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House of Representatives Standing Committee
on Agriculture and Water Resources

Inquiry into timber supply chain constraints in the Australian plantation sector

Supplementary information: (i) Matter on Notice (ii) Clarification

Dear Committee Secretary

At our public hearing on Wednesday 23 September, IFA/AFG undertook to take a matter on notice and provide more information to the Committee about 'period inequity' in the taxation of private forestry.

Another matter about selling standing plantations caused some confusion, which we're able to clear up.

Matter on Notice

Mr Brian Mitchell raised the matter of 'period inequity' in the taxation of private forestry, referred to in the IFA/AFG submission. Specifically, Mr Mitchell referred to the NOTE under the Recommendation box, which explained that *period inequity* "refers to where paying tax once on a lump sum (such as at final plantation harvest) at a high marginal tax rate is more then paying some tax each year at a lower rate on the same total sum received in annual instalments".

From his subsequent explanation of his question, Mr Mitchell appeared to be assuming that IFA/AFG is seeking to find a system whereby growers might somehow receive – and pay tax on – annual instalments of plantation revenue rather than waiting for one (hopefully large) final harvest revenue and a higher tax liability. And he asked how one would receive annual instalments prior to harvest.

Then he asked: "Are you suggesting in your submission that there should be some ability or facility in tax law to allow for that final harvest to somehow be back taxed as if it had been received in annual instalments?"

And he followed that up by asking if we had any specifics about what a "predictable neutral tax environment looks like".

Response

Before addressing Mr Mitchell's broader matters, a slightly more detailed explanation of the term 'period inequity' might be useful.

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

Recognition of period inequity is fundamental to the equitable tax treatment of long-rotation private forestry. It underpins the reasons for pursuing and removing impediments to private forestry that still persist in the taxation and superannuation laws and regulations, and in conditions attached to income-smoothing programs such as the Farm Management Deposits Scheme.

Private forest growers don't seek special treatment that unfairly advantages private forestry over other primary production. Rather, it can be fairly said that private forest growers seek the removal of impediments to equitable treatment in tax and superannuation law. In other words, a **"predictable and neutral tax environment"**.

Most private forest growers have fairly long time horizons. They understand the nature of a forestry enterprise and the journey they're embarking on, and don't expect to receive a substantial return from final harvest for many years.

Unfortunately, that is often accompanied by a muted focus on the unfortunate financial consequences of the substantial return they look forward to in decades to come, often as a form of private superannuation.

Alan Cummine describes this well in his own private submission to the Inquiry.

> "Growers face a **large tax liability after final harvest**, and some of the rules around tax, superannuation, and the Farm Management Deposits Scheme continue to discriminate. These constraints affect private forest growers unevenly – less impact, if at all, on significant farming operations with integrated forestry enterprises, and more impact (to varying degrees) on growers with forestry as their sole form of primary production, and especially those who grow their 25–40 year sawlog plantations as a form of superannuation.
>
> The latter group can be especially badly affected, and **their stories of unexpectedly high tax liabilities and of the unfairness of having grown their own superannuation only for it to go unrecognised have been known to discourage other potential private growers**. (Emphasis added.)
>
> To add insult to injury, conditions attached to the Farm Management Deposits Scheme discriminate against private plantation growers who don't intend to replant or to continue some form of primary production after final harvest of their carefully tended 30-year private form of superannuation. (Australian Forest Growers' Policy documents explain these constraints in some detail.)"

The solutions offered in Mr Mitchell's questions could be one approach to this inherent challenge of period inequity. The provision of 'annual income instalments' could be possible under particular business structures, such as a joint venture agreement between a timber buyer/processor and a forest grower whereby the final buyer of the harvest agrees to pay the grower an annuity throughout the growing period – or some similar cost-sharing arrangement. This deserves further investigation, beginning with what has been implemented in other countries that have significant private plantation-growing sectors.

But the solutions Australian Forest Growers (AFG) has been advocating for some time to meet the challenge of inequitable treatment **don't require 'special arrangements'**. They require merely (i) official recognition of this inherent feature of a forestry enterprise, and (ii) adaptation of the tax, superannuation, and FMD rules to accommodate this inherent feature.

Here are two illustrative extracts from the AFG Policy Statements of 2016. (These are now being combined and rationalised with IFA policies. But the issues and recommendations are still current.)

From Policy 28: Appropriate tax treatment for plantation forests

Australian Forest Growers advocates that the Australian Government:

- explicitly recognises the complex and unique characteristics of plantation forestry and its interaction with the tax system

[*Three points not included in this quote*]

- amends the 'active asset' condition of the small business CGT concessions to either (a) allow that a farm would still qualify as an active asset when leased; or (b) delete the requirement for the retiring taxpayer to have an active asset at the time of the sale or transfer of the property
- removes or raises the arbitrary asset value threshold (in the small business CGT concessions) in relation to private forests, to account for the appreciating nature of the asset
- considers as a priority the 1999 Ralph Review recommendation on the tax treatment of 'rights' such as profit à prendre, and issues a clear determination that resolves lingering uncertainty restraining the use of forest rights to enhance the liquidity of forest plantation investment.

From Policy 30: Tax and 'forests as superannuation'

Australian Forest Growers advocates that the Australian Government:

- explicitly recognises that amending the taxation rules applying to superannuation and biophysical self-generating assets (such as private forests) can help achieve its retirement policy objectives
- amends the rules applying to self-managed superannuation funds (SMSF) so that plantation forests established and managed to provide retirement income can be transferred into SMSF
- implements further revision to the conditions of the Farm Management Deposits (FMD) Scheme to remove discrimination against private forestry:
  - enable FMDs to be made on behalf of partnerships and family companies
  - re-define the withdrawal threshold in relation to death or retirement from primary production, with a specific extension of three years or more for forestry (and any other primary production enterprise characterised by long-term/lumpy returns).

Some further explanation from Policy #30 should be helpful.

Many private plantations have been, and continue to be, established and managed as an important component **and in some cases the totality, of a grower's 'superannuation'**. [Emphasis added.]

Despite this admirable intention, such growers are subject to severe discrimination within the superannuation system. This failure takes two major forms.

One is the endemic problem of 'lumpy returns', already described, whereby the grower receives 'superannuation' income at harvest in one lump sum, almost all of which is taxable at the highest marginal rate, **rather than at any form of concessional rate such as that applying to monies withdrawn from a superannuation fund.** [Emphasis added]

This problem is made worse for many private plantation growers by the conditional access they have to the Farm Management Deposits (FMD) scheme – set up to enable primary producers to smoothe their taxable income between the good and poor years, caused mainly by volatile seasons and commodity markets outside the producers' control.

For example, if the forest grower doesn't continue primary production after final harvest (very common), FMD eligibility quickly evaporates because any income placed in an FMD must be withdrawn within 120 days after primary production ceases. Such a short period after having already waited decades for the 'superannuation income' severely limits the value of an FMD to a forest grower.

An additional disincentive is the condition that denies FMD eligibility to companies. Many primary production enterprises, including private forestry, are run through small family companies.

Another important manifestation is the treatment of a private plantation with respect to its contribution to a grower's self-managed superannuation fund (SMSF). Although a private forest may be part of an SMSF where the forest operation is commenced by the fund, transfer of an established forest into an SMSF can only occur in very specific and rare circumstances that satisfy a number of the SMSF tests, such as 'sole purpose', 'related party' and 'business real property'.

Most private plantations now approaching harvest age were established well before the SMSF 'revolution', and have no chance of being made to fit the current SMSF regulations. [Emphasis added.]

If these provisions that discriminate against private forestry were removed, most forest growers would be quite satisfied and not be seeking any 'special treatment' or 'annual instalments', and more prospective growers would not be discouraged from embarking on this form of primary production. Forest growers are well aware of how long their enterprise will take to realise the substantial return they trust will eventuate. But they would prefer not to be penalised by discriminatory laws and regulations after having accepted the risks and made the commitment to a very long-term farming enterprise.

Clarification

Committee Chair, Mr Rick Wilson, asked why we saw an impediment to trading standing plantations, given that such trades are not infrequent in South West WA. We did not respond clearly because the question seemed contrary to our own understanding. But it now appears we had different issues in mind.

We have since referred back to the IFA/AFG submission and to AFG's policy statements, and made inquiries with our colleagues in WA. Although standing plantations are indeed being traded, as Mr Wilson stated – and not just in WA – most trades include the land the trees are growing on.

The impediments arise when a grower wants to either sell the land and keep the rights to harvest the trees, or sell the harvest rights but keep the land, which itself could be part of a larger rural holding. Both cases create two separate assets – property (fixed) and trees (crop), and continue to run into a web of tax rules and different state provisions about 'forest rights', and the tax treatment of 'profit à prendre'. Together they become a disincentive to those who may be attracted to planting and tending long-rotation sawlog trees but have an intention to sell or transfer either the land or the rights to the trees before the full rotation. This can also interfere with plans for dividing rural estates and assets within families.

We trust both these additional explanations can help with the Committee's deliberations.

Yours sincerely

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