

17th August 2005

Review of the Taxation of Plantation Forestry
C/- Department of the Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

REVIEW OF TAXATION TREATMENT OF PLANTATION FORESTRY.

The Forest Industries Association of Tasmania (FIAT) is an industry association formed in 1983 to represent the interests of processors of Tasmanian forest products. Our members' activities are diverse and include the production of veneers, hardwood and softwood timber, pulp and paper, woodchip production and both plantation and native forest management.

FIAT's 18 member businesses include all of the State's larger processors of forest products, including a significant proportion of the crown sawlog output, as well as all of the veneer produced in the State. FIAT Members' activities account for more than 75% of the gross value of production in the forest and wood products industry in Tasmania.

Our membership includes all of the larger private sector plantation development Companies in Tasmania with an estimated estate totaling over 130,000 hectares.

FIAT appreciates the opportunity to provide input to the current review of the taxation of plantation forestry. In this submission FIAT have firstly addressed issues that are of direct relevance to plantation establishment in Tasmania and secondly addressed each of the Terms of Reference as defined by the Government.

THE TASMANIAN PERSPECTIVE

Tasmania has a total land area of 6.8 million hectares, of this area approximately 3% is currently utilized by plantation forestry.

A report commissioned by The Department of Infrastructure, Energy and Resources (Rural Land Use Trends in Tasmania 2003) used spatial data for Tasmanian plantations as at December 2001 to determine the interaction between plantations and land capability. This analysis found that “a total of 195,100 hectares of plantation was present at that date. Of this, 168,600 hectares (86 per cent) occurred on Class 5-7 or unmapped land. 22,100 hectares (11.3 per cent) occurred on Class 4 land, and 4,400 hectares (2.3 per cent) was located on prime agricultural land (Classes 1-3).” The report states that “in general, while there has been some development of plantations on the better classes of agricultural land, the bulk of the plantation area is on Class 5-7 or unmapped areas. The proportion of forestry plantation area on prime agricultural land is very small.”

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

With recent changes to forest policy in Tasmania (Regional Forest Agreement and the Tasmanian Community Forest Agreement), the Tasmanian forest industry are faced with the need to rely more heavily on a changed resource comprised of regrowth native forest and plantation timber. This will require a significant investment in order to create a viable long rotation plantation forest resource. The only compensation provided to the industry to date, in order to create a plantation based resource has been provided to the public sector forest manager, Forestry Tasmania.

This compensation facility has been almost exclusively focused on calculation of the resource required to continue to supply the legislative minimum high quality sawlog supply of 300,000 m³ per annum and no facility has been created to allow for any growth in supply and thereby expansion of the Tasmanian forest and forest products industry. FIAT believe that demand for sawn timber will continue to increase and with one of the globally highest levels of reservation of our native forest resource the only sustainable way to supply this demand will be through the creation of a long rotation plantation resource managed for saw log production.

Given the long period of time from establishment to harvest we believe this would require an additional incentive to be provided to allow investment to flow and for investors to be encouraged to manage their plantation estates for longer periods and to invest in the silvicultural regimes necessary to produce sawn timber rather than management for fibre production.

The forest industry in Tasmania is the most highly regulated industry to operate in this State. The forest industry has significantly more legislative requirements placed upon it than similar industries such as agriculture. Not only do these requirements impact on carrying out everyday forestry operations, they also impose major financial constraints on the industry, so much so that significant forest companies that currently operate in Tasmania are considering or have already taken considerable investment dollars to other parts of Australia where the legislative and financial requirements are less cumbersome.

The industry is also concerned about a misinformation campaign that is being waged against forestry and plantation establishment in particular. In recent years there have been a number of claims made against plantation forestry that have been found to have no basis in fact. Although these claims have been discounted by scientific evidence, they still tend to become folklore and are used in campaigns against the industry. These campaigns adds to the disadvantage the industry already experiences through the high level of regulation and cost.

This information is partly funded by direct grants to a range of environmental organizations from the Commonwealth government. It is also partly funded by some of these organizations being registered as charities with tax deductibility for donations made to these organizations. This is despite their main roles being political lobbying. This is a totally unfair and unbalanced approach to the forest industry, which is partly supported by the tax system.

A portion of the Tasmanian plantation resource has now reached maturity and is currently being processed and sold for local processing as well as into export markets. The harvesting and sale of this plantation resource, which has been partly MIS funded demonstrates the commercial viability and purpose of these investments. It also provides additional regional employment and increased scale and viability for local enterprises, which in turn are significant contributors to taxation revenue.

This is prima facie evidence that there is a market for the Tasmanian plantation resource. We further believe that the growth in demand for fibre, sawn and veneer timber will provide a ready market for the harvest of plantations particularly those managed on long rotations to produce solid wood products.

TERMS OF REFERENCE

i. the commercial viability and current tax treatment of plantation investment

With respect to the current tax treatment of plantation investment, FIAT members support the continuation of the 12 month rule and recommend removal of the current sunset clause. To have the 12 month rule removed would result in a similar situation to that which occurred in 1999 when the 13 month rule was removed. The consequences of removal of the 12 month rule are that Managed Investment Scheme (MIS) plantation managers need to take massive risks in investing in land, seedling and contractors well in advance of wood lot sales and that these managers need to carry out silvicultural operations in sub-optimal seasonal conditions.

It is important to note that the 12 month rule provides no special incentive or subsidy for either the grower or the manager. Rather, the 12 month prepayment rule, as legislated, is merely a timing mechanism that enables the plantations to be established in a seasonally appropriate manner and does so without an attributable cost to public revenue. As the Forest and Wood Products Research and Development Corporation (FWPRDC) report “Impediments to Investment in Long Rotation Timber Plantations” notes, “if the 12 month rule is terminated it is highly likely to substantially reduce the current rate of plantation establishment (both long and short rotation), as well as the replanting of areas that are progressively harvested.”

FIAT are concerned that there is a perception that plantations are the beneficiaries of incentives or subsidies through the Australian taxation system. Plantation establishment and management do not receive special tax incentives or subsidies. Plantation forestry operates under the same basic tax regime as other agricultural enterprises – that is, deductions are available for claimable business expenditure, and tax is paid on the profit from the enterprise.

The main difference is that plantation growers have a very large expenditure in the first year or two, for which they claim deductions that some wrongly perceive as a special tax advantage. The difference that must be emphasized is that there is many years before the receipt of a harvest income, on which the growers incur a substantial tax liability. There is also a lumpiness of return which may mean higher marginal tax rates and considerably more tax paid than would occur with other enterprises with an annual return and taxation regime. FIAT recommend that any changes to address perceived anomalies within the Australian taxation system must be considered carefully to ensure changes do not disadvantage particular sectors of industry or undermine policy objectives e.g. the Plantation 2020 policy.

Through the current review of taxation treatment of plantation forestry, FIAT would like to see legislation passed that creates certainty for MIS investment structure and thus removes the constant questioning of MIS companies with respect to trusts the whether the investors are carrying on a legitimate agricultural pursuit or not.

In return for increased certainty there could be the introduction of a requirement for plantation growers to provide more transparency and surety in their reporting requirements in order to demonstrate that investment in plantations, particularly MIS, provides positive benefits to the Australian community. This could include reporting on growth rates, a mid rotation audit, and proper market reporting supported by an organization such as ABARE, for example.

ii. whether the operation of the Income Tax Assessment Acts impedes investment in longer term forest rotations which produce higher value products

The recently released report by the FWPRDC (“Impediments to Investment in Long Rotation Plantations”) identifies a number of major impediments to investment in long rotation timber plantations. These impediments included:

- limited development of secondary markets for plantations;
- lack of readily available market information;
- non market based log pricing and allocation;
- limited understanding of investor needs and the forest sector; and
- limited knowledge of hardwood sawlog plantations.

The impediment identified of limited development of secondary markets for plantations is impacted by Income Tax Assessment Acts. At the present time, the tax laws have been interpreted in such a way that if investors were to sell their managed investment plantation interests prior to final harvest, they would be required to repay their original tax deductions. This would provide a significant financial penalty for the original plantation growers. FIAT believe that to get an increasing level of interest in long rotation tree crops, investors will need some degree of assurance that they could sell their immature plantations without any fear of losing their initial tax deductions. FIAT believe that tax legislation should be altered to allow for the sale of immature plantations, established under managed investment schemes, after they have been held for a specified time prior to sale or alternatively, after the growers have earned an income from the thinning of the plantation.

This needs to be more than a simple change of interpretation in TR 2000/8 that will allow for a secondary market as this in itself will not provide certainty for plantations established today. Legislative change is necessary as the investment is dependent upon the law being consistent and predictable for a long period of time where plantation investment is involved.

iii. the role of State and Territory Governments in plantation industry development as investors, growers and land managers, and any implication this has for competitive neutrality with regard to tax liabilities and incentives

As previously identified the public sector forest manager in Tasmania has been provided substantial assistance by way of compensation packages flowing from a series of agreements between the Commonwealth and State Governments to facilitate plantation establishment to replace native forest resource locked up into reserve areas.

Through this mechanism the State public forest manager, Forestry Tasmania, has created considerable plantation estates within Tasmania that are intended to be managed on long rotations to provide approximately one third of the legislated minimum supply of sawlog by 2020 i.e. 115,000m³ out of 300,000m³. This does not permit any growth in outputs by the forest industry, which under existing arrangements will be capped artificially at the 300,000m³ output level with no capacity to expand and prosper.

Tasmania has only a limited supply of land for the establishment of plantations with a number of legislated, economic, formal and informal reservations, the most detailed, prescriptive Forest Practices system on both public and private land of any State and natural barriers to establishment. These barriers include the recently amended Permanent Forest Estate Policy, the Tasmanian Forest Practices Code, land availability, suitability of sites and the previously referred to public misinformation campaigns.

The competition for suitable land for plantation establishment with one significant player operating with funds provided by the Government does create an uneven playing field as does the potential competition for the product of the plantation estates as both public and private sector growers compete for the same the market.

The issue of competitive neutrality in this context is complex and includes an assessment of the “profit” motive of the public sector grower, the substantial assistance (100%) in capital investment and the competition that will subsequently occur for the market segment. To allow full competitive neutrality will require the provision of assistance to private growers through tax relief to allow for fair competition between the public and private sectors and to encourage investment in private sector plantation establishment.

If such assistance is not provided an almost inevitable conclusion will be the private sector withdrawing from this market segment due to lack of a capacity to compete with the heavily subsidized public sector grower. The heavy subsidization of the public grower means that it is in a position to accept lower prices than the private sector to achieve market share. The public grower does not have to achieve the same level of return on investment as the private sector to justify plantation investment.

As noted previously, the Tasmanian forest industry is a very highly regulated industry and associated with this level of regulation there are a number of significant financial imposts. In Tasmania the list of State taxes and levies that are imposed on private forest growers is immense and they are all disincentives to investment. These taxes and levies include a Private Forests Tasmania levy both at the time of planting and at the time of harvesting, the cost of Local Government development applications, the cost of Private Timber Reserve applications, the Tasmanian Farmers and Graziers levy (optional), the Forest and Wood Products Research and Development Corporation levy, the Tasmanian Forest Practices Authority Levy, the costs associated with the development of a certified Forest Practices Plans, land rates and taxes, Training levies, GST and the list goes on. These taxes and levies are on top of the indirect costs associated with compliance with legislation and voluntary forest industry codes, which in combination include the Good Neighbour Charter, the Forestry/Tourism Protocol Agreement, the State Fire Management Council, the Forest Practices Act and Code and the list goes on.

A further feature worthy on note under this term of reference is the considerable difficulty the forest industry in Tasmania encounter in many of our dealings with local councils. These difficulties embrace a broad range of issues including a highly combative and prescriptive approach by Councils to forestry operations within their municipal boundaries.

One specific manifestation of this problem has been a recent tendency for local councils to require direct forest industry contributions towards the cost of road and bridge maintenance and upgrade and the complete closure of some roads to "loaded log trucks" whereas this limitation is not afforded equally with other heavy vehicles using the same roads. Whilst this is not a tax, per se" it is a form of limitation imposed by a tier of Government that directly impacts on the viability of the industry and particularly the plantation sector.

iv. the capacity to adapt existing tax policies to contribute to achieving the Australian and State Governments' desire to achieve greater integration of plantation and natural resource management policies to improve the management of salinity and water quality

Plantations provide a range on environmental services including storage of greenhouse gases, increased biodiversity particularly on cleared land, land rehabilitation as well as improving the management of salinity and water quality.

Whilst plantation forestry in Tasmania is set to become an important contributor to the forest industry's overall economic performance, the owners and managers of plantation forests have also helped to preserve the environmental and landscape values in both regional and rural communities. FIAT believes that there is a strong case for the private costs of providing such public benefits to be recognised and rewarded. The value of providing these non-market benefits and environmental services should, in some way, be encouraged either directly through funding programs and grants or indirectly through taxation incentives or subsidies.

Currently in Tasmania there is little incentive to establish plantations to provide environmental services as usually the areas that require these services will not achieve economic growth rates.

Industry is willing to participate in the establishment of multi-purpose plantations and supports a stronger integration of natural resource management and plantation policies. However, a greater level of engagement in the design of such programs is required in order to improve the process for aligning the multiple objectives – environmental benefits, wood supply for industry, and reasonable rates of return for investors. In addition, there must be a demonstrated commitment to maintain those programs for a sufficiently long period that encourages investment into the establishment of a critical mass of commercial wood resources.

v. the relative roles and effectiveness of tax system and expenditure programs in the delivery of assistance to the industry.

FIAT are generally supportive of the current roles and effectiveness of the tax system and note the following points that have been presented throughout this submission:

- FIAT members support the continuation of the 12 month rule and recommend removal of the current sunset clause.
- FIAT would like to see legislation passed that creates certainty for MIS investment structure and other plantation investment groups.

- FIAT stress that plantation establishment and management do not receive special tax incentives or subsidies. Plantation forestry operates under the same basic tax regime as other agricultural enterprises – that is, deductions are available for claimable business expenditure, and tax is paid on the profit from the enterprise.
- FIAT is supportive of a tax structure that will encourage investment in long rotation timber plantations.
- FIAT supports a stronger integration of natural resource management and plantation policies, however, a greater level of engagement in the design of such programs is required in order to improve the process for aligning the multiple objectives – environmental benefits, wood supply for industry, and reasonable rates of return for investors. FIAT believes that there is a strong case for the private costs of providing public benefits such as environmental services to be recognised and rewarded.

Please do not hesitate to contact Katy Hobbs on (03) 6224 1033 if you require any assistance or additional information on this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Terry Edwards', with a small dot at the end of the signature.

Terry Edwards
Chief Executive