Introduction

In preparing this submission we would like to thank the Australian Government for the opportunity to comment on such a major issue facing rural communities and business currently operating in Australia. Managed Investment Schemes (MIS) as used by the plantation forestry sector, have had a major impact in rural communities, following exponential growth since the late 1990’s.

It appears somewhat ironic that the Government demands that our agricultural industries compete internationally on a level playing field, while here in our own back yard, MIS’s have effectively created specific domestic subsidies. As a result the Australian Tax payer has indirectly made significant contributions to fund enterprises managed by MIS promoters. To date, the private plantation forestry sector has been the primary beneficiary of such government funding.

Background

Like many other small businesses in areas where plantation forestry MIS companies operate, we are facing significant pressure on resources. In a region where Prime Agricultural Land is relatively limited (given geographic constraints), long term access to such land is rapidly disappearing to facilitate Tax driven MIS pine plantations.

As young business operators in the region, we believe our business model is very robust, however does rely upon the use of Prime Agricultural Land to sustain our enterprises (unlike Pinus Radiata). All we ask for is to compete on a level playing field, whereby enterprise profitability dictates land use. We recognizes that there are other factors that impact on land values, however the impact of significant tax benefits to investors through MIS’s is totally unacceptable. Independent economic information suggests that economic results for the timber plantation industry are at best questionable.

Plantation Forestry MIS on the ground.

Major market distortion arises in all of these schemes, whereby promoters remove themselves from production risk and charge inflated fees to facilitate the enterprise. 100% tax deductable fees of $8000 - $10 000 per ha for planting and establishment are
common, however variable costs (commonly deductible for agricultural production) associated with this process are more like $1500 per ha.

This represents a year 1 tax payer input of around $4000 per ha (assuming tax rate of 45 c in $), while a more realistic deduction would be $675 per ha. In this manner only a small percentage of the intended government assistance actually goes into the tangible process of planting and establishment, while the balance ($4000 - $675) $3325 per ha assists scheme promoters. It is this significant tax advantage for scheme investors over and above normal business deductions that allows promoters to outbid other users for land.

As a result the Australian tax payer effectively sponsors financing of such schemes, while competing players are generally required to fund their enterprise at cost through existing financial institutions.

It should be noted that although the initial fees of $8000 - $10 000 per ha are not technically to be used for land acquisitions in the year of planting, retained earnings from the previous years fees (initially 100% deductible for investors) may be used to purchase land.

Although the ATO rightfully removes itself from endorsing investment in any plantation MIS, it appears to neglect the fact that the ATO itself indirectly contributes around 50% of each investment on behalf of the Australian Tax payer. The Financial Review (July 1, 2006, p18) indicates that in $1.3 billion was raised to be washed through MIS schemes in FY2005/06.

This represents in excess of $500 million dollars of forgone income to the ATO and would suggest that the ATO has a duty of care to the Australian public to ensure that the investment is sound, and future returns (ie taxable income) are realistic. Recent Domestic and International plantation timber experience would suggest that final returns have been significantly below expectations. This situation is exacerbated where plantations are implemented on marginal land (i.e. sections of the Southern Monaro).

**Negative impacts of current MIS structures**

- Major profit driver for promoters is in the SCHEME (ie maximize unit sales) not the product (ie timber sales / market demand).
- Huge profits available to promoters has recently seen a major expansion in the range of agricultural industries that MIS’s operate. Much of this expansion has been driven by existing timber companies who are familiar with maximizing MIS profits. The larger outlet (ie timber, mangos, cattle, wheat, etc) enables a greater volume of funds to be washed through the scheme.
- Investors primary attraction to such SCHEMES is for tax avoidance purposes.
- For plantation timber, there is huge opportunity cost for local communities as future land use options are greatly restricted. Also, removal of existing businesses eliminate local annual cashflows.
High commissions paid to so call financial advisors who effectively act as salesmen swell income stream for promoters, and subsequent power in the marketplace.

High revenue streams for Promotors (driven by tax benefits for the investor and commissions for advisers) creates significant pressure on promoters to source land and realize short term profit from investor funds. This creates land price distortion.

Investment not driven by basic economic process of supply and demand. Eventual oversupply (eg viticulture, pulp, mangos, etc) will occur.

Non MIS investors unable to compete for resources in marketplace.

Decreased rural wealth as land asset shifts from individual private ownership to corporate entities via the Australian tax payer.

Government intent to assist fund MIS enterprises is abused with the majority of the investors tax advantage funding promoters profits.

As opposed to other MIS’s, the high upfront fees and associated profits for plantation forestry, makes it even more difficult for non players to compete.

**Recommendations**

1. Totally remove MIS structures that promote scheme profits and distort markets.
2. If government assistance is required to stimulate economic activity in a specific enterprise, do so via grants. The current plantation forestry assistance of $4000 per ha is being abused and a more tailored format is required if at all. For example a 80% cost recovery on planting and establishment would only cost $1200 per ha as structured in the UK.
3. A full independent review of Australia timber resource and market demand is required. If deemed that further plantations are required, joint venture farm forestry should be implemented. There is no reason why timber companies need become massive land barons via the MIS process. Core businesses for such companies should not be in raising revenue and facilitating schemes.
4. With relation to timber industries, government assistance should be focused on value adding existing resource. This would greatly assist the current trade deficit which is based on $ not timber volume (ie we export low value products and import higher value items).
5. Remove the favorable and discriminatory treatment of forestry plantations by ensuring any tax write offs for expenses are given in direct relation to the expenses incurred. The timing of the tax benefit must match the timing of the expense.
**Response to Minister Duttons Recommendations**

**Tax deductible cap**
We do not agree with a cap as such, but rather bring tax-deductible expenses in line with the normal process for business deductions. Investors would be entitled to 100% tax deductibility for ACTUAL expenses incurred during plantation establishment and management process. The timing of the deduction must match the timing of the expense. This would eliminate the current excessive profiteering by promoters, eliminate misuse of government funds and bring the plantation industry in line with other sectors attempting to compete for the same resources.

Although a cap would restrict deductibility of varying costs associated with a range of plantations (ie some plantations may cost more than others to establish), a more realistic figure would be $1800 - $2000 per ha. The current proposal of $6500 per ha still enables significant profiteering and misuse of government funds.

**Prepayment rule**
We believe that the 12 month rule should be removed immediately. Although not as significant a factor as the distortion of fees charged (ie $9000 per ha vs ACTUAL cost $1500 per ha and the associated 100% tax deductibility), it does promote a greater emphasis on such schemes as a tool for tax deductibility purposes. Long term enterprise profitability largely becomes a secondary consideration.

The 12 month rule also clouds funding of land purchases, and places pressure on its acquisition. As a result of the 12 month rule, investors have their tax deductions in their pocket and promoters significant cash injection well before land is purchased and trees planted. In this nature, a thirst for land is created as promoters strive to execute woodlot development following a injection of capital. The undesirable alternative for promoters is to return funds to the investor, along with the opportunity to retain a significant margin. We would question the current auditing process (or lack of) of the 12 month rule, with a number of promoters continually rolling over large amounts of money from one year to the next.

**Establishment of a secondary market**
We have major concerns for woodlot trading. It is evident that if there is any chance of at least replacing existing employment in regions where plantation companies operate, it is in downstream processing. A focus of trading (likely carbon credits) would have disastrous consequences for communities impacted by the loss of existing business and social structure to accommodate plantations.

**Certification**
Attempt by the industry to cling onto main profit driver associated with current scheme structure. Best practice ticket does not eliminate that fact that MIS’s do not work in real
world economies. We encourage the fact that Prime Agricultural Land must be preserved for future production capacities, however in too many cases this opportunity has already been lost.

If MIS structure was removed, timber returns would be unable to match those from agriculture production on Prime Agricultural Land. Although preservation of Prime Agricultural Land is a significantly better outcome than the status quo (which is an absolute disgrace), such a model would inevitably lead to distorted land values.

2011 Review
At the current rate of MIS expansion eating into rural Australia, by 2011 we will have effectively ruined both competing industries. For agriculture infrastructure and land availability will have largely (or totally) disappeared in regions where MIS forestry companies operate and for forestry a massive headache associated with oversupply. In New Zealand we have already seen forestry investment dry up as a result of maturing plantations falling miles short of projected returns, with prime land returning to agriculture.

If the Australian government is proactive and acts now, there is potential to savor some Win Win outcomes for both Forestry and Agriculture. Continuation of the status quo until 2011 spells disaster for regional Australia.

REFERENCES


CONTACT

John & Will Jeffreys
delegatestation@bigpond.com
ph / fax: 02 64588141