with regard to investor safeguards);
- prepare the product disclosure statement (PDS)(which includes numerous independent expert reports);
- secure an ATO Product Ruling (and maintain it under ATO surveillance);
- gain certification under the AFG Disclosure Code;
- commission independent research analysis;
- market the project;
- pay commissions; and
- have in place the extensive company infrastructure and qualified personnel to manage a project in various locations on behalf of hundreds/thousands of growers with identifiable title to woodlots.

**Attachment K** presents one company's work plan for preparing its 2007 PDS illustrates the complex activity required to release a retail forestry project on the market.

These additional costs are met from the management company's after-tax working capital. They vary from project to project, resulting in a wide range of total costs for retail forestry projects.

A dollar-value cap on deductibility to the grower in the first year has no scientific basis. It would be arbitrary and discriminatory – for several reasons, all related to the diversity and variety that create dramatically different cost structures.

First, timber plantations grown in MIS projects can be put into four main categories – so far.

- (i) **Short-rotation native hardwoods** (eucalypt and acacia) – woodchip for the paper industry, and small but growing potential in manufactured wood products.
- (ii) **Long-rotation softwoods** (pine) – sawlogs for appearance and construction-grade timber, and for poles and posts, woodchip for the paper and paperboard industries, and biofuels.
- (iii) **Long-rotation native hardwoods** (increasingly diverse eucalypt species) – higher value sawlogs for furniture, and for appearance and construction-grade timber, with thinnings used for woodchip, roundwood products, and biofuels.
- (iv) **Exotic hardwoods** (eg, teak, mahogany, sandalwood, paulownia) – for specialty applications that can realise exceptionally high values (eg, teak log royalties of \$2,000/tonne; sandalwood royalties between \$10,000/tonne (dryland, native) and \$40,000/tonne (irrigated, Indian)).

Second, these timber plantations are grown in diverse climates (eg, cool and warm temperate, tropical, sub-tropical), in medium to very high rainfalls, and both dryland and irrigated – with accompanying differences in preparation and establishment costs (especially with respect to soil types and weed control).

Third, various management regimes are applied to these plantations, often requiring quite different initial stocking rates (ie, planted stems per hectare) – from large-scale dryland plantations producing (mostly) lower unit-value product, through to smaller-scale irrigated or high rainfall plantations, requiring specialised agronomy and silviculture to produce high to very high unit-value product;

Fourth, the diversity of species, regions, management regimes and targeted end-products can have quite different nursery requirements – seedlings or cuttings?, specialised or widely available genetic material?

Fifth, not all timber plantation woodlots are sold or grown on a 'per hectare' basis. Some retail forestry project companies offer their projects on the basis of a 'plantation unit' that is whatever size necessary to achieve a target productivity level.

These factors – alone or in combination – cause very wide variation in establishment (and management) costs, even for the same species/category grown in different regions, locations, topography and soil types.

Table I1 indicates the vast ranges (expressed as \$ per hectare) for various sub-components of the initial fees paid by the participating growers.

Table I-1: Indicative ranges in cost categories for retail forestry projects

Cost item	Expenditure ranges (\$ /ha)
<p><b>On-ground plantation establishment</b></p> <p>(Subject to economies of scale – site preparation, pre-planting weed control, seed orchard and nursery acquisitions, planting, fertilising, post-planting pest control, initial irrigation if relevant, management and supervision, etc)</p>	2,100 – 6,500 – 26,000
<p><b>A margin that covers...</b></p> <ul style="list-style-type: none"> <li>• Product development and marketing</li> <li>• Commissions</li> <li>• Overheads, including compliance</li> <li>• Tax</li> <li>• After-tax profit</li> </ul>	<p>750 – 1,800 – 3,500</p> <p>400 – 1,500 – 7,000</p> <p>500 – 2,100 – 5,500</p> <p>800 – 3,800 – 12,500</p> <p>1,500 – 6,500 – 22,000</p>

Although tempting, it is not instructive to add each column in the table to compile totals of low, medium and high project costs, because no one project would have all of its costs consistently in only one column.

It may be argued that the additional costs specific to managed investment schemes support a case that MIS is an inefficient business model. This is easily countered, as follows.

The special attraction and utility of retail forestry projects is that, under the managed investment provisions of the *Corporations Act 2001*, private plantation growers can participate in the industry at a small scale while also benefiting from the large-scale operations that plantation forestry requires. Scale is especially important for accessing markets – something individual private growers consistently have serious difficulty doing, which is the most significant impediment to the more widespread adoption of private ‘family’ forestry.

The Federal Government has provided its own benchmark of large-scale plantation establishment cost in its \$96 million grant to the Tasmanian Government, under the Tasmanian Community Forestry Agreement, to establish 16,000 hectares of new plantations – a per hectare establishment cost of \$6,000 – on land already owned and managed as forest, with none of the MIS-related costs or commercial requirements. A further \$15 million is being provided for intensive silviculture of those plantations over time.

**(iii) Returns on Equity (ROEs) reveal no excessive profits in the afforestation MIS industry**

If retail forest project companies were making excessive profits, it would be evident in one of the most widely used investment indicators – Return on Equity (ROE).

Table I2 offers an indicative comparison of ROEs for several listed ASX-listed retail forest project companies (all in the Australian Stock Exchange (ASX) ‘small caps’ category) against ‘industry averages’ – in this case, the average of the top 200 ASX-listed companies, and the index of the ASX Small Ordinaries (‘small caps’) stocks.

Table I-2: Indicative comparisons of Return on Equity (ROE) and returns on capital

ASX category and industry sector	2004-05	2005-06
ASX 200 return on capital	20.32%	24.82%
ASX Small Ords Accumulation Index	28%	31%
ASX 200 and ASX 300 weighted average ROE	18.7%	
Range of ROEs for five listed MIS plantation management companies assessed by one broker	13%, 14%, 18%, 18%, 21%	N/A
ROE of one listed retail forestry company assessed by three brokers	11.60% 13.80% 11.60%	13.10% 12.30% 11.80%

Only one plantation company in 2004-05, with an ROE of 21%, was above the industry average, and the others' ROEs were on par or less than the industry average.

**(iv) Woodlot lease and management fees are set in a highly competitive market, and independent research appraisals and ratings demonstrate that fees and profits are not excessive and that grower returns are within acceptable ranges**

There is an existing market-based mechanism that has a significant influence on the competitive design and pricing of retail forestry projects, determining whether products are 'investment-grade'. Managers seek to meet these requirements in order to appeal to the market.

Retail forestry projects are assessed by the independent investment research houses and rated on performance including their return on investment. High, uncompetitive costs result in lower investor returns and a lower performance rating. These ratings are used by financial advisers to advise their clients where to place their funds, resulting in a direct and significant effect on the investment market. It is therefore in the interests of the plantation companies to keep costs competitive against other retail forestry projects and alternative financial investments.

Research reports by the independent research houses are now becoming as important as product rulings in marketing a project.

The research houses assess projects using their own models and assumptions, thus providing third-party, market-based protection to growers. The assessments include projected internal rates of return (IRR) to the growers. IRRs can range from around 6–8% for the low unit-value commodity projects up to around 15–16% for the very high unit-value specialty timber and oil projects – returns that are taxable in the hands of the growers.

An IRR to the grower of about 7% or better is necessary for a project to be given the highest rating, without which many of the financial planning dealer groups will not include a project on their approved product lists.

This IRR is consistent with the high single-digit returns expected by timberland investment management organisations (TIMOs) and pension funds in the northern hemisphere, some of whom are increasingly interested in established plantations in Australia (thus becoming likely buyers in a secondary market).

This IRR also compares favourably with the Government's Future Fund, which seeks a "long-term benchmark for real returns of between 4.5% and 5.5% – though the Government accepts that market conditions may mean this return is not achieved in all years".

## **Finally...**

Retail forestry project companies pay tax on the funds collected from growers, and the after-tax profits must provide an acceptable return to shareholders, as well as, in the form of retained earnings, providing the working capital that enables the managers to keep in place the extensive company infrastructure and qualified personnel to manage projects in various locations on behalf of hundreds/thousands of growers with identifiable title to woodlots. That working capital is also a funding source for necessary investment in regional timber processing facilities and infrastructure for the future development of the industry.

Retail forestry projects are very different to retail agricultural/horticultural projects that provide annual returns from no longer than the fourth year, and sometimes the first year. It is very difficult to attract private investment into long-term illiquid plantation enterprises that offer no more than three income events many years after the initial investment. It is only the access to standard business deductibility, with the 12-month prepayment provision, that offsets the lack of attractiveness of forestry investment.

Arbitrary barriers to such deductibility will dramatically reduce the flow of private funds to the timber plantation sector, with severe short-term and long-term consequences.

## Attachment J

# Regulation of forestry managed investment schemes (retail forestry projects)

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Forestry managed investment schemes (retail forestry projects) operate in a business environment tightly regulated by federal, state and local governments, by the Australian Stock Exchange (for ASX-listed companies), and by additional industry self-regulation. The primary purpose of this high degree of regulation is to protect the interests of growers – ‘investor certainty’, in regulator parlance.

Many points along the chain of operations enable ‘regulators’ and industry ‘watchdogs’ – including independent experts in tax law, risk management, forestry practice, harvesting and marketing – to intervene and take corrective or punitive action against a retail forestry project manager. In the last decade, it has been very rare for a regulator to take any such action that has not been quickly resolved to everyone’s satisfaction.

The chain of regulation can be grouped into six main categories:

1. **Australian Securities and Investments Commission (ASIC) and its application of the *Corporations Act 2001* – especially the provisions originally created by the *Managed Investments Act 1998*.**
  2. **Australian Taxation Office (ATO) and its application of the Australian taxation laws, especially the *Income Tax Assessment Acts 1936 and 1997*.**
  3. **Australian Stock Exchange Listing Rules (for ASX-listed plantation companies).**
  4. **Planning and environmental regulations, and other controls over forestry operations.**
  5. **Industry self-regulation, through various voluntary codes and charters.**
  6. **Other codes and quality control measures.**
- 

### 1. *Australian Securities and Investments Commission (ASIC) – the primary regulator*

In order to promote and manage a managed investment scheme, a retail forestry project manager must be a public company, and must comply with at least the following legal provisions.

- The directors of the company are subject to the basic requirements of the *Corporations Act 2001* with respect to **directors’ liability**.
- The company must be registered as a **Responsible Entity (RE)** holding an **Australian Financial Services Licence (AFSL)**, issued by ASIC after a thorough assessment. ASIC must be satisfied that the applicant has responsible officers with the appropriate education and experience in the industry. ASIC must also be satisfied that the RE’s Net Tangible Assets and cash reserves are adequate.
- All the **dealers and advisers** who recommend retail forestry projects must also have an AFSL and must comply with the financial advice provisions of the Act.
- Every retail forestry project must be registered with ASIC and be given an **Australian Registered Scheme Number (ARSN)**.
- The RE must have an ASIC-approved **Constitution and Compliance Plan**. The Constitution sets out the rights and liabilities of investors in the project. The Compliance Plan sets out the procedures the RE will follow to ensure it complies with the law, with

the Constitution, with its contractual obligations to growers, and with the statements made in the Product Disclosure Statement.

- Compliance Plans must be developed with reference to ASIC Policy Statement PS132 *Managed Investment Compliance Plans*, and Australian Standard AS3806-1998 *Compliance Programs*.
  - The Compliance Plan must be monitored by a **Compliance Committee**, comprising a majority of members who are independent of the RE.
- The **Product Disclosure Statement (PDS)**, plus addendums and supplements, is the legal offer document needed to sell the interests in the project. The PDS must comply with section 1013D of the *Corporations Act 2001*. It must be registered with ASIC and contain all the information reasonably required by a potential investor to make an informed decision. Every statement in the PDS must have been verified through a due diligence process to ensure the contents are not misleading or deceptive, and must be signed off by a due diligence committee that includes an external representative, usually a solicitor. **Due diligence files** must be kept for each project, cross-referenced to the PDS, available for random audit by ASIC.
    - ASIC has the authority, which it regularly uses, to **scrutinize any PDS and project at any time**, and to require changes if it has concerns, or worse, to issue **Stop Orders**.
  - There are numerous **ASIC policy statements** concerning disclosure, substantiation, and reasonable assumptions, which ASIC applies and monitors through periodic **audits** of industry sectors.

## 2. Australian Taxation Office (ATO)

As well as having to comply with the standard requirements of **all relevant parts of tax law**, retail forestry project managers and their participating growers are specifically affected by the application of a number of public tax rulings (particularly **TR 2000/8: Income tax: investment schemes**, and **TR 2001/14: Division 35 – non-commercial business losses**), the Product Rulings program, and the so-called 'promoter penalties' legislation. If a project doesn't comply with these two public tax rulings, ATO won't issue a Product Ruling, and without a Product Ruling, a project has no chance of commercial success in the market. All retail forestry projects on offer have been issued with Product Rulings.

- The **Product Rulings** program began in 1998 and was formalized in Product Ruling PR 99/95. Plantation companies submit their projects to ATO for a comprehensive and thorough three-month-long application and assessment process.
- A Product Ruling does not confer any tax concession, nor does it warrant the commercial viability of the project – although the issuing of the Commissioner's discretion under the non-commercial loss provisions is partially based on an assessment of commercial viability.
- A Product Ruling confirms that the Tax Commissioner recognizes and will honour the business tax deductions available to a participant in the project, as long as the project is carried out in accordance with the 'Arrangement' section of the Product Ruling. It also confirms that the primary purpose of the project is commercial and not tax avoidance.
  - The manager's commitment to carrying out the project in accordance with the PDS and the Product Ruling naturally includes the planting and harvesting of the trees.
  - ATO regularly conducts **field inspections** of plantation establishment and management.
  - ATO also carries out periodic **'integrity checks' and audits** to ensure the manager is complying with the strict 'conditions of use' that the manager must legally commit to.
- The new **'promoter penalties' legislation** (due to be introduced into Parliament early in 2006) gives the Taxation Commissioner additional powers to rapidly take 'real-time' action against promoters of blatant tax exploitation schemes and against promoters who blatantly and deliberately fail to carry out their projects in accordance with their issued Product Rulings. The retail forestry projects sector supports this legislation.

### 3. *Australian Stock Exchange (ASX)*

Another layer of scrutiny and regulation is added for those plantation managers that are listed on the ASX (currently, seven). In particular, the companies have a duty of continuous disclosure of material information to the share market, as well as making formal reports half-yearly on their activities and financial positions.

### 4. *Planning and environmental regulations, and other controls over forestry operations*

Retail forestry projects must comply with exactly the same planning and environmental regulations as all large-scale private plantations. These regulations can be at the Commonwealth level (under the **Environmental Protection and Biodiversity Conservation Act**), but especially at the State level (under various **environmental, threatened species, and water management** regulations) and local government level (eg, **planning and zoning**).

In addition, plantation forestry is carried out in compliance with **State codes of forestry practice**, which take account of other State environmental regulations. (Few other primary industries have similar codes of practice.)

Most particularly, all retail forestry projects engage the services of **an independent forester**, who carries out his/her functions in accordance with codes of conduct overseen by the Association of Consulting Foresters of Australia (ACFA) and Australian Forest Growers (AFG).

- The independent forester assesses the operations of the project; in particular, **species suitability, land selection, forest management, market outlook, and harvesting and marketing** operations.
- The independent forester's report is always embodied in the PDS, and thus becomes an integral part of the legal commitments the manager makes with ASIC and ATO, described under points 1 and 2 above.
- Most independent foresters are also engaged to **monitor** the growth and health of the plantations and provide a periodic **report to the growers**.

### 5. *Industry self-regulation, through various voluntary codes and charters*

The retail forestry project sector stands out in the diverse managed investments based industries as having taken a number of self-regulation initiatives that demonstrate the commitment of its members to ethical conduct and best practice.

- Although it is voluntary, compliance with the Australian Forest Growers' (AFG) **Disclosure Code for Afforestation Managed Investment Schemes** and the promotion of the companion AFG *Investors' Guide to Afforestation Investment* is another way in which the MIS plantation companies demonstrate their commitment to high standards of disclosure and conduct.
  - 2003-04 and 2004-05 were the first two years of operation of the Code, and around 80% of the total investment funds were raised through PDSs that had been independently certified by JASANZ-accredited certifiers under the Code.
  - The four main **research houses** that annually assess the forestry MIS products on offer now use AFG Code compliance as a factor in assigning ratings to the projects.
- Members of TIMA (Treefarm Investment Managers Australia), comprising 75% of the retail forestry projects sector, commit to complying with a **TIMA Members Code of Conduct**, as a condition of membership of the association.

- Plantation companies operating in Tasmania have adopted a **Good Neighbour Charter**, which is a voluntary code of conduct for plantation managers in their relations with neighbouring rural properties.
  - The industry is in the process of expanding this 'charter' for adoption by retail forestry project companies Australia-wide.

## 6. *Other codes and quality control measures*

Retail forestry project companies employ various other measures to ensure and maintain high quality and value in their operations and service delivery.

- Companies receive research reports from independent **research analysts**, which thoroughly assess projects and then assign ratings of investment value to assist financial advisers in the advice they offer to potential investors.
- Most companies have received certification for **quality assurance** and **environmental systems** under appropriate **ISO standards**.
- Most companies have achieved, or are in the process of seeking, accreditation under one or both of the two internationally recognized forest management certification standards – the **Australian Forestry Standard (AFS)**, and the **Forest Stewardship Council (FSC)**.
  - Both of these standards require strict compliance (and maintenance of that compliance) with comprehensive environmental, economic and community consultation criteria.
- All companies have in place **company-specific codes of practice** and codes of conduct for implementation by employees and contractors.



