



25 March 2011

The Secretary  
House of Representatives Standing Committee on  
Agriculture, Resources, Fisheries and Forestry  
PO Box 6021  
Parliament House  
Canberra ACT 2600

Dear Sir

### **Inquiry into Australian forest industry**

We refer to the terms of reference issued on 7 February 2011 in relation to the above named inquiry. AgriWealth operates a traditional forestry business and a MIS forestry business. We would like the Committee to consider the following points in their deliberations.

#### **An established industry contributing significantly to Australian GDP**

1. The Australian forestry industry is currently a significant contributor to Australia's overall economic development. It has an established and expanding infrastructure that employs tens of thousands of Australians who are located in rural and regional areas. It generates a not insignificant contribution to the overall level of Australian GDP, as it is one of Australia's largest manufacturing industries. However, Australia is not self sufficient in relation to saw log timber supply. Additional plantations need to be established in order to achieve a level of self sufficiency with regard to saw log timber supply.

#### **Continuing demand (domestic and export) for plantation timber**

2. The demand for timber resources continues particularly within the Asia-Pacific region where economic growth is predicted to continue through to 2020. The specific demand for renewable timber supply is also predicted to increase during this period. As producers continue to reduce reliance on native timber harvesting, increased reliance will be attached to plantation timber production.

#### **2020 Vision targets unachievable without incentives**

3. The aims and objectives as set out in the 2020 Vision remain valid. Both Federal and State governments were supportive of the 2020 Vision. We need more plantation timber established. Since 1994 the total national plantation estate has doubled to approximately 2 million hectares (as last measured in 2009). In order to achieve a target of 3 million hectares by 2020, we need to plant each year between 2011 and 2020 what has actually been planted each year between 1994 and 2009 PLUS an additional 36% more, each and every year. Additional incentives need to be offered in order to achieve this target.

#### **Additional incentives required for long-term (26-30+ years) saw log timber**

4. The incentives offered to-date in relation to MIS have primarily gone into short-term woodchip production that is mostly exported. In order for the Australian domestic market to achieve a greater level of self sufficiency in saw log supply, the government should align its incentives so as to encourage long-term saw log production. Short-term woodchip production generally takes around 11-12 years, whereas long-term saw log production takes around 26-30+ years. Where the government continues to provide incentives for short-term woodchip production, we consider that additional incentives are required in order to attract investment capital into long-term saw log production. For example, this could be in the form as was adopted in relation to research and development activities. That is, a tax deduction of 150% of expenditure would be available to investors in long-term saw log production. The 150% research and development deduction was given to investors in recognition of the long lead time between the time capital was invested and the time a commercial return was received. Given the 'life time' duration for an individual investor to see a return from final harvest of long-term saw log timber, such an incentive seems warranted.

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### Tax incentives were not the cause of corporate collapses

5. There is nothing wrong with granting a tax deduction to plant trees. The recent collapses of MIS companies did not arise because of the legislation that allows an investor a tax deduction to plant trees. The collapses arose because of the mismanagement by those entrusted with the responsibility to properly manage the respective plantations. In recent times institutional investors are primarily acquiring the plantations established by the failed MIS companies. Those same plantations will deliver significant profits to their purchasers. There is nothing wrong with the plantations – only those who could not carry out their stewardship in a commercially responsible manner. The tax incentive was offered so as to attract capital into establishing plantation timber – the incentive achieved its actual purpose.

### Tax incentives do not distort agricultural land and water use

6. It is a fallacy that tax deductibility for planting trees creates a distortion on agricultural land and water use. Advocates of this theory assert that forestry MIS investors have more money to acquire agricultural land than farmers because their expenditure in planting trees is tax deductible. This theory ignores the fact that a farmer also obtains a tax deduction for planting crops, etc. The farmer is not disadvantaged by the tax deductibility offered to an investor planting trees. On the contrary, the tax deduction simply puts an investor in a MIS forestry project on the same footing as a farmer. A farmer obtains entitlement to tax deductibility for expenditure incurred in planting crops, etc because the farmer is ‘carrying on a business’. A small investor in a forestry MIS project may not be ‘carrying on a business’ and accordingly, would not be entitled to a tax deduction for the same expenditure as incurred by a farmer. The specific forestry tax legislation simply allows the investor deductibility for expenditure of the same nature as incurred by a farmer in circumstances where the individual investor is not considered to be carrying on a business.

### MIS allows individuals entry and exposure to timber

7. When comparing the financial performance of the forestry/timber asset class against other asset classes (e.g. stocks, bonds, property, etc) over long-term periods, many analysts have stated that the returns from timber outperform all other asset classes, act as a hedge against inflation and that timber is a valuable asset for portfolio diversification since price movements have a very low correlation with most other asset classes. Unfortunately, historically, investment in the forestry/timber asset class has largely been the exclusive domain of government and institutional investors. The MIS regime in Australia has allowed individual taxpayers entry and exposure to the timber asset class that would not otherwise be achieved by such investors due to capital intensive barriers to entry.

Whilst individual taxpayers can obtain exposure to the forestry asset class under MIS structures, they cannot always take (like governments and large institutional investors) a long-term view to the receipt of financial returns. Where an individual invests in a long-term saw log plantation it would be expected that only one full-length rotation (26-30+ years) would take place during their lifetime, assuming they invested around 30 years of age. The normal day-to-day demand for living expenses dictates that their money is directed to investments that generate returns on a more frequent basis than the time frame generally associated with timber investment. Granting investors in forestry MIS tax deductibility for planting trees is partly intended to act as an incentive in attracting capital from individual taxpayers so as to offset the long-term timeframe before they receive any financial return from their timber investment.

### MIS promotes forestry ownership from government to private enterprise

8. The MIS incentive of granting individuals tax deductibility for planting trees and owning and operating a forestry business is consistent with the policy of allowing and encouraging a shift in plantation ownership and operation from government to private enterprise.

### Permit Product Ruling applications to be lodged earlier

9. Individual investors in MIS forestry projects do not generally receive sufficient time in which to properly consider their investment and participation in the forestry sector. Almost all financial advisers, planners, accountants, lawyers, bankers, tax agents etc, will advise investors not to invest in any project unless the Australian Taxation Office (ATO) has issued a Product Ruling that confirms the tax treatment of the relevant expenditures.

An application for a Product Ruling can only be lodged in the year in which an investor will invest. That is, an application for a Product Ruling cannot be lodged earlier than 1 July in relation to a project in which an investor will invest no later than the subsequent 30 June. For example, where an investor invests in a project on or before 30 June 2011, the application for a Product Ruling for that project cannot be lodged before 1 July 2010.

Our experience indicates that the ATO generally requires between 5-8 months to process the application (sometimes slightly shorter or longer) for a Product Ruling. A significant number of Product Rulings have issued between January and June of each year. Accordingly, most projects are actually marketed and sold to investors during the months of April-June. The result is that investors have a relatively short timeframe in which to properly and fully consider all of the implications associated with their investment.

If a Product Ruling could be applied for say, a year in advance of a project being offered to the market, then the project could be marketed and sold to investors in a less pressured environment and allow them the proper time in which to consider their investment decision. Specifically, investors would have more time to consider the commercial, structural and taxation issues associated with the project.

Prior to 2009 it was possible to apply for a Product Ruling prior to the year of investment however that measure was withdrawn.

**MIS forestry is an integral element in the production of plantation timber**

10. Forestry MIS projects form an integral part of plantation timber production. Whilst institutional investors participate in the forestry/timber sector they generally enter the sector after establishment risk has been eliminated. For example, in relation to long-term saw log timber institutions generally enter the market when the trees are around 15 years of age. At this time the institutions are able to more accurately determine the growth rate of timber for each specific plantation and therefore the relevant purchase price. Their entry occurs after establishment risk has passed.

Institutional investors will not replace individual investors in fulfilling the need to plant new plantations. Without incentives being offered to individual investors no new capital will be attracted to new plantation establishment other than from government.

We consider that the forestry MIS sector is an important and valuable contributor to plantation establishment, production and the growth of carbon sequestration. The establishment of more plantation timber in Australia will benefit rural and regional employment, Australian GDP, Australian self sufficiency of saw log timber supply and allow Australian individual taxpayers exposure to a high performing asset class.

The current tax incentives associated with attracting capital from individual investors should be maintained. However, the tax incentives should be expanded in relation to long-term saw log timber production. To date not enough capital has gone into production of long-term saw logs.

Yours sincerely



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