Australian Forest Growers
ABN 39 000 694 904

14 March 2005

Mr Vernon Joice
Board of Taxation Secretariat
Treasury Building
Langton Crescent
PARKES ACT 2600

Dear Mr Joice

BoT post-implementation review of the small business CGT concessions

Thank you for extending the time for Australian Forest Growers (AFG) to make a short submission to this Board of Taxation review. As I mentioned in last Monday's email, AFG didn't see the announcement of the BoT review, and was not on the list of organisations directly invited to participate.

AFG has had the benefit of reading and discussing the submission from National Farmers' Federation, which we believe has articulated very well two important issues of concern for private forestry — the 'active assets' test and the $5 million assets threshold condition, particularly as they apply to the small business 15-year CGT exemption.

This short submission supports the thrust of the NFF recommendations, and elaborates on NFF's supporting arguments by adding some comments that reflect features of taxpayer circumstances and commercial practice that are becoming more and more common in private forestry.

Retirement, leasing, and the active asset test

As part of the changing demographic of rural land ownership and primary production, farming families are increasingly finding themselves less able to manage in their later years, mostly suffering from a diminishing supply of help from the next family generation and readily available farm labour. It may be their intention to sooner or later either 'will' the property to their children, or sell the property to benefit themselves or the family estate, but, in either case, to retire.

NFF described leasing as a not uncommon commercial practice in farming, especially among ageing farmers. It is becoming increasingly common in suitable agricultural regions for the lease to be with a plantation management company — for all or part of the farm.

Leasing for plantation forestry is seen by many as a preferable alternative commercial arrangement to either selling the farm outright or to entering a joint venture in which the farmer commonly carries out a small but agreed proportion of the plantation management tasks. Under the small business CGT concessions, however, the consequences for a farmer intending to retire are significantly worse if the farmer is leasing.

It is this differential impact that AFG believes supports the case for revisiting the 'active asset' condition of the CGT concessions.

AFG suggests the solution could be either:
(a) to allow that a farm would still qualify as an active asset when leased; or
(b) to delete the requirement for the retiring taxpayer to have an active asset at the time of sale or transfer of the property.

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Following is an example that could become increasing typical but yet would penalise or at best seriously disadvantage a farmer leasing to a plantation management company.

> George and Lyn farmed their 800 hectare grazing and forestry property for 25 years from when both were in their twenties, with an expectation that their adult children would later take over management of the farm when George retired at about 65. When George was 55, George and Lyn leased 600 hectares of the farm at commercial rates to Pulpwood Management Company Ltd for 11 years, with the intention of continuing to graze cattle on the remaining 200 hectares and also to periodically agist some cattle on the leased portion at suitable times in the plantation growth cycle.
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> When George was 60 years old, George and Lyn learnt that their children no longer had any interest in continuing the family farming business, and would sell the property when it passed into their ownership.
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> The family decision at that point was that George and Lyn would sell the farm as soon as possible, retire from farming, and move to the coast. This would mean selling the property before the lease expired and with the lease as an encumbrance on the title.
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> The active asset test, as we understand it, would render George and Lyn ineligible for the 15-year CGT exemption for at least the 600 hectares leased to Pulpwood Management, for which George and Lyn would incur a substantial CGT liability ─ unless, by some miraculous application of the 'main use' test, their periodic agistment of cattle on the leased land somehow qualified that portion as an active asset.

There are diverse private forestry scenarios that could be created for particular business structures, farm and forestry operations, family circumstances and succession plans. Regardless of these alternative scenarios, the overall objective of the small business CGT concessions should be to treat taxpayers as equitably and as fairly as possible while fulfilling the policy intent of the tax measure, and to avoid forcing farm families to make absurd decisions in order to be eligible for what they should otherwise be entitled to.

Not treating as an active asset the leasing of one's farm land for primary production under arm's-length commercial arrangements should be seen as falling into that category, and it should be re-considered.

Retirement, forestry, and the $5 million assets threshold

The other threshold test of peculiar importance to private forestry is the requirement to have net CGT assets of less than $5 million.

Managing commercial trees for harvest creates a class of appreciating asset. For tax purposes, trees belong to the land they grow on, and only become trading stock when severed from the ground (felled).

This treatment can lead to a perverse outcome. Depending on a number of factors (eg scale, site quality, species, silvicultural management, market access, etc), engaging directly in private forestry can increase the likelihood of the landholder's assets exceeding the arbitrary $5 million threshold simply as a result of the landholder's choice of primary production.

Although the landholder is growing an appreciating asset, market valuations of relatively immature standing timber and plantations can often be somewhat less than the real potential value. A retiring landholder growing a 30-year sawlog plantation that is only 10 years old could receive a market valuation for the forestry which, when added to the land and other assets, serves to render the landholder ineligible for the 15-year exemption, but which remains well-short of the plantation's true potential commercial return to the grower or his/her family. Furthermore, since the landholder is retiring, he/she has no way to realise on this illiquid investment at this immature stage in its growth cycle, but is nevertheless confronted at the same time by a substantial CGT liability.

Private forestry already suffers at the hands of the tax system (through long-term illiquidity and period inequity/ ‘lumpy returns’). AFG believes that the current treatment of forestry under the small business CGT concessions further discriminates against private forest growers, and should be re-considered.

AFG acknowledges the points made in the NFF submission about the difficulties of selecting an arbitrary asset value threshold at a point in time in and in an economic environment where rural land values are moving rapidly over a period of time. AFG would similarly seek to be involved in any consideration the Board or Treasury may give to raising or otherwise changing the asset value threshold.

Finally...

AFG thanks you once again for the opportunity to make this brief submission at this stage of the review, to assist the Board’s understanding of the particular dimension that private forestry often brings to consideration of primary production tax matters.

The issues raised have not been discussed in as much detail as would have been done in a more considered submission, and AFG would be happy to have further discussions with the Board or the Secretariat on any matters raised here, or on any other forestry-related matters on which the Board may seek clarification or explanation.

I can be reached on 02 6162 9000 and 0427 488 927, and alan.cummine@afg.asn.au for any such discussions.

Yours sincerely

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