THE INSTITUTE OF FORESTERS OF AUSTRALIA &
AUSTRALIAN FOREST GROWERS

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Submission to the Farm Management Deposits Scheme Evaluation 2021

The Institute of Foresters of Australia (IFA) and Australian Forest Growers (AFG) welcome the invitation to make a submission to this evaluation.

Our submission addresses the elements of the Farm Management Deposits Scheme (FMDS) that are most relevant to private forest growers who are growing, tending and harvesting commercial trees at all scales and in all configurations.

While applying to all private forest growers, the issues arising from the application of the FMDS to forestry have the most impact on private growers for whom forestry is their only primary production enterprise.

From the 'Terms of Reference' document, the focus of our submission is on:

- the third guiding principle:
  "implications of the FMDS for Australian Government policies and programs, including those providing financial support to primary producers"

and

- Scope of the evaluation:
  "Outcomes of the FMDS, including … the impact of the FMDS on stakeholders and interactions and alignment with other Australian Government tax measures and rural policies and programs".

Conceptually, the FMDS is a sensible policy – following on from its forebear, the Income Equalisation Deposits scheme – and deserves to be retained. We expect others will have plenty to say about how successful the FMDS has been in aiding the intended target users, achieving its program objectives, meeting its budgetary requirements, and so on.

Our primary concern is that, in its original formulation, the FMDS did not embrace forestry as a form of primary production, and subsequently, despite years of advice and representations from AFG, the scheme has not been adapted in any way to accommodate private forestry.

We trust you will seriously consider the issues we've raised, which we'd be happy to follow up in subsequent discussions, if you feel that is warranted.

I can be contacted directly on kevin.harding@afg.asn.au and 0410 471 957. You might also contact Alan Cummine at alan.cummine@gmail.com and 0407 488 927.

Sincerely

Dr Kevin Harding
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Chair, Australian Forest Growers (a non-trading business wholly owned by IFA/AFG)

Institute of Foresters of Australia and Australian Forest Growers – Who we are

The Institute of Foresters of Australia (IFA) and Australian Forest Growers (AFG) is the independent professional body representing about 1,000 members who are forest scientists, professionals, private forest growers, and forest managers operating in all aspects of forest, natural resource management, and conservation, throughout Australia. Our grower members are owners of small to medium enterprises, and comprise a stakeholder group that can utilise the Farm Management Deposits Scheme.

Forestry professionals, informed by the science of natural resource management, play a crucial role in shaping the future of forests, including plantation forests and farm forestry projects. We advocate balanced land use that meets society's needs for sustainable forest management, timber supply, and effective conservation outcomes.

IFA/AFG is an independent and apolitical voice advocating for the development and application of the science of Forestry for the best practice management of all of Australia's forests including those owned and managed by private growers. The Institute of Foresters of Australia (founded 1935) and Australian Forest Growers (founded 1969) merged in early 2019.

Private forestry is primary production

Attracting large-scale private investment into plantation forestry to replace what used to be financed directly through State government forestry commissions (with Commonwealth-subsidised loans) faces different and peculiar challenges stemming from the unique nature of forestry enterprises and assets.

Although plantation forestry has features not shared by annual agricultural crops (for example, flexible harvest dates, within reason), it still faces the same general agricultural risks – rainfall variability, flood, fire, severe and extreme weather events, pest and disease outbreaks, commodity market variability, and more.

But forestry is different in that it is a much longer-term enterprise. with high establishment costs, illiquid assets subject to the risks noted above, very few income events, returns coming in large 'lumps', and (for private growers) a large tax liability at final harvest.

Planting long-rotation softwood plantations for a large sawlog final harvest looks 25–35 years ahead. Hence the repeated government and industry policy and program initiatives – particularly since World War 2 – to establish new plantations well in advance of an anticipated industry to process the intermediate and final plantation products.

Many hardwood forests, both in plantations and in managed native forest, can have rotations up to double that period, depending on the target purpose and product and the management regime.

Private forest growers can range from farmers who have integrated a forestry enterprise into their mixed farming operations – as diverse as can be imagined – to those who choose to practise forestry as their sole primary production enterprise. This can range, in turn, from managing a privately owned native forest to planting and tending a plantation, with or without the help of a professional forest manager.

In the latter case, many private forest owners have the intention of growing their forest as a form of self-funded superannuation, and don't plan to replant or to continue primary production after final harvest.

120 days – the primary focus of our interest in this evaluation

The conditions of use of the Farm Management Deposits Scheme (FMDS) and its predecessor, Income Equalisation Deposits (IED), have always discriminated against primary producers whose only enterprise is self-funded private forestry.

This discrimination is a consequence of the condition that all payments made into a Farm Management Deposit **must be withdrawn within 120 days once the grower ceases to carry on a primary production enterprise**.

Farmers with forestry as one of several enterprises can be reasonably flexible in managing their costs and income streams among their enterprises, and tend to be able to use FMDs effectively. By contrast, the cohort of private forest owners whose forests are their only primary production can be especially badly affected, and their stories of unexpectedly high tax liabilities and of the unfairness of having grown their own superannuation investment only for it to go unrecognised, including by the FMDS, have been known to discourage other potential private growers.

The restrictive access to the FMDS adds insult to the injury suffered by a grower's (hopefully) high harvest return being taxed at the grower's highest marginal tax rate, despite having waited decades for that return. This is the problem of lumpy returns – or period inequity* – inherent in a very long-term primary production enterprise with only one or two intermediate returns (from thinnings, if fortunate to have access to a market like pulp for small log thinnings) and one much much larger final harvest return.

***Period inequity** is the term for the different tax impacts of lump-sum income compared to annual income. Period inequity is inherent in a plantation forestry enterprise, which offers one to three income events spread over periods from 10 to 40 years. Because most of the income in large income events (commercial thinning harvests and final clearfall harvest) is taxed at the forest grower's highest marginal tax rate, it can be seen that, subject to the taxpayer's individual circumstances, more income tax is likely to be paid on a plantation forestry enterprise than if the same total amount of income had been received and taxed annually over the equivalent period —as is the case with most livestock, cropping and horticultural enterprises.

Although some plantation critics like to claim that the deferral of tax liabilities for many years until harvest constitutes some form of special treatment, such a claim ignores the simple fact that the plantation growers are waiting many years to receive the income on which that tax is to be paid. Furthermore, this investment is usually financed by after-tax earnings, so the forest grower has already contributed to the Government's revenue base for many years while waiting for the forest to mature and bear dividends. This long-term deferral of income then incurs an inequitably large tax liability that reduces the after-tax return on investment to uneconomic levels. This acts to discourage plantation investment by private growers.

IFA/AFG acknowledges that 'changes to the tax treatment of FMDS deposits and repayments' has been declared to be outside the scope of the evaluation, and we are not seeking to use this evaluation as a means to achieve such changes. However, it is fundamental that the tax treatment of an annual income stream from livestock, cropping or horticultural crops over 30–40 years will almost certainly be considerably less than that from a single very large return from a mature plantation harvest.

It is therefore reasonable to seek to **extend beyond 120 days the period over which a private forest owner may retain a legitimate Farm Management Deposit after having ceased primary production. IFA/AFG <u>recommends</u> that this period be extended to at least a minimum of three years.**

Over many years, Australian Forest Growers has advocated a small number of policy and program changes to **remove disincentives** to the uptake of on-farm plantations – at any scale and configuration. IFA has often actively supported the AFG's position.

Some of these changes have been adopted. But this restrictive condition of the FMDS has yet to be amended in a way that recognises and accommodates the inherent characteristics of this long-term form of primary production to address the inherent discrimination against it.

Why this recommended change is important and justified

The 'permission' for the evaluation to include consideration of this recommended change is contained in the **Guiding principles** and the **Scope of the evaluation,** specifically:

<u>Guiding principle #3,</u> *to provide advice on:*

— *'implications of the FMDS for Australian Government policies and programs, including those providing financial support to primary producers'*

<u>Scope of the evaluation</u>, *to assess:*

— *'Outcomes of the FMDS, including … the impact of the FMDS on stakeholders and interactions and alignment with other Australian Government tax measures and rural policies and programs'*.

The central issue embodied in these parameters of this evaluation is the Australian Government's commitment to reverse and expand the last decade's decline in the national plantation estate and **to revive and strengthen the role of private growers in this expansion**.

The most recent official evidence of the Australian Government's commitment is presented in its 2018 plan: ***Growing a Better Australia: A billion trees for jobs and growth***. It was launched jointly by The Hon David Littleproud and Senator The Hon Richard Colbeck – at the time, the Minister and Assistant Minister respectively for Agriculture and Water Resources.

Selected extracts from that document are instructive and worth including here.

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> ***Farmers will play a vital role***
>
> *The next generation of plantation growth in Australia will also rely on, and reward, our farmers. The Government is determined to ensure that we support our farming communities and regional centres, and they will be a centre piece of this forest industries plan. …*
>
> *Working with farmers to secure a long-term 'wood bank' for the forest industries' future will be an economic win for all the parties involved, the farmers and the forest industries. At maturity, when the trees have been established in the right quantities and in the right locations, they will provide wood and fibre resources for processing facilities and income for farming families.*

Pages 10 and 11

> ***Reducing barriers to forestry expansion***
>
> *The forest sector has projected that Australia needs to establish approximately a billion trees (equivalent to 400,000 hectares) of new plantations over the next decade to meet our future demand for wood.*
>
> *Planting new trees in commercial plantations* ***and through farm forestry*** [emphasis added] *will provide greater certainty and confidence for our forest industries, which in turn will drive investment, innovation and jobs growth****. It is important that farm forestry be fully integrated into the existing commercial supply chains.*** [Emphasis added.]
>
> *If the forest industry plants one billion new trees over the next 10 years, an estimated additional 18 megatonnes of carbon dioxide will be sequestered per year by 2030. …*
>
> *Plantation trees on farms are investments not only for the present, but for future generations. …*
>
> *The Australian Government will take action to remove impediments to, and enable the sustainable expansion of, plantations.*
>
> ***Actions***
>
> *The Australian Government will support a goal of adding a billion new plantation trees by: …*
>
> *ii) working with industry and state governments to allow Regional Forestry Hubs to maximise their capacity to accommodate plantation expansion in the right places*
>
> ***iii) reviewing other legislation, policies and processes that may be unintentionally restricting plantation expansion.*** [Emphasis added.]

It is important to note that the National Farmers Federation supports this plan and that it was developed from extensive consultations undertaken by the Forest Industries Advisory Council.

In the past decade, the Australian Government and Parliament, and the forest industry, have conducted several inquiries and studies to identify impediments to a revived and expanded plantation estate, and possible policy and program solutions that could achieve that expansion sustainably and acceptably.

Complementing the *Growing a better Australia* plan, quoted above, the most recent is the House of Representatives 'Inquiry into timber supply chain constraints in the Australian plantation sector', which reported in March this year – *Aussie logs for Aussie jobs*.

To varying degrees, these inquiries and studies – and many more dating back to the mid-1980s – include references to the **lingering disincentives for private forestry** being taken up and integrated into the timber supply chain at the desired scale that is so often talked about. A number of these – documented by AFG over decades – are not, of course, FMDS-related. But, taken as a 'collection' of disincentives, they combine to create a formidable impediment to achieving the commitment of yet another Government to reinvigorate the national plantation supply chain.

AFG has learnt over decades that removing some of those well-documented disincentives can involve significant and sometimes complex effort, resources, political will, and sheer good fortune or timing.

It is IFA/AFG's view that extending the period a private forest owner may continue to hold an FMD after final forest harvest from 120 days to at least three years need not be in that too-hard category. IFA/AFG is willing and able to work closely with the Government and other industry bodies to implement that change.

Off-farm income limit excludes many private forest growers

For those investing in forestry alone without other on-farm income from livestock or crops, the $100,000 limit on off-farm income is a barrier to their access to the FMDS.

For a forest investor to save the capital needed (approximately $10,000 / hectare) to self-fund a plantation investment of any reasonable scale (100+ha) requires considerably more after-tax income than that available from an annual income of $100,000.

To encourage the scale of forest investment that the current Australian Government plan – *Growing a Better Australia: A billion trees for jobs and growth* (described above) – aims to attract, requires a more realistic consideration of restrictions placed on off-farm income earnings.

Current government support targeting families in the 2021/22 budget looks to assist families with income up to $150,000 (Government reveals $1.7b Budget pledge to slash childcare costs, Labor hits out at 'missed opportunity' – ABC News). **We suggest that the FMDS limit for off-farm income should at least match this figure of $150,000, although a case can be made for incentives exceeding that level.**

This incentive would demonstrate recognition that no annual income will be obtained from a planted forest for many years (25-40 years for sawlogs) and large off-farm income (already incurring high marginal tax rates) will be needed to self-fund this investment.

Other significant FMDS matters

The conditions attached to the FMDS include four other matters that add further disincentive to a significant cohort of private forest growers from participating in the scheme.

Two are embodied in the 'early withdrawal' provisions, and two have been listed as 'out-of-scope' of the evaluation. We'll mention all of them only briefly here, in the hope that the **evaluation team will recognise how these matters run counter to the Government's plantation expansion plan** (above), and are worthy of further separate investigation and dialogue. Although there are numerous other disincentives to a much larger private forestry contribution to the timber supply chain, there seems little reason for the FMDS to compound these disincentives. This evaluation and future dialogue that can flow from it, present a worthwhile and logical opportunity that shouldn't be passed up.

Early withdrawal of FMDs for primary producers affected by drought and 'natural disasters'

Eligibility for **drought-affected** primary producers to withdraw deposits within 12 months without losing tax benefits explicitly excludes primary producers "solely involved in the following industries":

- commercial fishing, pearling and related activities (other than farming of aquatic animals)
- felling of trees
- transporting trees, logged by the transporter, to a mill or processing plant for milling or processing.

In other words, two of the three listed industries affect private forestry, in particular the 'sole enterprise' cohort of growers. IFA/AFG would appreciate an opportunity for dialogue on why this is so, and how it can be amended.

Eligibility for similar early withdrawal of deposits by primary producers affected by **'natural disasters'** (separate from the natural disaster of drought), while not explicitly excluding private forestry, impose conditions that do not recognise the 'lumpy return' nature of forestry, stipulating when deposits must have been made. Although a deposit already held for 12 months doesn't invoke this provision, private growers losing part or all of their forest investment to such natural disasters as fire, cyclone, severe hailstorms and other extreme weather events need to fund their salvage and clean-up as soon as they are able, which may fall foul of the condition.

Enabling family companies to utilise the FMDS

Many private forest growers have chosen to operate under a family company structure – often with only two or three family members. This applies not only to the cohort of forestry-only growers but also to farming families with diverse mixed enterprises that include forestry. All are denied access to the 'averaging' financial management afforded by the FMDS. This exclusion should be revisited so that forest growers are not penalised for having chosen the 'wrong' business structure.

Enabling forest growers to hold more than $800,000 in FMDs for the period until their statutory withdrawal

A substantial area of private forest, say 50ha, could generate a gross return of much more than $800,000 (perhaps double) in the year of final clearfall harvest of sawlogs, depending on the timing within a year of harvest and sale. Being able to deposit such an amount (after costs) into an FMD is one avenue for offsetting the grower's large and inequitable tax liability after having waited 30-odd years for this 'superannuation', particularly if it can be held and drawn down more evenly over <u>at least</u> three years (as proposed, instead of the current 120 days).

IFA/AFG would advocate the adoption of any means by which this taxation 'period inequity' can be offset. Amending the FMDS limits as proposed is one such partial solution.

Another approach to encouraging private forestry investment

As described at the start of this submission, forestry faces similar natural and market risks as most other forms of primary production. A changing climate is appearing to exacerbate some of these risks, particularly damage and destruction from fire and increasingly severe and extreme weather events, and the prospect of zones of good forest growth becoming less suitable during the decades of a sawlog plantation.

The Farm Management Deposits Scheme remains a valuable tool to help primary producers plan and manage their operations in variable future conditions. **The FMDS can and should be improved to ensure private forest growers are not denied access to this management tool**.

If this evaluation and any further consideration of some of IFA/AFG's proposals turn out to be beyond the capacity for amendment of the existing FMDS, we offer an additional approach (**not** as a replacement) that could open up the encouragement of private farm forestry investment intended in the Government's *Growing a better Australia* plan. It would be particularly worthwhile in attracting, at scale, potential forest owner investors whose only primary production is forestry and not balanced by returns from a mixed rural business.

It has been drafted and put forward by one of IFA/AFG's leading and longstanding grower members, a life member of AFG, who has harvested his substantial pine sawlog plantation in recent years and has dealt with the issues identified in this submission. Even though this proposal is in its very early stages of development, we offer it to the evaluation team for passing on to the department and its Ministers for serious consideration and further dialogue.

A Forestry Deferred Payments Scheme

The following characteristics of a customised Forestry Deferred Payment Scheme for private forest investors should convey the reach and scope of such a scheme.

i) Be accessible for 10 years after harvest and not dependent on continuing in the industry. This would take a grower's potential withdrawals out to say 75 years old for an owner who has the income available when 35 years old to self-fund a substantial planting. Note that the shortest crop of pine sawlogs would be about 30 years, so this grower would be 65 years old before obtaining a return on this investment. Costs to purchase, prepare and plant trees on a hectare of land and then maintain this planting for high survival, pest and weed control and fire protection is around $10,000 – so the accumulated self-funded investment would be about $1 million for a 100 ha plantation.

ii) Be available to spouse, partnership or company ownership business structure, but exclude large forestry companies with assets over, say, $15 million. A way to attract larger landholders able to plant a large plantation (100–500+ ha) is needed. Such farm businesses are often structured as companies.

iii) The plantation asset needs to be able to be transferred to dependents with the same conditions attached and this could be a valuable component of a retiree's wealth.

iv) A restriction to have held ownership of the plantation for at least five years would stop undesired manipulation by on-selling near harvest.

v) Limited to the return from the harvest. In the event of a bushfire, the insurance money or early harvest of fire-damaged trees could be treated as harvest money. This would at least assist with the problem of environmental risk.

vi) The scheme would not apply to thinnings, and therefore any thinning income would be considered part of the management of the plantation and treated as income in the normal way.

vii) Payments by the processor or exporter are paid direct into a special account with the bank with comparable arrangements to the current Farm Management Deposit scheme. No other funds can be placed in the account besides those from the processor or exporter.

viii) The costs of replanting a second rotation of trees could be taken from first rotation returns and untaxed to encourage keeping the land under trees, thereby contributing to the identified need for increased wood supply into the industry supply chain.

The overall aim is to employ such a Forestry Deferred Payment Scheme to create a strong incentive for landholders to enter into the forestry industry and appropriately gain when the returns are proven.

Concluding remarks – future directions

The FMDS is a worthwhile facility to help primary producers manage the risks and variability inherent in so many forms of primary production, and should be retained. Private forestry shares those risks and vagaries, but many of its practitioners cannot participate freely in the FMDS when handicapped by some of the conditions and thresholds in the design of the scheme.

This submission has brought these to the attention of the evaluation team, with possible solutions. Some may be beyond the designated purpose of the FMDS, even after amendments, and instead merit consideration of another approach that better addresses the particular characteristics of very long-term private forestry enterprises.

The Government's commitment to expanding the national plantation estate to 400,000 ha – including 100,000 ha on farms – and the explicit commitments quoted in this submission, add particular focus and momentum to the urgency of removing disincentives to private forestry investment. Amendments to the FMDS, and perhaps an additional forestry-specific scheme, will be important factors in meeting that objective.

IFA/AFG is ready and willing to contribute to any further discussions on these matters.