

REVIEW OF TAXATION ARRANGEMENTS FOR PLANTATION FORESTRY

Submission from Robert Belcher, Director & Chair Sustainable Agricultural Communities Australia Ltd (SACA)

JULY 2006

INTRODUCTION

In preparing this submission, SACA would make the point that we have identical intentions to those stated in the *Australian Financial Review* (1-2/7/06) by the Assistant Treasurer, the Hon Peter Dutton MP, "we want to make sure that people producing the same products are competing on a level playing ground and we want to make sure we are not inadvertently distorting that process. In the end the government has to make sure that we are not providing an unfair advantage for some over others."

None of the above exists under the Managed Investment Scheme (MIS) arrangements for plantation forestry and it would appear, across an ever growing number of agricultural industries.

We note that the 2020 Vision Statement is based on an assumption that full market conditions will prevail to deliver a sustainable timber industry. As the author of this submission said, again in the *Australian Financial Review* (1-2/7/06), "you can't have an economic rationalist government supporting economic development that is not based on any form of market signal because it guarantees the outcome will be disastrous."

MIS do not exist to produce a product for profit by market signals within a competitive marketplace; rather they represent a tax avoidance cash flow with huge profits built in (via product rulings from the Australian Tax Office (ATO)) to the promoters. The industries who employ MIS thus become subsidized giants capable of out-competing alternative industries constrained by market and capital reality. The MIS sector's ability to raise cash flow via the tax arrangements makes all other forms of business (large or small) uncompetitive.

As written about recently in the media, share market investment (promoter, not investor) in a sandalwood Ord River scheme was an attractive opportunity not necessarily from returns from the product (not until 2012), but rather from the profit the promoting company made from investors. That is, invest in the company, not the product. The failure of this entity as a positive economic investment (MIS management) turns on the core issue, the investment

represents tax avoidance to the investor whilst it is a guaranteed profit to the promoter, yet the economic activity is peripheral to the whole exercise.

To date, we have been unable to find any independent economic opportunity costings to compare cost benefit by reallocation of natural resources from agriculture to forestry. This is amazing, if the government possesses the above, we request that this be made public.

Available independent economic information suggests that economic results for the timber plantation industry are less than fantastic and trends over the last ten years indicate no improvement. We note that the current status quo is tenaciously defended by the recipients, but the consequences are generating an ever increasing community and business backlash from all states and sectors of the rural economy.

The issue is really about business structure and competitiveness from which either the outcomes enhance wealth and reinforce our market and property rights or they represent a direct attack upon all of the above. We believe, unfortunately that the latter is the case.

We do however congratulate the Government's budget initiatives in taxation relief and superannuation reforms, which will help alleviate some of the irrational investment directed towards MIS. However, given the economic costs to the nation and future losses from these schemes, a clear and decisive change is required now. In order to protect the nation's revenue base and wealth creation the current arrangements must cease.

RESPONSE TO MINISTER DUTTONS RECOMMENDATIONS

1. The 12 Month Repayment 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.

The 12 Month Rule exists not for planting or management issues, (it could apply to most agricultural pursuits), but rather to facilitate the collection of tax avoidance revenue at the end of the Financial Year. The "investors" are not driven by planned economic decision making, but rather an urgent tax avoidance desire. The government is exploiting this, and it is not edifying. Likewise, the notion that investors are carrying on a business is pure contrivance and lacks equity to other genuine business operators. Both conditions make MIS highly advantaged.

2. Forestry MIS 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 investors contribution deductible in the following year.

Could the government please explain why a real cost of \$1200 – 1800 for planting becomes a \$9000 deduction now, and under this proposal drops to \$6500. This is government sanctioned profiteering to the ultimate cost of the taxpayer and all other business competitors. Further, given that the MIS core business is to collect from investors and not necessarily to profit from product, all this cap will do, is shift plantations to cheaper country. As experienced on the Monaro NSW, a plantation in low rainfall country hardly aspires to fulfil 2020 aims. But the promoter profit is still intact.

We also ask the question, where does the money for the huge land grab come from, if not from the investor's 100% tax deduction? We note lately the promoters claim they raise funds via the financial or stock-exchange sectors. Yet in the past they have admitted to using the investor's funds. This issue is canvassed in the Senate review of plantations September 2004 (Senator Murphy's minority report). This suggests that on the face of it, money allowed as a deduction is used to acquire capital. This must be audited and retrospective adjustments made. The land price surge associated with plantations has severely affected land competitors. Price caps that cater for anything other than planting costs will as usual end up inappropriately used.

3. The period within which planting must occur as a condition of deductibility would be extended from 12 months to 18 months.

Please refer to answer number 1

4. Trading in forestry MIS investments acquired after 30th June 2008 would be allowed such that:

- i) 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.**
- ii) all returns to an investor treated as assessable income, and**
- iii) the cost of acquiring a MIS interest on the secondary market to be deductible against income received at disposal or harvest.**

We look at this with great scepticism. Given the generosity of product rulings, the only stricture being the fulfilment of an end specified product, this calls into question the concept of being in business to produce a product. This really becomes pure trading. What were product rulings created for, and why? Further, the prospect of an end product being changed to a carbon sink leads us to totally oppose the suggested change. This possibility is disastrous and represents a breach of faith to rural communities. It is also scientifically questionable.

5. Deductibility would also be conditional on the certification of the MIS company to insure best practice in forestry, regional planning, land use, and natural resource management, under arrangements to be developed by DAFF.

Whilst we agree, this should have existed 10 years ago. The current estate is a mess and requires fixing. DAFF would require independent supervision. The above recommendation calls into question the performance and responsibility shown by all three levels of government. Outcomes to date are disgraceful.

6. 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.

Is this activity profitable? If yes, what is the need for a MIS? Rural Australia will be asking; when do we receive 'appropriate treatment' to enhance our business prospects. Is this an economy driven by free market forces or is this an economy driven by government subsidies?

7. The administration of GST for MIS arrangements would be simplified by ensuring that individual investors in a MIS are treated as passive investors for GST purposes (thereby removing them from the GST system), subject to the agreement from the States and Territories.

A status of being a primary producer and at the same time being a passive investor belies the contrivance and hypocrisy of this scheme. The more the government seeks to fit these arrangements, the more credibility it loses amongst the community and business world.

8. The proposed taxation arrangements for forestry MIS investors 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.

At the rate the MIS time bomb is ticking in the economy, 2011 seems a little too far into the distance. Remember every other business is disadvantaged. Even if all MIS other than forestry were removed, there are still a large number of businesses, industries, and communities who are adversely affected. Recently I was asked by the dairy industry to consider assisting them. Their predicament is that they have lots of stainless steel and nothing (no milk) to put into it. As you would be aware forestry plantation is devouring dairy land, yet the returns from dairy are much better than forestry. Perhaps the solution would be to remove the MIS in 2006, and allow the two industries to compete on a level playing field. If the current situation continues to 2011, you will have impoverished the dairy industry and significantly reduced the national wealth. The same principles apply to other competitive land use businesses. It is fascinating that a recently deregulated (thrown to the wolves) industry in the painful process of

rationalization is confronted head on by an industry enjoying an MIS (subsidy) with no compelling market imperatives.

NEGATIVE OUTCOMES OF MIS – SUMMARY

- Poor plantation resource – no audits;
- Income derived from investor by promoter (core business);
- Natural resource allocated by tax avoidance not income potential;
- Land price distortion;
- Agricultural and other industries damaged;
- Oversupply (e.g. viticulture, pulp, horticulture etc);
- 12 month rule (18 proposed) disadvantages all other businesses and encourages tax avoidance;
- Flow of funds from tax avoidance motive makes established investment funding sources uncompetitive and unable to match volume;
- Change from private to promoter land ownership on a massive scale;
- Huge profits built into MIS allow promoters to enter new agricultural schemes with oversupply outcomes;
- Financial advisors receiving 10% average commissions (similar to Westpoint);
- Water usage is immense and to date unplanned and free;
- Ad-hoc development has massively enhanced the risks of wildfire;
- Plantation estate expansion does not relate to world supply or price trends;
- Opportunity cost to national wealth is negative; and
- MIS effectively amounts to a subsidy which contradicts government philosophy of economic rationalism and optimal economic growth.

RECOMMENDATIONS TO GOVERNMENT

1. Terminate tax avoidance incentive based investment schemes. MIS are intrinsically non-market driven.
2. Accept Senate Review Recommendation 1. 1.3.35 “The committee therefore recommends that the revised 2020 Vision be amended by deleting all reference to trebling the acreage by 2020 or plantation acreage of 3 million hectares. This should be replaced with the target of increasing acreage of plantation forests at a sustainable and economic level”.
3. Audit existing plantation estate, Senate Recommendation 2. 2.3.40 “The committee recommends that the government commission an independent assessment of how the plantation prospectus industry relates to the 2020 Vision, including an evaluation of prospectus assumptions against returns likely to be achieved”.
4. A full water audit by independent and scientifically qualified personnel. The Water Initiative must be applied to this industry.
5. Tax treatment must at the very least exclude capital as a deduction in the financial MIS chain. Should it be proven that forestry is incapable of viability without government support, then the incentive if given must:

- a. Not distort or damage competition for the natural resource. The free market must be able to allocate the resource.
 - b. Arrive when the product has been harvested and returned a profit.
(See Snowy River Interstate Landcare Submission July 05 to Treasury Review – Scottish Solutions attachments)
6. Cease using industry research and economic analysis of plantations as a basis for government policy. Review industry influence in government (e.g. DAFF).
7. Initiate a Treasury economic impact analysis of plantation development on agricultural industries, infrastructure, and communities. That is estimating the opportunity cost to date.
8. Provide a full explanation to the community at large regarding investor deductions of \$9000 per unit when real costs range from \$1200 to \$1800 per unit. In doing so, explain ASIC's and ATO's full responsibilities and limitations in this arrangement. Audit the capital assets of the promoter sector of MIS and sources of finance.

REFERENCES

1. Financial Review July 1-2 2006, Perspective – “The Tax Schemes That Ate Australia” by Narelle Hooper and Fleur Anderson, pp 17-19.
2. Senate Review Plantations for Australia the 2020 Vision, September 2004, Rural and Regional Affairs and Transport Reference Committee.
3. Senator Shane Murphy's Minority Report p163 Senate Review.
4. Snowy River Interstate Landcare Committee Submission regarding Taxation treatment Plantations, July 2005 (see attachments regarding Scottish solution to similar taxation incentive problem).

CONTACT

Robert Belcher
rbelcher@warruga.com.au
Ph/Fax: 02 64580244

