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TIMBER QUEENSLAND POLICY STATEMENT

Forestry MIS — essential to meet Queensland's demand for wood products

March 2009

Managing supply and demand

Australia has a \$2 billion annual trade deficit in wood products, up from \$1.7 billion ten years ago. Queensland is only 80% self-sufficient in sawnwood, and growing demand will see this level drop to 75% within five years.

The Australian and State Governments acknowledged the risks of a growing gap between demand and local wood supply in 1997 by launching the national plantations strategy (Plantations for Australia: The 2020 Vision), which has the notional goal of trebling the Australian plantation estate to provide wood security for domestic and export markets.

Simply put, Australia, and especially Queensland, needs to grow more plantations to meet domestic and export demand for wood and paper products.

Delivering plantation expansion

Forestry investments by their nature are long term, with relatively high inputs at establishment, with returns from harvest for some types of plantation taking decades. As a result, most plantation investment has historically been made directly by governments.

However, over the last decade, more than 70% of new investment in Australian plantations has come from the private sector via Managed Investment Schemes (MIS), and the proportion is increasing each year. At the end of 2007, MIS-financed forestry comprised a third of the total national plantation estate of 1.9 million hectares.

From the mid-1990s, most forestry MIS projects were established to produce short-rotation Australian hardwoods for export woodchip to help address the significant trade deficit in pulp and paper products and to replace native forest sources that were no longer available for production. More recently, investment has begun flowing into the production of softwood and hardwood sawlogs to meet the under-supplied domestic demand, and also into high-value tropical cabinet timbers, such as teak and mahogany.

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The Australian Government supports forestry MIS as an effective means of encouraging long-term investment by the private sector in forest plantations to address Australia's growing trade deficit and to increase the security and viability of Australia's timber supply.

It also represents an important investment into regional Australia, using city funds to improve regional economies through diversification.

Traditionally, how did MIS operate?

MIS allows small investors to pool resources in forestry projects and share returns in proportion to their investment.

Under the tax arrangements that applied for decades up until June 2008, investors in forestry MIS projects were considered to be carrying on a business, rather than purchasing a capital asset.

As such, they had access to the same tax treatment as any other business (including primary producers living on the land), being a tax deduction for eligible business expenditure at the marginal tax rate in the year they incurred the costs, and a tax liability in the year they received returns. The scheme manager was also liable for company tax in the same year.

These arrangements were recently upheld in a test case brought by the Tax Commissioner before the full bench of the Federal Court.

Forestry MIS also had a prepayment rule that allowed the scheme managers twelve months to establish the plantations; giving them time to acquire and prepare the land, and grow and plant the seedlings.

Recent changes to forestry MIS

A review of forestry MIS tax arrangements during 2005 and 2006 confirmed the Australian Government's support of MIS as an effective way to deliver their commitment to expand the plantation estate, and new tax arrangements came into effect after June 2008.

There is now a specific statutory deduction for investors in forestry MIS, which delivers the same outcomes as the previous arrangements.

Although investors no longer need to be carrying on a business, the new tax arrangements still allow investors to claim full deductibility in the year they incur costs, whilst the scheme manager remains liable for paying company tax on the collected funds in the same year. Investors continue to pay tax in the year they receive returns from the sale of forest products.

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Other significant changes include:

- At least 70% of the investor's funds must now be spent on 'direct forestry expenditure' associated with planting, tending and harvesting the trees, limiting the amount that can be used by the scheme manager on commissions, marketing, general business overheads etc.
- To account for some of the seasonality issues associated with plantation establishment, the scheme manager has up to 18 months to establish the plantation.
- Initial investors can on-sell their woodlot interests – provided they have held them for at least four years. These arrangements were put into place to make long rotation 'sawlog' plantations more attractive than they had been by giving investors confidence that they can on-sell their investment if they need access to their money.

Although a few schemes give investors an option to purchase the land for their plantations, this is not the norm. Where land is purchased rather than leased, it is still the case that scheme managers use funds sourced from borrowing, raising equity, or after-tax reserves, as for any other capital investment.

Positive future for forestry MIS

In contrast to wildly inaccurate claims about forestry MIS, the new tax arrangements represent a positive investment for the Government. As well as the company tax having to be paid in the same year that the investors claim their deductions, the collected funds also quickly become taxable income in the hands of company employees, contractors and suppliers, so the arrangements remain tax-neutral in terms of public revenue.

The Australian Agribusiness Group estimated that forestry and agribusiness MIS projects in 2005/06 would generate government income tax revenue up to three times the value of the deductions applying to the original investments.

Forestry MIS has been effective in raising city funds for investment in regional Australia. This has led to the development of new industries in many regions, and through diversification, has revitalised many towns and secured their future.

Plantations financed through forestry MIS are now an inextricable component of Australia's regionally-based wood and paper industry. MIS remains an essential vehicle for securing the necessary funds to expand Queensland's plantation estate to meet future timber demand.

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