

Taxation in Relation to Forestry

Farm Forestry in the Adelaide Hills / Fleurieu Peninsula - Farm Forestry Note 12/05

Introduction

Farm forestry is treated in much the same way from a taxation viewpoint as other forms of primary production. Income is taxable and costs are deductible.

Your individual farm forestry tax treatment will be dependent on your own situation, income level, business structure, the nature of the forestry enterprise, and its integration with other agricultural and landcare activities. Changes to the Income Tax Assessment Act over recent years have resulted in more favourable treatment of forestry activities than in the past.

Before proceeding on any project it is advisable to seek expert advice applicable to your own specific circumstances and tax position.

Primary production

'A taxpayer who is engaged in 'forest operations' is a primary producer for income tax purposes if their forestry activities constitute the carrying on of a business (section 4 TR 95/6).'

You do not have to derive all your income from 'forest operations' to qualify as a primary producer. What is important is that your forest operations are significant enough to be regarded as 'the carrying on of a business.'

There are many elements to consider in determining whether you are carrying on a business of primary production. These elements are discussed briefly in a later section however Taxation Ruling 97/11: Income tax: am I carrying on a business of primary production? Together with Taxation Ruling 95/6: Income tax: primary production and forestry are essential reading.

Non-commercial Losses

The non-commercial losses measure applies from 1 July 2000. The measure allows losses from an individual's business activity to be offset only against income derived from that activity either in the current year or a future income year. This prevents losses (deductions) from one activity being held against income derived from other sources.

Losses from one business activity can only be offset against other income if one of four tests is satisfied, the exception is met or the Commissioner exercises his discretion.

The "Four Tests"

Assessable income test - income from the activity must be greater than \$20,000pa.

Profits test – there must be assessable income greater than deductions from the activity for at least 3 of the past 5 years.

Real property test – the cost base of real property used in the activity on a continuing basis must be greater than \$500,000.

Other assets test – the total value of other assets used in the activity on a continuing basis must be at least \$100,000.

The Exception

This is an exception to the non-commercial losses measure. Where you have a loss from a primary production business and in that year the total of your assessable income from sources unrelated to that business activity is less than \$40,000 you will be able to offset the loss.

The Commissioner's Discretion

If you do not meet one of the four tests and are ineligible for the primary production exception you may be able to apply for the Commissioner's discretion. The Commissioner may exercise his discretion if the business activity has started to be carried on and, because of its nature, has not satisfied one of the four tests, and there is an objective expectation, based on evidence from independent sources, that within a period that is commercially viable for the industry concerned, the business activity will meet one of the tests or produce an excess of assessable income over allowable deductions. You need to apply in writing to the Commissioner for an exercise of the Commissioner's discretion.

Indicators of carrying on a primary production business

For forest activities to be forest operations they must be undertaken in 'carrying on a business'. The following elements will provide a guide as to whether your activities can be regarded as carrying on a business:

- whether the activities have a significant commercial purpose;
- whether you have more than just an intention to engage in business (purpose and intention);
- whether you have a purpose of profit as well as the profitability of the activity;
- the scale of the activities;



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- whether the activity is of the same kind and carried on in a similar manner to that of the norm within the industry;
- the nature of the activities, particularly whether they have the purpose of making a profit (the profit time frame is not limited to a particular year);
- the repetition and regularity of activities;
- whether the activities are planned, organised and carried on in a business-like manner (whether a business plan exists);
- the volume of the operations and the amount of capital employed (the size, scale and permanency of the activity);
- whether the activities may properly be described as the pursuit of a hobby or recreation;
- the degree of control you have over the development and the maintenance of the land;
- whether there are commercial sales of product or services; and
- whether the taxpayer has knowledge or skill beyond that of a layperson.

(from TR 97/11 section 18)

Forestry

Does the taxpayer have an interest in an identifiable piece of land?

Are the operations carried on in a way comparable to ordinary forestry, albeit on smaller scale?

Is the project commercially viable?

Are operations carried out in a businesslike way with respect to soil, rainfall, planting and tending techniques?

Has the person a significant degree of control over the operations?



What are forest operations?

Forest operations that qualify as primary production include:

- the planting or tending in a plantation or forest of trees intended for felling; or
- the felling of trees in a plantation or forest;

and includes:

- the transport, by a person who has felled trees in a plantation or forest, of those trees or parts of those trees from the plantation or forest to a place where they are to be first subjected to milling or processing....;

where:

- the operations are carried on in the course of, or for the purposes of a business (section 5 TR 95/6).

Taxable income

Undertaking 'forest operations' as a form of primary production will mean that:

- income derived by you from carrying on forest operations is assessable income. Your assessable income will include;
 - any receipts from the sale of felled timber;
 - the proceeds from the sale of standing timber;
 - royalties received from allowing other persons to fell and remove timber;
 - insurance recoveries;
 - reforestation incentive grants or payments.(section 18, 91TR 95/6)
- you will be eligible for primary producer averaging provisions to this income; and
- you may be eligible for other tax concessions that apply to primary producers.(section 85 TR 95/6)

Deductions

Significant taxation concessions are available for landowners undertaking farm forestry projects. The majority of deductions available arise under section 51(1) of the Income Tax Assessment Act.

'All losses or outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income.'

Costs of a capital nature are generally not immediately deductible and must be written off over a number of years.

Allowable deductions from forest operations include:

- the purchase price of an established plantation or forest, (subject to conditions);
- amount paid for the right to fell standing timber on someone else's land (royalty payments);
- the value of trees introduced into a new business, (subject to conditions);
- costs of establishing a plantation or forest; site preparation (ploughing, ripping, mounding, weed control), seedlings and planting costs;
- costs of tending; watering, fertilising, pruning, thinning;
- costs of felling and transporting timber;
- depreciating assets (such as machinery and fences to protect the trees) - deductions are generally worked out using the effective life of the assets;
- capital expenditure on water facilities (such as the cost of constructing a dam for watering or firefighting) - deductible over three income years;



- capital expenditure incurred on landcare operations (such as the cost of plantings that specifically fight land degradation) – deductible in the year the expenditure is incurred.

Where you decide to purchase land and subsequently establish a plantation, no part of the cost of the land is attributable to the trees and therefore no deduction on the purchase price of the land is allowable. On the other hand where land is leased specifically to establish and grow a plantation, the lease payments are an allowable deduction.

Capital Gains Tax

What is capital gains tax?

Capital gains tax is the tax you pay on any capital gain you make and include on your annual income tax return. There is no separate tax on capital gains, it is merely a component of your income tax. You are taxed on your net capital gain at your marginal tax rate.

Your net capital gain is:

your total capital gains for the year
minus
 your total capital losses (including any net capital losses from previous years)
minus
 any CGT discount and CGT small business concessions to which you are entitled.

You may make a **capital gain** from most **CGT events**, if your **capital proceeds** are greater than your **cost base**—for example, if you received more for an asset than you paid for it. You make a **capital loss** if your **reduced cost base** is greater than your capital proceeds. You can also make a capital gain if a managed fund or other trust distributes a capital gain to you.

Prospectus / Product Disclosure Statement (PDS) Investments - afforestation schemes

Many Prospectus or PDS based afforestation schemes are the subject of Product Rulings issued by the Australian Taxation Office. Product Rulings provide certainty for potential participants regarding the tax implications of such schemes. A product Ruling will indicate the availability of tax benefits arising from an investment before you commit

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For further information, contact the Mount Lofty Ranges Farm Forestry Program

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any funds and whether the Commissioner will exercise his discretion to allow losses from the activity to be offset against income from other sources.

When investing in a prospectus or PDS based afforestation scheme or forestry based managed investment scheme (MIS), if your prepaid expense is for seasonally dependent agronomic activities that occur during the establishment period, it is immediately deductible through the twelve month rule where:

- the eligible service period for the expenditure is 12 months or less, and:
- the 12-month period ends no later than the last day of the income year following the year in which the prepayment was incurred.

If your prepaid expense is not for seasonally dependent agronomic activities that occur during the establishment period, or the 12-month rule is not satisfied, your deduction for the expenditure is determined in accordance with either the tax shelter or general prepayment rules discussed in the other fact sheets in this series.

What is a prepaid expense?

A prepaid expense is expenditure you incur for things to be done (in whole or in part) in a later income year. If expenditure is incurred for something to be done in full within the same income year, it is not a prepaid expense to which the prepayment rules apply.

There are no hard and fast rules, the facts of each case must be examined to determine whether a business of primary production is being carried on.

Further information can be obtained from the Australian Taxation Office. Particular rulings to refer to are:

Taxation Ruling 95/6 Income Tax: primary production and forestry.

Taxation Ruling 97/11 Income Tax: am I carrying on a business of primary production?

Sales Tax Determination 97/3 Forestry activities in the agricultural industry.

Information for primary producers (NAT 1712-6.2002)

Prepaid Expenses – investments in plantation Forestry managed agreements.



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