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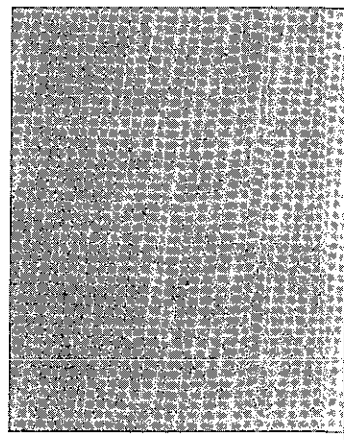
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Review of the Taxation of Plantation Forestry  
C/- Department of Treasury  
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Via email: [plantations@treasury.gov.au](mailto:plantations@treasury.gov.au)

**Re: Review of the Taxation of Plantation Forestry**

In response to the Review of the Application of taxation law plantation forestry being conducted by the Department of Treasury and the Department of Agriculture, Fisheries and Forestry with the Department of the Prime Minister and Cabinet, I provide the following submission on behalf of the Government of South Australia.

Yours sincerely

**Hon Rory McEwen MP**  
MINISTER FOR AGRICULTURE, FOOD AND FISHERIES  
MINISTER FOR STATE/LOCAL GOVERNMENT RELATIONS  
MINISTER FOR FORESTS

## **REVIEW OF TAXATION TREATMENT OF PLANTATION FORESTRY**

### **GOVERNMENT OF SOUTH AUSTRALIA SUBMISSION**

The South Australian Government welcomes the opportunity to make a submission to the Department of Agriculture, Fisheries and Forestry and Department of Treasury review of the taxation treatment of plantation forestry.

Plantation forestry has played an important part in the economic development of South Australia. The South Australian Government was a world pioneer in the late 1800s in the planting of Radiata pine for commercial uses, and later pioneered and developed softwood sawmilling and kiln drying techniques. From these beginnings, South Australia now has just under 10% of the Australian plantation estate, and commercial softwood plantations and processing have spread across the Southern Hemisphere, first to other States, New Zealand and South Africa, and later to Chile, Argentina, Uruguay and Brazil.

The importance of South Australia's plantation forest resource to the State economy and to the Australian economy is reflected in the latest ABS manufacturing data (ABS 2004). South Australia contributes 8.4 per cent of Australia's total manufacturing industry value added, but 10.4 per cent of the nation's total wood and paper product manufacturing industry value added.

Plantation forestry has also played an important role in the development of regional economies in South Australia. This is demonstrated by a recent study (Econsearch Pty Ltd, 2005) of the economic impact of the forestry and wood products industry in the South East of South Australia, the processing hub for the Green Triangle plantation forestry resource. The study found that the forest and wood products industry contributed 27% of gross regional product, and directly and indirectly, 21% of employment in the region. Between 1995/96 and 2003/04, the contribution of the industry to gross regional product in \$M terms increased by just under 50%. Over the same period, direct and indirect employment grew by 3.2%. Together these data demonstrate the efficiency and increased productivity that have resulted from the significant capital investment undertaken by the industry in the region in recent years.

As a signatory to the National Forest Policy Statement (1992), which remains the overarching government policy framework for the forestry and wood products industry, the South Australian Government is committed to "expand Australia's commercial plantations of softwoods and hardwoods so as to provide an additional, economically viable, reliable and high-quality wood resource for industry".

The South Australian Government has also, along with other jurisdictions represented on the Primary Industries Ministerial Council, endorsed *Plantations for Australia: The 2020 Vision*, which has as its major objective a sustainable increase in Australia's plantation resources, based on a notional target of trebling the area of commercial tree crops by 2020.

Each of these agreements commits signatory jurisdictions to removing impediments to expanding the plantation resource. The National Forest Policy Statement specifically notes that 'it will be necessary to ensure the impediments to plantation development are minimal in areas such as taxation' (Section 4.5).

In the remainder of this submission each of the terms of reference is addressed in turn.

**a) The commercial viability and current tax treatment of plantation investment**

Expansion of short rotation hardwood plantations has provided a significant impetus to the establishment of new plantations in Australia. In 1994, the Australian plantation estate stood at 1,042,600 hectares, of which softwood plantations comprised 883,980 hectares. As at December 2004, the total plantation estate stands at 1,716,172 hectares, of which softwood plantations comprise 1,000,642 hectares (National Forest Inventory 2005).

In South Australia, the contribution of hardwood plantation establishment to the expansion of the plantation estate is marked. In 1994, there were zero hectares of *Eucalyptus globulus* plantations; as at September 2004, the hardwood plantations total was 39,438 hectares. Apart from a very small area of farm forestry hardwood species, all of these hardwood plantations are of short rotation *E. globulus*, likely destined for the export woodchip market. Since 2000, the South Australian plantation estate has increased by 21%; increased hardwood plantations have accounted for 66% of the increase in area.

A number of the larger managed investment scheme (MIS) forest companies are active in South Australia and have been very successful in attracting capital from investors for plantation establishment.

**Commercial viability**

The bulk of the short-rotation hardwood plantation estate has been established within the past ten years and will be harvested between now and 2009. It is noted that since the initial plantings were made there have been improvements in tree breeding, plantation establishment and management that will contribute to improving the productivity of plantations.

ForestrySA has managed *Eucalyptus globulus* farm forestry projects since the early 1990s. The first plantings in these projects will be harvested shortly, and indications are that the anticipated returns will be realised.

## Current tax treatment of plantation investment

Under the current tax treatment, managed investment schemes have been very successful in mobilising capital for investment in regional areas in short rotation hardwood plantations. The Australian Government Department of Agriculture, Fisheries and Forestry has estimated that between 1997 and 2004, over \$4 billion has been invested in establishing new plantations. Between 1994 and 2003, 452,000 hectares of new plantations were established in Australia; of these new plantations, 353,000 hectares were of short rotation hardwood, and 63% were funded by managed investment schemes (FWPRDC, 2005). By 2004, MIS plantation management companies were managing about 350,000 hectares of plantations for around 400,000 growers (Cummine, 2005).

Plantation investment via managed investment schemes receives no tax concessions or special treatment. The Australian Securities and Investment Commission (ASIC) registers and oversees managed investment schemes. Such schemes cover a wide variety of investments, including cash management and property trusts, many agricultural schemes (eg horticulture, aquaculture, commercial horse breeding), Australian and international equity trusts and some film and timeshare schemes (ASIC, 2005).

Similarly, product rulings which provide certainty to investors on the tax consequences of investment are provided by the Australian Tax Office on a range of products, which include agribusiness projects, films and financial products, as well as afforestation projects (Australian Taxation Office, 2005). The Product Rulings system has provided significant administrative efficiencies and cost savings to the Australian Taxation Office, and its removal for afforestation managed investment schemes could impose significant administrative costs on the Australian Government if upward of 5,000 investors annually seek private product rulings.

The only provision in the current taxation treatment of investment in plantation forestry establishment that is specific to plantation forestry is the 12 month rule, which simply acknowledges the seasonal nature of plantation establishment. The 12 month rule only applies to seasonally dependent agronomic activities associated with plantation establishment, and provides a mechanism to synchronise plantation investment with establishment costs, which are necessarily incurred within the planting season and span across two financial years.

The perception of plantation forestry as a tax-driven investment stems largely from the nature and timing of the investment. Most of the expenses of plantation establishment are incurred within the first two years, whereas in the case of short rotation plantations, no returns are received until harvest, after ten to twelve years. It is understood that growers investing in plantations receive the same deductions for expenses as for any other investment in primary production, and pay income tax on any profits from their investment. In relation to other investments, forest investments may well be disadvantaged, because profits are received in one year, following harvest, and are assessed for income tax in that year.

The nature of plantation investment has been recognised by the National Forest Policy Statement, which in Section 4.5 acknowledges that the nature of plantations creates 'taxation difficulties ... as a result of the concentrated nature of income derived from private forestry operations' and recognises that 'the long-term nature of plantation investments ... can cause difficulties in attracting investment capital'.

The development and refinement of the managed investment scheme framework as applied to plantation forestry in the past decade has done much to address the issues identified by the National Forest Policy Statement and to overcome the difficulties of attracting investment capital for plantations, at least for short rotation tree crops. The taxation deduction for plantation establishment expenses in the initial year of investment is attractive to some investors, and the capital invested by around 40,000 growers is contributing to the stated objectives of the National Forest Policy Statement and *Plantations for Australia: The 2020 Vision*, to grow a valuable resource base.

When assessing the current taxation treatment of plantation forestry, and specifically the 12 month rule, the Review Committee must consider the commercial and economic impacts of changes in the regulatory regime. There were significant impacts on forestry at the time the 13 month rule was changed, including the surge in plantings in 1999 and 2000, directly driven by the change in the taxation regime, followed by a slump in plantings that had a direct impact on plantation companies and on regional economies. The significant level of plantation forestry investment currently occurring can only be maintained if the regulatory, tax and policy environment remains stable and predictable.

**b) Whether the operation of the Income Tax Assessment Acts impedes investment in longer term forest rotations which produce higher value products**

The data presented in this submission on investment and plantation establishment in recent years demonstrates that managed investment schemes, within the current taxation and policy regime, have been very effective in attracting private capital from retail investors for short rotation hardwood plantations, and thus in assisting governments in Australia to meet their forest policy objectives as set out in the National Forest Policy Statement and *Plantations for Australia: The 2020 Vision*.

It is clear, however, that impediments remain to attracting private investment in long rotation plantations. As noted previously in this submission, of the 103,100 hectares of plantations to be established with capital raised by forestry schemes in 2004-05, only 8,000 hectares will be of long-rotation pine.

There are two associated factors impeding investment in long-rotation plantations. One is the operation of Paragraph 48 of TR 2000/8; the other is the absence of liquid markets for established long-rotation plantations.

Paragraph 48 of TR 2000/8 determined that investors wishing to qualify for year of expenditure deductions in forestry investments will not be eligible for those deductions if there is evidence that the investor intends to exit the scheme prior to the flow of income from that investment, has the intention not to maintain the investment beyond the initial years, or there is an intentional default (FWPRDC, 2005).

The operation of Paragraph 48 prevents MIS companies from marketing schemes targeted at promoting long rotation plantation investments based on sale at a specified time in the future, or offering an option for sale of plantation assets prior to harvest.

As pointed out by FWPRDC (2005), the taxation provisions applying to the sale of plantations prior to harvest are somewhat ambiguous. The 4 year rule preventing the Australian Taxation Office from making retrospective assessment of taxation liability effectively renders Paragraph 48 irrelevant for tax assessments after the fifth tax year following investment.

While it could be argued that this and other avenues exist for investment in long-rotation plantations, it is likely that without a product ruling enabling deduction of expenses in the year incurred, the attractiveness of the investment is potentially reduced.

Essentially, while the current tax treatment of plantation forestry is neutral with regard to short rotation plantations, it discriminates against long rotation plantations, and this discrimination is evident in recent patterns of plantation investment and establishment, as demonstrated by FWPRDC (2005). Over the decade 1994-2003, 78% of new plantations established were of short rotation hardwoods; a total of 22% were of long rotation hardwoods and softwoods. Turning to the source of investment funds, 63% of plantations established were by MIS companies, 18% by governments, and 17% by industrial plantation companies. It is clear that under the current tax and policy settings, only governments and industrial plantation companies have the planning horizons and access to long-term funding to enable investment in long rotation plantations.

The second factor, lack of liquid secondary markets for plantations, is associated with the operation of Paragraph 48 inhibiting participation by the MIS companies in long rotation plantations; the current taxation regime is weighted against growers who sell their plantation holdings before harvest and therefore the development of secondary markets for plantations has been inhibited. FWPRDC (2005) presents data on trade in established plantations over the decade 1994-2003. Approximately 340,000 hectares of plantation were traded over that period. Long rotation softwood plantations accounted for 74% of the total, largely as a result of a few large transactions such as the sale of the Victorian Plantation Corporation estate. Similarly, of the 20% accounted for by short rotation hardwood plantations, most represents a few large transactions between industrial plantation companies.

A review of Paragraph 48 of TR 2000/8 to place long-rotation plantations on the same neutral tax footing as short rotation plantations would encourage the involvement of retail investors, and promote the development of secondary markets for plantations, in accordance with all Australian governments' policy commitments under the National Forest Policy Statement and *Plantations for Australia: The 2020 Vision*.

At PIMC-3, the Primary Industries Ministerial Council sought advice on the impediments to investments in sawlog plantations and the development of secondary markets for plantations, and options for removing these impediments.

The recently revised *Plantations for Australia: The 2020 Vision*, endorsed by the Primary Industries Ministerial Council and the Natural Resources Management Ministerial Council, promotes 'the development of appropriate structures to encourage investment in the plantation sector', and seeks to remove outstanding impediments to 'ensure a regulatory system that:

- Is supportive of long-term investments with irregular income such as plantation forestry, particularly where public good benefits are delivered, and
- Enables the development of secondary markets'.

Such policies also recognise the potential for regional economic development as the wood produced by longer rotation plantations provides greater opportunities for the development or expansion of integrated value adding wood processing industries. The South East of South Australia is an example and referred to in the introduction.

**c) 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**

The South Australian government was a pioneer of softwood plantations, and continues to own 82,700 hectares of long rotation softwood plantations, which are managed on a commercial basis by the South Australian Forestry Corporation. The South Australian Forestry Corporation, trading as ForestrySA, was established in 2000 as a government-owned corporation under the *Public Corporations Act 1993*, in accordance with the Competitive Neutrality Principles and South Australia's own policies directed at placing government-owned enterprises on a competitive footing with private sector enterprises. The Corporation's Charter requires it to, *inter alia*, 'manage plantation forests for commercial production in line with best practice standards for forestry operations and environmental management'. The Corporation is also required to undertake a range of non-commercial activities that are separately funded by the Government.

Compliance with competitive neutrality requirements is assessed by the National Competition Council.

**d) The capacity to adapt existing tax policies to contribute to achieving the Australian and State Governments' desire to achieve a greater integration of plantation and natural resource management policies to improve the management of salinity and water quality**

The second meeting of the Primary Industries Ministerial Council in October 2002:

'RECOGNISED the role of commercial plantations and tree farming in delivering environmental services, and supports the use of environmental funding programs to create leverage through commercial investment; [and]

ACKNOWLEDGED the sub-economic nature of plantation development based on timber alone in the low and intermediate rainfall zones, but recognises the scope for integration of timber, water, carbon and biodiversity values to create economically viable conditions for development.'

The environmental services provided by reforestation are well recognised and may include the protection of soil and water quality, carbon sequestration, biodiversity benefits, and importantly, controlling rising water tables and salinity.

However, as recognised by the Primary Industries Ministerial Council, market failures exist that are discouraging the establishment of plantations in the medium to low rainfall areas where these environmental services can be of benefit in meeting natural resource management objectives. These market failures include:

- in medium to lower rainfall areas, lower growth rates require longer rotations to grow sufficient volumes of harvestable wood. Returns on plantation forestry are not sufficient to attract private investment;
- silvicultural and processing techniques for plantation grown long rotation hardwoods are relatively undeveloped in Australia compared to other countries. This presents risks to prospective investors together with the sovereign risk associated with long rotation plantations. These risks mean that a significant risk premium increases the rates of return required by prospective investors relative to other plantation alternatives (FWPRDC, 2005);
- the lack of secondary markets for plantations in Australia reduces the liquidity of plantation investments and makes forestry less attractive as part of an investment portfolio. This factor also increases the target rate for long rotation plantation investments; and
- the lack of markets and pricing for environmental services such as carbon sequestration, contributions to biodiversity and the mitigation of salinity.

Public investment in reforestation in these less than commercial regions is justified by the range of public benefits offered, and as recognised by the Primary Industries Ministerial Council, can leverage private investment to maximise the natural resource management outcomes relative to the level of public funding.

It is not sufficient, however, to simply subsidise reforestation in areas of medium to low rainfall to increase rates of return to commercial levels. Public funding can be better targeted and more cost effective if the number of factors outlined above that act to increase the rates of return required by prospective investors in long-rotation hardwood plantations are addressed.

Review of Paragraph 48 to reduce or remove the discrimination in the current tax treatment against long-rotation plantations would encourage the development of transparent, liquid secondary markets for plantations, thus reducing the level of risk associated with the development of longer-rotation plantations in marginal areas, and increasing their attractiveness to prospective investors.

Increased public investment in research and development of silvicultural and processing technology for plantation-grown long rotation hardwoods would also reduce the level of risk associated with these investments.

The development of secondary markets for plantations would have added benefits in that it would increase the attractiveness of farm forestry to landholders. The median age of agriculture workers increased from 44 in 1981 to 50 in 2001 (Barr, 2004, cited in Productivity Commission, 2005). In the absence of robust secondary markets for long rotation plantations, the attractiveness of 25 to 30 year rotations is understandably sharply diminished for landholders. This factor alone has held back widespread integration of farm forestry into agricultural systems.

**e) The relative roles and effectiveness of tax system and expenditure programs in the delivery of assistance to the industry**

The current support mechanisms provided for afforestation projects along with a range of other industry sectors, including horticulture, films and financial products, have been demonstrated to be effective in mobilising capital to support plantation investment, responsive to market forces and cost-effective in that use of taxation mechanisms to support these projects minimises the administrative and compliance costs to government.

In considering initiatives to remove impediments to similar investment in long-rotation plantations, the review should take these factors into account.

**SUMMARY**

The South Australian Government welcomes the opportunity to contribute to this review of the taxation treatment of plantation forestry.

- South Australia has played a pioneering role in the world development of *Pinus radiata* plantation forestry and processing.
- Forestry and wood processing is important to the South Australian economy and to its regional economies.
- The current taxation treatment of plantation forestry is not unique to forestry. Managed investment scheme arrangements cover a wide variety of industries and projects, as does the system of Product Rulings.
- The 12 month rule is the only feature of the current treatment that is unique to plantation forestry. This rule simply recognises the seasonal nature of plantation establishment.
- The current taxation treatment of plantation forestry is in accordance with the National Forest Policy Statement, which acknowledged the taxation difficulties caused by the nature of plantation forestry operations.
- Current taxation arrangements, and specifically Paragraph 48 of TR 2000/8, distort investment decisions between short and long rotation plantation investment, and inhibit the development of robust, liquid secondary markets for plantations.

- Changes to Paragraph 48 to ensure a neutral investment environment between short and long rotation plantations would contribute significantly to natural resource management outcomes, by encouraging the development of plantations in marginal rainfall areas subject to dryland salinity and other land degradation issues.

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