Trees on Farms initiative

Development of awareness of taxation treatment of plantation trees for commercial purposes in a farming framework

Prepared by Sylva Systems for the Green Triangle Forestry Industries Hub Project 5 – July 2023

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Department of Primary Industries and Regions

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About the Trees on Farms initiative

Launched in March 2022, the Trees on Farms initiative is aimed at growing and developing the on-farm forest plantation sector, particularly in the Green Triangle region. Key components of the program, including this report, are being delivered Green Triangle Forest Industries Hub (GTFIH) under funding provided by Department of Primary Industries and Regions (PIRSA)

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Summary

In considering taxation, it 'just depends' on the actual attributes of a specific situation relative to laws and treatments at that time. This document does not seek to solve issues nor provide advice; its sole purpose is to raise awareness of possibilities to prompt detailed and specific consideration, supported by appropriate experts. Recognising the complexity and detail, this report provides a distilled account of trees, taxation and superannuation with minimal references. This is supported by comprehensive and fully referenced appendices around each topic. Taxation treatment revolves around time (e.g. the age of individuals), taxable income (e.g. ordinary income less allowed deductions) and whether broadly as an individual, a trust, a company or via superannuation.

Trees for harvest are both the factory and the product (as consumable biological assets) and are part of a land asset (as *fructus naturales*). While the cost of establishment can be expensed, at the time when a tree is planted, it becomes an asset. Indeed, good silviculture towards improved growth is a requirement to be classed as a primary production forest operation (for taxation purposes).

A motivation to plant trees and the intended primary outcome contributes to defining taxation treatment. Motivations can be linked to an individual farmer's or grower's needs and wants, within a framework of a farming enterprise. This includes consideration of succession and estate planning within a farming family. Trees can provide shade and shelter as woodlots (deductable expenses) or amenity (a non-deductable expense). If carrying on a business activity, trees with the intent to harvest as part of primary production are classed as a 'forest operation' with specific taxation treatment. The cost of establishment could be claimed at the time of occurrence to offset other income in a financial year to reduce taxable income (e.g. subject to non-commercial losses or company taxation provisions) or be claimed at the time of generating an income at harvest. Taxation treatment of tree as a forest operation requires that there is an intent to sell the resulting logs to another party to make a profit; as an individual, a trust, a company or by a superannuation fund. These four scenarios are explored and the outcomes presented.

Again as a point of caution, this analysis does not seek to provide specific treatment and outcomes, but rather to demonstrate what may be possible subject to a range of considerations. Seeking an individual private ruling from the Australian Taxation Office provides a legally binding taxation treatment of a tree growing endeavour.

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Acronyms

Acronym	Definition
AASB	Australian Accounting Standards Board
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ABN	Australian business number
AGO	Australian Greenhouse Office
ATO	Australian Taxation Office
CGT	Capital gains tax
ECPI	Exempt current pension income
FMD	Farm management deposit
FTDT	Family trust distribution tax
FTE	Family trust election
GMT	Green metric tonne
GST	Good and services tax
GT	Green Triangle
GTFIH	Green Triangle Forest Industry Hub
MIS	Managed investment scheme
NALI	Non-arm's length income
NCT	Non-commercial thinning
NPI	National Plantation Inventory
PAYG	Pay as you go
PIRSA	Primary Industries and Regions, South Australia
SMSF	Self-managed super fund
TFN	Tax file number
TRIS	Transition to retirement income stream

Introduction and the purpose of this document

When considering planting trees, it is prudent to understand ‘why’ you wish to plant trees. Further, beyond a range of practicalities (e.g. sites and tree species), a pragmatic requirement is to determine and understand all implications. This is consistent with an overall prudent approach to any activity; understand and document the ‘why’. From such an awareness, a party would then seek to determine the business case (e.g. addressing investment risk, diversification and viability), commencing with an exit strategy. While often omitted, defining an exit strategy will inform many other attributes of an endeavour that allows realisation of the ‘why’. A next step should be a consideration of the operating structure within which the trees are grown, including via trusts and within a superannuation fund. The nature and treatment of income and cashflows is fundamental, as is dealing with assets. There are overall considerations linked to the why; the attributes of the farmer, the farming family and the farming activities. Taxation and tax are outcomes of the combined attributes of an endeavour and while structures and mechanisms will define these outcomes, it is prudent to not have tax solely driving an arrangement.

An important element of financial considerations linking back to the motivation to plant trees is the taxation treatment from an expense and revenue, and assets perspective. A fundamental principle in regard to taxation is that ‘it just depends’. Taxation treatment depends on the specific circumstance and the taxation rules at the time. Indeed Slinn (1968, p.339) reporting on taxation of trees into farming noted that the chapter was *‘applicable to legislation current as at 30 June 1967’*.

Taxation and superannuation are technical areas which require attention to detail and currency of treatment. This document seeks to present a user-friendly guide by distilling this body of information into a format that is simple to navigated. To assist, this document is split into a front section presenting this distillation, and the detailed information sourced from the Australian Taxation Office (ATO) and other sources is presented in a series of appendices (see Table 1). Combining the technical nature of taxation with a need for clear examples, this document makes use of case studies to demonstrate principles and concepts with a caveat that any specific implementation will need to seek specific and current advice.

Table 1: The structure of the supporting appendices which present the detailed and technical information.

Section	Narrative
Appendix A: Primary production	The ATO definition and treatment of primary production activities including planted trees with an intent to harvest.
Appendix B: A financial and legal perspective of trees	Definition of trees from a financial and legal perspective placing taxation and superannuation considerations into perspective.
Appendix C: Goods and services tax	An overview of the Australian GST system.
Appendix D: PAYG taxation of individuals	The ATO treatment of taxation of individuals.
Appendix E: PAYG taxation on a business	The ATO treatment of taxation on a business.
Appendix F: Non-commercial business losses	Addresses the ability to offset losses from a primary production enterprise against other income from an un-related activity.
Appendix G: Superannuation and taxation	An overview of superannuation from a taxation perspective.
Appendix H: Trusts	An overview of trusts and trust mechanisms from a taxation perspective.
Appendix I: Taxation treatment of trees as a crop	An overview of trees as a crop from a taxation perspective.
Appendix J: Carbon sink forests	The treatment of carbon sink forests as a specific tree growing activity.
Appendix K: Capital gains taxation	An overview of the capital gains taxation treatment framework.

A focus on the farmer

Farmers, farming and the farm

A farming business can include *'long multi-generational family history, family members at different ages and stages, a large asset with low and variable return'*, and potentially emotional connections (Beattie, 2014). Beattie (2014) provides the following description. A farm is a large tangible asset with a value independent of operational returns of the business. Business returns on the asset value are generally low and variable (compared to other investments). A farm usually is the majority of a farming family's wealth. These factors make it difficult to 'pass on' a viable farming business with an equal (fair) distribution of the family assets to all parties.

Consultation with a range of farmers in the Green Triangle (GT) with current or recent tree growing experience indicated a range of strategies around the farm and the farming family (see Jenkin, 2022). Trees for harvest have been planted to provide for retirement, as part of succession planning and to make use of land difficult to maintain as agriculture. While retirement funding was stated, this was in a broad sense and not specific to trees within a superannuation fund. Succession planning was in some cases, part of retirement planning; income from a tree harvest reducing pressure on farm income to fund the previous generation. Trees have also been established in sections of land difficult to maintain as pasture (e.g. sandy rises).

Planning for life; succession and estate planning

Historic stereotypical farm succession planning had the oldest (or strongest) son taking over the family farm or family estate. Potentially, other sons seeking to farm were helped to get established with daughters left smaller 'tokens' of the family wealth. Now the expectation is that family assets are divided equally, backed-up by law where the courts can override wills (Beattie, 2014).

A range of guides to succession planning are available (e.g. Wilkinson & Sykes, 2007 prepared for the Grains Research and Development Corporation) and specific advice should be sought for an individual situation. Succession planning aims to ensure the continuation of a business through generations or through layers of management (MLA, 2023). It is *'the orderly transfer of management, responsibility, ownership and control, over time'*. For a farm business there is a continuum of transferring ownership of some machinery and/or livestock, transferring management of part of a farm, and eventually transferring ownership (Wilkinson

& Sykes, 2007, p.4). In reality, succession planning should be separated from estate planning as two parts to change (Beattie, 2014).

While there remains many uncertainties, planning should consider the possible and indeed seek to create a desirable future. Retirement and succession planning are time-based events linked to the age (and possibly health) of individuals in a farming family. Planning can be segmented into planned and *ad hoc* events. In regard to succession planning, Beattie (2014) identifies a need to address and understand potential events ('the D words'); death, divorce, disagreement and disability. Based on farmer consultation, family education needs, retirement, later-age care (e.g. resident in an aged care facility) and treatment of non-farming siblings in an estate are further considerations.

The process of succession planning

Succession and estate planning of a family farming business is a complex process requiring *'good communication, planning and ideally a long lead in time to maximise the chance of a successful transition'* (Beattie, 2014). It should address *'the needs and wants of the 'retiring' generation, the new farmer(s) and their partners and often siblings of the new farmers who will not be farming in the future'* (Beattie, 2014). The older generation often remains involved in business operations and there are varying needs and wants of the 'retiring' generation as compared to the new farmer(s) and their partners (Beattie, 2014). Box 1 outlines the elements of a successful succession and estate transfer process.

Box 1: The elements of a successful farm succession and estate planning process (Beattie, 2014).
1. Define the approach or ground rules to decision making. 2. Define and discuss individual objectives/needs and group these. 3. Determine the guiding principles for business succession and asset transfers. 4. Explore all options and possible strategies. 5. Agree on the best option and strategic plan required to get there. 6. Discuss the what ifs and implications of agreements and refine where necessary. 7. Complete structures and agreements. 8. Determine review time-frames.

The nature of trees and fit with succession planning and a farm

Trees are long-term with a typical 'short-rotation' at 10 to 12 years for Tasmanian blue gums (*Eucalyptus globulus*) or a longer rotation of 28 to 34 years for the final harvest for radiata pine (*Pinus radiata*). An appropriate commercial species should be selected for the desired rotation length. While a nominal rotation may be set, there is some latitude to increase

rotation lengths to match the timing of succession events and needs. Funding succession planning is one consideration. For example, a possible strategy is to create a tree asset which can be inherited by non-farming siblings, reducing a requirement for external debt by the siblings taking-over the farm, to payout the others. That is, the trees are harvested and sold or passed on standing (Lord, 2006). One perspective is to consider trees as a green bank which appreciates in value as the trees grow and increase the volume of potential logs to be recovered at harvest.

Motivation for planting trees

A history of financial advice on trees into farming

How should a farmer consider trees? Historically trees were an impediment to progress and agriculture, with deforestation promoted and encouraged by Governments. Some conversion continues in some states, with many farmers with living memory of such activities. The rise of landcare principles in the 1950s saw some revegetation and Jacobs (1968, foreword) noted a wide range of purpose of revegetation *'...whether it be for ornamental purposes around homesteads, for protection of animals from sun and wind, for the production of timber, for amenity planting along highways or in parks and reserves or for protecting steep slopes from soil erosion'*. A plethora of publications exist in regard to trees into farming. Financial and taxation issues are often included (e.g. Brown & Hall, 1968; Bachelard et al., 1985; Reid & Wilson, 1985; Oates & Clarke, 1987; Borland et al., 1991; Reid & Stephen, 1999; Davidson et al., 2006) but it is prudent to review any information for currency and robustness. The same caution is required for references with a specific focus on legal and taxation issues. For example, the Australian Greenhouse Office (AGO) published a guide to legal, taxation and contractual issues in 2006 (AGO, 2005) and while the principles noted provide insights, the AGO cautions that a party should seek their own independent professional advice (AGO, 2005, p.1).

Government objectives and response to economic shocks

Plantation development in Australian has gone through a series of phases (Ferguson *et al*, 2002; Jenkin, 2018, p.37). Government policy in regard to wood supply was one driver. Plantation development in South Australia and Victoria commenced in response to concerns as to wood supply (Box 2). Subsequent development included motivation for resource security. In 1949, State and Commonwealth Forest Service heads met with a residual 'co-operative federalism' resulting from World War II's timber control, motivating a strong resolve to avoid timber shortages. Shortages during World War II from a complete cessation of imports combined with the added pressure of the demand for wood for post-war reconstruction (Carron, 1990, p.17). The policy objective was enhanced by declining native hardwood forest supply and a steadily increasing supply from plantation softwoods (Carron, 1990, p.17).

Box 2: Commencement of the South Australian and Victorian plantation estates.
South Australia: the first plantations in 1876 (Carron, 1990, p.15&16). *'Within thirty years of first settlement in 1836, people both within and outside government began to express concern at the rate at which the limited native forest resource was being used up and the apparent lack of any planning for future supplies of timber. G.W. Goyder (Surveyor General) and F. E. Krichauff (a member of the House of Assembly) pooled their influence to have the Government legislate to preserve the remaining forest cover, to south-east) and at Wirrabara and Bundaleer (north of Adelaide) where the first plantation, of native hardwoods, exotic hardwoods and softwoods, was established in 1876.'* (Carron, 1990, p.12&13) '.....*South Australia's policy was supported by the United Kingdom in 1926 by a grant of migration funds toward 2000 hectares per year for ten years to assist migrant employment*'. Victoria: the first plantations in 1872-3 (Carron, 1990, p.12). *'The first stimulus to the establishment of plantations in Australia arose from the discovery and mining of gold in Victoria in the 1850s. The large-scale destructive cutting of forests to meet the voracious demands of a rapidly expanding population and a frenetic mining industry prompted an otherwise unlikely troika of the Surveyor General, the Assistant Commissioner of Lands and Survey and the Secretary for Mines to strongly recommend in 1865 that the Government establish plantations of indigenous and exotic species. ......Twenty years after the first nursery was established at Mount Macedon in 1872, there were 1,000 hectares of plantations fed by nurseries at Creswick, Havelock, Gunbower Island and the You Yangs, mainly of hardwoods but with increasing use of radiata pine which had shown sufficient promise for commercial planting to begin in the Macedon area in 1880'*

Internationally, economic shocks have played a significant role in plantation development. The oil crisis of the 1970s impacted the US and had a profound impact on Uruguay which was 100% reliant on imported petroleum. To address energy costs, in the early 1980s some local industries converted their boilers to fuelwood, resulting in significant savings; fuelwood consumption increased from c.1.4 million m^3/y in the mid-1970s to 2.8 million m^3/y in the mid-1980s. By 2016, Uruguay's energy system was c.80% renewable installed capacity; electricity was close to 100% renewable with 18% baseload generation from biomass. Economic reforms have stimulated interest by farmers in alternatives to agriculture. Deregulation of Uruguay (in the 1970s) and in New Zealand (in 1985) resulted in agricultural down-turns leading to land availability for plantations. Direct agricultural shocks included a European Commission ban on Uruguayan beef imports (1973) and depressed wool markets (1987) stimulating consideration of alternative land-use and income for farmers with trees as a solution.

In response; plantations as an alternative to agriculture

Motivations for private plantation growers under government policy have included agricultural down-turns and taxation treatment of afforestation. Agricultural down-turns (e.g. poor commodity prices) in the south west of Western Australia in the early 1980s motivated aging farmers to contemplate involvement in tree growing either via joint ventures or leasing land to tree growers. Farmers preferred lease arrangement to investment of their own capital. Development of radiata pine plantations in New Zealand was in response to wood resource concerns. By the 1920s and 1930s afforestation was concentrated on land *'not suitable for agriculture'*, which can also be poor for commercial forestry. In 1937 a cobalt deficiency was identified in pumice soils in New Zealand allowing agriculture; addressing the

micronutrient deficiency for livestock limited further expansion of the plantation estate (Rhodes & Novis, 2004, p.5).

Taxation treatment of plantations

Taxation treatment has been a cornerstone of influencing afforestation in a number of countries (e.g. Australia, New Zealand and Uruguay) with the timing of taxation treatment change clearly evident in the rates of afforestation (Jenkin, 2019). There is a need to separate taxation treatment via financial products (e.g. managed investment schemes – MIS) and direct investment. The rapid expansion of the Australian plantation estate from the mid-1990s was facilitated by financial products providing tax effective investment for ordinary retail investors.

Current drivers and motivations for tree planting

Consultation with farmers in the GT region indicated a range of motivations for planting trees (see Jenkin, 2022); for example, trees have been planted to provide shade and shelter for livestock with and without an intent to harvest. A pragmatic view expressed was that if undertaking tree planting, it could be prudent to plant trees with ultimate wood markets. When ready for harvest, the trees may or may-not be harvested depending on consideration of the livestock and other farm benefits. This has implications for the taxation treatment. Some farmers expressed a specific motivation to grow a tree crop for harvest as a long-term investment or for carbon benefits. This was often combined with selecting sites to plant to trees that where difficult to maintain as pasture. Enhancing biodiversity by permanent revegetation around specific features has been undertaken to better protect the land. Some farmers noted that once trees have been established and grown, this creates a better working environment for the farmer and their staff, contributing to worker retention. Other farmers have included trees as part of retirement and succession plans to provide future cashflows. A final motivation was that many farmers simply just liked trees.

Growing trees and tree growing ventures

How to consider trees?

The nature of trees as a crop

While by their nature many events (e.g. related to succession planning) cannot be placed in specific timing or expected year, it is possible to plan for broad timing. Trees with an intent to harvest are a long-term crop; a short rotation hardwood crop (for pulpwood) is over a 10 to 12 year rotation (Table 2) or a long-rotation softwood crop over 28 to 34 years (for posts, poles, pulpwood and sawlogs) (Table 3) in the GT. Both regimes have current and active markets. Trees by their nature have a degree of flexibility in year of harvest, particularly after first thinning of a radiata pine stand. Logs or roundwood are recovered from the standing trees after harvesting.

Table 2: A summary of Tasmanian blue gum plantation regimes in the GT (Parsons & Jenkin, 2023).

Operation		(Units)	Clear fall	Clear fall
			Whole tree chipping	Cut to length
Age		(y)	12	12
Initial stocking		(stems/ha)	950	950
Stems removed		(stems/ha)	950	950
Bark			Debarked	Debarked
Harvest yield	Lower	(GMT/ha)	105	105
	Average	(GMT/ha)	205	205
	Upper	(GMT/ha)	305	305

Table 3: A summary of conventional radiata pine plantation regimes in the GT (Parsons & Jenkin, 2023).

Operation		(Units)	Thinning			Clear fall	
			T1	T2	T3	CF	CF
Age		(y)	12	18	24	34	30
Initial stocking		(stems/ha)	1,550	700	450	300	300
Stems removed		(stems/ha)	850	250	150	300	300
Bark			Bark-on	Bark-on	Bark-on	Bark-on	Bark-on
Harvest yield	Lower	(GMT/ha)	60	55	105	360	270
	Average	(GMT/ha)	90	80	130	460	370
	Upper	(GMT/ha)	120	105	155	560	470

Logs can be debarked (eucalypts) or sold with the bark on (pines; see Figure 1). There is segregation standing trees and the *'processing of agricultural produce after harvest'* (IFRS, 2023). The ATO specifically excludes milling or processing activities (e.g. whole tree chipping) from the definition of a forest operation as they relate to a tree growing enterprise as part of primary production (ATO, 2010a, s.13). The ATO makes a clear distinction that a forest operation generates logs for sale. In certain circumstances it is possible to sell a harvest right to standing trees well in advance of harvest. This provides a processor with an ability to plan for resource flows but perhaps not the specific year of occurrence.

Figure 1: The out-put of a harvesting a pine plantation.

A financial and legal description

While as a biological structure creating ecosystems and microclimates when planted in stands ameliorating and protecting sites, trees have a novel attribute from a legal and financial perspective. Trees in a plantation are biological assets, felled trees are agricultural produce and the products of harvest are logs and subsequently lumber (AASB, 2015, s.4). The ATO also considers trees as an asset (with potential limitations and restrictions).

The Australian Accounting Standard Board (AASB) segments biological assets into consumable (the tree is the product) and bearer (products are taken from the tree) assets. From a wood production perspective, a tree is both the factory and the product; *'few if any other products are so difficult to distinguish from their production plant'* (Ferguson, 1997, p.70). The AASB notes that *'biological assets are often physically attached to land (for example, trees in a plantation forest)'* (AASB, 2015, s.25). The treatment of trees as part of the land depends on the nature of the trees. To be considered as part of the land, a tree crop must be *fructus naturales* (ATO, 2009, s.82 to 84); trees planted for timber production are regarded as *fructus naturales*. With an appropriate business structure and treatment, trees can be established and the costs expensed, along with ongoing costs, to create a consumable biological asset. A tree becomes a biological asset when the seedling or cutting

is planted and can be sold as going concerns or harvested in the future to generate revenue. In effect, a stand of trees can be treated as a green bank.

The nature of tree growing

Tree growing frameworks and arrangement

Direct investment in commercial and for harvest tree growing is defined as a party funding the investment and having day to day control or input to the operations undertaken. This is distinct from a passive investment where the investor has no inputs (e.g. under an MIS).

From many perspectives, the business and administrative arrangements under which trees are established, grown and harvested are critical. The business structure employed and income will determine tax registrations and obligations (ATO, 2021a, p.1). From a taxation perspective, arrangements contribute to and define many outcomes. There are three broad arrangements under which commercial trees can be grown (see Table 4). A joint venture and as an independent grower are active in tree growing whereas a lease does not provide a landowner with participation in tree growing. The National Plantation Inventory (NPI) defines leaseholds as '*leased land where the grower has sole primary production and access rights of the trees'* (Wood *et al.*, 2001, p.169).

Table 4: A snap-shot of the different tree growing arrangement and land access mechanisms (based on Jenkin, 2018).

Arrangement	Role	Basis	Payments	Duration	Risk
Lease	Passive arrangement	An interest in land given by a land-owner (the land lord or lessor) to another person (lessee or tenant) for a fixed duration (Nygh et al., 1997, p.320). A landowner provides access to land in return for payment by a tree grower. Under such arrangements, the landowner has no financial interest in the tree outcomes.	Fixed, periodic and independent of the crop outcomes.	A finite period defined by the tree rotation.	A counter-party can fail and depending on the reason, who owns the trees?
Independent grower	Active in tree management	A tree growing arrangement where a single party invests in a tree crop, and the net harvest proceeds are owned by the grower. The tree grower is responsible for all activities and bears all risk.	Payment at harvest.	A finite period defined by the tree rotation.	The intended market fails, tree growth is poor and/or losses due to damage agents.
Crop share or joint venture	Variable levels of inputs.	An agreed share of the net harvest revenues, hence there is uncertainty as to the returns (Curtis & Race, 1998, p.vii). It is possible to enter into a joint venture where multiple parties have a financial interest in the tree outcomes. Each party contributes towards the tree crop and there is an appropriate share in the net-harvest revenues once the trees are harvested.	Returns at harvest.	A finite period defined by the tree rotation.	Counter-party and crop risks.

Where a party undertakes tree growing, it can be as an individual or via an entity (see Box 3). Taxation treatment of base rate entities differs to other companies; a base rate entity is a company with an aggregated turnover of less than $50 million for the 2018–19 to 2021–22 income years and where assessable income is 80% or less as passive income (e.g. interest, dividends, rent, royalties and net capital gain) which replaces the requirement to be carrying on a business (ATO, 2021a). An individual undertaking an operation in their own name outside of a company framework can be as an individual, sole trader or as a partnership. Superannuation is a specific arrangement.

Box 3: The ATO defined structures (ATO, 2023a).	
Sole trader	*A person wholly owns and who operates a business.*
A partnership	*A group of people in business together.*
A company	*A separate legal entity that is taxable on its net taxable income. For tax law purposes, a company includes either:* • *A body corporate* • *Any other unincorporated association or body of persons.*
A trust	*A trust exists when a person (a trustee) holds property as its nominal owner for the good of one or more beneficiaries.*
Superannuation	*A system where money is placed in a fund to provide for a person's retirement. Often shortened to 'super'.*

The physical and temporal point of sale

Standing trees can be sold by harvesting and a royalty paid for logs produced (Figure 1), or prior to harvest as a going concern. Therefore, the point of sale includes tree condition (e.g. standing or as logs), a physical location (e.g. point in the supply chain) and a temporal definition (e.g. tree age); what, where and when. The physical point of sale of logs is the point when ownership changes hands and this will determine a grower's gross revenue from logs sold and the expenses incurred (see Box 4). The most likely points of sale are on the stump or at the mill gate. It is suggested that the process of selling trees should commence around six months prior to the intended harvest time (Geddes & Parsons, 2023).

Box 4: A summary of different points of sale at harvest of plantation grown trees (Geddes & Parsons, 2023).		
Point of physical sale	Description	Comments
On the stump	Trees sold as standing trees and a purchaser pays for harvesting and handling.	A simple transaction. Grower interests can be protected by understanding standing volumes and potential product mixes. Potentially sale as a job-lot.
At the stump	Logs are sold at the stump after harvesting and processing into logs. A purchaser pays for handling logs from the stump to a processing site.	Grower managed harvest or by use of a service provider. A grower 'could' undertake harvesting with associated risk (not a recommended strategy). Log types (products) can be segregated for different markets.
At roadside	A grower harvests trees and presents full-tree lengths or logs at the edge of a plantation for collection by a purchaser	Operational risk increases with greater grower hands-on involvement. Could be via contracted service providers.
At farm gate	Trees are harvested and transported to a property boundary for collection by a purchaser.	Operational risk increases with greater grower hands-on involvement.
On-truck	A grower harvests trees to roadside and loads a purchaser's truck (loaded at either the roadside or farm gate).	Operational risk increases with greater grower hands-on involvement. Specialist equipment required.
Mill gate	A grower harvests and transports the logs to purchasers' processing centre mill gate where logs are sold.	Operational risk increases with greater grower hands-on involvement. Specialist equipment required. A processor would be required to be able to buy logs in such a way.
Part processed goods	A processor will process grower's delivered logs on a toll basis (a charge to use facilities). For example, woodchips sold for export.	Taxation implications need to be considered.

Specific taxation treatment of trees

Primary production and carrying on a business

Generating income (units sold and the price received per unit) from agricultural and forestry business activities can vary between years and generally income is not guaranteed. This is recognised by the ATO and individuals classed as primary producers may have specific treatment; use of income averaging provisions, use of farm management deposits (FMD) and exemptions to non-commercial business loss mechanisms. The ATO (2022a, p.1) defines primary producers as running *'a business of plant or animal cultivation, fishing or pearling, or tree farming or felling'*. A primary producer *'can be an individual, partnership, trust or company'* (ATO, 2022a, p.1). Carrying on a business is a critical element. There is specific recognition of carrying on a business where a grower received a reafforestation grant (e.g. from a government agency) with each situation addressed on a case by case basis. The ATO test of carrying on a business is presented in Box 5.

<table>
<tr><td colspan="2">Box 5: The steps to determine if a party is carrying on a business (taken from ATO, 2023b).</td></tr>
<tr><td>Step 1: Identify all relevant, related activities

Examples of relevant, related activities include:
➢ keeping records
➢ obtaining and maintaining licences and permits
➢ if you rent out premises or goods, everything you do to rent out those premises or goods
➢ if your activity is providing goods or services, everything you do in providing them.</td><td>Step 2: Are the activities a business?

The more of the following questions you answer yes to, the more likely it is your activities are a business:
• Do you intend to be in business?
• Do you intend and have a prospect of making a profit from your activities?
• Is the size or scale of your activity enough to make a profit?
• Are the activities repeated and continuous?
• Are your activities planned, organised and carried out in a business-like manner? For example, do you:
➢ keep business records and have a separate business bank account?
➢ advertise and sell your goods and services to the public, rather than just to family or friends?
➢ operate from business premises?
➢ maintain required licences or qualifications?
➢ have a formal business plan or budget?
➢ have a business name or an ABN?</td></tr>
</table>

Purposes and intent for growing trees

Trees can be grown with an intent to harvest or as permanent revegetation / afforestation and the ATO has specific tests (Figure 2). Permanent revegetation can have the intent of amenity, sequestering carbon, livestock shade and shelter or environmental benefits. Trees for harvest are cut-down and either used by the owner or sold. While trees for harvest can provide the range of benefits of permanent revegetation, the point of harvest with an intent to sell to generate a profit is the key difference. From an ATO treatment perspective, trees planted for amenity are not part of primary production whereas trees planted as shelterbelts to benefit the farming enterprises are primary production. A shelter belt by ATO definition *'is a line of trees or shrubs planted to protect an area from fierce weather'* (ATO, 2022a, p.15). The purpose of developing a shelterbelt is to protect crops and livestock, improve biodiversity and/or to prevent or fight land degradation (e.g. soil erosion or degradation of vegetation (ATO, 2022a, p.15). Trees planted for carbon sequestration without an intent to harvest, are recognised as a specific form of tree growing (ATO, 2019a). It is recognised that an intent may change and the ATO addresses the potential of selling trees as a going concern prior to harvest. This is effectively selling trees on the stump and exclusive of harvest.

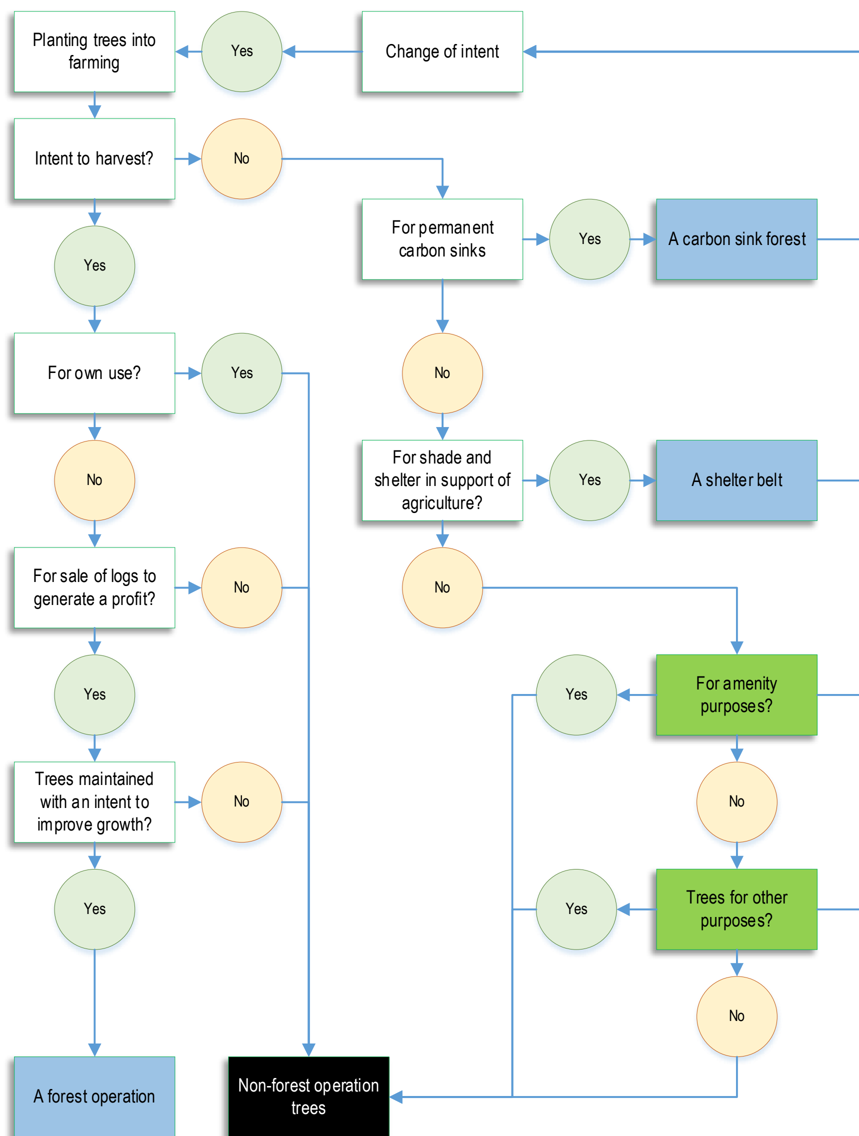

Figure 2: A summary of the ATO rules to determine whether tree growing is primary production as a forest operation.

A forest operation

Treatment of a plantation as a forest operation by the ATO provides a range of advantages (Figure 3). A key attribute is that a forest operation has the intent to harvest the trees grown and sell the resulting logs for a profit (see Figure 2). Activities are organised and run in a business-like way, including actively maintaining the trees with an objective to improve tree growth (ATO, 2022b, p.1). Forest operations include growing, harvesting and haulage to the place of first processing (provided that this is on behalf of the grower), but excludes onsite processing into woodchips. It is possible to change intent and include trees and land initially developed for another purpose as a forest operation with the trees then destined for harvest and sale for profit. By this requirement, forest operations are limited to growing and recovery of logs for sale to another party. The intent to harvest and maintain the planted trees can be documented in a business plan for a tree growing enterprise and in management plans for

the trees grown. A management plan will define the silviculture to be undertaken including the species to the planted. The intent to harvest can be underpinned by selection of commercial plantation species with current and active markets. For example, reference to NPI reports identifies the predominant species currently grown in a region (see ABARES, 2022). The intent to maintain can be documented making reference to locally specific silviculture to grow trees of the required size for local markets. A change of intent is possible as noted; a shelterbelt initially regarded as permanent could be planned for harvest for a range of reasons and become classified as a forest operation. Another change of intent is where a stand of trees is sold prior to harvest or treated as a permanent (not for harvest) planting.

Sale of trees at the point of harvest

It is possible for a grower undertaking a forest operation to organise the harvest and delivery of logs to a buyer (at the mill gate). This is a complex process and the grower may not have the skills nor contacts to facilitate a transaction (Geddes & Parsons, 2023). An alternative is that a grower seeks another party to organise all works or the buyer of the trees organises all aspects and the logs are sold at the stump. A range of instruments are available to arrange log sales (see Table 5) and each has a fit-for-purpose role. For example, a potential grower may seek an off-take agreement to underpin confidence to become involved in tree growing. With such arrangements, tree ownership does not change hands; the arrangement is a definition of future sales terms and conditions (e.g. whether a thinning or a final harvest).

Table 5: A summary of the different contract mechanisms for wood supply (based on Jenkin, 2018).

<table>
<tr><th>.</th><th>Parties</th><th>Basis</th><th>Basis</th><th>Change of ownership</th><th>Timing</th></tr>
<tr><td>Wood supply agreement</td><td rowspan="3">Grower and processor</td><td rowspan="3">Between the parties</td><td rowspan="3">A bespoke contract setting terms and conditions.</td><td rowspan="3">At time of harvest.</td><td>For a current fibre supply.</td></tr>
<tr><td>Off-take agreement</td><td>A future and yet to be initiated fibre supply.</td></tr>
<tr><td>Forward contract</td><td>For a future sale.</td></tr>
</table>

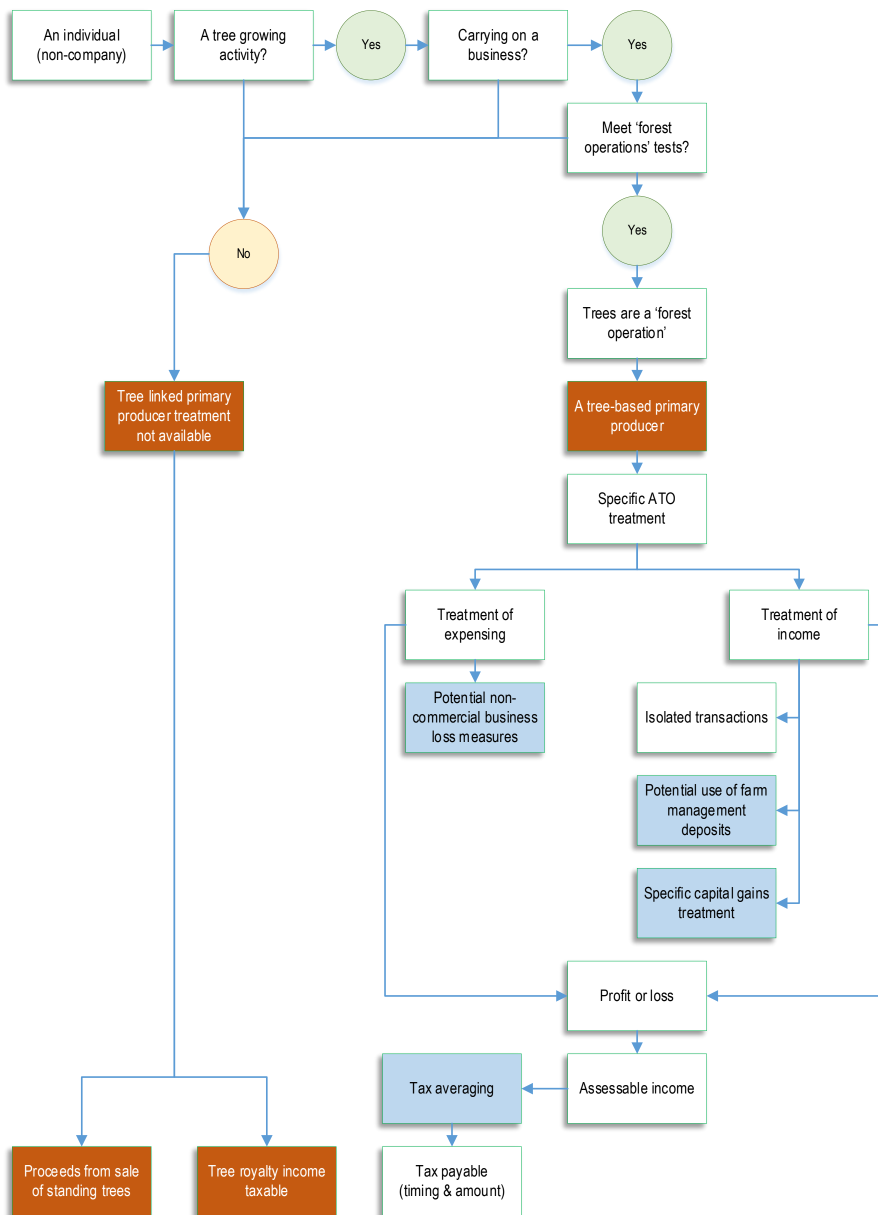

Figure 3: A summary of the treatment of a forest operation from a taxation perspective.

Sale of trees as a going concern from a grower's perspective

Trees can be sold standing (as a going concern to grow on) with ownership changing hands prior to a future harvest. This involves a seller and a buyer, and consideration of each perspective is required. A sale of standings trees as a going concern is generally treated as a capital sale and acquisition. A grower carrying-on a forest operation can create and sell a legal right to harvest the trees under a felling right for some time in the future. This is in effect selling the trees standing. Creation of a felling right creates an asset subject to capital gains tax (CGT) and can trigger a CGT event once created and sold. Payments are regarded as a royalty. A royalty is generally payments made by one person for the use of rights owned by another person; they can be periodic, irregular or one-off payments (ATO, 2022q). Regardless of whether a person is carrying on a forest operation, royalties are

treated as assessable income. From the buyer’s perspective, the purchase cost of a felling right is deductable in the year of actual harvest on a *pro rata* basis of the portion of the trees harvested.

Where a grower contracts for sale of the standing timber or via a rights-mechanisms, this may constitute a profit à prendre. A profit à prendre is a specific mechanism as an interest in land and is an asset separate from the land, created at the time of its grant. It is *‘the right to take some product of the land or part of the soil from the land of another including fish, fowl, grass, minerals etc)’* (CCH, 1993, p.454). A key element of a profit à prendre is that the holder benefits from future growth of the trees which would be subject to individual assessment. A profit à prendre is a post-CGT asset and is treated accordingly defined by the timing of the instrument. Where a profits à prendre was granted after 25 June 1992, CGT provisions effective from 26 June 1992 apply. Such trees would be 31 years old in June 2023 and be close to harvest.

Taxation treatment of structures and super

While this section provides an overview and concepts in regard to taxation and superannuation, situation specific advice is required as the basis of any decision making. This section is for information only and as a prompt for thinking.

Individuals

The Australian taxation system for individuals relies on self-assessment combined with tax collected (withheld) by employers as part of pay as you go (PAYG). The tax withheld is based on income brackets with tax applied from 0% to 45% for taxable income (see Table 6). Taxable income is the basis of tax to be paid and is assessable income less any allowable deductions. Assessable income includes money received and goods or services (rather than money) declared at the market value. Allowable deductions include expenses related to generating an income and some donations. At the end of each financial year, an individual submits an annual tax return based on self-assessment (supported by adequate records) which provides details of income, deductions and tax already paid 'as you go'. This can change the taxable income up or down, and the taxation obligation is 'reassessed' and a tax bill (increase in taxable income) or refund (reduced taxable income) results.

Table 6: The 2022/23 financial year PAYG taxation rates exclusive of the Medicare levee (ATO, 2022d).

Taxable income		Tax on this income	Calculated cumulative average tax rate
$0	$18,200	Nil	0.0%
$18,201	$45,000	19 cents for each $1 over $18,200 to $45,000	11.3%
$45,001	$120,000	$5,092 plus 32.5 cents for each $1 over $45,000 to $120,000	24.6%
$120,001	$180,000	$29,467 plus 37 cents for each $1 over $120,000 to $180,000	28.7%
$180,001 and over		$51,667 plus 45 cents for each $1 over $180,000	It depends on the total income

A company

In carrying on a business as a company, most income received is assessable for income tax purposes. The amount of income tax a business pays depends on its taxable income (assessable income less any deductions). It is dependent on the business structure and excludes goods and services tax (GST) payable on sales made, or GST credits on expenses incurred. Expenses directly related to carrying on a business and related to earning an assessable income can be claimed as deductable expenses. These are day-to-day operating expenses, purchases of products or services, or certain capital expenses (e.g.

depreciating assets such as machinery and equipment) used in a business. Appropriate record keeping is critical. The quantity and timing of claiming a deduction depends on the type of expense and any private or domestic purpose use reduces any deductions. Deduction for the cost of capital assets is addressed under CGT rules; there are exceptions for capital works, plant and certain expenditure by primary producers on improvements to land. A company will pay tax on a year's taxable net income (profits), and losses are carried forward to subsequent financials periods to be offset against future profits.

The tax rate is 30% for companies not eligible for the lower company tax rate. A small business may get small business tax concessions where a business operates for all or part of the income year with a turnover less than $10 million in that income year (excluding the small-business income tax offset and the CGT concessions). A tax rate of 25% applies for base rate entities.

Superannuation

Superannuation is money saved for retirement and is a long-term investment expected to grow over time. There are two broad types of superannuation funds. The first is a fund professionally managed on behalf of usually an unlimited number of members and the second is a self-managed super fund (SMSF). A superannuation fund has three phases of operation; accumulation (no pensions paid and contributions made), transition to retirement (part pension and contributions made) and retirement or pension phase (no contributions and pension paid). When all interests in a SMSF are in retirement-phase income streams (i.e. with no accumulation accounts or transition to retirement income streams being paid), the fund's assets are held 'solely' to support retirement-phase income streams; the '100% in retirement phase'. During the accumulation phase fund, income is taxed at 15%, including concessional contributions and fund earnings (with no distributions). The transition to retirement phase includes concessional contributions and fund earnings taxed at 15%, as well as distributions (but not a full pension). During both the accumulation and transition to retirement, non-concessional contributions are possible and are tax free on entry.

Fund concessional contributions include employer superannuation guarantee payments based on a set percentage of pre-taxation income, salary sacrificed contributions (part of an employer's contribution) and personal contributions claimed as tax deduction. The maximum combine concessional contribution is capped (in the 2023 financial year at $27,500). Non-concessional contributions include personal contributions where no income tax deduction is claimed for the contribution and are currently capped at $110,000 per financial year. There is an ability to bring forward future year's non-concessional contributions subject to fund

balances; funds with less than $1.48 million, can bring forward three years or $330,000. Such contributions are not taxed as income to a super fund provided the threshold is complied with. Non-cash (real property) or *in specie* contributions are possible by the owner of the *in specie* asset, into their own super fund. Real property generally means land and buildings used wholly and exclusively in a business. This must be compliant with the non-concessional cap requirements. The contribution of an *in specie* asset is the same as selling the asset and can trigger a CGT event for the individual making the contribution, but going into a fund it is treated as a personal contribution and is not taxed. A complying SMSF can deduct outgoings incurred as part of generating assessable income or in carrying on a business to generate income. A net loss by a super fund is carried forward. Funds held within a super fund are classed as tax paid on contribution and on fund earnings (tax free on the way out) or un-taxed (taxable on the way out). Payments from a super fund can be as a lump sum or a pension, or a combination of both subject to annual limits. The tax-free component is tax-free on withdrawal and the taxable component is taxable on withdrawal at a rate of 15%. Taxation treatment of a lump sum distribution varies with circumstance from no tax to the highest withholding tax rate.

A trust

A trust is a structure within which assets can be owned and managed, and financial activities undertaken. A trust is established by deed and the trustee must comply with the intentions of the deed and act in accordance with applicable laws (e.g. tax law). A trust holds property as its nominal owner for the good of one or more beneficiaries and is specific to the beneficiaries of that trust. A discretionary trust operates with the trustee having the discretion to annually nominate the trust beneficiary to benefit and the amount they will receive from the trust. Entitlement to trust income or capital is set-out in the trust deed or can be acquired when a trustee exercises a discretion to pay a beneficiary income or capital. A trust can be a primary producer and a nominated beneficiary is carrying on the business of primary production. As a primary producer, a beneficiary can make use of primary producer income averaging and FMD provisions. The beneficiary status as a primary producer may remain the case where a primary production trust has made a loss or has no income.

The advantages of a trust are asset preservation, income tax distribution and the ability to achieve family-flexible succession as part of estate planning. Asset preservation occurs as a trust separates ownership from control, quarantining assets from any claims against that person. A discretionary trust enables flexibility for income distribution among beneficiaries, potentially specific to individual circumstances.

Assets must enter into a trust. The mechanisms to allocate money into a trust are by gifting the funds or by establishing a repayable loan to the trust. Real property can enter a trust by transferring the property title as a gift or by selling a property to a trust via a contract of sale at or below market value. The resulting CGT liability (to the seller) is based on the market value price.

The net income of a trust is assessable (taxable) income for a financial year less allowable-deductions. Losses made by a trust in a financial year are carried forward to offset net income in a later year. Where a trustee is liable for tax, an income tax assessment will be issued to the trustee. The trustee is (generally) taxed on the trust income at the highest marginal rate applicable to individuals and with trust-type based exceptions, at modified individual rates. A trust is not liable to pay PAYG instalments but rather, the beneficiaries are liable based on their share of the trust's instalment income regardless of when or whether the income is actually received.

There are specific mechanisms to share the outcome of trust activities (see Box 6). A beneficiary generally receives income from a trust on a defined proportionate basis unless operating as a discretionary trust where the trustee determines distributions on an annual basis. An exception is where a trust deed makes specific allocations of assets to individual beneficiaries or includes specific entitlements to capital gains. Subject to a trust deed, a beneficiary may be entitled to a franked distribution resulting in the beneficiary being taxed on this distribution. Certain beneficiaries can then claim a credit for the tax paid on their behalf by the trustee.

Box 6: A summary of the mechanisms under a trust arrangement for distribution of trust net annual income.

Mechanism	Narrative
Equal proportions	Each beneficiary received an equal share of the trust net income.
Set proportions	Each beneficiary received a defined share of the trust net income.
Discretionary	The share of the trust income allocated can vary each financial year.
Specific allocations	There is a specific allocation of specific assets to specific individuals.
Specific entitlements	There is a specific entitlement to the capital gains from specific assets by a specific individual.

With the sale of a trust asset, a capital gain event results, with a capital gain or loss determining the trust's net capital gain position for a financial year. A net capital gain is treated as income reported in the trust's net income and a net capital loss is carried forward to offset against future capital gains. A net capital gain is allocated proportionately to beneficiaries provided that no beneficiaries are specifically entitled to the capital gain, or the trustee elects to be taxed on a capital gain. A trustee is taxed on trust net income at the top

marginal rate and is not entitled to the CGT discount on the gain. Where the capital gains are distributed to beneficiaries, the 50% CGT concession is possible (where CGT is based on 50% of the change in asset value subject to specific requirements). With the taxation of trust net income within a trust at the highest marginal tax rates, there is an incentive to distribute trust net income to the beneficiaries.

Taxation treatment of trees

Ordinary income or capital gains?

Trees harvested and sold by a grower as part of a forest operation generates ordinary income subject to taxation at situation specific rates. Where trees are sold standing and prior to harvest, this triggers a CGT event with the net capital gains taxed combined with other income. It is important to understand that CGT is not a separate tax but part of the overall taxation treatment of income. That said, CGT does have concessional treatment of the income base taxed. There are other CGT events; granting an easement, a profit à prendre or a licence over an asset, and the loss or destruction of an asset. Caution is required in making this distinction. In regard to taxation treatment of trees, it is possible to seek a legally binding private ruling from the ATO.

Ordinary income

Tree growing as an additional business activity

Growing commercial trees in a forest operation may not be a usual or core business activity. Regardless, profits from an isolated transaction (e.g. associated with tree growing) can generate assessable income. The term *'isolated transactions'* refers to *'transactions outside the ordinary course of business of a taxpayer carrying on a business; and those transactions entered into by non-business taxpayers'* (ATO, 1992a). An isolated transaction is *'when the taxpayer has a profit making intention or purpose and the transaction was entered into in the course of carrying on a business, or in carrying out a business operation or commercial transaction'* (ATO, 2010a, s.62). Where trees sold do not form part of a forest operation, the income generated remains as ordinary and assessable income for the grower of the trees.

Income and the harvest of trees

The ATO defines assessable income in regard to trees as beyond the sale of logs. It includes cash inflows from grants, insurance payouts (income can be spread over five years for assessment as taxable income) and selling the resulting trees standing. A grower would be taxed on the net insurance payout or grant after utilisation of the funds; for example use of insurance to replant a site destroyed or a grant to establish a plantation. A grower can grant a right to fell timber on land they own and receive a royalty which is assessable income. The timing of income from a taxation perspective will depend on the selling arrangement; the income is taxable in the financial year of a sale. While sale of logs is an obvious point of receipt of revenue, if trees have been fallen and remain as logs at the end of

a financial year, they are treated as trading stock and an income (revenue) must be recorded.

Income and trees sold as a going concern

Regardless of an initial intent to harvest planted trees and sell the resulting logs, trees can be sold standing with ownership passing to another party independent of harvesting. If standing trees are sold, then the revenue generated is taxable in the financial year of that sale; it is a CGT event. The value of the trees sold can be at a market value or based on the Commissioner's opinion. Valuation of the standing trees can be achieved by engaging a consulting forester making use of appropriate forest valuation standards (see Leech & Ferguson, 2102; Leech, 2012; IFA & NZIF, 2020). Treatment of trees as a going concern depends on the timing of ownership; if owned prior to 20 September 1985, there are no CGT consequences for the logs harvested and sold as the trees and land are regarded as a single-assets. Trees owned after that date are separated from the land and two capital gains assets are created.

Treatment of expenses associated with commercial trees

Timing of deductions

Taxable income from a tree growing activity is the net income once allowable expenditures have been deducted and there are two treatments. The first is to claim deductable expenses associated with tree growing at the time when they occur and the second is to claim expenses associated with the tree growing activities against the future income (e.g. harvesting). It can be advantageous to claim expenses at the time they occur rather than to carry such expenditure to a future time.

If expenses occur without any or adequate revenue, a loss results, which can have a specific treatment. A non-commercial loss is where expenses are in excess of revenue for a given financial year *'from a business activity that is not related to your primary source of income'* and could *'be a hobby or lifestyle benefit'*. Regardless of the business-like attributes, *'if it is unlikely to ever make a profit and doesn't have a significant commercial purpose or character, you can't offset this non-commercial business loss against your other income'*. It would be an advantage if such losses could be claimed against other un-related income in a given financial year.

There are excepted activities not required to apply non-commercial loss measures; for example a professional arts business as an author (of a literary, dramatic, musical or artistic work), a performing artist or a production associate (ATO, 2018d). Primary production is also a conditionally excepted activity. If an individual is undertaking primary production, they can claim *'primary production losses immediately against other income'* if they meet the following conditions (ATO, 2022b, p.8).

- The primary producer is a sole trader or a partner in a partnership (e.g. not an entity).
- The primary producer's *'assessable income from other sources is less than $40,000, excluding any net capital gain'*.

There are other tests to negate a requirement of non-commercial losses measures. A sole trader or partnership annually earning $250,000 or less can test their circumstance against the non-commercial loss rules to assess whether a loss can be offset or needs to be deferred to the time of income from tree growing (see Figure 4). A member of a partnership can also test their circumstance against the non-commercial loss rules to assess whether a loss can be claimed immediately or needs to be deferred (ATO, 2018a, p.1 to 4).

Deductions for trees purchased as a going concern

While trees purchased as a going concern become the property of the party purchasing the trees, claiming a deduction of the cost of this purchase is at the time of generating an income from the trees (e.g. at harvest) or on a subsequent sale to another party. The purchaser must carry the expenditure in the trees until harvest, and only when all purchased trees have been felled, can the full amount be expended. This can be referred to as a '*cost of bush'* treatment and the tree value at the time of purchase must be defined. If a party sells the purchased tree standing, it may not be possible to deduct the deemed purchase price of the trees. With trees purchased as a going concern, a non-commercial thinning (e.g. no revenue) does not qualify for a cost of bush expensing but a commercial thinning with logs sold and income generated can.

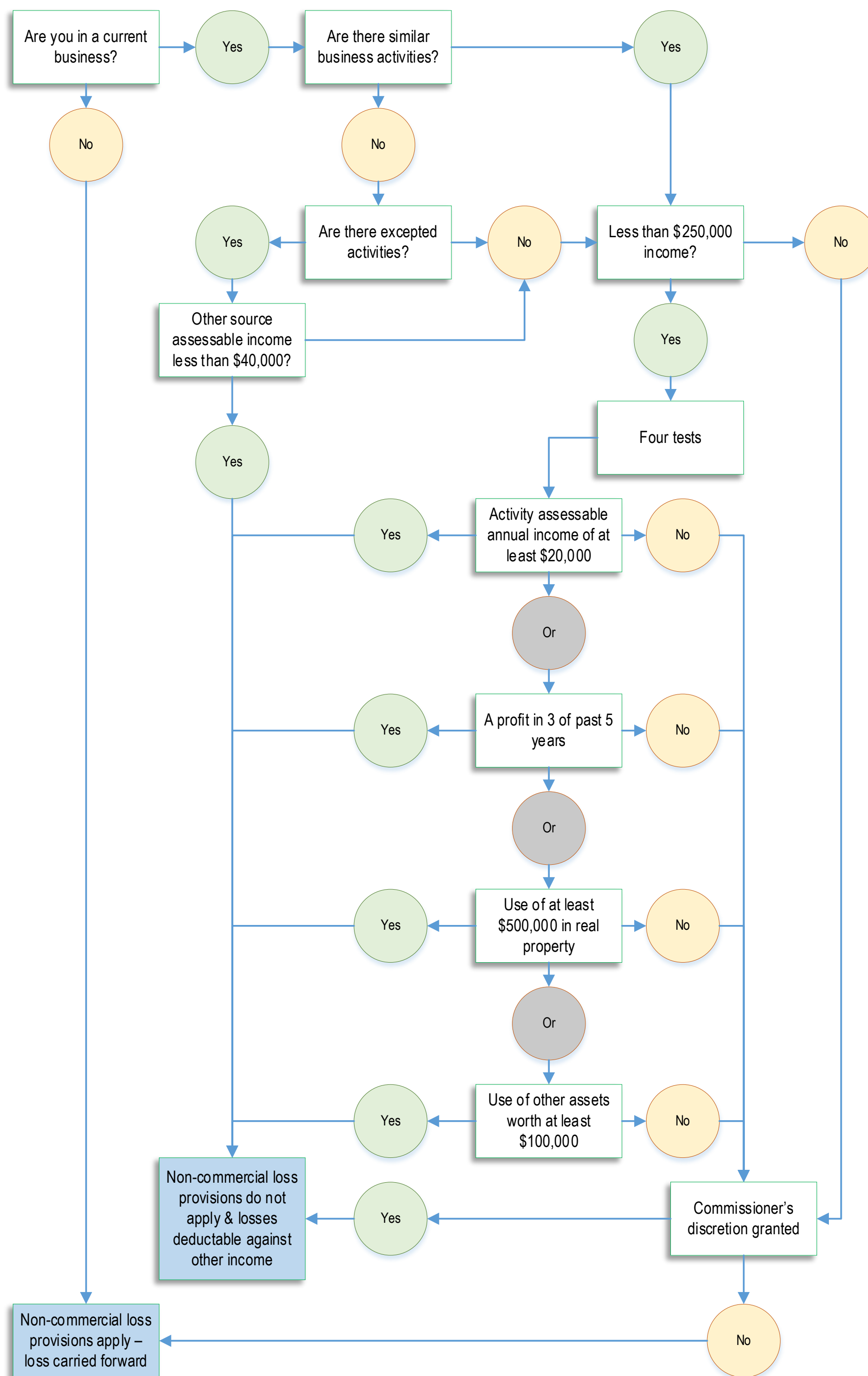

Figure 4: The test of eligibility of a sole trader to negate use of non-commercial business losses mechanisms.

Treatment of expenses associated with a forest operation

Over the life of a well-managed plantation there are a range of management inputs and associated costs. Management inputs seek to maximise tree growth and value, and are deductable expenses. Indeed undertaking activities to improve tree growth forms part of the requirements of a forest operation. In carrying on a tree farming business, it is important to determine deductable expenses. Some expenses are not deductable; for example, initial

expenditure on clearing or preparing the land for planting is a capital cost and not deductible (these activities are defined in Box 7). Deduction for the following costs can be claimed when incurred subject to a range of provisions (tests); establishing, maintaining and harvesting and transporting timber (ATO, 2022b).

Box 7: A high-level summary of the treatment of expenses relating to plantations (taken from and based on ATO, 2010a, s.13; ATO, 2022b, p.2).

Deductable expenses	Non-deductable expenses
Establishing a plantation or forest • Second and subsequent rotation pushing-out and windrowing of stumps and debris for planting that land. • Cost of seedlings and plants. • Expenses that relate to the planting process, such as deep ripping, mound ploughing, raking, levelling and weed control. • Watering and fertilising costs. • Capital costs of installing dams, sprinkler systems and fences (boundary or internal). Maintaining a plantation or forest • Firebreak and track maintenance. • Costs of shooting or baiting feral animals. • Forest health surveys and consultant advice. Harvesting and transporting timber • Harvesting and transport costs related to diseased trees or thinning operations.	Establishing a plantation or forest • Clearing or preparing the land for planting is a capital cost and not deductible. • The costs for the initial pushing-out and windrowing of stumps and debris (not part of a previous tree crop). Processing beyond logs • Onsite processing of logs.

Trees not part of a forest operation

Carbon sink forests and shelterbelts are not forest operations but have specific ATO treatment. A carbon sink forest has specific treatment of establishment costs. Rather than an outright deduction in the year of establishment, allowable establishment expenses are claimed over a deduction period of 14 years and 105 days. That is, each year a grower claims 7% of allowed costs until all have been claimed. Shelterbelts are regarded as supporting generating a farm income and there are eligible deductions (including supporting fencing) in the financial year of occurrence. Where trees do not form part of a forest operation, nor are shelterbelts or carbon sink forests (e.g. that is trees planted for amenity or to protect a farm house), no deductions are possible.

Taxation rates

Table 7 presents a summary of a taxation treatment of a super fund. Taxation treatment of taxable income is presented in Table 8 for individuals, individuals as sole traders or in a

partnership, a company and a trust. The taxation treatment of a trust varies between the income taxed within a trust compared to net income distributed to the beneficiaries. If the trustee elects to retain any net revenue, this is taxed at the highest marginal rate. The income distributed to beneficiaries adds to their individual taxable income and their tax liability is recalculated to either generate a refund or a tax liability.

Table 7: Treatment of a super fund by the taxation system.

Fund phase	Fund income						Fund distributions	
	Concessional contributions	Non-concessional contributions	In specie contributions	Excess contributions	Fund earnings	Tax rate	Status	Tax rate
Accumulation phase	Yes	Yes	Yes		Yes	15%	Not applicable	Not applicable
				Yes		Highest rate	Not applicable	Not applicable
Transition to retirement	Yes	Yes	Yes	Yes	Yes	15%	Tax free	0%
							Taxable	15%
Pension phase	None	None	None	None	Yes	0%	Tax free component	0%

Table 8: Taxation on ordinary income under the taxation system.

Primary producer	Carrying on a business	GST registration	A forest operation	Non-commercial business losses	Isolated transaction	Taxation basis	Allowed deductions	Tax rate	GST treatment	At year end
No	No	No	No	Applies	Yes	Assessable income includes tree sales.	No tree-crop related deductions.	See Table 6	Non-claimable	Recalculation of taxable income and determination of tax payable. Either a refund or a requirement to pay the deficit.
Yes	Sole trader or partnership	Yes	Yes	Applies	Yes	Assessable income includes tree sales.	Losses deferred till a profit is made.	See Table 6	Claimable	Recalculation of taxable income and determination of tax payable. Either a refund or a requirement to pay the deficit.
Yes	Sole trader or partnership	Yes	Yes	Not applies	Yes	Assessable income includes tree sales.	An ability to offset tree related expenses to other income in year of occurrence.	See Table 6	Claimable	Recalculation of taxable income and determination of tax payable. Either a refund or a requirement to pay the deficit.
Yes	A company (small)	Yes	Yes	Not possible	Yes	Assessable income includes tree sales.	Losses carried forward.	25%	Claimable	Calculation of taxable income and determination of tax payable.
Yes	A company	Yes	Yes	Not possible	Yes	Assessable income includes tree sales.	Losses carried forward.	30%	Claimable	Calculation of taxable income and determination of tax payable.
Yes	A trust	Yes	Yes	Not possible	Yes	Undistributed net income	Losses carried forward	Highest marginal rate	Claimable by the trust	Calculation of taxable income and determination of tax payable.
Yes	A trust	Yes	Yes	Not possible	Yes	Distributed income	Losses carried forward	Individual beneficiary tax rates	Claimable by the trust	Recalculation of taxable income and determination of tax payable. Either a refund or a requirement to pay the deficit.

Trees for retirement and succession planning

The farm situation

The farm, farmers and farming activities

A scenario has been compiled and developed based on insights collected during farmer consultation (see Jenkin, 2022) and does not reflect any specific situation; it is to demonstrate a series of trees and taxation principles. To demonstrate the principles, the farm is either as a proprietary limited company or operating in a discretionary trust structure.

A 600 ha farm is part of a family-owned primary production enterprise. The family has current senior farmers and the next generation of two siblings with their partners. The three full-time farmers usually each receive a pre-tax income of $60,000 per year (depending on the structure as employees or as trust distributions), and with PAYG treatment and no deductions, each pays $9,967 in tax with an after tax (in the hand) income of $50,033 (this excludes Medicare and any other levees) and receive a $6,600 superannuation contribution via the super guarantee mechanism. The sibling's partners have off-farm employment as well as contributing to farming activities.

The primary farming enterprise is a beef breeding business turning-off 12-month-old vealers. In support of their grazing, they have centre pivots irrigating lucerne and improved pasture. There are three farm houses each with a single family in residence. The farm has limited shade trees and is exposed to prevailing winds. The farm is 100 km from the Port of Portland. Based on discussions with neighbours, their stock agent and after reviewing a range of information, the collective view is that they need to plant trees for the following reasons.

- To provide shade and shelter for the livestock, particularly during calving and as wind-breaks for the houses. Trees around the property will also provide amenity and protect waterways.
- To fund successional change between the current farming senior generation and the children by supporting their retirement.

A potential trees into farming strategy is to develop a 'green bank' by investing some surplus farm revenues (from good years either by the company or within the trust), farmer direct investment as an individual or growing trees as part of a SMSF. The resulting 'green bank' assets are to provide funds for retirement of the current generation.

Primary production, running as a business and documentation

The farm primary production enterprises are run on a fully commercial basis; they are indeed running a business. This is supported and backed-up by the series of plans underpinning all activities and the prudent approach to record keeping. The family and farm plans have been documented with the assistance of a range of trusted advisors; farm management plans developed with an agronomist and stock agent, accounting records and financial plans with an accountant and financial planner, and a farm succession plan with the farm's legal advisor and the banks. Paper work and records are second nature in support of taxation requirements. After an initial review of a wide range of available information and discussions with other farmers, a local forestry consultant was engaged to prepare a concept plan of a tree growing venture. This plan considered tree growing options and based on the age of the current and 'soon' to retire farming family, a short rotation (12-year crop cycle or rotation) Tasmanian blue gum regime was selected. While radiata pine was an option, a 28-year rotation was considered too long. However, the next generation of farmers are considering this species as it could match their retirement and succession plans by re-planting the Tasmanian blue gum sites post-harvest. It is recognised that the costs to remediate back to pasture are significant and that the initial motivations to plant trees would remain. Other species were considered (e.g. *Corymbia maculata* - Spotted gum) but none had current nor active local markets (defined by markets within a commercially viable log haulage distance).

Trees as a crop and green bank

The tree crop and strategy

Tasmanian blue gums over a 12-year rotation are to be planted with the intent to supply pulp logs with a single harvest event (see Table 9). This species is a predominant tree-crop in the region with 121,071 ha under management in 2020/21 (ABARES, 2022, p.7, Figure 5) and with current and active export markets. The species is well understood and advice on site-specific silviculture can be sourced from a number of companies. The plantings are to be over sequential years. The objective is to plant five hectares per year for 12 years to provide a mini estate of 60 ha (10% of the total farm area). It is important to note that small-scale woodlots would result in higher site preparation and harvesting costs. The land to be used will be spread around the farm in a range of arrangements from strategic plantings with an additional benefit of shade and shelter for livestock, establishment of weak sandy rises difficult to maintain as pasture and around centre pivots making use of odd shaped land to reduce the adverse wind impacts on the pivot's delivery of water. The wood outputs can be sold as logs to woodchip exporters.

Table 9: The proposed management regime for a Tasmanian blue gum plantation with cut-to-length harvesting (based on Parsons & Jenkin, 2023).

Physical attributes	(Units)	Values
Initial stocking	(stems/ha)	1,100
Stems harvested	(stems/ha)	950
Productivity	(m^3/ha/y)	17.0
Rotation	(y)	12
Harvest yield	(m^3/ha)	204
	(GMT/ha)	224

Funding the trees, ownership and outcomes

Up-front tree establishment and ongoing costs can be part of the farming business, funded by any annual business cash surplus. Alternatively, the farmers invest in the trees as individuals or via a SMSF. At age 12-years the trees are to be clear fallen generating a net-revenue. There are no returns from any carbon benefit assumed in this scenario. The net revenues are paid to the tree owner; the individual farmer, the farming business or the SMSF depending on the arrangement.

The nature of trees

Trees by their nature generate a lumpy cash-flow with up-front establishment costs and in the case of Tasmanian blue gums, a once-off harvest after 12 years. In between, there are active management inputs to ensure and indeed maximise tree growth and yield at harvest (a requirement of a forest operation). Working backwards, harvest net revenues (a residual stumpage) results from the log price at the mill gate less production costs (haulage costs to the mill, on-farm roading for truck access and harvesting costs from tree falling, processing into logs and loading on B-doubles trucks). While the farmers have chainsaws and tractors, they recognise the skill required and risks. Further, on consultation with their insurance broker, it was determined that harvesting and haulage of trees was not part of the farm policy coverage. It was determined to engage with a suitable party to arrange the harvest and sale of the trees in the future; while this is another cost or overhead, such parties will have access to contractors and markets. There are two current local markets for the trees grown. The first is the Port of Portland which takes woodchips delivered to the port gate and Myamyn which takes logs. A forest operation primary production excludes onsite chipping as a deduction (treated under other mechanisms) so if outputs are to be supplied to the Port of Portland, the trees would need to be sold at the stump on a residual stumpage basis. If the logs are to be sold to Myamyn for chipping, then the sale of logs could be on a mill door basis. Figure 5 presents the cash flows for a single planting of five hectares and Figure 6 presents the outcome where five hectares is planted each year for 12 years.

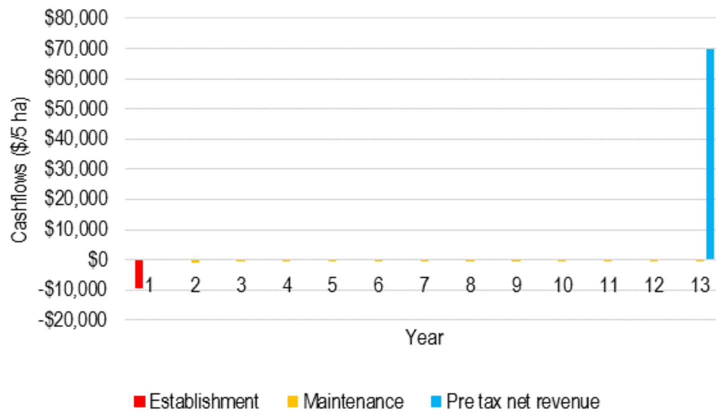

Figure 5: An example of the cash flows for a five-hectare short-rotation hardwood woodlot grown for sale as logs for subsequent processing into woodchips.

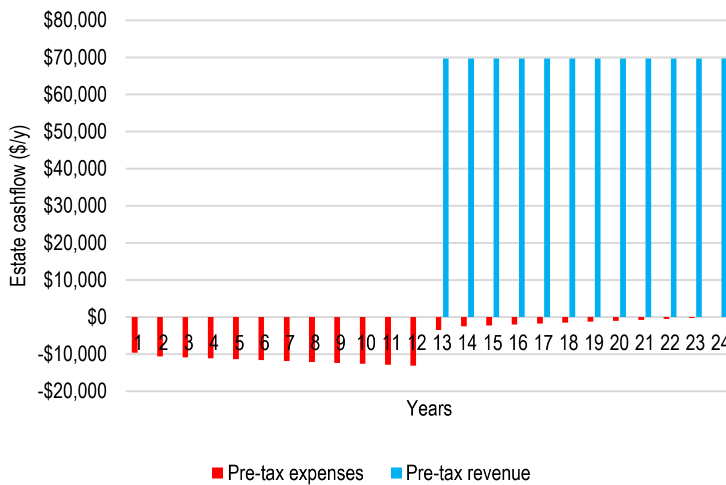

Figure 6: The annual cashflows for the estate resulting from establishment of five-hectare short-rotation hardwood woodlots each year for 12 years.

The quality and attention to detail of establishment and maintenance of the trees is important to ensure good growth and to maximise returns. Getting it right the first time is the best approach which can be supported by good planning and knowledge of required inputs. A careful assessment is required of the taxation treatment of costs. For example, in preparing the sites for planting, works associated with initial clean-up of old fences, patches of weeds and other impediments may not be deductable and be treated as improvements to the land asset. Seeking a private ruling from the ATO is a prudent course of action to provide legally binding certainty. Works associated with the tree planting are likely allowed deductions. There is however, a need to not waste money on activities that do not return value. For example, there is no requirement to prune trees planted when destined for sale as pulp logs. The farmers may choose to prune for aesthetics, but there is no current price premium for pruned Tasmanian blue gum logs.

Documented plans and the tree growing arrangement

A farm management plan and trees

Given implications for the farm and farm enterprises, the farm management plan was revisited to determine the best locations for the tree growing activities. The objective is to have a series of dispersed woodlots providing maximum benefits with an intent to harvest. To assist, the forestry consultant became part of the team assisting the farming family in this re-drafting. The process was to have the agricultural advisor identify where planting trees best suited the farm and then the forestry consultant to provide guidance as to whether the trees in each location could be harvested. Four categories of trees were identified. The first was as shelterbelts (e.g. no harvest intended) which can be claimed as a deductable expense. The second was as amenity trees around the family homes (e.g. no harvest intended) which cannot be claimed as a deductable expense. The third was trees for permanent revegetation around a drainage line for which local grants would be sought rather than attempting to claim a tax deduction. The fourth category was trees for harvest and sale to generate a profit as part of a forest operation as addressed under the taxation regime.

As noted, there are four options for funding the proposed trees and a careful assessment of each is required (see Table 10; funding by individual farmers, funding by farm enterprise cashflows either, as a company or via a discretionary trust, or development within a SMSF). Again, working backwards, it is prudent to consider the expected returns and taxation treatment of this income. This consideration *just depends* on many factors including the working status of the farmer planning for retirement. Will harvest commence before or after retirement? Will the farmer seek a transition to retirement working part time drawing a part pension?

Trees developed by an individual farmer

Development of trees by a farmer as a sole trader and primary producer in their own right allows a range of treatments. An exemption is potentially available to the farmer as a sole trader and primary producer in their own right to use of non-commercial losses where the expenses of establishing the trees are offset against the pre-taxation wages drawn. At tax time and with submission of an annual tax return, a refund is likely as the tree related expenses have reduced the taxable income on which PAYG has already been withheld.

Table 10: A summary of the green bank options planting Tasmanian blue gums for harvest and sale as pulp logs.

Scenario	Strategy	Tree ownership	Expenses	Revenue
Farmer as an individual / sole trader	As part of individual farmer retirement funding. Final harvest will be after farmer retirement.	The trees are established on the farm by the farmer and are owned by the individual farmer.	The farmer obtains exemptions of non-commercial losses provisions. Tree costs offset against PAYG income. Up-front establishment costs at the start, maintenance of the crop and insurances.	The farmer has ceased working and is retired. At age 12 years the trees are clear fallen generating a net-revenue. There is no carbon benefit claimed. The farmer receives the funds directly and is required to pay tax on the earnings.
Farm green bank (company)	Development of a green bank by investing some surplus farm revenues.	The trees are established on the farm and are owned by the farming business.	Up-front establishment costs at the start. Ongoing maintenance of the crop and insurances. Includes farmer labour inputs with the farmer as an employee of the farming business.	The farmer continues to be employed by the farm beyond retirement age. At age 12 years the trees are clear fallen generating a net-revenue. There are no carbon benefits claimed. The farmer continues to draw a wage under the PAYG regime. Super contributions continue.
Farmer superannuation	As part of individual farmer SMSF operating as a primary producer.	The trees are established on the farm funded by the SMSF after concessional contributions by the farmer. The tree assets are held by the SMSF.	The up-front establishment and ongoing maintenance costs and insurances are paid by the SMSF. These are claimed as expenses in the fund.	The farmer now fully retired and draws a tax free pension. At age 12 years the trees are clear fallen generating a tax-free net-revenue. There are no carbon benefits claimed. All revenues are received by the SMSF. A tax free pension is possible.
Farm green bank (trust)	Development of a green bank by investing some surplus farm revenues.	The trees are established on the farm and are owned by the farming trust.	Up-front establishment costs at the start. Ongoing maintenance of the crop and insurances. Includes farmer labour inputs with the farmer as an employee of the farming business.	The farmer retires. At age 12 years the trees are clear fallen generating a net-revenue. There are no carbon benefits claimed. The farmer receives beneficiary distributions and pays tax.

The eventual harvest returns would be treated as taxable income and tax paid at the appropriate marginal tax bracket rate. If this occurs before retirement, part could be taxed at the highest rate of $0.45 in the dollar if the combined individual farmer income is more than $180,001. As a primary producer there is potential use of income averaging provisions or making use of FMD. With income averaging over five year periods and a planned 12-years of harvesting, this mechanism may not assist. A FMD capacity of $800,000 is a useful option that should be considered. If harvest commences after retirement, the farmer's total income

would be reduced potentially resulting a lower marginal tax rate applied, generating an annual income for 12 years (Figure 7). Without developing trees, the farmer's gross annual income of $60,000 ($50,033 net after tax) ceases after year 12. With developing a series of woodlots and claiming non-commercial business losses while working, the farmer receives a tax refund of $3,120/y to $4,258/y over the period of tree development reducing the gap between a farmer without and with woodlot development after tax income to $3,360/y to $4,585/y. With retirement (not drawing a wage), the farmer's income swaps to the after-tax tree harvest income of $54,190/y to $56,560/y for 12 years.

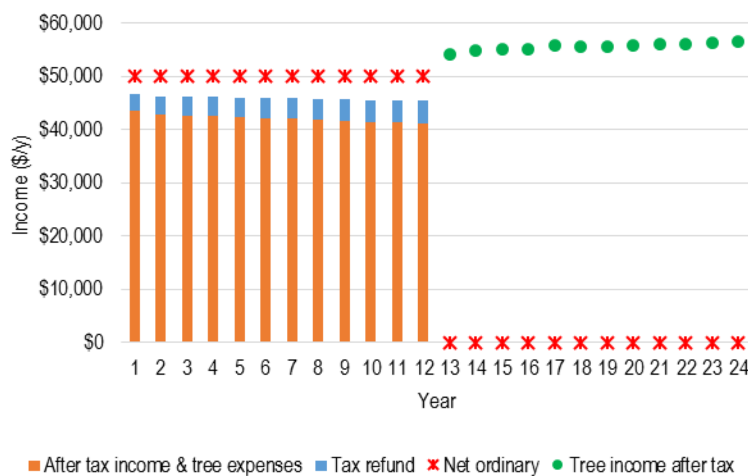

Figure 7: Modelled pre- and post-tax cash flow for a short-rotation hardwood plantation mini-estate owned by an individual farmer. Retirement occurs at the end of year 12.

Tree developed by the farming business operating as a company

With the tree development under the primary production company, allowed expenses can be claimed and tree revenues could add to the overall farm revenues as profits from an isolated transaction. A tax rate of 25% is applied to the assessable income less allowed deductions depending on entity attributes. Any losses are carried forward to a future period when a profit is generated. The analysis does not consider other farm income which could be use the fund the pre-tax plantation development and management expenditure presented in red. The total expenditure to develop and manage the woodlots in this case was $157,200 over 24 years returning a total pre-tax revenue of around $836,000 with cashflows commencing after 12 years with the harvest of the first woodlot. The scenario is presented in Figure 8 and assumes the tree income is stand-alone and taxed at 25%.

Figure 9 presents the same scenario but assuming that plantation development expenses are carried forward until harvesting commences and are used to offset this income. The result is tax free income for the first two years but this is after carrying a loss of $157,200 for 12 years. In reality the tree income from both treatments would be off-set against the

ongoing wage for the farmer and the farmer would then pay tax under the PAYG tax framework.

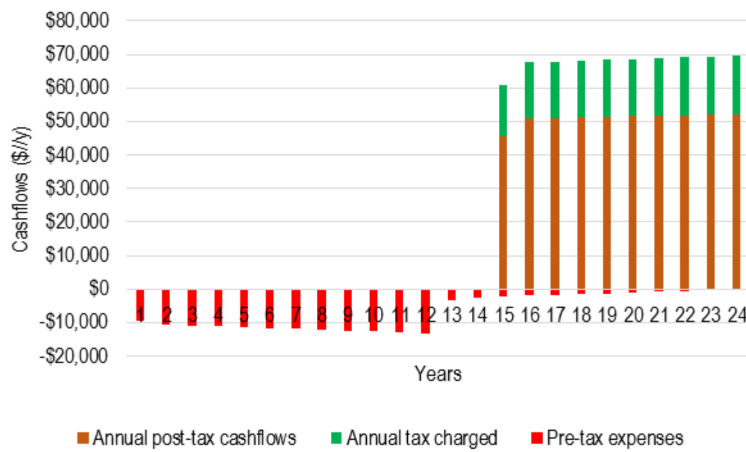

Figure 8: An example of pre- and post-tax cash flow for a short-rotation hardwood plantation mini-estate. This estate is owned by the farming company. Plantation development is offset against other income.

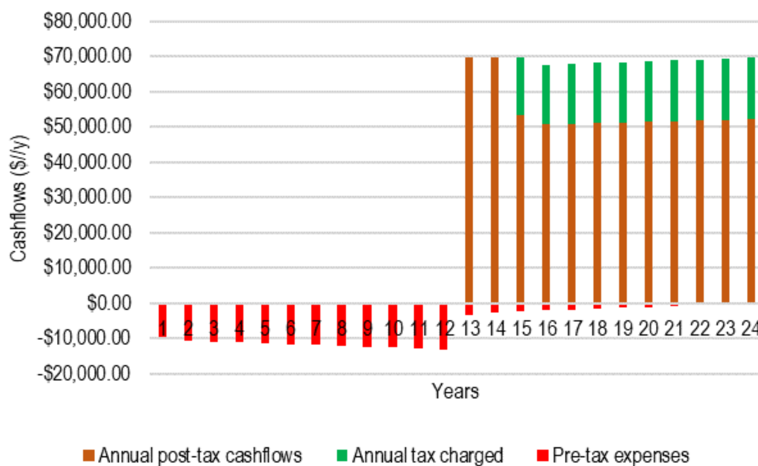

Figure 9: An example of pre- and post-tax cash flow for a short-rotation hardwood plantation mini-estate. This estate is owned by the farming company. Plantation development expenses are carried forward.

Trees developed in a self-managed super fund

While it is potentially possible for the farmer to develop the trees in their own right and make an *in specie* contribution of the land with the trees into a SMSF, there are implications. The first is whether the value of the combined land with trees asset would breach non-concessional contributions limits (e.g. a maximum $330,000) and tax charged at $0.45 in the dollar on the excess. To transfer the land (and trees) would require separate titles which with dispersed woodlots, may not be possible. There would potentially be CGT issues. Finally, there would be implications for the other owners of the land (via the farming business).

Development of trees within a SMSF is an option where the fund trust deed and investment strategy allow such activities (see Figure 10). The trees could be funded by the farmer's super guarantee contributions (for 2023/24 at 11.0% of pre-tax income) and/or via use of salary sacrifice during the fund accumulation phase. The trees would be owned by the

SMSF and be for the farmer's retirement during the fund pension phase. Treatment in a SMSF depends on the status of the farmer member at the time of harvest and revenue generation. If harvested during the accumulation phase, net income would be taxed at 15% in the fund, whereas if harvested during the 100% retirement phase, this income would be tax free, as would the pension received. Without developing trees, the farmer's gross annual income of $60,000 ($50,033 net after tax) ceases after year 12.

The tree development is funded by annual superannuation contributions. In addition to the super guarantee inputs during the fund accumulation phase, the farmer makes an annual salary sacrifice equivalent to the pre-tax (at 15%) funds required to develop a 5 ha woodlot each year for 12 years. This generates a tax refund of around $1,150 to $2,260/y over the period of woodlot development due to a salary sacrifice of around $3,530 to $6,940/y. Harvesting commences after full retirement of the farmer with the SMSF in a 100% pension phase; the harvest net revenue enters the fund tax free. With harvest the SMSF earns a tax free income of around $69,670/y. The farmer's tax free pension can be drawn down from the fund supported by the tree harvest revenue as fund income.

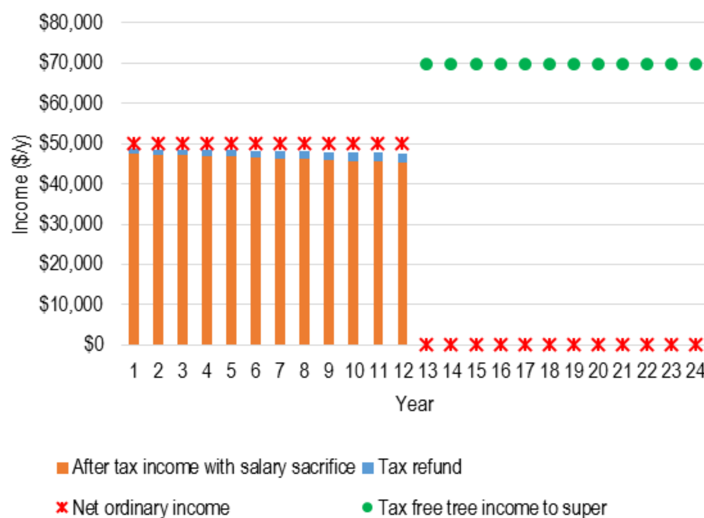

Figure 10: An example of pre- and post-tax cash flow for a short-rotation hardwood plantation mini-estate. This estate is owned by the farmer's SMSF.

Trees developed by a primary producer trust

This scenario addresses trees developed in association with a discretionary trust undertaking primary production activities. It is possible to develop a series of woodlots external to a primary production trust, and either sell or gift the trees to the trust. If the trees are sold to the trust, regardless of the selling price, this will trigger a CGT event and the farmer selling the trees will pay CGT on the market value of the trees. There would also be potential stamp duty considerations. The implications of gifting the trees where the trees are

a forest operation with taxation benefits claimed, would need to be determined (e.g. what will be the CGT treatment?).

A strategy to develop the trees within the trust is possible, with the trees qualifying as a primary production forest operation (subject to compliance with requirements). The trees can form part of the trust's assets and be a specifically allocated asset or be part of a specific entitlement to an individual beneficiary. With specific allocations or entitlements, this net revenue is locked-in to be provided to a specific individual beneficiary. Where the trees remain unallocated, at the time of harvest, the trustee must determine which beneficiaries are to receive the trust's net income. If the trust retains the revenue as assessable income, this net income will be taxed at the highest marginal tax rate and any distributions will be franked. If the revenue is distributed, the income will form part of the beneficiary's taxable income. With a discretionary trust at the time of harvest, the trustee can allocate a portion of the trust income to the retired farmer.

The trees can be developed using annual surplus revenue from the other primary production activities (Figure 11). In this scenario, if electing to do so, the trustee can distribute all of the harvest revenue to the beneficiaries assuming all plantation costs are funded from alternative trust net income. The beneficiaries must then declare this income and pay tax at the appropriate rate. If expenditure on the trees results in a net loss (e.g. the trees are not funded by other activities within the trust's net revenue), this loss is carried forward by the trust to be used when the trust activities generate a profit (Figure 12). This reduces the trust's net income as the trees are expensed and reduces the tax paid by the trustee (if electing to) or reduces the distributions to the beneficiaries and their individual tax liability. An important point is that in this scenario, it takes two years of harvesting and revenue generation to generate a net income for a year. This delays potential distributions to the beneficiaries after which they will be required to pay tax on the funds received.

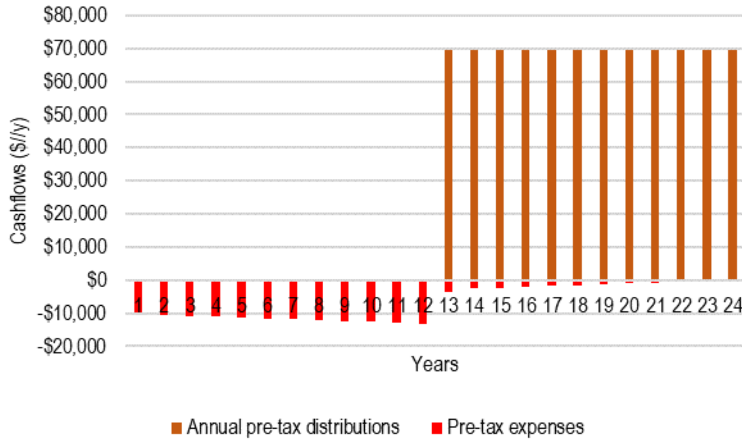

Figure 11: An example of the cash flow for a short-rotation hardwood plantation mini-estate. This estate is owned by a trust. Plantation development expenses are funded by other trust income.

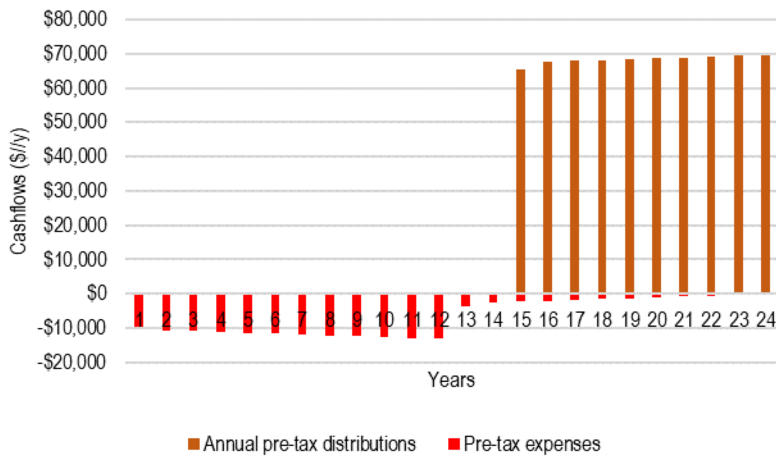

Figure 12: An example of the cash flow for a short-rotation hardwood plantation mini-estate. This estate is owned by a trust. Plantation development expenses are carried forward till harvest.

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Appendix A: Primary production

Primary production and tree growing

Trees for harvest

A primary producer *'can be an individual, partnership, trust or company'* (ATO, 2022a, p.1). The ATO (2022a, p.1) defines primary producers as running *'a business of plant or animal cultivation, fishing or pearling, or tree farming or felling'*. Tree farming activities as presented in Box 8, have an important and specific attribute that the trees are intended for harvest.

Box 8: The ATO definition of tree farming activities (taken from ATO, 2022a, p.3).

Tree farming and felling includes:
• planting or tending trees in a plantation or forest that are intended to be felled
• felling trees in a plantation or forest
• transporting trees or parts of trees that you felled in a plantation or forest to the place
    ○ where they are first to be milled or processed
    ○ from which they are to be transported to the place where they are first to be milled or processed.
If you are operating a business of establishing trees for the purpose of carbon sequestration (carbon sink forests), you will be eligible for carbon sink forest deductions.

Shelter belts

The ATO defines a shelterbelt as '*a line of trees or shrubs planted to protect an area from fierce weather'* (ATO, 2022a, p.15) to protect crops and livestock, improve biodiversity and/or to prevent or fight land degradation (e.g. soil erosion or degradation of vegetation) (ATO, 2022a, p.15). There are a range of eligible deductions and expenses that are ineligible for deduction (see Box 9). The role of potential government support is noted and any expenses that are eligible deductions and are claimed, funded or re-couped, then this support is treated as assessable income (ATO, 2022a, p.16).

Specific mechanisms

Tax averaging

Income from primary production activities is generally not guaranteed and results from the units produced and sold, and the price received per unit. Recognising this attribute, the ATO (2017) provides a tax averaging mechanism that *'evens out your income and tax payable over a maximum of five years to allow for fluctuations in prices and production. This ensures that you do not pay more tax over a number of years than taxpayers on comparable but steady incomes'.* This averaging mechanism is available to individual primary producers

(e.g. not a company) and is presented in Box 10, and is based on income in a specific year relative to the average income over five years.

Box 9: Treatment of expenditure in a shelterbelt planting without an intent to harvest the trees grown (based on ATO, 2022a).		
Treatment	When you can claim a deduction.	When you cannot claim a deduction.
Intent or situation	If you establish a shelterbelt on land on which you conduct a primary production business.	A shelterbelt created for a private purpose, such as to protect a home.
Element	You can claim the following. • An immediate deduction for any costs for new fencing and reticulation (such as, pipes, fittings, sprinklers, pumps and bores). • A deduction for the costs of site preparation, chemicals and trees – if the shelterbelt is established mainly to prevent or fight land degradation.	You cannot claim the following. • Site preparation or tree planting costs if the shelterbelt is not established mainly to prevent or fight land degradation. The trees are not considered depreciating assets. • These costs are part of the cost base of the land for CGT purposes.

Box 10: The ATO tax averaging mechanism (taken from ATO, 2017).
When your average income is: • less than your taxable income (excluding capital gains) – you receive an averaging tax offset • more than your taxable income (excluding any capital gains) – you must pay extra income tax. The amount of the averaging tax offset or extra income tax is calculated automatically and your notice of assessment will show you the details. You can choose to withdraw from the averaging system and pay tax at ordinary rates each year. If you have withdrawn from averaging it will be automatically reinstated after 10 years, after which time you can choose to withdraw from averaging again.

Farm management deposit scheme

Another mechanism to address income variation between years for individual primary producers (e.g. not a company) is the use of *'farm management deposits'* (FMD) (ATO, 2019b). A FMD works by allowing deposit of funds by an eligible primary producer in a surplus year with a tax deduction claimed ('under certain conditions'; see Box 11 for eligibility requirements). A FMD may generate interest from the institution offering the deposit service, but the interest earned is assessable to the individual FMD holder in the year earnt and cannot be paid into the FMD account (ATO, 2022f). Financial institutions are not allowed to deduct any amounts (e.g. fees) from a FMD (ATO, 2022f), hence the deposit is quarantined to the deposited amount. As the funds are redrawn from the account, the ATO treats *'the amount as assessable income in that year'* (ATO, 2019b). A withdrawal within 12 months of depositing may negate the ability to claim a tax deduction. There is provision for a

repayment '*due to an exceptional circumstance, such as drought or an applicable natural disaster, it can be deductible'* (ATO, 2019b).

Box 11: The eligibility requirements to claim a deduction to a FMD account (taken from ATO, 2022f).
To be eligible to claim a deduction for a deposit to an FMD account, you must: • be an individual (including a partner in a partnership, or beneficiary of a trust) • be carrying on a primary production business in Australia when you make a deposit • have no more than $100,000 in taxable non-primary production income in the income year you make the deposit • hold no more than $800,000 in total in FMDs. Companies and other entities are not eligible for an FMD. You can't make a deposit jointly with another person or people.

Appendix B: A financial and legal perspective of trees

Underpinning the taxation treatment is a need to understand the nature of trees from a financial and legal perspective. Box 12 presents a delineation of trees into consumable and bearer biological assets. With consumable biological assets, the tree is the product whereas a product is taken from bearer biological assets. The second concept is the connection of trees with land and whether the two parts are a single asset (Box 13). Crops regarded as *fructus industrials* are created by actions of a party and are separate to the land (e.g. a crop of wheat). With *fructus naturales*, the crop (e.g. the trees) is natural in nature and is connected to the soil, even for planted trees.

Box 12: A delineation between biological assets as consumable or bearer assets (taken from AASB, 2015, s.44).

Type	Consumable biological assets	Bearer biological assets
Description	Those that are to be harvested as agricultural produce or sold as biological assets.	Those other than consumable biological assets and are not agricultural produce but, rather, are self-regenerating.
Examples	Livestock intended for the production of meat, livestock held for sale, fish in farms, crops such as maize and wheat, and trees being grown for lumber.	Livestock from which milk is produced, grape vines, fruit trees, and trees from which firewood is harvested while the tree remains

Box 13: The definition of crops and land from a property perspective.

Classification	*Fructus industriales*		*Fructus naturales*	
Reference	ATO (2009, s.82 to 84)	SROV (2011, p. 2)	ATO (2009, s.82 to 84)	SROV (2011, p. 2)
Definitions	Refers to agricultural produce and crops resulting from cultivation of the land.	Refers to a crop or harvest of the earth produced annually by labour and industry, through sowing and reaping, planting and gathering of the relevant crop or harvest.	Originally meant produce that occurs naturally, without human cultivation, such as grass.	*Fructus naturales* refers to plant or plant produce that grows naturally from the soil, that is, without human cultivation.
Crops	Most annual crops are not considered part of the land on which they stand.	Include corn, hay, oats, wheat and potatoes.	Includes some planted trees and planted crops. On this basis, fruiting trees are considered part of the land on which they stand.	Items include the trees found in pine and timber plantations, fruit trees and grape vines.
Treatment	Do not form part of the land, even while they are attached to the land.	Although grown in the ground, this class of produce is not treated as part of the land as its characteristics are similar to those of primary production goods.	Form part of the land on which they stand until they are severed.	The common law regards such items as being part of the soil. Are considered to be fixtures regardless of whether they have been planted for the purpose of harvesting or felling. This is because the labour involved in the planting of these items represents a small part of the overall process and its development is deemed to have occurred naturally from the soil. Items are only considered to be goods upon their actual severance from the land.

Appendix C: Goods and services tax

Goods and services tax (GST) is a broad-based tax of 10% on most goods, services and other items sold or consumed in Australia. For a business or other enterprise with a GST turnover (gross income from all businesses less GST) of $75,000 or more, or for providers of taxi travel (including ride-sourcing), registration for GST is required. A registered business must determine whether sales are taxable (e.g. subject to GST) and include GST in the price of taxable sales, issue tax invoices for taxable sales and obtain tax invoices for business purchases. A business claims GST credits for GST included in business purchases and collects GST to pay when due by lodging activity statements or annual returns and pay GST or receive a GST refund. To register for Standard GST, an Australian Business Number (ABN) is required (ATO, 2021b). Sales of business assets (e.g. office equipment and motor vehicles) are usually taxable sales and include GST when trading in or disposing of by transferring ownership. A sale of property includes land, land and buildings, interest in land, rights over land, a licence to occupy land, and GST applies (ATO, 2021b).

Appendix D: PAYG taxation of individuals

Determination of tax payable

Taxable income

An Australian resident for tax purposes must declare all income earned in Australia and overseas on their annual Australian tax return. There are specific tests of an Australian resident for tax purposes status (ATO, 2022g). Income can be defined as ordinary income and taxable income (Box 14). Taxable income is the basis of tax to be paid and is assessable income less any allowable deductions. Allowable deductions do not directly reduce the amount of tax paid but rather they reduce taxable income, which then reduces the amount of tax to pay (ATO, 2023c). Most of personal income earnt exceeding the tax-free threshold will be assessable income on which tax is paid. Examples of assessable income are presented in Box 15 (ATO, 2023c) and it includes goods or services (rather than money) declared at the market value (ATO, 2023c).

Box 14: Definitions of income types (taken from ATO, 2023a).	
Ordinary income	Income according to ordinary concepts. Generally, this is amounts that everyone would consider to be income.
Taxable income	Gross income minus business deductions.

Allowable deductions

There is a wide range of potential deductions against taxable personal income (Box 16) but there is a requirement to determine whether each is an allowed deduction. The deductions include expenses related to generating an income and donations.

Records required

The Australian tax system relies on self-assessment, hence the ATO accepts that the information provided by an individual is accurate. An audit process is possible of individuals and if the required evidence (e.g. to support claims for a deduction) is lacking, a claim can be disallowed (ATO, 2023f). Prudent record keeping is required as evidence of expenses and deductions claimed. Records must be maintained for 5 years from the tax return lodgement date. A record is written (either paper or electronic) evidence of an income or expenses (ATO, 2023f). Most expenses must be supported by a receipt or a similar

document from the supplier. The content and details of an acceptable record of an expense is presented in Box 17. A full list of ATO requirements should be considered.

<table>
<tr><td colspan="2">Box 15: Elements of assessable income to declare.</td></tr>
<tr><td>Examples of assessable income to declare include the following (taken from ATO, 2023c).
• Salary and wages
• Tips, gratuities and other payments for your services
• Some allowances, such as for clothing and laundry
• Interest from bank accounts
• Dividends and other income from investments
• Bonuses and overtime an employee receives
• Commission a salesperson receives
• Pensions
• Rent.</td><td>Other income which must be declared (taken from ATO, 2023d).
• Foreign and worldwide income: Declared foreign income with tax payable depending on residency for tax purposes.
• Government payments and allowances: Required to declare taxable and tax-free government payments, pensions and allowances.
• Superannuation pensions and annuities: Required to declare income from superannuation pensions or annuities.
• Business, partnership and trust income: Declaring income earnt as a sole trader, as a partner in a partnership or from a trust.
• Compensation and insurance payments: Required to declare compensation and insurance payments which includes settlements.
• Scholarships, prizes and awards: Required to declare scholarships, prizes and awards.
• Crowdfunding: Money raised to support a project or venture.
• The sharing economy: Activities where assets are shared or services provided for a fee through a digital platform.</td></tr>
</table>

Box 16: Categories of items of potential deductions (taken from ATO, 2023e).
• Cars, transport and travel: Deductions for car, transport and travel expenses incurred in the course of work. • Tools, computers and items for work: Deductions for tools, computers, internet, stationery, books and other items used for work. • Clothes and items you wear at work: Deductions for clothes, glasses, protective gear and other work apparel. • Working from home expenses: Deductions for expenses incurred to work from home (e.g. stationery, energy and office equipment). • Education, training and seminars: Deductions for self-education, conferences and training. • Memberships, accreditations, fees and commissions: Deductions for union fees, professional memberships, working with children check, agency fees and commissions. • Meals, entertainment and functions: Deductions for meals, snacks, overtime meals, entertainment and functions. • Personal grooming, health and fitness: Deductions for medical assessments, vaccinations, COVID-19 tests, gym fees, cosmetics and personal grooming. • Gifts and donations: Deductions for gifts or donations made to deductible gift recipients, and the records required. • Investments, insurance and super: Deductions for investment expenses, income protection insurance, personal super contributions and foreign pensions. • Cost of managing tax affairs: Deduction for expenses to manage your tax affairs, such as lodging with a registered agent.

Box 17: The required details for a record of an expense (taken from ATO, 2023f).	
• The name or business name of the supplier. • The amount of the expense or cost of the asset. • The nature of the goods or services you buy.	• The date you buy the goods or services. • The date the document was produced.

Taxation rates

The tax rates applied to an individual's income is on a tax bracket basis as presented in Table 11.

Table 11: The 2022/23 financial year PAYG taxation rates exclusive of the Medicare levee (taken from ATO, 2022b).

Taxable income		Tax on this income	Calculated average tax rate
$0	$18,200	Nil	0.0%
$18,201	$45,000	19 cents for each $1 over $18,200	11.3%
$45,001	$120,000	$5,092 plus 32.5 cents for each $1 over $45,000	24.6%
$120,001	$180,000	$29,467 plus 37 cents for each $1 over $120,000	28.7%
$180,001 and over		$51,667 plus 45 cents for each $1 over $180,000	

Appendix E: PAYG taxation on a business

Determination of tax payable

Business taxable and assessable income

The Federal Government provides the following guide to business income tax (Business, 2023a). The amount of income tax a business must pay, depends on a business's taxable income; this is the assessable income less any deductions. In general, most income received from carrying on a business is assessable for income tax purposes (ATO, 2021a, p.1). A business's assessable income is dependent on the business structure and the ATO provides broad guidance of the type of income to be reported (see Box 18). It excludes GST payable on sales made, or GST credits on expenses incurred. In support, the ATO requires that a business undertakes the range of activities listed in Box 19.

Box 18: The elements of assessable income from an ATO perspective (taken from ATO, 2023g).	
• Business's assessable income • Cash and cash equivalent income • Non-cash income and barter transactions • Cryptocurrencies • Commissions, investment earnings, gratuities and compensation payments • Income not part of everyday business activities • Government payments	• Capital gains and losses • Income from online activities • Income from the sharing economy • Income from crowdfunding • Personal services income • Foreign income • Other information

Box 19: The ATO's requirements for addressing income and deductions for business (taken from ATO, 2023h).
1. Keep accurate and complete records of your assessable income and expenses. 2. Use the correct method for calculating and reconciling the amounts you claim. 3. Report all income and deductions to us at the right time. 4. Pay any amounts owed on time.

Eligible deductions

The ATO provides directions on the treatment of business related expenses (ATO, 2023i). Expenses directly related to carrying on a business *'directly related to earning your assessable income'* can be claimed as tax deductions. The ATO provides three golden rules of acceptable deductions (see Box 20) with a recurrent theme of appropriate record keeping. The quantity and timing of claiming a deduction depends on the type of expense (e.g. certain

capital expenditures are deductible over time) and any private or domestic purpose use which will reduce the deduction. Deduction for the cost of capital assets (e.g. land a business premises is on) are addressed under the CGT rules; there are exceptions *'for capital works, plant and certain expenditure of primary producers on improvements to land'*. The general rules applied are presented in Box 21.

Box 20: The ATO's three golden rules for valid business deductions and assessable income (taken from ATO, 2023i).
1. The expense must have been for your business, available as an allowable deduction and not for private use. 2. If the expense is for a mix of business and private use, you can only claim the portion that is used for your business. 3. You must have records to prove it.

Box 21: The treatment of business expenses as allowed and not allowed deductions by the ATO (ATO, 2023i).	
Business expenses deductions potentially able to be claimed.	Examples of expenses that are not deductible.
• Day-to-day operating expenses. • Purchases of products or services for your business. • Certain capital expenses, such as the cost of depreciating assets like machinery and equipment used in your business.	• Entertainment expenses, other than those you provide as a fringe benefit traffic fines. • Private or domestic expenses (e.g. childcare fees or clothes for your family). • Expenses relating to earning income that is not an assessable income. • Payments which have not met PAYG withholding or reporting obligations (non-compliant payments). • The GST component of a purchase claimable as a GST credit reported in a business activity statement.

Standard taxation treatment of a company

The ATO applies a full company tax rate of 30% to all companies not eligible for the lower company tax rate (ATO, 2022h). A small business may get small business tax concessions from the ATO (Business, 2023a). The ATO allows a small business (sole traders, partnerships, companies or trusts) a range of concessions (e.g. including payment and reporting options). Qualification for such treatment is dependent on an assessment each income year (ATO, 2021a). A small business is a sole trader, partnership, company or trust with the following attributes (as of 1 July 2016; ATO, 2021c).

- Operations: Operates a business for all or part of the income year, and;
- Turnover threshold: With a turnover of less than $10 million in that income year. The following are excluded.

- The small-business income tax offset (a $5 million turnover threshold).
- The CGT concessions (a $2 million turnover threshold).

The company tax rate for base rate entities is 25% from the 2021–22 income year for a company with both the following attributes (ATO, 2021a).

- Turnover: An aggregated turnover less than the aggregated turnover threshold of $50 million for the 2018–19 to 2021–22 income years.
- Income type: The assessable income is 80% or less is base rate entity passive income (e.g. interest, dividends, rent, royalties and net capital gain) which replaces the requirement to be carrying on a business.

Appendix F: Non-commercial business losses

Attributes

A non-commercial business loss is where expenses are in excess of revenue for a given financial year for a sole trader or partnership *'from a business activity that is not related to your primary source of income'* and could *'be a hobby or lifestyle benefit'*. Regardless of business-like attributes, *'if it is unlikely to ever make a profit and doesn't have a significant commercial purpose or character, you can't offset this non-commercial business loss against your other income'*. The loss is deferred until the business activity makes a profit depending on *'the operation of the non-commercial loss measures in that year'* (ATO, 2022e, p.1).

The exceptions rule

There are excepted activities which can offset non-commercial business losses against other commercial activity income. These include (ATO, 2018d) a professional arts business as an author (of a literary, dramatic, musical or artistic work), a performing artist or a production associate. A primary producer is an excepted activity and can claim *'primary production losses immediately against other income'* provided that the both following conditions are satisfied (ATO, 2022b, p.8).

- A primary producer is *'a sole trader or a partner in a partnership'* (e.g. not an entity).
- A primary producer's *'assessable income from other sources is less than $40,000, excluding any net capital gain'*.

It is noted that *'this is an exception to the non-commercial business loss measures, which generally don't allow businesses to claim deductions for losses incurred in activities that are not commercially successful'* (ATO, 2022b, p.8).

A combined assessment of eligibility

A sole trader can test their circumstance against the non-commercial loss rules to assess whether a loss can be offset or must be deferred (ATO, 2022e, p.2&3); see Box 22. A member of a partnership can test their circumstance against specific non-commercial loss rules to assess whether a loss can be offset or needs to be deferred (ATO, 2018a, p.1 to 4) (Box 23).

Box 22: The test for the ability of a sole trader to be exempted from the non-commercial business loss requirements (ATO, 2018a, p.1 to 4, combined with ATO, 2022e, p.8).

- Are you in business? To allow a claim of a loss, your activity must be 'in business' which has commenced activity.
- Similar business activities: If carrying on more than one business activity and they are similar, they can be grouped together when considering the non-commercial loss rules.
- Excepted activity: If your loss-making business is an 'excepted business activities' (primary production or in professional arts) with an assessable income from other sources is less than $40,000 (excluding any net capital gain), you can offset your losses from you're the other income.
- Less than $250,000 income requirement: The sum of your taxable income, reportable fringe benefits, reportable super contributions and total net investment losses must less than $250,000 to be eligible to offset losses in the current year.
- Four tests: Combined with the income threshold, a party must pass one of the four tests.
  1. *Your business produced assessable income of at least $20,000*
  2. *Your business has produced a profit in three of the past five years (including the current year)*
  3. *Your business uses real property or an interest in real property worth at least $500,000 on a continuing basis*
  4. *Your business uses other assets worth at least $100,000 on a continuing basis.*
- Commissioner's discretion: As a result of a failure to meet the income requirement or any of the four tests, a party can apply for the Commissioner's discretion to allow the claim.

Box 23: The test for an ability of a member of a partnership to offset their share of the partnership losses (ATO, 2018a, p.1 to 4).

If you are a partner in a partnership, you – as an individual – may offset your share of a partnership loss against your other income, subject to the non-commercial loss rules.

- Income requirement: The non-commercial losses income requirements are applied to the individual partners the same as for an individual. The sum of taxable income, reportable fringe benefits, reportable super contributions and total net investment losses must less than $250,000 to be eligible to offset losses in the current year.
- Assessable income test: The assessable income of the whole partnership must be at least $20,000 before the individual members can deduct losses. Where an individual member earns assessable income from the business activity external to the partnership, that assessable income can only be taken into account by that member.
- Profits test: A party meets the income requirement claiming a loss for a business activity in a partnership, a claim if activity income has been greater than tax deductions for at least three out of the past five years (including the current year). Income and deductions must consider both your income from the partnership and any the individual partner's income have earned in your own right from that activity.
- Real property test: As a member of a partnership, the value of the real property used in the whole partnership must be at least $500,000 before an individual members can deduct losses. This excludes all other assets associated with the partnership members beyond the partnership (e.g. exclude the value of any other assets attributable to companies or trusts beyond the partnership). This is subject to other tests.
- Other assets test: As a member of a partnership, the value of the other assets of the whole partnership must be at least $100,000 before an individual members can deduct losses. This excludes all other assets associated with the partnership members beyond the partnership (e.g. exclude the value of any other assets attributable to companies or trusts beyond the partnership). This is subject to other tests.

Appendix G: Superannuation and taxation

Superannuation; the nature of fund options

Superannuation is money saved for retirement (ATO, 2023a) and is a long-term investment expected to grow over time. There are two types of superannuation funds and the ATO provides a comparative table (ATO, 2022i). The first type is a fund professionally managed on behalf of usually an unlimited number of members and the second is a SMSF. The structure of a new SMSF entity since on or after 1 July 2006 is as an accumulation fund, with defined benefit funds only available for funds established before 1 July 2006 (ATO, 2022j). A SMSF can have a maximum of 6 members. In a SMSF, the trustees develop and implement the fund's investment strategy and make all investment decisions. With non-SMSF funds, most allow some control over the mix and risk level of an individual's super investments, but an individual generally can't choose the specific assets invested in (ATO, 2022i). Self-managed super funds pay a supervisory annual levy of $259 to the ATO (ATO, 2023k; ATO, 2023l).

The three phases of a superannuation fund

A superannuation fund has three phases of operation; accumulation, transition to retirement and retirement or pension phases (Box 24). When all interests in a SMSF are in retirement-phase income streams (i.e. with no accumulation accounts or transition to retirement income streams being paid), the fund's assets are held 'solely' to support retirement-phase income streams. This is defined as the '100% in retirement phase'. If a fund in such a state receives contributions or a rollover in an accumulation interest, the fund ceases to be 100% in retirement phase (ATO, 2022k).

Contributions into a superannuation fund

Preserved benefits

Since 30 June 1999, all contributions to a SMSF made by or on behalf of a member, and all earnings, are preserved benefits. Preserved benefits may be cashed voluntarily only if a condition of release is met and subject to any cashing restrictions imposed as part of the condition of release (ATO, 2023l).

Box 24: Timing and timing over the life of a SMSF.		
Phase	Narrative	Reference
Accumulation phase	The period during which a superannuation interest is not in the retirement phase.	Taken from ATO (2023a)
Transition to retirement	A 'transition to retirement' strategy lets you access some of your super and keep working.	Moneysmart (2023).
Transition to retirement income stream (TRIS)	Effective 1 July 2017, the government removed the tax-exempt status of earnings from assets that support a TRIS that is not in the retirement phase. Earnings from assets supporting a non-retirement phase TRIS will be taxed at 15% regardless of the date the TRIS commenced. Members will also no longer be able to treat super income stream payments as lump sums for taxation purposes. Where a member has reached age 65 or has met another nil cashing restriction condition of release and notified the fund, the TRIS will move into retirement phase and the fund will receive the earnings tax exemption.	Taken from ATO (2023a)
Retirement phase	The period during which a superannuation income stream is currently payable, or, if it is a deferred superannuation income stream, when a person has met a relevant nil condition of release. An earnings tax exemption applies to a superannuation income stream in the retirement phase.	Taken from ATO (2023a)

Concessional contributions

Concessional contributions are contributions made into a super fund before tax and are taxed at 15% on entry to a super fund (ATO, 2023a). Concessional contributions are employer contributions (including contributions made under a salary sacrifice arrangement) and personal contributions claimed as a tax deduction (Box 25). The current annual cap is $27,500 for all ages (ATO, 2023m). Where eligible for super guarantee (SG) contributions, an employer must pay the minimum contribution based on the current super guarantee rate (see Table 12) of the employee's ordinary time earnings (up to the maximum contribution base) into their super account at least four times a year (ATO, 2023n). The ATO defines ordinary time earnings as *'generally earnt for ordinary hours of work; over-award payments, commissions, allowances, bonuses and paid leave'* (ATO, 2021e). Salary sacrifice is a mechanism to increase contributions to a superannuation account (ATO, 2019d). It is an arrangement with an employer to forego part of an individual's salary or wages in return for the employer providing benefits of a similar value. An important point is that a salary sacrifice agreement does not impact the ordinary time earnings used to calculate super guarantee entitlement nor does it count towards the super guarantee contributions an employer is required to make (ATO, 2019d). Therefore, salary sacrificed super contributions are classified as employer super contributions and are taxed in the super fund at a maximum rate of 15% (ATO, 2022l).

Box 25: The ATO definition of concessional contributions (taken from ATO, 2023a).
Concessional contributions are contributions that are made into your super fund before tax. They are taxed at a rate of 15% in your super fund. Concessional contributions include: • employer contributions • personal contributions you are allowed as an income tax deduction • notional taxed contributions if you are a member of a defined benefit fund (including constitutionally protected funds for 2017–18 onwards) • unfunded defined benefit contributions • some amounts allocated from a fund reserve • certain family and friend contributions (unless you are under 18 years of age).

Table 12: The current and immediate future superannuation guarantee rate (taken from ATO, 2023n)

1 July 2022 – 30 June 2023	10.5%
1 July 2023 – 30 June 2024	11.0%
1 July 2024 – 30 June 2025	11.5%
1 July 2025 – 30 June 2026	12.0%

Non-concessional contributions

Non-concessional contributions include personal contributions where no income tax deduction is claimed for the contribution, and excess concessional contributions for a financial year; they are from after tax income and are not taxed in a super fund (ATO, 2023a). Such non-concessional contributions do not include super co-contributions, structured settlements or orders for personal injury, or CGT related payments where a *'member has validly elected to exclude from their non-concessional contributions'* (ATO, 2022l). The current non-concessional contributions cap is $110,000. Members of a fund who are under 75 years of age may be able to make non-concessional contributions of up to 3 times the annual non-concessional contributions cap in a single year (see Table 13). If an individual's non-concessional contributions exceed the cap, a tax of 47% is levied on the excess contributions with the individual member being personally liable for this tax with the super fund releasing an amount of money equal to the tax liability (ATO, 2022l). Mechanisms to make personal contributions include a downsizing contribution associated with selling the place of residence (home) once 65 year of age or older (ATO, 2021c).

Table 13: A summary of the contributions and bring it forward mechanisms for individuals under 75 years of age (taken from ATO, 2022l).

Superannuation balance as at 30 June of prior financial year	Contribution and bring-forward available
Less than $1.48 million	Access to $330,000 cap (over 3 years)
Greater than or equal to $1.48 million and less than $1.59 million	Access to $220,000 cap (over 2 years)
Greater than or equal to $1.59 million and less than $1.7 million	Access to $110,000 cap (no bring-forward period, general non-concessional contributions cap applies)
Greater than or equal to $1.7 million	Nil

Non-cash contributions

A transfer of assets into a SMSF is an option as controlled by regulation and legislation; therefore it is possible to transfer land into a SMSF. While a usual contribution to a SMSF is via cash, it is possible to make an '*in specie*' (asset) contribution in the form of a non-monetary asset (ATO, 2022m, p.32). In general, it is not allowed to *'intentionally acquire assets (including in specie contributions) from related parties'* of a fund. There are exceptions including listed shares and other securities, and business real property (ATO, 2022m, p.32). A transfer of an *in specie* asset is deemed to have been sold by the party contributing, triggering a CGT event. A further requirement is that a SMSFs must transact on an arm's-length basis, hence the purchase and sale price of fund assets must reflect the true market value of the asset, and the income from assets held should always reflect the true market rate of return. Any non-arm's length income (NALI) is taxed at the highest marginal rate (ATO, 2021f).

It is possible to transfer business real property under the in-house asset and related party acquisition rules. '*Business real property generally means land and buildings used wholly and exclusively in a business'* (ATO, 2022n). Business real property can include real property used in a primary production business (e.g. a farm) and can meet the test of being used wholly and exclusively in a business even if it contains a dwelling used for private or domestic purposes. A compliant *'dwelling must be in an area of land no more than two hectares and the main use of the whole property can't be for domestic or private purposes'*. The level of investment in business real property must comply with a fund's investment strategy, *'including diversification of assets, liquidity and maximisation of member returns in your fund'* (ATO, 2022n). The treatment of planted trees is a specific issue. The treatment of planted trees as part of a land asset (real property) depends on the nature of the trees. There are two types of crops; *fructus naturales* or *fructus industriales* (ATO, 2009). To be

considered as part of the land, a tree crop must be *fructus naturales* (ATO, 2009, s.82 to 84) (see Box 13). Trees planted for timber production are regarded as *fructus naturales*.

Payment of benefits

A SMSF can pay benefits in the form of a lump sum, an income stream (pension) or a combination of both, if compliant with super law and the fund's trust deed (ATO, 2020a).

An income stream

A SMSF can pay benefits to a member as an income stream (pension) if the member has met one of the conditions of release. A super income stream is a series of regular payments; paid weekly, fortnightly, monthly, quarterly or annually (ATO, 2021g). There is a maximum annual payment limit of 10% of the account balance. These income streams can only be commuted to a lump sum in limited circumstances (ATO, 2021g). The taxation treatment of withdrawals from a super account depends on the taxation status of the fund and an individual's preservation age relative to the age at payment. The preservation age is the minimum age a super fund member may be able to access their preserved benefits; preservation age varies depending on when you were born (ATO, 2023a). A super income stream may have two components (a taxable and tax-free component). The taxable component includes the untaxed element (untaxed in the fund) and/or taxed element (taxed in the fund). The 'no-tax file number' withholding rate is not applied to the tax-free component, or taxed element of a capped defined benefit income stream, if the payee is 60 years old or over and the total of the amounts is below their defined benefit income cap and the taxed element of an account-based super income stream (ATO, 2021h). In short, the 'tax-free component' of a super account is tax-free when withdrawn and the 'taxable component' is taxable when withdrawn, at a rate of 15% (ATO, 2020a, ATO, 2021i).

Lump-sum treatment

A super lump-sum payment includes payment to an individual where a condition of release has been satisfied (e.g. retirement, terminal medical condition, severe financial hardship, compassionate grounds), a lump-sum death benefit paid to an individual following the death of the member or account holder, or commutation of a super income stream either part or all for a lump-sum (ATO, 2021b). The taxation treatment of a super lump sum is presented in Table 14 with the age of the member as a determinant of treatment.

Table 14: The withholding tax rates for super lump sums (ATO, 2020b, Table A)

Type of payment and tax component	Age of person at the date the payment is received	Amount subject to PAYG withholding	Rate of withholding
Member benefit – taxed element of the taxable component	Under preservation age	Whole amount	22%
	Preservation age to 59 years	Amount up to low rate cap	None
		Amount above the low rate cap	17%
Member benefit – untaxed element of the taxable component	Under preservation age	Amount up to untaxed plan cap	32%
		Amount above untaxed plan cap	47%
	Preservation age to 59 years	Amount up to low rate cap	17%
		Amount above the low rate cap up to the untaxed plan cap	32%
		Amount above untaxed plan cap	47%
	60 years and above	Amount up to untaxed plan cap	17%
		Amount above untaxed plan cap	47%
Member benefit: total of preserved benefits is less than $200	Any age	None – amount is non-assessable, non-exempt income	n/a
Member benefit: terminal medical condition payment	Any age	None – amount is non-assessable, non-exempt income	n/a
Death benefit paid to a dependant: taxed and untaxed elements of the taxable component	Any age	None – amount is non-assessable, non-exempt income	n/a
Death benefit paid to a non-dependant: taxed element of the taxable component	Any age	Whole amount	17%
Death benefit paid to a non-dependant: untaxed element of the taxable component	Any age	Whole amount	32%
Death benefit paid to the trustee of the deceased estate	Any age	None	None

The accumulation phase of a superannuation fund

The assessable income of a 'complying fund' SMSF is generally taxed at a concessional rate of 15% and for a non-complying fund, the taxation rate is the highest rate (ATO, 2015a; ATO, 2015b). The most common types of assessable income for complying SMSFs are assessable contributions, net capital gains, interest, dividends and rent. Assessable contributions include employer contributions (including salary sacrifice contributions) and personal contributions notified as intended to claim as a tax deduction (ATO, 2015b). A complying SMSF can deduct any losses or outgoings incurred in gaining or producing assessable income or incurred in carrying on a business for the purpose of gaining or producing such income. An exception is where losses and outgoings relate to an exempt

current pension income; they are generally not deductible as they are incurred in earning exempt income (ATO, 2015c).

Retirement income (pension) phase

Exempt current pension income (ECPI) is the ordinary and statutory income a small superannuation fund earns from assets held to support retirement-phase income streams and is exempt from income tax (ATO, 2023p). The ATO defines ordinary income as income according to ordinary concepts and is the amounts that everyone would consider to be income (ATO, 2023a). Statutory income is defined by the ATO as income that is not ordinary income and included in a fund’s assessable income under specific tax law (e.g. net capital gains) (ATO, 2023a). The ECPI is claimed in a SMSF’s annual return based on all of a fund's assets valued at current market value (ATO, 2023p). From 1 July 2017 income from assets supporting a transition to retirement income streams (TRIS) are not ECPI. This applies to all TRIS regardless of the date the TRIS started (ATO, 2023p).

Operating standards, investment restrictions and other rules and regulations that apply to SMSFs in the accumulation or growth phase, continue to apply when members begin receiving a pension from a SMSF (ATO, 2023p). Assets of a complying fund are defined as current pension assets supporting retirement-phase income streams and the sole purpose of these assets is to pay retirement-phase income streams (ATO, 2022k). To identify the assets, there are two methods for calculating the amount of ECPI a fund can claim. The first is the segregated method where the assets are segregated as to whether they are current pension assets supporting retirement-phase income streams or not. The second is the proportionate method where a fund allocates a proportion of the assets held into, current pension assets or not. Assets that are not supporting retirement-phase income streams are those the fund holds in accumulation phase (ATO, 2022k).

Losses and outgoings relating to ECIP are generally not deductible; they are incurred earning an exempt income. With both accumulation and pension members, expense may need to be apportioned to determine the amount that the fund can deduct; that is, deductions pertinent to the accumulation phase income (ATO, 2015a). Remaining tax losses can be offset against assessable income of the SMSF until the assessable income is reduced to zero when any further losses are carried forward to the next financial year (ATO, 2022o).

There is different treatment of capital gains and capital losses under the segregated assets and proportionate methods used to calculate ECPI. With segregated current pension assets, any capital gains or capital losses resulting from the disposal of these assets is ignored

(ATO, 2022k; ATO, 2022p). A capital loss must not be offset against any other capital gain earned by a SMSF. With the proportionate method, capital gains and capital losses must be addressed. A net capital loss, can be carried forward each year until offset against an assessable capital gain. A capital gain less any capital losses is the net capital gain which is added to the SMSF's assessable income prior to determining how much of income is tax exempt, as per the actuarial calculation for the relevant year (ATO, 2022p).

Appendix H: Trusts

What is a trust?

A trust is a structure within which assets can be owned and managed, and financial activities undertaken. A trust is a legal term and a relationship but not a legal entity; trusts are treated as taxpayer entities for the purposes of tax administration (ATO, 2019f, p.1). *'A trust exists when a person (a trustee) holds property as its nominal owner for the good of one or more beneficiaries'* (ATO, 2023a). It is an *'obligation imposed on a person or other entity to hold property for the benefit of beneficiaries'* (ATO, 2019f, p.1). A trust deed creates a trust and defines its rules, powers and discretions (Wolfsbauer & Bobbin, 2017). A trust has a tax file number (TFN) used in lodging income tax returns and an Australian Business Number (ABN) if the trust is carrying on an enterprise (ATO, 2019f, p.8).

Parties in relation to a trust

The trustee

The trustee(s) of a trust can be a person or a company and must be legally capable of holding trust property in their own right for the benefit of the beneficiaries. If a trust is established by deed, the trustee must comply with the intentions of the settlor (the party creating the trust) and act in accordance with applicable laws (e.g. tax law). In compliance with tax law, *'the trustee is responsible for managing the trust's tax affairs, including registering the trust in the tax system, lodging trust tax returns and paying some tax liabilities'* (ATO, 2019f, p.2).

The beneficiaries

A trust is specific to the beneficiaries of that trust; *'a trust beneficiary can be a person, a company or the trustee of another trust'* (ATO, 2019f, p.2). Entitlement to trust income or capital is set-out in the trust deed or can be acquired when a trustee exercises a discretion to pay a beneficiary income or capital (ATO, 2019f, p.2) if this is an option.

A discretionary trust

Operation of a discretionary trust

A discretionary trust operates by the trustee having the discretion to nominate the beneficiaries to benefit each financial year and the amount that they will receive from the trust. The ATO classifies discretionary trusts based on the main income sources; from service and/or management activities, from trading activities or from investment activities (ATO, 2019g).

Advantages of a discretionary trust

There are three advantages of a trust structure; asset preservation, income tax distribution and the ability to be flexible to achieve family succession as part of estate planning (Wolfsbauer & Bobbin, 2017). Asset preservation occurs as a discretionary trust separates ownership from control; ownership by the trustee for the beneficiaries' benefits quarantine assets from any claims against that beneficiary (person). A discretionary trust enables flexibility for income distribution among beneficiaries, potentially with decisions specific to individual circumstances. For example, taking into account the taxation rates that are applicable to individuals in that financial year. The way a trustee distributes income can be changed from year to year to reflect change in circumstances of the beneficiaries (Wolfsbauer & Bobbin, 2017), within the limits of the trust deed.

Direction of benefits

Beyond the discretion of the trustee of a discretionary trust, it is possible to make specific allocations. A beneficiary is *'absolutely entitled to an asset of a trust if they have a vested and indefeasible interest in the entire trust asset'* (ATO, 2019f, p.6). When such occurs, they can *'direct the trustee to immediately transfer the asset to themselves or to someone else'* (ATO, 2019f, p.6). Under such conditions the asset involved is treated for CGT purposes as if it is owned directly by the beneficiary (and not the trustee) and any actions taken by the trustee are taken to have been undertaken by the beneficiary directly. Where a CGT event occurs, any capital gain or loss will be made directly by the beneficiary and not form part of the trust's net income (ATO, 2019f, p.6). Another mechanism to direct capital gains to a specific beneficiary is by making them specifically entitled to the gain. This is possible even if a beneficiary does not have an entitlement to trust income. A specifically entitled beneficiary's capital gain is taken into account in determining their net capital gain for that financial year by including any discounts or concessions to which they are entitled (ATO, 2019f, p.6).

Family trusts

A family trust is a specific arrangement, after the trustee has made a valid family trust election (FTE); this is beyond a claim of simply including the words 'family trust' in a trust's name (ATO, 2021j, p.1). A key attribute is to define the family group, as the trust must be controlled by a 'family group' (ATO, 2019f, p.11). A point of caution is to ensure that the parties captured as part of the family group are intended to be beneficiaries of a trust. Any benefits beyond the family would attract a family trust distribution tax (FTDT) (ATO, 2019f, p.11). Any FTDT payable by a trustee is at the highest marginal rate plus the Medicare levy. Where a beneficiary received distributions on which FTDT has been paid, they receive the distribution as non-assessable, non-exempt income (ATO, 2019f, p.11).

Trust assets

Assets into a trust

Money and real property can form part of a trust's assets. There are two mechanisms to allocate money into a trust; by gifting the funds or by establishing a repayable loan to the trust as either a defined or non-defined arrangement (Gartley, 2022). For real property, the first option is transferring the property title as 'a gift' to the trustee by implementation of a 'gift deed' to establish that ownership of the property is being transferred without payment. The second option is to sell a property to a trust via a contract of sale either at or below market value. A transfer of assets into a trust can trigger a CGT event and generates a stamp duty liability. It is important to note that the CGT liability to the seller will be based on the market value price (Property Tax Specialists, 2023).

Land and state land taxes

Land can be held in a discretionary trust and land taxation treatment depends on the date of acquisition and land-use, under State-specific thresholds and rules applying to the trust (Raiss, 2022). For example, in South Australia, an exemption may apply to land used for the business of primary production subject to all relevant criteria being complied with (RevenueSA, 2023).

Taxation treatment of a trust

Treatment of income and losses

The mechanisms in a trust deed determines the trust's income, with the net income determined by tax law; the two amounts can be different. The net income of a trust is its assessable (taxable) income for a financial year less allowable deductions assuming the

trustee is a resident (ATO, 2019f, p.3). Net losses made by a trust in a financial year are not distributed to beneficiaries, but rather can be carried forward to offset net income in a later year (ATO, 2019f, p.4). A beneficiary can receive income from a trust's net income at a set percentage with a proportionate approach, unless with a discretionary trust where the trustee can make such decisions.

Basis of taxation

A trust is not liable to pay PAYG instalments, but rather the beneficiaries (or the trustee when assessed on their behalf) are liable based on their share of the trust's instalment income (ATO, 2019f, p.7&8). The beneficiaries of a trust include their share of the trust's net income in the partnership/trust distributions section of their individual tax returns (ATO, 2019f, p.8). This is regardless of when or whether the income is actually received (ATO, 2019f, p.2); for example where a capital gain is due a change in value and not a transaction.

Where the trustee is liable for tax, an income tax assessment will be issued to the trustee, separate to their own assessment as an individual or corporate tax entity (ATO, 2019f, p.8). Special rules exist for some types of trust (e.g. family trusts, deceased estates and super funds) (ATO, 2019f, p.1). The trustee is (generally) taxed on the trust income at the highest marginal rate applicable to individuals with some trust-type specific exceptions (e.g. deceased estates) which are taxed at modified individual rates (ATO, 2019f, p.4). Where a trust has paid tax on the trust net income, the distributions are franked distributions (tax has already been paid).

Specific rules apply to franked distributions and capital gains included in the trust's net income (ATO, 2019f, p.3). Subject to the trust deed, a beneficiary may be entitled to a franked distribution; this results in the beneficiary being taxed on the franked distribution. With a discretionary trust, this allows the franked distributions to be streamed to specific beneficiaries for tax purposes. Where no beneficiary is specifically entitled, the franked distribution is distributed to each beneficiary proportionately based on their entitlement to the trust income (ATO, 2019f, p.4). These beneficiaries pay tax on their share of the trust's net income at their individual and applicable tax rates (ATO, 2019f, p.4). Adult and company beneficiaries can claim a credit for the tax paid on their behalf by the trustee (ATO, 2019f, p.4).

Capital gains taxation treatment

With the sale of a trust asset, a capital gain or loss event occurs. Such gains or losses are included in determining the trust's net capital gain position for a financial year. A net capital

gain is treated as income reported in the trust's net income and a net capital loss is carried forward to offset future capital gains. Any net capital gain is allocated proportionately to the beneficiaries based on their entitlements, provided that no beneficiaries are specifically entitled to the capital gain, or the trustee elects to be taxed on a capital gain. Where a trustee is taxed on trust net income (at the top marginal rate), they are not entitled to the CGT discount on the gain (ATO, 2019f, p.5). Where the capital gains are distributed to natural person beneficiaries, the 50% CGT concession treatment is possible (Wolfsbauer & Bobbin, 2017).

Primary production trusts and beneficiaries

A trust can be a primary producer (ATO, 2022a, p.1). A beneficiary of a primary production trust is in the business of primary production where the beneficiary is nominated by the trustee as a chosen beneficiary or is the beneficiary of a fixed trust (ATO, 2022a, p.3). (A fixed trust is a form of trust used for estate planning). With a discretionary trust, the beneficiary must be a compliant choice by the trustee. The choice must be in writing, signed by the trustee and the beneficiary, and be retained as a record of the choice. The choice must be completed by the time the trust return is lodged. The choice cannot be varied and is irrevocable. For other trusts, a beneficiary is carrying on a primary production business if they are currently entitled to income if the trust had income for a year (ATO, 2021k, p.1 & 2). As a primary producer, a beneficiary can make use of primary producer income averaging and FMD provisions (ATO, 2021k, p.1). The beneficiary status as a primary producer may remain the case where the primary production trust has made a loss (ATO, 2022a, p.3). Where a trust has no trust income for which a beneficiary can be presently entitled, the beneficiary can still be carrying on a primary production business (ATO, 2021k, p.1 & 2).

Appendix I: Taxation treatment of trees as a crop

Certainty via a private ruling

Any discussion or information in regard to taxation and superannuation must include a specific and overarching statement of it just depends on the circumstance. Each situation is different and specific, and the ATO has a mechanism to seek a private ruling. *A 'private ruling is binding advice that sets out how a tax law applies to you in relation to a specific scheme or circumstance'* (ATO, 2018b). Further, a private ruling legally binds the ATO if it applies to a party and they rely on it (ATO, 2018b).

The plantation intent and tree growing business

Plantation intent

In carrying on a business of tree farming as a primary producer, a grower *'may be entitled to primary production concessions'* including FMDs and primary production averaging for the income made from tree farming activities (ATO, 2022b, p.1). To be carrying on a tree farming business, there must be an intent to harvest the trees to sell the logs to generate a profit. Activities must be organised and run in a business-like way (e.g. a grower actively maintains the trees, ATO, 2022b, p.1). To support assessment and proof of carrying out a business, the ATO provides a series of tests as presented in Box 5. The first consideration is whether a tree farming operation is a forest operation (see Box 26). A key element is the intended outcome of the tree planting; for harvest or not for harvest. Where planted trees are destined for harvest, then a range of taxation treatments are potentially triggered.

Management activities of trees planted with the intent to harvest are regarded as part of forest operations and included an objective to improve the growth of the trees (Box 27). Trees planted for amenity and/or shelter without the intent to harvest are not regarded as forest operations. It is important to note that trees planted as part of forest operations can also provide amenity and shelter while being destined for harvest. To assist with proof of this test, the following could be undertaken.

- A plan: Develop a business and management plans for the planted trees with a clear statement of the intent to harvest.
- Species: Planting of commercial species with active local markets coveys an intent to harvest.

Box 26: Requirements for a tree farming activity to be regarded as a primary production forest operation (taken from ATO, 2010a, s.4&5).

Forest operations as primary production

4. A taxpayer who is engaged in 'forest operations' is a primary producer for income tax purposes if those forestry activities constitute the carrying on of a business.

5. The definition of the term 'primary production' in subsection 6(1) of the Income Tax Assessment Act 1936 (the Act) includes 'forest operations'. The term 'forest operations' is defined in subsection 6(1) as:

- 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 (including processing for the production of posts, poles or railway sleepers) or to a place from which they are to be transported to such a place;

where

- the operations are carried on in the course of, or for the purposes of, a business.

Box 27: The treatment of plantation establishment and management activities (taken from ATO, 2010a, s.6 to 8).

Planting or tending of trees

6. The planting or tending of trees in a plantation or forest qualifies as forest operations if the trees planted or tended are intended for felling. The planting or tending of trees other than in a plantation or forest does not qualify as forest operations. The planting or tending of trees is also not forest operations if they are intended solely for decorative purposes or to provide shelter, irrespective of where they are grown.

7. The definition of 'tend' in the Macquarie Dictionary includes 'to look after; watch over and care for...'. Therefore, tending of trees in a plantation or forest includes the maintenance of the trees and activities to improve the growth of the trees.

8. A person who receives royalties under a right to fell or remove trees on land owned by that person is not regarded as conducting forest operations if the trees were not planted or tended for the purpose of felling.

A forest operation by carrying on a business

A forestry operation in relation to plantations must be carrying on a business as defined by the ATO (see Box 5). To support a grower's intent, Box 28 presents elements of the test of carrying on a business. There is specific recognition of carrying on a business where a grower received a reafforestation grant (e.g. from a government agency) with a caveat that each situation would be addressed on a case by case basis (Box 29).

Box 28: The framework for developing a plantation and the requirement to be 'carrying on a business' (taken from ATO, 2010a, s.14, 15, 86, 87, 88 & 89).
<u>Carrying on a business</u> 14. The planting, tending or felling of trees will only be forest operations if those operations amount to the carrying on of a business. A person who plants, tends or fells trees but is not carrying on a business is not conducting forest operations. This is so even though the person may be conducting another form of primary production business. Similarly, a person who merely sells standing timber without tending or felling those trees is not conducting forest operations. 15. The question of whether a taxpayer's activities amount to the carrying on of a business depend on the facts of each particular case. Activities that have a commercial or profit making purpose and are organised in a business-like way will generally amount to carrying on a business. Guidelines for determining if a taxpayer is carrying on a business are set out in paragraphs 86 to 89. 86. One of the tests which must be satisfied for forest activities to be forest operations is that the operations carried on by the taxpayer are carried on in the course of, or for the purpose of, a business. The term 'business' is defined broadly in subsection 6(1) to include any profession, trade, employment or vocation. However, whether or not the activities of a taxpayer amount to the carrying on of a business is a question of fact and degree to be decided on the facts of each case. 87. In determining whether particular activities constitute the carrying on of a business, courts and tribunals have considered the following elements to be relevant: (i) whether the activities have a significant commercial purpose (Thomas v. FC of T 72 ATC 4094; (1972) 3 ATR 165); (ii) the scale of the activities (a person may carry on a business even though they do so in a small way) (Thomas (supra)); (iii) the nature of the activities, particularly whether they have the purpose of profit making (however, profit making in a particular year is not essential) (Ferguson v. FC of T (1979) 37 FLR 310; 79 ATC 4261; (1979) 9 ATR 873); (iv) repetition and regularity of the activities (Ferguson (supra)); (v) whether the activities are organised in a business-like manner (Ferguson (supra)); (vi) volume of the operations and the amount of the capital employed (Ferguson (supra)); (vii) whether the activities may properly be described as the pursuit of a hobby or recreation (Ferguson (supra)); (viii) the degree of control held by the person over the development and maintenance of the land (Case L1 79 ATC 1; (1979) Case 8 23 CTBR (NS). 88. A person who plants, tends or fells trees but is not carrying on a business in these activities, is not conducting forest operations. This is so even though the person may be conducting another form of primary production business. For example, a farmer may plant and tend trees solely to provide shelter belts for stock. This will be part of the farming operations and will not amount to a separate business of forest operations. 89. As to whether a person who has invested in an afforestation scheme is carrying on a business, refer to Taxation Ruling IT 360.

Box 29: A specific case of carrying on a business (taken from ATO, 2010a, s.90).
<u>Reafforestation grant or payment</u> 90. Although it depends on the facts of each case, as a general rule, if a person receives a reafforestation grant or payment, they are taken to be carrying on a business of forest operations: Ashgrove's case.

A change of purpose and intent with the purchase of trees as a going concern

While an initial intent of purchase of land and trees could be for non-timber benefits (e.g. shade and shelter) it is possible that trees could be regarded as fit-for-purpose for recovery of wood products. With such a change of intent, taxation treatment can vary accordingly (Box 30). Where such trees are harvested, the net assessable income can be reduced by the cost of the trees purchased.

Box 30: Treatment of a change of purpose and intent of trees to being part of forest operations (ATO, 2010a, s.45).
Taxpayer appropriates land and trees to a new business 45. If land and the trees thereon, originally acquired and used for purposes other than forest operations, are later ventured into a business of forest operations, the net profit from the sale of the timber when felled will be assessable income of the taxpayer under subsection 25(1). In calculating the net profit, the sale proceeds are reduced by an appropriate amount based on the market value of the timber at the time the trees were ventured into the business: Gutwenger v. FC of T 95 ATC 4008 at 4023; (1995) 30 ATR 82 at 98.

Not part of a forestry business

An important distinction is made of a contractor service provider and a party undertaking a forest operation in regard to the hauling of logs as a service provider (Box 31). Where a party is engaged to transport another party's trees, the cartage contractor is not undertaking a forest operation.

Box 31: The delineation of contract service providers in regard to log haulage (taken from ATO, 2010a, s.12).
Transportation of the trees 12. A person engaged in transporting timber which has been felled by somebody else is not undertaking forest operations.

While often promoted, onsite transformation of logs into next stage products is not regarded as a part of forest operations from a tree growing perspective (Box 32). By this requirement, forest operations are limited to growing and recovery of logs for sale to another party. This is an important consideration and requires that if the intent is to part-process logs beyond logs, then such operations will require specific management and treatment as part of a grower's operations.

Box 32: A delineation of processing of logs recovered from trees grown (taken from ATO, 2010a, s.13).
13. Milling or processing activities undertaken on-site using portable machinery will not constitute forest operations. The production of posts, poles and railway sleepers and in-field chipping is regarded as milling or processing. However, milling or processing does not include the normal preparation for the removal of felled trees (e.g., the lopping of branches and heads, removal of bark or the sawing into manageable lengths).

Treatment as primary production

Forest operations are regarded as primary production (Box 33). In (if) carrying on a business of tree farming as a primary producer, a party may be entitled to primary production concessions including FMDs and primary production averaging for the income from tree farming activities (ATO, 2022b, p.1). Trees as a forest operation are defined by the intent to harvest (e.g. compared to tree for amenity). The felling of trees is defined by the ATO (see Box 34) and is specific to the production of logs. While the definition includes removal of the bark as an example, for softwood logs the bark is retained on logs at harvest, whereas the bark is generally removed for eucalypt logs. The point of sale (see Box 4) will vary but the logs are likely to require transport to a processor; defined as the mill door or mill gate. The transport of logs by or on behalf of the grower are regarded as a forest operation (Box 35).

Box 33: A forest operation is regarded as primary production (taken from ATO, 2010a, s.85).

Forest operations as primary production

85. The term 'forest operations' is defined in subsection 6(1) of the Act. The implications of being in forest operations are:

- income derived by a taxpayer in the course of carrying on a business of forest operations constitutes assessable income (subsection 25(1));
- the averaging provisions apply to this income;
- the taxpayer may be eligible for other tax concessions which apply to primary producers.

Box 34: The intent and action of felling the trees planted (taken from ATO, 2010a, s.9).

Felling of trees

9. Forest operations includes the felling of trees in a plantation or forest, even though the taxpayer concerned did not plant or tend the trees. The normal preparation for removal of felled trees (e.g., the lopping of branches and heads, the removal of bark or the sawing into manageable lengths) is to be regarded as part of the felling operations if it is carried out by the person who felled the trees (or that person's employees or contractors - see paragraphs 16 and 17).

Box 35: The treatment by the ATO of haulage of harvested logs with a clear distinction of a haulage contractor (taken from ATO, 2010a, s.10 & 11).

Transportation of the trees

10. Forest operations includes the transport of trees or parts of trees by the person who felled the trees (or that person's employees or contractors - see paragraphs 16 and 17) to the place where the first stages of milling or processing of the timber takes place. Forest operations also includes the transport by the person who felled the trees to a delivery point (e.g., a railway loading point) from which the trees are to be transported for milling or processing.

11. A person who contracts with a mill to supply timber, and who is required to cut, snig and haul the timber, in most cases will be engaged in forest operations. (Taxation Ruling IT 235).

Income from forest operations; trees harvested

Overall

To generate a profit, a forest operation must generate an income and this is not limited to the sale of logs recovered. The ATO defines assessable income beyond logs and includes cash inflows from grants, insurance payouts and selling the resulting trees standing (Box 36). Regardless of not carrying on of a business, income from the sale of standing timber and royalties received from allowing others to harvest and remove timber is treated as assessable income but not as primary production income (ATO 2022b, p.1).

Box 36: The basis of generating assessable income from sales associated with forest operations (taken from ATO, 2010a, s.18 to 19).
Assessable income from forest operations 18. Income derived by a taxpayer in the ordinary course of carrying on a business of forest operations constitutes assessable income in the year of income in which it is derived (subsection 25(1) and section 48). Receipts which constitute assessable income may include: • proceeds from the sale of felled timber; • proceeds from the sale of standing timber; • royalties received from granting rights to other persons to fell and remove timber; • insurance recoveries; • reafforestation incentive grants or payments. 19. The amount which is included in assessable income may be subject to the comments in paragraph 45 if a net profit amount is to be included.

Logs produced either sold or stockpiled; assessable income

Revenue from the sale of logs recovered from trees grown and harvested is treated as income in the financial year of harvest and sales (Box 37). A key component is the definition of the point of sale and this is usually defined by a log sales agreement (see Table 5) as to when ownership changes (which can include prior to payment). This is an important attribute to be defined by a grower. While sale of logs is an obvious point of receipt of revenue, if trees have been fallen and remain as logs at the end of a financial year, they are treated as trading stock and income (revenue) must be recorded (Box 37). A decision is required as to the basis of valuation of the logs at the plantation edge. It is a plausible scenario that a grower will contract with a party to harvest the trees and recover logs and be paid for the logs recovered. This payment is referred to as a royalty by the ATO (Box 38); other terms applied by industry are that this is a stumpage or a residual stumpage. Regardless, this is treated as assessable income regardless of the status of the grower in regard to carrying out a business of forest operations (Box 39). Profits from an isolated transaction can generate assessable income (Box 39). The term 'isolated transactions' refers to *'transactions outside*

the ordinary course of business of a taxpayer carrying on a business; and those transactions entered into by non-business taxpayers' (ATO, 1992a). There are two requirements to qualify as an isolated transaction as defined in Box 39.

Box 37: The treatment of revenues from the sale of logs harvested logs remaining in a stockpile at the end of a financial year.
Sale of felled timber (taken from ATO, 2010a, s.21) 21. Total receipts derived from the sale of felled timber by a taxpayer carrying on forest operations will generally constitute assessable income of the taxpayer in the year of income in which the timber is sold. The question of when felled timber is sold must be determined in accordance with general contract law. This is normally the date on which property in the timber passes and a debt becomes due and owing (see generally Gasparin v. FC of T 94 ATC 4280; (1994) 28 ATR 130, and the cases cited therein). Trees as trading stock and valuing the trading stock (taken from ATO, 2010a, s.52) 52. Trees form part of the land on which they grow and while standing do not constitute trading stock. Trees on hand at the end of a year of income that have been felled for the purpose of manufacture or sale in the course of carrying on a business of forest operations constitute trading stock and must be taken into account in calculating the taxpayer's taxable income (subsection 28(1)). Valuation of trading stock (taken from ATO, 2010a, s.53) 53. The taxpayer has the option of valuing felled timber that is trading stock on hand at the end of a year of income at its cost price, market value or replacement price (subsection 31(1)).

Box 38: The definition of royalties as income.
The definition of royalties as income (taken from ATO, 2022q). Royalties are generally payments made by one person for the use of rights owned by another person. They may be periodic, irregular or one-off payments. Royalties (taken from ATO, 2010a, s.26) 26. Royalties received by a taxpayer from the grant of a right to fell timber on land owned by the taxpayer are assessable income of the taxpayer (subsection 25(1)). The royalties are assessable income of the recipient even if the taxpayer granting the right is not carrying on a business of forest operations.

Box 39: The treatment of profits from an isolated transaction.
Profits from isolated transactions (taken from ATO, 2010a, s.62) 62. An isolated transaction involving forest operations may give rise to assessable income. This may occur when the taxpayer has a profit making intention or purpose and the transaction was entered into in the course of carrying on a business, or in carrying out a business operation or commercial transaction. The factors which are considered relevant in determining whether an isolated transaction amounts to a business or commercial transaction are set out in Taxation Ruling TR 92/3. A test of treatment of profits from an isolated transaction (taken from ATO, 1992a, s.6). 6. Whether a profit from an isolated transaction is income according to the ordinary concepts and usages of mankind depends very much on the circumstances of the case. However, a profit from an isolated transaction is generally income when both of the following elements are present: (a) the intention or purpose of the taxpayer in entering into the transaction was to make a profit or gain; and

(b) the transaction was entered into, and the profit was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

Other income

Where a plantation is part of carrying on the business of a forest operation and is damaged (e.g. by fire or wind) and the plantation is protected by insurance, a payout is treated as an income event. This income can be spread over five years for assessment as taxable income. While the receipt of a reafforestation grant is part of the evidence of carrying out a business (see Box 29), it is treated as part of assessable income (Box 40). The tax payable on such a grant is defined by the net-grant after the grant funds have been expensed (e.g. establishment of trees).

Box 40: The treatment of an insurance payout and grants by the ATO as income (taken from ATO, 2010a, s.27 to 29).
Insurance Recoveries 27. If trees in a plantation or forest, planted or tended in the course of carrying on a business of forest operations, are destroyed, insurance monies received for the loss of the profits or income that would have been derived from the trees constitute assessable income in the year of income in which the amount is received (paragraph 26(j)). 28. If the trees are destroyed by fire, the taxpayer may elect to have the amount of the insurance recoveries spread over five years of income (section 26B). Only amounts received under a contract or policy of insurance, or like agreement, may be spread over five years of income. This concession does not extend to amounts received as compensation or damages received for the loss of trees. Reafforestation incentive grants or payments 29. The receipt of a reafforestation grant or payment is assessable income of the recipient under subsection 25(1): Ashgrove & Ors v. FC of T (1994) 124 ALR 315 at 324; 94 ATC 4549 at 4554; (1994) 28 ATR 512 at 520 (Ashgrove's Case).

Treatment of expenditure on trees

Taxable income is the net income once allowable expenditures have been deducted. The type and nature of deductions to determine net taxable income are presented in Box 41 and non-deductable costs include investment in assets such as land (Box 42). An important consideration is that allowable deductions (expenses) are over a range of years (e.g. establishment costs are in year zero) and are not always aligned with revenues from harvest. Such operations and inputs mostly occur in the first year of a plantation. Routine establishment is likely and possible to occur over two financial years. For example, tillage of a site is usually undertaken in Q2 of a financial year, whereas planting can occur in Q4 of that financial year or Q1 of the next financial year (e.g. in July). A well-managed plantation includes management inputs to maximise tree growth and value, and are deductable expenses. Indeed undertaking activities to improve tree growth forms part of the definition of a forest operation (see Box 26). Depending on the point of sale of trees, there is likely to be harvesting of trees and haulage of logs to a mill door (see Box 4). These costs are treated as deductable expenditure in the year of harvest (Box 42).

Box 41: The type of deductions (expenses) as part of assessment of taxable income (taken from ATO, 2010a, s.30).
Allowable deductions from forest operations 30. Allowable deductions from forest operations may include: • purchase price paid to acquire a plantation or forest; • amount paid for the right to fell standing timber; • value of existing trees introduced into a new business; • costs of establishing a plantation or forest; • costs of tending a plantation or forest; • costs of felling and transporting timber, • costs of construction of an access road.

Box 42: A delineation between expenses and investment in assets (taken from ATO, 2010a, s.46 to 50).
Costs of establishing a plantation or forest (taken from ATO, 2010a, s.46 to 47) 46. Expenditure incurred in the course of establishing a plantation or forest, provided the expenditure is not of a capital nature, is an allowable deduction under subsection 51(1). 47. If a taxpayer acquires land and then plants or establishes trees, no part of the cost of the land is attributable to the trees. Accordingly, no deduction is allowable under section 124J in any year of income in which trees are felled. Costs of tending a plantation or forest (taken from ATO, 2010a, s.48) 48. Expenditure necessarily incurred in tending a plantation or forest in the course of carrying on a business of forest operations is an allowable deduction in the year of income in which it is incurred. Costs of felling and transporting timber (taken from ATO, 2010a, s.49). 49. Expenditure incurred in felling and transporting the timber is allowable in the year of income in which the expenditure is incurred.

Appendix J: Carbon sink forests

A carbon sinks forest

Trees can be planted to create carbon sink forests. A carbon sink forest is established for the primary and principal purpose of carbon sequestration; carbon sequestration is when trees take in carbon dioxide from the atmosphere for greenhouse gas abatement. A carbon sink forest can be tree seedlings grown in pots and transplanted into a site or deliberately regenerated on-site from natural seed sources (ATO, 2019a). To commence the process of making expenditure deduction claims for a carbon sink forest, a party must complete and lodge a *'Notice of establishment of trees in a carbon sink forest'* (NAT 72196). The form must be completed either when lodging a tax return or five months after the end of the income year, whichever comes first (ATO, 2019a). The details required in this notice are presented in Box 43. It is possible to acquire a carbon sink forest and information should be sought from the previous rights or interest holder to support a claim for deductions.

Box 43: Content of a *Notice of establishment of trees in a carbon sink forest* (NAT 72196) (taken from ATO, 2019a).
The completed form must include all the information we need to determine whether you are eligible to claim the deduction, including: • The Australian business number (ABN) of the business. • The latitude and longitude of a central point and boundary points of the area occupied by the trees. • A description of the shape and size of the area occupied by the trees. • The species of trees established. • The estimated number of trees per hectare. • The details of how the establishment of the trees meets the environmental and natural resource management guidelines for carbon sequestration. • The expenditure of establishing the trees.

Deductions for expenses incurred in a carbon sink forest

Claiming establishment expenses

Deductions for expenses incurred in establishing a carbon sink forest are possible (ATO, 2019c). Rather than an outright deduction in the year of establishment, deductions are claimed over a deduction period of 14 years and 105 days. From a taxation point of view, trees in a carbon sink forest are considered established when the seedlings are permanently planted in the ground. Expenditure is then claimed at a write-off rate of 7% per year over the deduction period commencing with first day of the income year in which the trees were established. If the land ceased to be used for carbon sequestration within the 14 years and 105 days period, deductions for that final year are based on the number of days when the

land was being used for carbon sequestration (ATO, 2019a). A first step in claiming deductions is proof of eligibility (see Box 44), however, not all expenses associated with a carbon sink forest are eligible deductions as presented in Box 45.

Box 44: Eligibility to claim a carbon sink forest expenses as deduction is based on the following requirements (taken from ATO, 2019a).

• The party is carrying on a business.
• At the time, an interest is held or rights in the land or trees that is most specific to the carbon sequestration activities.
• The land and the forest is for the primary and principal purpose of carbon sequestration by the trees.
• The purposes in using the land do not include felling the trees or using the trees for commercial horticulture.
• A party or another entity incurred expenditure for establishing the trees in the income year or an earlier income year.
• The expenditure was not incurred under a managed investment scheme (MIS) or a forestry MIS.
• The trees establishing in the carbon sink forest:
  o Meet the requisite forestry characteristics.
  o Adhere to certain environmental and natural resource management guidelines.

Box 45: Treatment of expenses related to tree planting for carbon sequestration (taken from ATO, 2019a).	
What you can claim	What you cannot claim

Deduction for the establishment expenditure is possible, which includes the following expenses.
• Acquiring the trees or seeds.
• Raising tree seedlings in pots and potting mixtures.
• Grafting trees and germinating seedlings.
• Allowing seeds to germinate (whether by broadcasting, deliberate regeneration or planting seeds directly).
• Preparing the area for planting (e.g. ploughing, scarifying, contouring, top dressing, fertilising, weed spraying, stone removal and top soil enhancement).
• Planting the trees or seeds.
• Surveying the planted area.
	Non-establishment expenditure cannot be claimed, including the following.
	• Rights that allowing access to land to establish a forest (e.g. forestry rights).
	• The land (e.g. expenditure related to purchasing land for establishing trees).
	• Draining swamps or low-lying land, or clearing land.
	• Assets separate from the trees, such as
	  o Fencing
	  o Water facilities for the trees
	  o Roads within the forest
	  o Fire breaks
	• Establishing other plants for another purpose (e.g. trees for felling or horticultural plants).
	• Expenses incurred in establishing other plants used for purposes associated with carbon sequestration (e.g. companion planting).
	• Carbon credits to be traded in the future (e.g. carbon sequestration rights).

Appendix K: Capital gains taxation

An overview of capital gains tax

Basis of capital gain tax and capital gains taxation events

The following defines CGT based on ATO (2022r). Capital gains tax is the tax payable on profits from selling assets (ATO, 2023a) (e.g. property) and forms part of income tax; it is not a separate tax. The assets subject to CGT require specific consideration of ATO requirements. The trigger of CGT treatment is a CGT event; for example, the creation of a right (including granting an easement, profit à prendre or licence) over an asset is a CGT event (ATO, 2018c). Other CGT events include loss or destruction of an asset (see Table 15). The type of CGT event may affect the timing and how to calculate a capital gain or loss for taxation purposes (ATO, 2022s).

Treatment and determination of capital gains for trees

The treatment of CGT is defined by the ATO (ATO, 2020c). Capital gains and capital losses are reported as part of an income tax return and tax is paid on net capital gains resulting from a CGT event. A CGT event is the point when a capital gain or loss results (e.g. in the financial year of the event). A capital gain results when an asset is sold for more than it cost and capital loss results when an asset is sold for less than it cost. Determination of capital gains is net of allowed deductions and such deductions can only be claimed if they have not been eligible for claim under other mechanisms (see Box 46). The treatment of land and trees can separate the two assets. Where the market value of standing timber is part of assessable income, the capital proceeds from the sale of land is reduced accordingly for CGT purposes. In a similar manner, CGT does not apply to profits from the sale of standing or harvested trees as these profits will either be assessable as ordinary business income or income from an isolated commercial transaction (ATO, 2022b, p.2). The taxed base is 50% of the net capital gain for Australian individuals where the asset has been owned for 12 months or more. The tax charged is based on the usual rate of taxation applicable to the party receiving the capital gain (ATO, 2023a).

Table 15: A summary of CGT events based on ATO information (taken from ATO, 2022s)

CGT event	Timing	Capital gain	Capital loss
A1: Disposal of a CGT asset	When the disposal contract is entered into or, if none, when the entity stops being the asset's owner.	The capital proceeds from disposal less the asset's cost base.	The asset's reduced cost base less the capital proceeds.
C1: Loss or destruction of a CGT asset	When compensation is first received or, if none, when the loss is discovered or destruction occurred.	The capital proceeds less the asset's cost base.	The asset's reduced cost base less the capital proceeds.
C2: Cancellation, surrender and similar endings	When the contract ending an asset is entered into or, if none, when an asset ends.	The capital proceeds from the ending less the asset's cost base.	The asset's reduced cost base less the capital proceeds.
C3: End of an option to acquire shares etc	When the option ends.	The capital proceeds from granting the option less the expenditure in granting it.	The expenditure in granting the option less the capital proceeds.
D1: Creating contractual or other rights	When the contract is entered into or the right is created.	The capital proceeds from creating the right less the incidental costs of creating the right.	The incidental costs of creating the right less the capital proceeds.
D2: Granting an option	When the option is granted.	The capital proceeds from the grant less the expenditure to grant it.	The expenditure to grant the option less the capital proceeds.
D3: Granting a right to income from mining	When the contract is entered into or, if none, when the right is granted.	The capital proceeds from the grant of right less the expenditure to grant it.	The expenditure to grant the right less the capital proceeds.
D4: Entering into a conservation covenant	When covenant is entered into.	The capital proceeds from covenant less the cost base apportioned to the covenant.	The reduced cost base apportioned to the covenant less the capital proceeds from covenant.
F1: Granting a lease	For granting a lease: when the entity enters into the lease contract or, if none, at the start of the lease. For a lease renewal or extension: at the start of the renewal or extension	Capital proceeds less the expenditure on grant, renewal or extension.	Expenditure on grant, renewal or extension less the capital proceeds.

Box 46: The treatment of the cost-base for determination of capital gains (taken from ATO, 2010a, s.83).
<u>Capital Gains and non-capital costs</u> 83. The cost base of a plantation or forest may include non-capital costs incurred by the owner of a plantation or forest that was acquired after 20 August 1991 (paragraph 160ZH(1)(ba) and subsection 160ZH(6A)). These costs may only be included in the cost base if they are not otherwise deductible (subsection 160ZH(6B)). However, non-capital costs cannot be taken into account in working out a capital loss and will not be eligible for indexation.

Treatment of capital gains under superannuation

A SMSF's assessable income includes any net capital gains (unless an asset is a segregated current pension asset). A complying SMSF is entitled to a CGT discount of one-

third provided that the relevant asset had been owned for at least 12 months; that is a taxation rate of 10% rather than 15%. A net capital gain in a year is the total capital gain less total capital losses for that year, and any unapplied capital losses from earlier years less the CGT discount and any other concessions. A capital loss is not an allowable deduction; it is only able to be offset against capital gains, hence where capital losses are greater than capital gains in a financial year, they are carried forward to be offset against future capital gains (ATO, 2019e).

Outright sale of standing trees

An intent of harvest rather than sale as a going concern

It is possible for a party to change the intent from grow and harvest (a forest operation), to selling of trees standing. Such trees are regarded as an asset with a sale subject to specific treatment (Box 47) from a taxation point of view. An important point is that a sale of trees as a going concern was not the intent and the ordinary course was to grow trees and conduct the harvest. This intent can be documented in the business and management plans for a stand. If the standing trees are sold standing, then the revenue generated is taxable in the year of that sale. The value of the trees sold can be on a market value basis or based on the Commissioner's opinion (Box 47).

Box 47: The treatment of sale of trees (as part of carrying on a business of forest operations) as a going concern and prior to harvest (taken from ATO, 2010a, s.22 to 24 & 56).
Disposal of standing timber not in the ordinary course of business 22. A disposal of trees owned by a taxpayer and which have been planted (not necessarily by the taxpayer) and tended for the purpose of sale may result in the value of those trees being included in the taxpayer's assessable income under subsection 36(1), in the year the disposal takes place. This may be so whether or not the taxpayer is carrying on a business of forest operations, so long as the taxpayer is carrying on a business and the disposal is not in the ordinary course of carrying on that business. What is required is that the trees constitute the whole or part of the assets of that business. 23. Whether or not a particular contract results in a 'disposal' of trees, as distinct say, from a 'sale' of an interest in land, will depend on the interpretation of that contract. Subsection 36(1) will not apply if the trees are on leased land and the lessee does not have entirety of ownership of the trees on that leased land: Rose v. FC of T (1951) 84 CLR 118; 9 ATD 334. 24. The value of the trees is either: • the market value on the day of disposal; or if in the Commissioner's opinion there is insufficient evidence of the market value - the value which the Commissioner considers reasonable (paragraph 36(8)(a)). Disposal of standing timber not in the ordinary course of business 56. The comments in paragraphs 22 and 23 apply equally to a person not conducting forest operations so long as the trees disposed of constituted assets of the business carried on by the taxpayer.

Determining the value of standing trees

A grower may need to declare the market value of standing timber as assessable income. This can occur when selling the land on which the trees are growing, and the trees were planted and maintained with the intent to sell for a profit, hence the payment received will be assessable income (ATO, 2022b, p.1). Regardless of not carrying on a business, a party can still claim a deferred deduction for the cost of the plantation or forest (ATO, 2022b, p.3). To address treatment of standing trees, a party must be able to identify the part of the purchase price relating only to the trees at the time of purchase of a plantation. Evidence should be documented; for example, a valuation provided by the seller or having the amount relating to the trees specifically stated in a contract (ATO, 2022b, p.3). A market value of standing trees is the arm's length price an independent purchaser would be willing to pay. Market value prior to selling land can be achieved by engaging an appropriate valuer (ATO, 2022b, p.1); for example, by engaging a consulting forester making use of appropriate forest valuation standards (see Leech & Ferguson, 2102; Leech, 2012; IFA & NZIF, 2020).

Treatment of the purchase price of trees as a going concern

It is possible that a stand of trees is purchased from another party. A purchase could be between parties with an interest in the underlying land and where tree ownership is separate to the land. The purchase of standings trees as a going concern is generally treated as a capital acquisition and is not an allowable deduction at the time of purchase. The taxation treatment of such a purchase is to align (delay) any claim of expenditure until the trees are harvested and an income is generated (Box 48). The purchaser must carry the expenditure until that time and only when all trees have been felled can the full amount be expended. This can be referred to as a 'cost of bush' treatment. An important point is that at the time of the purchase of the trees as a going concern, the tree value must be specifically defined. The trees are then assigned a value equal to the purchase price on the day of purchase (Box 49). At the time of harvest and sale of logs, an equivalent portion of the cost of the trees can be claimed against income in that year. If rather than harvesting the purchased trees, a party sells the tree standing, it may not be possible to deduct the deemed purchase price of the trees.

Box 48: The taxation treatment of expenditure in trees as a going concern (taken from ATO, 2010a, s.31 to 36).

31. A deduction is not generally allowable for expenditure incurred on the acquisition of a plantation or forest in the year of income in which the expenditure is incurred. However, where part of the purchase price of land is attributable to timber standing on that land, section 124J of the Act may apply. If the taxpayer fells the trees for sale or use in manufacture for the purpose of producing assessable income or timber is felled pursuant to a right granted to another person for which amounts as or by way of royalty are payable, a deduction will be allowable to the taxpayer under section 124J in the year of income in which the timber is felled.

32. A deduction is allowable in each year of income in which trees are felled for the purpose of sale or use in manufacture. The amount of the deduction is the proportion of the price paid for the trees that is attributable to the timber felled during the particular year of income. This proportion may be based on either timber volume or tree numbers. If timber is felled over more than one year of income, the deduction allowable for each year is the amount of the cost of the timber that is attributable to the timber actually felled in that year.

33. An acceptable method of calculation is as follows:

$$\frac{A}{B}\ x\ C$$

where:

A is the number of trees felled or volume of timber felled;

B is the total number of trees available for felling or the total volume of timber available for felling; and

C is the total purchase price of the land or right attributable to standing timber at the time of purchase.

(Note: Trees felled either as thinnings to waste or where they are diseased and are not felled for sale or use in manufacture are excluded from both A and B - refer to paragraphs 37 and 38.)

34. The deduction is allowable to the taxpayer whether the taxpayer fells the trees or the taxpayer receives royalties under a right granted to another person to fell trees.

35. The year in which the final deduction is claimed under section 124J for the purchase price of the trees will depend on when the last of the trees to which the purchase price relates are felled. Factors listed in paragraph 11 of Taxation Ruling IT 362 will be relevant in deciding whether the full purchase price will be allowable to the taxpayer.

36. If none of the purchase price of the plantation or forest is attributable to the standing timber at the time of purchase, then no deduction will be allowable under section 124J on a subsequent felling of that timber. The part of the purchase price attributable to the trees must be identifiable at the time the plantation or forest is purchased. Although the amount relating to the trees does not need to be specifically stated in the contract, there should be documentary evidence that part of the purchase price is attributable to the trees. The onus will always remain with the purchaser to establish this amount.

Thinning; non-commercial for stand hygiene and for wood production

The condition of the standing trees purchased is important. Where a stand requires thinning to waste (e.g. to promote better growth) and where thinning does not generate revenue, a cost of bush treatment is not applied with no deductions relating to the purchase price of the trees (Box 50). Where thinning is to recover logs for sale, then the usual costs of harvesting and haulage of the resulting logs are deductable expenses. It is possible that some trees within a stand of purchased trees may have pathogens or insect infestations and it is prudent to remove such trees from a stand. If such trees are removed (thinned) as part of routine operations and logs sold, this would include of a cost of bush calculation as an expense claimed against the harvest revenues (Box 50).

Box 49: Determination of the value of trees based on purchase price of trees as a going concern (taken from ATO, 2010a, s.39 to 41).
Purchase price where vendor assessed under subsection 36(1) 39. If a taxpayer purchases trees from a person who is assessable on the value of the trees under subsection 36(1) (refer paragraphs 22 and 23), the taxpayer is deemed under this provision to have purchased the trees at a price equal to their value on the day they were acquired from the previous owner. Expenditure on the deemed purchase price of the standing trees, i.e., their value on the day of acquisition, is generally expenditure of a capital nature and therefore not deductible under subsection 51(1). 40. Where the trees are acquired in circumstances covered by subsection 36(1) and the taxpayer fells the timber for sale or use in manufacture for the purposes of producing assessable income or timber is felled pursuant to a right granted by the taxpayer, a deduction for the deemed cost attributable to the trees felled in a particular year of income is allowable in the taxpayer's assessment for that year of income (section 124J). 41. However, if the trees are subsequently sold by the purchaser prior to felling or granting rights to another to fell, then the purchaser may not be entitled to a deduction for the cost attributable to the trees, even though the taxpayer may be assessable under subsection 36(1). The Government announced on 9 May 1995 that it proposes to amend the Act so that a deduction will be available in these circumstances.

Box 50: The treatment of thinning of trees purchased as a going concern (taken from ATO, 2010a, s.37&38).
Thinning operations 37. No deduction is allowable under section 124J for expenditure incurred by the taxpayer on thinning operations where the trees are not felled for sale or use in manufacture (e.g., thinning to waste). However, deductions may be allowable under subsection 51(1) for costs in respect of those operations in the year of income in which those costs are incurred (e.g., felling and transporting). Thinning operations carried out in relation to a right to fell timber granted by the taxpayer to another person may give rise to a deduction under section 124J where that right was granted 'in consideration of payments to be made to the taxpayer as or by way of royalty' (subparagraph 124J(b)(ii)). Felling of diseased trees 38. Diseased trees, if felled with other trees as part of felling operations for sale or use in manufacture, will not prejudice the deductions allowable under section 124J. If diseased trees are felled in separate felling operations then that part of the purchase price attributable to those trees will not be allowable under section 124J unless the diseased trees are felled for sale or use in manufacture, or pursuant to a right granted to another person for which amounts as or by way of royalty are payable. However, deductions may be allowable under subsection 51(1) for costs incurred in respect of those operations in the year of income in which the trees are felled (e.g., felling and transporting).

Access to standing trees

Creating and selling a forestry right

A felling right conveys a legal right to a party to harvest another party's trees with the actual harvest occurring some-time in the future. A party carrying on forest operations can create and sell a felling right relating to the trees owned. A felling right created and sold is regarded as a capital item (Box 51) triggering a CGT event (Box 52). This is in effect selling the trees standing and resulting proceeds of such a sale are treated as assessable income. The nature of the treatment will depend on the specific details of the forestry right. Payments are regarded as a royalty. A royalty is payments made by one person for the use of rights owned by another person; they can be periodic, irregular or one-off payments (ATO, 2022q). Regardless of whether a person is carrying out a forest operation, royalties are treated as assessable income (Box 53).The purchase price of such a right is deductable by the

purchaser in the year of actual harvest on a *pro rata* basis of the portion of the trees harvested.

Box 51: The treatment of a felling right as a capital item and deduction treatments (taken from ATO, 2010a, s.25 & 42 to 44).

Disposal of rights to standing timber

25. A taxpayer carrying on forest operations may sell standing timber by granting a right to someone to cut and remove the timber, whether or not the right to remove the timber is exercised. The proceeds from sale are assessable under subsection 25(1).

Amount paid to acquire a right to fell timber

42. Expenditure incurred in acquiring a right to fell standing timber is generally of a capital nature: Kauri Timber Company Ltd v. Commr of Taxes (NZ) [1913] AC 771. However, a taxpayer who acquires a right to fell timber on someone else's land for sale or use in manufacture for the purpose of producing assessable income or timber is felled pursuant to a right granted by the taxpayer to another person for which amounts as or by way of royalty are payable, is entitled to a deduction in a year of income in which the trees are felled (section 124J). The amount of the deduction is the cost of so much of the right as is attributable to the timber felled during the particular year of income.

43. Section 124J will also apply where the taxpayer has acquired a right to fell standing timber even though the payment has not been made to the grantor of that right. The payment must be seen as resulting in the acquisition of the right by the taxpayer. Thus, deductions under section 124J are allowable to the purchaser of a right to fell standing timber where the timber is felled under a right initially granted by the owner of the standing timber to a person who then 'sold' that right to the purchaser: Marbut Gunnersen Industries Pty Ltd v. FC of T and FC of T v. Monaro Sawmills Pty Ltd (1982) 60 FLR 241; 82 ATC 4182; (1982) 12 ATR 926.

44. The comments in paragraphs 31 to 38 concerning the practical operation of section 124J also apply where a taxpayer acquires a right to fell standing timber. It is not necessary for the taxpayer's activities in the forestry industry to constitute the carrying on of a business.

Box 52: Disposal of rights to standing timber (taken from ATO, 2010a, s.22, s.57 to 60).

Standing timber

Disposal of standing timber not in the ordinary course of business

22. A disposal of trees owned by a taxpayer and which have been planted (not necessarily by the taxpayer) and tended for the purpose of sale may result in the value of those trees being included in the taxpayer's assessable income under subsection 36(1), in the year the disposal takes place. This may be so whether or not the taxpayer is carrying on a business of forest operations, so long as the taxpayer is carrying on a business and the disposal is not in the ordinary course of carrying on that business. What is required is that the trees constitute the whole or part of the assets of that business.

Disposal of rights to standing timber

57. In Stanton v. FC of T (1955) 92 CLR 630; 11 ATD 1, a taxpayer received a lump sum, payable in instalments, for agreeing to sell standing timber. The agreement provided for a limitation on the quantity of timber sold, with a reduction in the price if the amount of timber found to be standing on the land was less than that contracted for, whether the timber was cut and removed or not. The quarterly instalments of the purchase price were due independently of the amount of timber removed. The amount in question was held not be a 'royalty' for the purposes of paragraph 26(f). The case should be contrasted with the decision in E K White v. FC of T (1968) 120 CLR 191; 15 ATR 173, where the taxpayer's land became devoted exclusively to the sale of standing timber and the sale proceeds were held to be assessable income. Subsection 36(1) would generally not apply to these situations unless the preconditions described in paragraph 22 were met.

58. Where payments received in these circumstances exceed the contract price, whether or not the contracted tonnage has been exceeded, the excess payments constitute royalties and assessable income under subsection 25(1): Ashgrove & Ors v. FC of T (1994) 124 ALR 315 at 338; 94 ATC 4549 at 4564; (1994) 28 ATR 512 at 533.

59. In certain cases, the parties to the contract for the standing timber may never intend to meet the terms of the contract. Instead, the true intention of the contract is to pay for the amount of timber taken at a price based on the market price at the time the timber is taken. In these cases, the payments for the timber are royalties under paragraph 26(f).

60. There may also be capital gains tax consequences on the disposal of rights to standing timber. These are discussed in paragraphs 66 to 83.

A profit à prendre

A profit à prendre is a specific mechanism as an interest in land and is an asset separate from the land, created at the time of its grant. A profit à prendre is *‘the right to take some product of the land or part of the soil from the land of another including fish, fowl, grass, minerals etc)’* (CCH, 1993, p.454). A key element of a profit à prendre is that the holder benefits from future growth of the trees which would be subject to individual assessment (see Box 54). As a profit à prendre is a post CGT asset, it is treated accordingly.

Box 53: The treatment of royalties under a forest right (taken from ATO, 2010a, s.8, 26 & 61).
8. A person who receives royalties under a right to fell or remove trees on land owned by that person is not regarded as conducting forest operations if the trees were not planted or tended for the purpose of felling. Royalties 26. Royalties received by a taxpayer from the grant of a right to fell timber on land owned by the taxpayer are assessable income of the taxpayer (subsection 25(1)). The royalties are assessable income of the recipient even if the taxpayer granting the right is not carrying on a business of forest operations. Royalties 61. The comments in paragraph 26 apply equally to a taxpayer not conducting forest operations. Also refer to the comments in paragraph 58 above.

Box 54: Attributes and determination of a profit à prendre (taken from ATO, 2010a, s.70 to 72).
70. To determine if a profit à prendre arises, the test in Marshall v. Green [1875] 1 CPD 35 should be applied - that is, where at the time of the contract it is contemplated that the purchaser will derive a benefit from the further growth of the thing sold, then the purchaser acquires an interest in the land, i.e., a profit à prendre: Ashgrove's case. 71. The terms of each individual agreement must be examined to determine the intent of the parties regarding the benefit of any future growth, i.e., whether it is an agreement for the sale of goods to which the right to enter and sever the timber is ancillary, or whether it is an agreement for the sale or creation of an interest in the land (a profit à prendre). 72. The grant of a profit à prendre may give rise to the disposal of a post-CGT asset created by the grantor (see below Capital Gains Tax and Profits à Prendre at paragraph 76). The proceeds from the 'sale' of the timber are treated as part of the consideration received from the granting of the profit à prendre.

Selling trees not part of forest operation

Trees may not be classed as a forest operation (see Box 26 and Figure 3 for a definition and test). There are two potential transactions which can apply to trees not in a forestry operation; sale of trees and, creation and sale of a felling right which may or may not include profits from isolated transactions. The treatment of these events depends whether a party is a seller generating income (Box 55) or the buyer incurring an expense (Box 56). And assessable income and deductions result.

Box 55: Disposal of trees not in a forest operation (taken from ATO, 2010a, s.54 to 55).

Assessable income from trees not in a forest operation

54. A taxpayer may dispose of trees but not be carrying out forest operations (refer to paragraph 14). Disposal of the trees may give rise to assessable income. Assessable income may include:

- proceeds from the sale of standing timber;
- royalties received from granting rights to other persons to fell and remove timber;
- profits from isolated transactions.

55. The capital gains tax consequences of the disposal of trees are discussed in paragraphs 66 to 83. If the disposal of trees is covered both by ordinary income concepts and capital gains tax, subsection 160ZA(4) will apply.

Box 56: Allowable deductions for trees not in a forest operation and purchased as a going concern (taken from ATO, 2010a, s.63, 64 & 65).

Allowable deductions for trees not in a forest operation

63. Allowable deductions may include:

- purchase price paid to acquire a plantation or forest;
- amount paid for the right to fell standing timber.

Purchase of a plantation or forest

64. The comments in paragraphs 31 to 36 on the purchase price of land and trees, and the comments in paragraphs 39 to 41 on the purchase price where the vendor is assessed under subsection 36(1), apply equally to a taxpayer who is not conducting forest operations.

Amount paid to acquire a right to fell timber

65. The comments in paragraphs 42 to 44 apply equally to a taxpayer who is not conducting forest operations.

Capital gains tax; land and trees defined by timing of ownership

The felling or the sale of trees as standing timber results in two post-CGT assets; the land and the trees. The timing of tree ownership impacts capital gains treatments (Box 57) and the basis of disposal will impact the treatment as a CGT event. Where trees and land on which the trees are grown were owned before 20 September 1985, there are no capital gains consequences for the logs harvested and sold. However, if the owner contracts for sale of the standing timber or via a rights mechanism, this may constitute a profit à prendre. For land and trees acquired after 19 September 1985, the felling of trees or the sale of trees as standing timber results in two post-CGT assets; the land and the trees. Where the trees are sold, any net capital gain is treated as assessable income in the year of disposal (i.e. is deemed to have occurred). This timing can be separate to the year the trees are harvested. Trees grown or owned before 20 September 1985 will be 38 years of age in September 2023 if planted in winter 1985.

The CGT treatment of a profit à prendre is defined by the timing of the grant (see Box 58). Where a profits à prendre was granted after 19 September 1985 and before 21 September 1989 and the land was acquired before 20 September 1985, capital gains provisions do not apply. Where a profits à prendre was granted after 20 September 1989 and before 26 June 1992, capital gains provisions apply regardless that the underlying asset (e.g. the land) was acquired before 20 September 1985. Where a profits à prendre was granted after 25 June 1992 CGT provisions effective from 26 June 1992 apply.

This demonstrates the need for accurate and robust record keeping, including the supporting evidence.

Box 57: Capital gains taxation treatment of land and trees owned before 20 September 1985 (taken from ATO, 2010a, s.66 to 69) and after 19 September 1985 (taken from ATO, 2010a, s.73 to 75).	
<u>Land and trees owned before 20 September 1985</u>	<u>Land and trees acquired after 19 September 1985</u>
66. There are no capital gains tax (CGT) consequences for a taxpayer on the disposal of timber felled by the taxpayer after 19 September 1985 where the taxpayer owned the land and trees before 20 September 1985 (Taxation Determination TD 93/79). 67. While the trees are attached to the land, the land and trees are considered to be a single pre-CGT asset owned by the taxpayer. After the trees are cut, the taxpayer still retains ownership of the timber (now a chattel). In effect, the original asset has been split into two pre-CGT assets. However, there has been no change in the ownership of any asset as a result of the cutting of the trees. Accordingly, there is no disposal for capital gains tax purposes (section 160M). 68. If the taxpayer later sells the timber, the sale of this asset will not be subject to capital gains tax as the taxpayer will be disposing of a pre-CGT asset. 69. Where the owner of pre-CGT land and trees sells timber according to one or more post-CGT contracts providing: • a contract for the sale of the uncut timber; and • a contract for granting the purchaser of the timber the right to enter the taxpayer's property over a period of time and remove timber as and when required; the transactions taken together may constitute the grant of a profit à prendre (Taxation Determination TD 93/81). A profit à prendre is an interest in land and is an asset separate from the land. It is created at the time of its grant.	73. For capital gains tax purposes the felling of timber or the sale of standing timber on land acquired on or after 20 September 1985 results in the original asset (the land with the trees) being split into two post-CGT assets (the land and the timber). 74. The cost base, indexed cost base or reduced cost base of the timber sold will be the amount of the relevant cost base of the combined asset that is attributable to the timber (subsection 160ZH(13)). If the taxpayer disposes of the land, the original cost base, indexed cost base or reduced cost base of the land will be reduced by the amount that was attributed to the timber (subsection 160ZH(14)). 75. Any net capital gain arising on the disposal of the timber (or land) is assessable income of the year of income in which the disposal occurs or is deemed to have occurred (refer to subsections 160U(3) and (4)). This need not necessarily be the year in which the timber is felled.

The CGT treatment of a profit à prendre is defined by the timing of the grant (see Box 58). Where a profits à prendre was granted after 19 September 1985 and before 21 September 1989 and the land was acquired before 20 September 1985, capital gains provisions do not apply. Where a profits à prendre was granted after 20 September 1989 and before 26 June 1992, capital gains provisions apply regardless that the underlying asset (e.g. the land) was acquired before 20 September 1985. Where a profits à prendre was granted after 25 June 1992 CGT provisions effective from 26 June 1992 apply.

This demonstrates the need for accurate and robust record keeping, including the supporting evidence.

Box 58: Capital gains tax and profits à prendre (taken from ATO, 2010a, s.76 to 82).

Capital Gains Tax and Profits à Prendre

76. As outlined above (paragraph 70) a right to remove standing timber may constitute a profit à prendre. The effect of the capital gains tax provisions on a taxpayer who grants a profit à prendre after 19 September 1985 depends on when it was granted.

Profits à prendre granted after 19 September 1985 and before 21 September 1989

77. The granting of a profit à prendre during this period is treated as a part disposal of the land in terms of section 160R. The capital gains provisions do not apply if the land had been acquired before 20 September 1985 (Taxation Ruling IT 2561).

Profits à prendre granted after 20 September 1989 and before 26 June 1992

78. A profit à prendre is an asset created at the time it was granted. The asset is taken (by former paragraph 160M(5)(c)) to have been acquired by the grantor. Subsection 160C(2) then treats the grantor as owning the asset. The time of acquisition is determined by section 160U.

79. Where ownership of the asset changes, i.e., where the grantee becomes the owner of the profit à prendre, there is a disposal of the asset by the grantor (and an acquisition of the asset by the grantee) in terms of subsection 160M(6): refer to obiter comments of Hill J in Ashgrove & Ors v. FC of T (1994) 124 ALR 315 at 335-336; 94 ATC 4549 at 4562; (1994) 28 ATR 512 at 531.

80. It follows that, if the grant of the profit à prendre occurs on or after 21 September 1989, there is an acquisition by the grantor of a new asset created after that date. The capital gains provisions apply on the disposal of the new asset notwithstanding that the underlying asset, for example the land, may have been acquired before 20 September 1985. (Taxation Ruling IT 2561)

Profits à prendre granted after 25 June 1992

81. Amendments to the capital gains tax provisions effective from 26 June 1992 apply to profits à prendre granted after 25 June 1992.

82. The effect of these amendments is that when a profit à prendre is granted, the asset is taken by paragraph 160M(6A)(a) to have been acquired by and commenced to be owned by the grantor. The time of acquisition is determined by subparagraphs 160U(6)(a)(ii) or (b)(ii). Further, the grantor is taken by paragraph 160M(6A)(b) to have subsequently disposed of the asset to the grantee in whom it is vested on its creation. The time of disposal is determined by subparagraphs 160U(6)(a)(iii) or (b)(iii).