The Forestry Taxation Regime

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Background

The current forestry taxation regime has applied from the 1991 income year. The taxpayer's gross income includes all amounts derived from the extraction, removal, sale or other disposition of any timber, or the sale or disposition of any right to take timber, and any income from any other source.

The regime allows certain forestry related costs to be deducted from a taxpayer's gross income in the year they are incurred, but requires other costs to be "held" as part of the cost of timber account and deducted from the proceeds of sale of the trees. Of course the net proceeds of sale are taxable in the hands of the taxpayer.

Expenses such as pruning, thinning and planting are deductible when incurred. Land development costs are deductible year by year under a special depreciation approach. Costs that are not deductible when incurred are carried forward to the cost of timber account (often referred to as cost of bush and cost of forest). The different types of forestry expenditure and their deductibility are considered in more detail below.

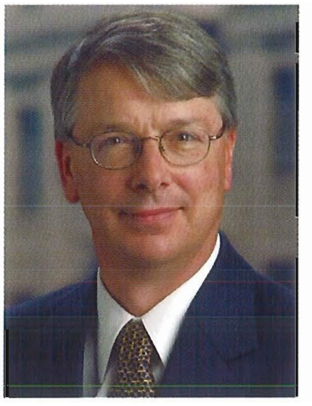
Pre-acquisition Expenses

Pre-acquisition expenses, that is fees and other costs incurred prior to the purchase of the investment are not deductible under the specific forestry deductibility provisions. However, a taxpayer already undertaking a forestry business may incur expenditure to establish whether a block of land is suitable for planting. In this case it could be argued that this expenditure is part of the ongoing expenses of the business and therefore deductible on revenue account.

The Commissioner is able to allow such a deduction as he thinks fit for expenditure incurred by a taxpayer for the preparation and registration of any lease of property used in the derivation of the taxpayer's gross income, or of any renewal of such lease, or in the borrowing of money employed by the taxpayer as capital in the derivation of gross income.

Land/Timber Acquisition

The cost of acquiring forestry land is capital in nature and non-deductible. If the land acquired also includes standing timber the purchase price is apportioned between the land and the timber. The portion attributable to the standing timber



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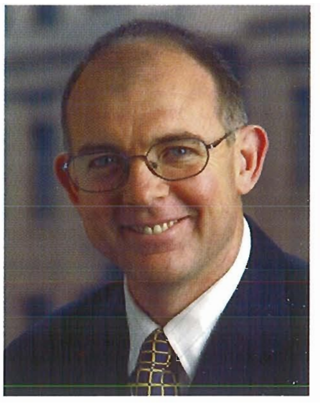

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is part of the cost of timber which will later be deducted from the ultimate gross proceeds of sale.

If a taxpayer does not acquire the land but acquires a right to harvest the timber on the land the cost of acquiring the forestry right is also part of the cost of timber.

If a taxpayer leases the land the ongoing lease payments will be deductible at the time they are incurred.

Land Preparation

The taxpayer is allowed a deduction on a diminishing value basis for certain types of costs incurred in preparing and developing the land provided that the expenditure has been of benefit to the business in that income year. By way of example such costs include, the felling, clearing, destruction, or removal of timber, stumps, scrub, or undergrowth in preparation of the land for the planting of trees on the land.

In addition to this the taxpayer can also claim a deduction for expenditure incurred by another taxpayer in preparing or developing the land provided once again that the expenditure has been of benefit to the business in that income year. This deduction is also on a diminishing value basis but is based on the unamortised balance of the expenditure incurred by the previous taxpayer. This deduction is concessionary and is not available to someone carrying on a forestry business on land they do not own.

Forest Roading Expenditure

From 1994 the deductibility of maintenance expenditure is determined under the general deductibility provisions. As a rough guide maintenance expenditure which does not upgrade the road would generally be treated as being of a revenue nature and therefore deductible.

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Expenditure incurred in constructing metal or sealed roads is deductible on the same basis as the land preparation expenditure above. There is also a diminishing value deduction for expenditure on constructing partially sealed or unsealed roads. Expenditure incurred in constructing temporary access tracks that are used for a specific purpose (and for less than 12 months) is fully deductible in the year incurred.

Tree Planting and Maintenance/Operating Expenses

Expenditure on planting or maintaining trees is fully deductible in the year that it is incurred. An immediate deduction is available for certain operating expenses such as rent, rates, insurance premiums, administrative overheads and other similar expenses. Even if an item of expenditure is not specifically listed it may still be deductible under the general deductibility provisions.

Certain items of expenditure may be paid in advance and they must be matched with income in the year to which each part of the expenditure relates. Expenditure of this kind is referred to as accrual expenditure. The "matching" is achieved by making the expenditure wholly deductible in the year in which it is incurred, but including in gross income the unexpired portion relating to future income years. There are thresholds with respect to different types of expenditure and if the unexpired portion of a certain type of expenditure falls below the threshold then the accrual expenditure provisions do not need to be applied.

Sale of Timber

The taxpayer's gross income includes all amounts derived from the extraction, removal, sale or other disposition of any timber, or the sale or disposition of the any right to take timber. This gross income is then offset by a deduction for the cost of timber. The cost of timber includes the initial acquisition cost and the accumulated forestry development and maintenance costs that do not qualify for a current year deduction. Where only a portion of timber is sold the cost of the timber will be apportioned so that a deduction is only available in respect of the cost of the timber or rights actually sold or disposed of.

Where timber is sold together with other assets of a business the Commissioner has the power to determine the portion of the proceeds attributable to the sale of the timber.

If timber is sold prior to harvest the cost of timber up to the date of sale will be deductible against the sale proceeds.

If timber is sold for inadequate consideration, it is deemed to have been sold for tax purposes at its market value.

Amounts received by a taxpayer as compensation for the loss or destruction of timber are taxable although a deduction for the cost of timber is still available.

If the owner of land creates a forestry right in his or her favour this is not a sale or disposition of a forestry right. This situation would typically arise where a taxpayer wants to sell the land but retain ownership of the trees.

Sales to Associated Persons

A taxpayer is unable to create a loss by selling timber to an associated person (e.g. a related company or relatives). Where the sale is to an associated person the taxpayer's deduction for the cost of timber is limited to the amount derived from the sale or disposition. Any remaining portion of the cost that is not deductible is effectively transferred to the purchaser (associated person).

Income Spreading

At the taxpayer's option income derived from the sale of timber or timber cutting rights can be spread over a period of up to four years. This period is the year of sale and up to three of the preceding income years. If the taxpayer elects to do this the cost of the timber or rights must be spread on an equivalent basis. Spreading the income back over this period does not give rise to adverse penalty implications.

Post Harvest Expenditure

After the harvesting of a forest, expenditure will be incurred for tasks such as de-stumping. There are alternate views as to the timing of the deduction for such expenditure.

One view is to treat the expenditure as part of the cost of timber and deduct it against the proceeds of sale.

The other view is to allow the deduction in the year in which the expenditure is incurred. If however the land was being cleared for the purpose of carrying on a forestry business the expenditure would be deducted on the diminishing value basis referred to under land preparation above.

Future Developments

IRD has recently released a policy document proposing to rewrite several parts of the tax legislation. It does not appear that this rewrite makes any substantive changes to the way the forestry regime is currently taxed. However, it is likely that the rewrite will result in some unintended changes through the utilisation of different wording and structure of the provisions.