



1 September 2008

The Secretary
Senate Standing Committee on Rural and
Regional Affairs and Transport
PO Box 6100
Parliament House
Canberra ACT 2600

rrat.sen@aph.gov.au

Dear Ms Radcliffe

**Submission to the Inquiry into the implementation, operation and administration of
the legislation underpinning Carbon Sink Forests, and any related matter**

Thank you for the opportunity to make a very late submission to this Inquiry.

Treefarm Investment Managers Association (TIMA) represents the interests of forestry managed investment schemes (MIS), with a specialized and unique focus on corporations and tax law and the operations of the primary regulators of managed investment schemes, ASIC and ATO.

TIMA initially felt that the Inquiry was only of peripheral interest to it, because the carbon sink forests legislation specifically lists as ineligible any forest established for harvest or under a forestry managed investment scheme. Further, TIMA is confident that carbon sink forests will be grown—as they are now—primarily on land that is regarded as marginal for commercial timber plantations, and therefore will create little or no competition for very high-priced ‘prime agricultural land’.

Having drawn these reasonable conclusions, TIMA is now alarmed at the way the Inquiry has progressed.

First, it has allowed the true purpose of the carbon sink forests legislation to be misrepresented as some sort of competition between trees and food on high rainfall prime agricultural land, which it is not. The comparative price of carbon will work strongly against such a situation.

Second, and worse, under the term of reference “any related matter”, the Inquiry has provided a platform for an attack on forestry managed investment schemes, despite the fact that MIS forestry is specifically excluded from the scope of the legislation. This attack actually had its genesis in the so-called ‘debate’ in the Senate, in which almost every statement about the tax treatment of MIS forestry was either misleading, half true, or incorrect, and has then been particularly evident in the subsequent submissions and hearings of this Inquiry.

TIMA makes this submission in order to correct some of the most blatantly inaccurate statements that have been made about the taxation of MIS forestry, to put some relevant and important facts on the record, and to place MIS forestry in a context quite different to the misrepresentations made to the Inquiry.

First — MIS forestry in perspective

Plantations established through MISs are now embedded in the plantation production and distribution chain in Australia, growing the resource for export and domestic wood and paper industries—including in facilities operated by the MIS forestry companies themselves.

MIS forestry is responsible for 70-80% of all new and replanted plantations in Australia since the launch of the national plantations strategy (*Plantations for Australia: the 2020 Vision*) in 1997, replacing the steady decline in large-scale industrial and State government plantation investment, and filling the gap left by the reservation of many native forests from production. Around two-thirds of all MIS forestry funds raised are spent directly in rural Australia—well over \$2 billion so far. This has been achieved without the assistance measures used in all other countries, such as grants, direct subsidies, concessionary loans, bounties and special tax incentives.

MIS forestry plantations have traditionally produced Australian hardwood for woodchip export and domestic pulp mills (in place of native forest woodchip), and softwood for the domestic sawn timber and pulp and paper industries. In the last several years, there has been an expansion of the area growing native and exotic tropical species to produce high value cabinet timbers for domestic and export markets.

Increasingly, MIS forestry projects are being grown with off-take agreements or long-term contracts already in place.

With its rapid move towards becoming the core of Australia’s future long-term wood supply, there is an imperative to maintain a stable and predictable policy and regulatory environment for MIS forestry.

MIS forestry is one of the most highly regulated and scrutinized industries in Australia—by ASIC and the ATO, and by numerous State and local laws and regulations for forest practices, land use, planning, natural resources management, environment protection, etc.

TIMA accepts that the rapid expansion of MIS forestry during the past decade has caused concern in some rural industries and communities. Much of this concern is based in perception and anecdote, not supported by the facts, and even contradicted by empirical studies, such as those conducted by the Bureau of Rural Sciences. But some of the concern is indeed real and needs to be addressed. MIS forestry companies are paying ever-greater attention to effective community and local engagement programs as an integral part of their operations.

In seeking to resolve genuine concerns about landscape and land use change and impacts on communities and other industries, it is important to evaluate and utilize the federal, state or local government policy and regulatory instruments that are the best suited and most appropriate, and to ensure that the basis for action is supported by facts and evidence.

This is particularly relevant with respect to the tax treatment of MIS forestry, which is in place so as to not impede private investment in timber plantations for Australia. Changing that tax policy would have unintended consequences far worse and far wider than imagined by those who mistakenly call for tax entitlements to be removed.

The following discussion should be considered in that context.

The **discussion expands on the following six key points:**

- Incorrect statements that MIS forestry is ‘tax-subsidised’ cannot be justified by any properly informed objective analysis.
- Standard year-of-expenditure deductibility for plantation forestry investment partially compensates for the well-known tax discrimination against plantation forestry.

- The new tax arrangements for MIS forestry maintain these same basic principles, but in a specific deduction with additional conditions.
- MIS forestry generates tax revenue and is a positive investment for the Government
- MIS forestry is an easy but wrong target for those who oppose land use change and higher rural land values.
- It is unlikely that the proposed Carbon Pollution Reduction Scheme will result in any additional expansion of timber plantations.

Incorrect statements that MIS forestry is ‘tax-subsidised’ cannot be justified by any properly informed objective analysis

- Statements made during the Inquiry about MIS forestry being ‘tax-subsidised’, ‘benefiting from the diversion of tax revenues’, or enjoying an unfair tax advantage over other agricultural enterprises are simply incorrect, and cannot be justified by any properly informed objective analysis.
- Such statements—oft repeated in recent times by state and national farming organizations, plantation detractors, and misinformed commentators, all reciting the same hypnotic mantra—demonstrate a comprehensive misunderstanding of the treatment and implications of tax law for long-term primary production enterprises.

Standard year-of-expenditure deductibility for plantation forestry investment partially compensates for the well-known tax discrimination against plantation forestry

Here are the facts.

- The fundamental principle for private plantation forestry—whether small-scale family forestry, large-scale industrial forestry, or managed investment scheme forestry—is that, because the trees are ‘the crop’ (ie, there is no produce until the trees are cut down), the costs of establishment, management and harvest are all regarded as non-capital business expenditure, and are thus 100% tax-deductible under section 8-1 of the *Income Tax Assessment Act 1997* in the year the business incurs the expenditure.
- 100% tax deductibility for non-capital business expenditure in the year it is incurred has been repeatedly and mischievously misrepresented by detractors and commentators as something unusual or special or concessionary. It is nothing of the sort. By contrast, it is exactly what is available to all Australian businesses—including cropping, grazing, dairying and horticultural enterprises, and the local milk bar, shoe shop, service station and accountant’s office—and **the tax deduction is applied at the taxpayer’s marginal tax rate.**
- It is well accepted, by those who understand, that forestry suffers from ‘lumpy returns’ and ‘period inequity’—the latter best described by ABARE in its seminal ‘forestry and tax’ paper in 1991. The consequence of these two phenomena is that, depending on an investor’s individual circumstances, **forestry can be taxed more heavily than agriculture that is based on annual crop or livestock income.**
 - ‘Lumpy returns’ — only one to three income events in 25+ years, with one big one at the end, at forest clearfall.
 - ‘Period inequity’ — the total tax paid on one single large income event (eg, forestry clearfall harvest at year 25) is significantly more than the total tax that would be paid if the same income amount had been received in 25 annual instalments (eg, from an annual wool clip or wheat crop or sugar crop).

- If the full deductibility of establishment, management and harvest costs in the year they are incurred were to be denied, there would be no private plantation investment at all. In New Zealand in the mid-1980s, year-of-expenditure deductibility was removed, and private plantation investment stopped dead, recovering (gradually) only after the policy was reversed and the law repealed.
- In this respect, MIS forestry is no different. If the plantation establishment costs could not be deducted in the investor's year-of-expenditure, there would be no MIS forestry investment. The principle is the same. In other words, if MIS forestry investors were denied the same 100% deductibility as is available to all other businesses (especially agricultural enterprises), there would be no private forestry investment at all.
 - The reason is that few if any individuals, businesses or institutions (except for, say, superannuation funds, although they avoid being the 'initial investor') are willing to conduct a long-term illiquid business or investment with agricultural risk that allows no offsetting deductions until the end of the project in 25+ years.

The new tax arrangements for MIS forestry maintain these same basic tax principles, but in a specific deduction with additional conditions

- The new tax arrangements for MIS forestry introduced in 2007 do not change the basic standard principles described above—ie, full deductibility of non-capital business expenditure in the year the investor incurs the expense.
- This principle has been in place since the *Income Tax Assessment Act 1936*. It is relevant to note that NO changes were made to any tax provisions for MIS forestry when the Plantations 2020 Vision strategy was launched. The industry simply kept operating under the same standard provisions that had been in place for many years.
- The new 'specific deduction' (Division 394 of ITAA 1997) was enacted to enable plantation investment to continue while safeguarding it from the Tax Commissioner's new interpretation of the law—ie, that investors in these projects can no longer be treated as carrying on a business, and thus can no longer be entitled to the standard business deduction provisions described above. Rather, MIS investors should now be classed as 'passive investors' contributing non-deductible capital expenditure to a trust.
 - An ATO test case on this strongly contested interpretation is being currently considered by the full bench of the Federal Court.
- Extra conditions in Div 394 require the MIS forestry company to demonstrate that at least 70% of the funds collected will be for 'direct forestry expenditure' over the life of the project (measured at net present value and arm's length prices), and not for expenses such as marketing and commissions.

MIS forestry generates tax revenue and is a positive investment for the Government

- Far from being 'tax-subsidised' (and other similar inaccurate labels used pejoratively by detractors during this Inquiry), MIS forestry actually generates tax revenue, and is thus revenue-positive for the Government. This happens several ways.
- First, the tax law contains a unique legal provision requiring MIS forestry companies to bring forward their payment of company tax (on gross funds collected from investors, before the companies' own outgoings can be deducted) into the same year the investors make their payments and claim their deductions. This is effectively a 'prepayment' of company tax and imposes a severe cashflow burden on the companies.
 - Thus, the only cost to the budget in the first year is that created by the difference between company and personal income tax rates.

- Second, the expenditure of investors' funds to establish and manage the plantations quickly becomes assessable income in the hands of employees, suppliers and contractors.
- Third, investors pay substantial income tax on the net harvest returns.
- The independent research house, Australian Agribusiness Group (AAG), estimated that Government income tax revenue over the terms of the 2005-06 forestry and agribusiness projects will be three times the amount of investors' tax refunds for expenditure on these projects.

MIS forestry is an easy but wrong target for those who oppose land use change and higher rural land values

- MIS forestry is but one of several competing land uses in a highly competitive rural land market putting upward pressure on rural land values. Other competitors include farm consolidation, broadacre cropping, dairy and beef cattle expansion, intensive agriculture and horticulture, urban encroachment, rural subdivision, and 'lifestyle farming'—especially near the coast and near regional centres.
- The changes these competitors represent have been taking place against the background of relentless decline over decades in the number of family farms, in the profitability of smaller and inefficient farms, and in 'next generation' family farmers.
- Where MIS forestry companies are prepared to pay more than others for some land, that value simply reflects the higher returns expected from the timber enterprise.
- By contrast, **forestry MIS companies are frequently outbid for suitable land**, particularly land also suitable for bananas, beef cattle and dairying. Companies are outbid mostly by neighbouring farmers, or by overseas interests, as is occurring in the dairying and intensive agriculture country in southern Australia, where NZ dairy farmers are paying twice the amount that forestry MIS companies could reasonably afford.
- Forestry MIS companies do not and cannot buy land with investors' funds, which is held in trust until spent on plantation establishment and management. To buy land, companies borrow, raise funds in the equity markets, and use up their after-tax retained earnings.
- Much of the land that has been purchased by MIS forestry companies has been eagerly offered, having been unsuccessfully on the market for years—waiting for a buyer who can pay the asking price.
- Governments at any level should think very seriously about the dangers of intervening in rural land markets in such a way as to take away landholders' rights and prevent farmers cashing out their 'superannuation' at the best available market price.

It is unlikely that the proposed Carbon Pollution Reduction Scheme (CPRS) will result in any additional expansion of MIS forestry plantations

- Some detractors of MIS forestry are now referring to forestry's 'opt-in' inclusion in the proposed CPRS as some form of 'free kick', and are using it to create renewed fear of an explosion of new MIS forestry on prime agricultural land. **They are mistaken.**
- The basic carbon accounting convention that the CPRS will adopt imposes a full emissions liability on the plantation at the time of harvest—and harvest is mandated by law for MIS forestry. Thus, any emissions permits held on behalf of a plantation will have to be surrendered at harvest. If no permits are held, they will have to be purchased—possibly at a higher price than any earned credits would have been sold for years earlier. This contingent liability will probably deter most MIS forestry companies from participating in the CPRS at all.

Finally — a comment about the sugar industry’s attack on MIS forestry

Representatives of the sugar industry have used the ‘any related matter’ term of reference as a vehicle to attack MIS forestry and, in particular, the forestry MIS tax arrangements.

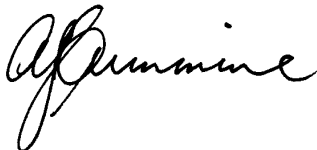
The sugar industry’s ‘case’ is not all that it seems, and is based on false foundations, some of which have been identified in this submission. Other counter-arguments are contained in a short article *Forestry and sugar should work together* (attached).

The sugar industry is placing heavy reliance on an unbalanced consultancy report that it commissioned. Perhaps not surprisingly, that report (revealingly titled *Sugar versus forestry in Queensland*) plays down the long-term benefits of an expanded plantation industry for local employment, skills development, value-adding infrastructure, business prosperity and local community development—all benefits that are evident in other regions where plantation forestry industries have become established.

It is a great shame that the sugar industry is adopting this short-sighted position. It threatens to deprive towns of the benefits of new industries and the security of diversified regional economies. The diversity created by a sustainable forest and timber industry producing high-value tropical cabinet timbers would help protect sugar communities during the all-too-frequent downturns in the world price of sugar, and would help protect against the effects of drought because of the long-term nature of growing trees.

A better alternative would be for the sugar industry to work with the forest and timber companies to bring value-adding investment to both industries, and thereby generate the wealth and prosperity that north Queensland communities have a right to expect.

Your sincerely

A handwritten signature in black ink, appearing to read 'Alan Cummine', written in a cursive style.

ALAN CUMMINE
Chief Executive
Treefarm Investment Managers Association



Forestry and sugar should work together

BY ALAN CUMMINE

Sadly, the sugar industry apparently believes that attacking the managed investment plantations sector will help divert public and political attention away from the continuing decline in the viability of cane farmers and sugar mills in Queensland.

In recent months, the Queensland regional media have carried numerous stories and statements by a few sugar industry spokesfolk critical of the increasing presence of new plantations in areas conventionally growing sugar cane along the coast of central and north Queensland. The (mostly mis-informed) media reports have been elaborated upon in intensive representations to the Queensland State Government and local councils by the Australian Sugar Milling Council and the Australian Canegrowers Council.

The central argument in their public and political campaign is that the sale of cane farms to MIS plantation companies is leading to an irreversible loss of caneland, which in turn threatens dire consequences for sugar mills, for remaining cane farmers, and for regional sugar towns. They argue that sugar mill feedstock, and therefore mill output, will fall below critical levels and cause mills to be closed, leaving remaining cane farmers stranded with uneconomic farms, and will dry up the major contribution to local economies and communities.

Other issues must be considered

Treefarm Investment Managers Australia and its member companies have been engaging with the sugar industry representative bodies, and with a number of Queensland Government ministers and their portfolios, conveying alternative views to those being put by the sugar industry.

During those discussions, and in other talks with local councils and cane farmers, a number of issues have emerged that need to be addressed with much more balance than is being reflected in the sugar industry's public arguments.

First, sugar mills have been closing down fairly consistently for three decades. Nine mills have been closed since 1974, three of these since 2003. Plantation forestry has played no part in any of these mill closures, most of which have occurred because of the periodic and all too frequent downturns in the state of the sugar industry and because the mill owners found it more efficient than continuing to operate uneconomic mills.

Second, and related to the first, there is considerable speculation within the cane farming communities that more mills will have to close regardless of the expansion of the plantation industry. Others have even surmised that MIS plantations have become the new 'scapegoat' to enable mills to be closed with less approbrium than the mill owners might otherwise attract.

Third, despite repeated sugar industry government assistance programs over decades, including the recent \$444 million rescue package, even the larger and more efficient cane farmers are struggling to remain viable, while the smaller growers are just surviving – if at all – only with the help of off-farm incomes. Their situation will worsen in 2008 with forecast increases in interest rates and in the cost of fuel, fertiliser and chemicals.

Fourth, related to the third, it should therefore be no surprise that many cane farmers want to find a way to leave the industry having realised a realistic value for their primary asset



The once dominant sugar industry is struggling to remain viable.

(their land), and are thus eagerly offering their farms to the plantation companies.

Finally, there is apparently widespread dissatisfaction among cane farmers at the position being adopted by their own representative organisation and by the Australian Sugar Milling Council, and also being entertained by a few of the sugar region local councils.

Reliance on unbalanced report

The sugar industry is placing heavy reliance on an unbalanced consultancy report that it commissioned. Perhaps not surprisingly, that report (revealingly titled 'Sugar versus forestry in Queensland') plays down the long term benefits of an expanded plantation industry for local employment, skills development, value adding infrastructure, business prosperity and local communities – all benefits that are evident in other regions where plantation forestry has become established.

Furthermore, the sugar industry is knowingly misrepresenting the tax treatment of MIS plantation forestry as providing an advantage to the plantation companies that the sugar industry alleges distorts the land market against cane farmers seeking to expand.

Among other elements in its campaign, the sugar industry is asking the State Government to intervene and effect immediate changes to local planning arrangements in Queensland to protect existing and even unused caneland from other land uses, as well as discriminate against plantation forestry as an agricultural land use.

It is a great shame that the sugar industry is adopting this shortsighted position. It threatens to deprive towns of the benefits of new industries and the security of diversified regional economies. The diversity created by a sustainable forest and timber industry producing high value tropical cabinet timbers would help protect sugar communities during the regular downturns in the world price of sugar, and would help protect against the effects of drought because of the long-term nature of growing trees.

A better alternative would be for the sugar industry to work with the forest and timber companies to bring value adding investment to both industries, and thereby generate the wealth and prosperity that north Queensland communities have a right to expect.

Alan Cummine, Executive Director, Treefarm Investment Managers Australia.

