

Minimising stamp duty : a forestry primer

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This paper was written before the Budget night announcement that forestry rights (and all other profits a prendre) are exempt from lease duty from July 1, 1994. The paper documents a method which could have been used to minimise stamp duty on forestry rights created before that date. Since there is a three-month period in which to present an instrument for stamp duty, it may still be applicable for some ventures.

Background

Stamp duty applies to instruments (documents) involving land transfers under the Stamp and Cheque Duties Act 1971. In forestry, such transactions include the purchase or lease of land or forested land and the creation of forestry rights usually under the Forestry Rights Registration Act 1983. The transfer of shares and the sale of Crown Forest Licences are not subject to stamp duty, as they do not confer an interest in land.

Until recently, stamp duty was not a significant payment in the creation of a forestry right. Landowners granting such rights did so for a token consideration without incurring stamp duty. At the time of creation, a forestry right has little, if any, value.

However, by the end of 1993, the IRD was taking a closer assessment of forestry rights. Under section 8 of the Act, a grant of a forestry right is deemed to be a land lease. Under section 26(1)(a), duty payable on a lease is \$0.40 for each \$100 of the maximum rental that is or may become payable under the lease in any one year. The maximum rental which may become payable under a typical forestry joint venture occurs at the end of the rotation when the landowner and the investor split the harvest revenue according to some pre-arranged percentage. The problem is that the stamp duty payable on that total revenue is due when the venture is created.

Stamp duty is no longer an insignificant matter. An understanding of how it works on both freehold and leasehold land

is important for anyone investing in forestry. While the IRD's recent position creates problems for forestry rights, there is a way to structure a joint venture which would minimise the stamp duty payable.

Freehold land

The purchaser of freehold land and trees is liable for stamp duty (conveyance duty) on the GST inclusive value of the land, trees, and any buildings on the land. If land is sold subject to timber-cutting rights, these rights are subject to lease duty. Stamp duty rates are as follows:

- 1.0% on the first \$50,000;
- 1.5% on the second \$50,000;
- 2.0% on the balance.

This is a straightforward payment. The law is clear that for the purposes of stamp duty, the trees are considered to be part of the land and assessable. They are not a crop (IRD, 1993).

Leasehold land

Lease duty of 0.4 per cent of the maximum annual rental payable is chargeable on the grant of a licence to cut timber in addition to a possible initial conveyance duty. In many joint ventures created under the Forestry Rights Registration Act 1983, the landowner contributes land and possibly labour and an outside investor contributes capital.

The IRD uses the initial feasibility study to estimate future value of the timber at harvest (in 25 or 30 years) and computes the landowner's share of that value. This they consider to be the maximum annual rental. Stamp duty is assessed on this value and is payable when the forestry right is created.

The forestry right is registered against the appropriate certificate of title. However, this does not take place unless and until the forestry right has been assessed for stamp duty by the IRD.

Requirements and penalties

Documents must be presented for stamping within three months of their execution or penalties will be incurred. The time for presenting the documents for stamping runs for three months from the date that the documents are executed (section 50). There is a penalty of \$0.01 for every dollar of duty payable for each month or part-month that the document is late (section 57).

Example: structuring to save stamp duty

Case A: CutclearCo enters into a joint

venture with a landowner. CutclearCo purchases from the landowner the registered forestry right in a block of land planted in four-year-old *Eucalyptus nitens* with the intention of milling the trees in 25 years. The purchase price is \$22,222 plus GST (i.e., \$25,000 including GST). In addition, the landowner and CutclearCo will split the final harvest value. The joint venture feasibility study estimates the landowner's future share is \$168,664 plus GST (i.e., \$189,747 including GST). Total stamp duty is computed as follows:

Convenience duty	1.0% * \$25,000	= \$ 250
Lease duty	0.4% * \$189,747	= \$ 759
Total stamp duty		\$1009

Case B: same company; same landowner; same stand of trees; same up-front payment. In this case, rather than CutclearCo and the landowner splitting the value of the harvest, CutclearCo pays the landowner an annuity of \$2666.67 plus GST (i.e., \$3000 including GST).¹ Total stamp duty is computed as follows:

Convenience duty	1.0% * \$25,000	= \$ 250
Lease duty	0.4% * \$3,000	= \$ 12
Total stamp duty		\$ 262

Note the difference in stamp duty. The difference in percentage terms, 74%, would be even greater if this transaction involved no initial convenience duty.

Discussion

Forestry joint ventures are often structured so that an investor and a landowner split the value of the harvest according to some pre-arranged percentage. This percentage is based on the estimated value of the landowner's inputs as a proportion of the estimated value of the harvest. An alternative method of structuring such a venture would be to provide the landowner with two possible payments, one guaranteed and one conditional.

The first would be a guaranteed fixed payment based on the annualised value of his or her share of the estimated harvest revenue. The second would be a conditional payment at harvest. The conditional payment would be based on the final harvest value. If the final harvest value was greater or less than the value estimated in the initial feasibility study, then the landowner would share a proportion of this difference. If the final harvest value was exactly the same as estimated in the

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If you assume no inflation and a 7% real discount or reinvestment rate, the future value of the \$2666.67 annual payments is equal to the landowner's share of the harvest value in Case A, that is, \$168,664.

initial feasibility study, then there would be no supplementary payment.

The advantage of such a scheme would be that stamp duty would be minimised. Both the investor and the landowner would share in the rewards and risk of forestry. If the rewards were greater than originally anticipated, then they would share accordingly. If the rewards were no greater, then each would still get his/her anticipated return. If the rewards were less than anticipated in the feasibility study, then each would share in the lower returns. At the same time, initial stamp duty would be minimised.

There are disadvantages with structuring a venture like this. The first is financ-

ing. Such a structure requires more financing from an outside investor to make annual payments to the landowner. The second is income taxes. Income taxes would be payable by the landowner on each annual payment. From the perspective of the overall joint venture, however, such a transfer would be tax neutral because the investor would be able to deduct the payment from income taxes. The third disadvantage is that at harvest it is possible that additional stamp duty may be required. At the start of the venture, the expected value of the supplementary payment is zero. However, at harvest if the landowner gets an additional one-off payment, this may be subject to

stamp duty. In any case, such additional stamp duty would not be imposed or paid until harvest.

The IRD's recent review towards forestry joint ventures creates difficulties regarding stamp duty. There should be legislation which turns stamp duty into a neutral tax. However, even under current legislation it should be possible to structure a joint venture to minimise stamp duty and still enjoy the benefits of a growing forestry investment.

Reference

Inland Revenue Department. 1993. "Stamp Duty on Forest Sales". Tax Information Bulletin. April. 4(8): 5-6.

NZ forestry faces tough competition from South America

New Zealand forestry faces tough competition from South America, and we will have to invest heavily in technology to produce sizeable volumes of value-added products if we are to become a significant player in global markets. That is the message from a New Zealand delegation of forestry members back from a recent tour of Chile and Brazil, reports New Zealand Forestry Bulletin.

In just two years Brazil has established a large furniture export industry based on its southern pine resource.

Europe, its major market, is worth \$US200 m a year, and the industry aims to be a billion-dollar export earner by the year 2000.

In Chile, furniture exports grew 21% during 1993, earning the country \$US30 m, and the industry has projected a 334% increase during the next six years.

"Chile has made remarkably rapid strides in the remanufacturing industry," says Tradenz's Laurie Halkett, who was with members of the Radiata Pine Remanufacturers' Association on the tour. "But Brazil is gearing up to an equally spectacular performance."

Laurie Halkett says he is not suggesting that New Zealand's log exports should cease, but stresses that the country is at a crossroads. "We have to decide whether we will remain predominantly a commodity producer or whether we invest in technology to make us more competitive in the global manufacturing market.

"The Chileans are definitely showing New Zealand the way in remanufacturing. They have proved that radiata pine can be sold in discerning US and European furniture markets—not only at the low end, but also in the mass middle market range," he says.

Most of Chile's furniture is exported in ready-to-assemble (RTA) form. Laurie Halkett says manufacturers pay a great deal of attention to design, as they realise this is crucial in gaining market share.

The Chileans have also given close attention to introducing the right processes and technology. "Foundation Chile's Centec, a fully commercial remanufacturing plant, is a good example. It has been set up to demonstrate processing and technology to the private sector. These sorts of initiatives, plus the competitive advantages over New Zealand in labour, raw material and freight costs have firmly established Chile as the world leader in value-added radiata pine," he says.

Despite their competitiveness, New Zealand and Chile have agreed to work in conjunction in promoting radiata pine remanufacturing.

The Corporacion Chilean de la Madera (the equivalent of the New Zealand Forest Industries Council) and the RPRRA have agreed to the:

- exchange of existing standards and will work towards common minimum standards on particular products;
- exchange of market intelligence where conflict with common customers may occur.

Laurie Halkett says the Radiata Pine Remanufacturers Association is addressing the challenges faced by New Zealand industry.

"The Association will be gathering groups of companies together to develop opportunities in export markets, an investment programme, an educational programme to upskill employees and establish relationships with other elements of the timber industry," he says.

Forestry Corporation of New Zealand results at a glance

In the year ended March 31, 1994 Forestry Corporation:

- made gross sales of \$454.2 million;
- made an after-tax profit of \$157.1 million;
- paid a \$112 million dividend to the Crown;
- made other payments to the Crown totalling \$101.7 million;
- harvested approximately 3.5 million cubic metres of timber from its Bay of Plenty plantation forests;
- planted five million *Pinus radiata* and Douglas fir seedlings to ensure sustainable management of its forests;
- processed 400,000 cubic metres of logs at its Waipa Processing Plant;
- sold 2.3 million cubic metres of logs on the New Zealand market, representing 68 per cent of all the Corporation's log sales;
- sold more than 75 per cent of its *Pinus radiata* harvest on the New Zealand market;
- began working towards longer-term supply contracts with its domestic customers to help ensure security of supply and pricing;
- continued to modernise its Waipa Processing Plant, installing three high temperature kilns and two gas-fired timber reconditioners;
- confirmed its intention to build a new mouldings and millwork processing plant at Waipa;
- developed and implemented a comprehensive environmental policy;
- supported its local Bay of Plenty community by sponsoring a rescue helicopter; a forestry skills training programme for Ngati Manawa; and secondary school scholarships.