



Australian
Forest
Products
Association

AUSTRALIAN FOREST PRODUCTS ASSOCIATION

Multinational Tax Integrity – strengthening
Australia's interest limitation (thin capitalisation)
rules

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To whom it may concern

Public consultation submission on multinational tax integrity – strengthening Australia's interest limitation (thin capitalisation) rules

AFPA welcomes the opportunity to provide feedback on the proposed *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin Capitalisation Interest Limitation*.

As an organisation representing the majority of large plantation forest growers in Australia, we have a number of concerns regarding the current proposal which are set out below, in addition to our proposed method to resolve these concerns.

About Australian Forest Products Association

The Australian Forest Products Association (AFPA) is the peak national industry body representing the Australian forest, wood and paper products sector's interests to governments, the general public and other stakeholders on matters relating to the sustainable development and use of Australia's forests and associated manufacturing and marketing of wood and paper products in Australia. Relevantly AFPA represents the interests of over 90% of Australia's forestry grower entities.

Our sector is carbon positive with our plantations storing an estimated 258 million tonnes of carbon. Our Industry plants around 70 million plantation trees every year and supports the Federal Government's ambition to plant an additional one billion plantation forestry trees, which will sequester over 500MT CO₂-e by 2050.

Australia's forest industries directly employ approximately 80,000 people and another 100,000 indirect employees and is a major employer in many regional towns. Australian Forest Industries contribute \$24 billion to the Australian economy each year. The Australian economy has a trade deficit of timber and forest products of over \$2 billion every year.

Executive Summary

A number of our plantation owning companies understand that the proposed changes to the Treasury Laws Amendment (Measures for Future Bills) Bill 2023 means that they would no longer be able to claim plantation re-establishment costs as a deduction.

Australia's Plantation estate has shrunk significantly in recent years from 2,008,900 Hectares in 2009/10 to 1774,660 Hectares in 2021.

As a result the Albanese Government went to the 2022 election campaign supporting the one billion tree goal which was supported by a number of election policies including the soon to be released \$86 million plantation grants to help grow the plantation estate. Unfortunately it will be more difficult to replant the existing plantation with the tax changes which will undermine the government's push to grow the plantation estate to meet our future needs.

Sovereign capability

In Australia over 25% of our emissions come from the construction industry. The choice of wood or steel by a homeowner makes the difference between starting with either a healthy CO2 credit or deficit. A typical wooden house frame has absorbed 9.5 tonnes of CO2 from the atmosphere – A typical steel house frame emits 4.5 tonnes of CO2 into the atmosphere. So, for example building a house with a timber frame offsets the emissions of four vehicles for a year, whereas in contrast building with steel increases emissions equivalent to two cars for a year.

However, over the past six years across Australia, as a result of successive Government decisions, the plantation estate has been permanently reduced by 230,000 hectares. Australia already relies on imports for 25% of our timber for housing demand. A recent report by Forest & Wood Products Australia (FWPA) has found that the demand for new housing will rise from 183,000 new dwellings per annum now to 258,000 per annum by 2050, driving an increase of almost 50 per cent in demand for timber and doubling our reliance on imports by 2050.

Half of the weight of wood products is stored carbon and replacing more emissions intensive building material is a priority internationally to meet other countries respective targets so demand for timber internationally is soaring to meet growing demand for sustainable, renewable products. During COVID we could not fill this gap in timber supply driving up prices and leading to the collapse of many building companies turning many home builder's dream into a nightmare.

Climate Change

The Federal Government is committed to achieving a net zero by 2050 target and has legislated a 43% reduction of 2005 levels by 2030.

Unlike any other industry, forest and forest products industries provide real and material solutions for both sides of the carbon ledger. Working forests actively draw carbon from the atmosphere, and then store it securely in a product that has a lower carbon footprint than current alternatives (for example, timber is used in the built environment as a substitute for steel or concrete). Nature has provided us with a proven approach which we can sustainably leverage for the benefit of all Australians. Forests are the most economically and physically effective carbon capture and storage process currently available. When trees are harvested and replanted, that forest continues to operate as a carbon sink while the harvested wood products store the captured carbon.

The forestry industry will have a strong part to play in Australia achieving its 43% by 2030 target.

Chubb review

In July 2022, Hon Chris Bowen, Minister for Climate Change and Energy [announced](#) an independent review of Australian Carbon Credit Units (ACCUs). The review was headed up by Professor Ian Chubb AC.

On 9 January 2023 the final ACCU Report was released, in the report Professor Chubb says:

“After experimentation and speculation for decades, the only pathway known to science that has the immediate capacity to remove [Greenhouse gases] (CO₂) from the atmosphere at scale **is photosynthesis**: the mechanism by which plants and some other organisms use light, CO₂ and water to create energy (stored as sugars) to fuel cellular activity and growth.

Science and technology may well develop effective and scalable options to meet the twin challenges of GHG removal and secure long-term (millennial) storage. But to start at scale well before 2050, **the land sector** will have to carry much of the immediate load, starting now.”

Photosynthesis is the only carbon capture and storage mechanism available currently, at scale, to the Federal Government. Due to its sequestration capacity, and carbon storage in its products, forestry has a clear role to play in achieving Australia's net zero by 2050 goal. The ACCUs created by plantation forestry are high integrity credits.

As was mentioned in the Synthesis Report of the Intergovernmental Panel on Climate Change Sixth Assessment Report (IPCC report), forestry is a key tool for policy makers to achieve the globe's climate change ambitions. In the IPCC report, it stated that the use of 'long-lived wood products, can be used instead of more GHG-intensive (Greenhouse Gas-intensive) products in other sectors.' This refers to, for instance, the replacement of greenhouse intensive steel with increased use of timber in the built environment to reduce the carbon profile of a building and the building sector more broadly. Farm forestry, where farmers plant production trees on their farms was also mentioned in the IPCC report multiple times as an effective adaptation option and effective mitigation option. These opportunities have already been recognised by the Federal Government.

Clean Energy Finance Corporation - \$300 million

The Clean Energy Finance Corporation is currently running a \$300 million program to encourage the use of mass timber construction across the property sector. This is due to identified capacity for timber to substantially cut construction-related emissions.

Plantation Establishment Grants - \$86.2 million

The Albanese Government has announced that it will be rolling out an \$86.2 million grant program to encourage the expansion of plantation forestry estate in Australia.

A key focus of the program will be to encourage farmers to adopt farm forestry, planting plantation forestry over existing marginal farmland, increasing forest cover, increasing sovereign capability of timber supply for the Australian market and in some cases, offsetting greenhouse gas emissions for a farming enterprise. The forestry companies caught by the changes in the proposed rules are vital for the successful roll out of this program. Their experience in the sector mean they have, or are developing, products to manage farmer wood lots and assist farmers navigate the carbon market.

The consequential expansion of the Australian forestry estate will assist in achieving Australia's climate ambitions: 43% reduction by 2030 and net zero by 2050. AFPA is concerned that the proposed changes to the tax regime will have a negative impact on the roll out of this program.

Deforestation pledge

The Australian Government has signed up to the Glasgow Leaders Declaration of Forests and Land Use, through which Australia pledged to halt and reverse deforestation by 2030.

The Food and Agriculture Organization of the United Nations defines 'deforestation' as:

The conversion of forest to another land use or the long-term reduction of the tree canopy cover below the minimum 10 percent threshold.

Explanatory note:

- 1. Deforestation implies the long-term or permanent loss of forest cover and implies transformation into another land use. Such a loss can only be caused and maintained by a continued human-induced or natural perturbation.*
- 2. It includes areas of forest converted to agriculture, pasture, water reservoirs and urban areas.*
- 3. The term specifically excludes areas where the trees have been removed as a result of*

harvesting or logging, and where the forest is expected to regenerate naturally or with the aid of silvicultural measures.

AFPA is concerned that the proposed rules will drive deforestation in Australia (as detailed below). The reversion of forestry assets to other agricultural uses will constitute a deforestation event, and will need to be accounted for at an Australian Government greenhouse emissions reporting and in the context of the deforestation pledge.

Proposed rules

A number of our plantation owning companies have had advice from their taxation advisers with respect to the Treasury Laws Amendment (Measures for Future Bills) Bill 2023, and changes to capitalisation rules which would take effect from 1 July 2023.]

These companies understand that they would no longer be able to claim plantation re-establishment costs as a deduction on their tax return. Consequently, the cost of re-establishment would significantly increase for these companies.

A key concern that has been raised by AFPA members with the Treasury Consultation Paper “Multinational Tax Integrity – strengthening Australia’s interest limitation (thin capitalisation) rules” which was released by Treasury on 16 March 2023 (proposed rules) is the definition of tax EBITDA.

An entity’s ‘tax EBITDA’ is determined according to the process set out section 820-49 of the proposed rules (on page 7 of the exposure draft).

Having reviewed the explanatory memorandum, AFPA is of the view that there has been an oversight of the impact these changes will have for forestry businesses. As discussed at 1.46 of the explanatory memorandum:

1.46 An entity’s ‘tax EBITDA’ for an income year is worked out according to the following steps:

- Step 1: Work out the entity’s taxable income or tax loss for the income year (disregarding the operation of the thin capitalisation rules and treating a tax loss as a negative amount).
- Step 2: Add the entity’s ‘net debt deductions’ for the income year.
- Step 3: Add the sum of the entity’s decline in value and capital works deductions (if any) for the income year.
- Step 4: Add the sum of each of the entity’s deductions for tax losses from earlier income years.

Subject to Step 5, the result of Step 4 is the entity’s tax EBITDA for the income year.

- Step 5: If the result of Step 4 is less than zero, treat it as being zero.
[Schedule 1, items 12 and 60, sections 820-49 and 995-1]

TAX EBITDA

AFPA considers that further adjustments to Division 43 in relation to Capital works deductions need to be made to increase tax EBITDA for the following items:

- Deductions claimed under s70-120 of the *Income Tax Assessment Act 1997* for the capital costs of acquiring trees or a right to fell trees. Amounts claimed under this section relate to capital expenditure incurred by plantation businesses that is amortised over time as trees are felled. These costs represent a significant capital

outlay at the commencement of the business and from a policy perspective, should be treated in the same way as amounts claimed under Subdivision 40-B and Division 43. This treatment will result in a closer alignment to the definition of EBITDA, Earnings before Interest, Tax, Depreciation and Amortisation.

- Deductions for 'site preparation costs' and 'establishment costs' are generally deducted under section 8-1 of the Income Tax Assessment Act 1997. These costs are normally capitalised to the cost of the plantation asset for accounting purposes but are fully deductible for tax purposes.

Site Preparation Costs are costs associated with the preparation of the site for planting and it includes slash treatment, site clean-up, cultivation and site drainage work, weed control, post-plant spot fertiliser application, survival survey, and renewal planting.

'Establishment Costs' are costs associated with seedling production (or seedlings purchased from third party nurseries), delivery and handling, planting the site and management of the site post planting for up to 12 months.

Other costs such as weed control, post-plant spot fertiliser application and survival survey incurred after 12 months of planting are treated as forest maintenance costs and not site preparation or establishment costs.

Therefore, Site Preparation Costs and Establishment Costs are incurred up-front when plantations are replanted. Australia's primary pine species require approximately 25 to 32 years before the timber is of sufficient quality and strength for final harvest to be utilised as structural timber (timber for building houses). Upon final harvest, taxable income is generated.

Under s820-57 of the proposed rules 'Special deduction for previously FRT disallowed amounts – fixed ratio test', it is proposed that a special deduction for debt deductions is available to general class investors for the previous 15 years. AFPA is concerned that this puts forest assets at a significant disadvantage than other investments, due to the long lead time of the asset. There is a significant difference between this 15 year 'carry forward' period and the 25-32 years required for plantation assets to mature to final harvest. Some species have an even longer rotation age.

It is AFPA's understanding that not adding back these items for plantation forestry businesses means that the income from harvested areas is assessable, but the costs of these are not allowed for in tax EBITDA calculation. AFPA believes this is inconsistent with the intent of the proposed rules. As set out in 1.86 of the explanatory memorandum.

1.86 The 15-year period is introduced to limit the tax benefit of disallowed amounts to a defined period. This reduces the impact of debt deductions being permanently disallowed and allows for the level of an entity's net debt deductions to be linked to its earnings over time.

AFPA draws your attention to the intent to allow 'for the level of an entity's net debt deductions to be linked to its earnings over time.' This intention is not fulfilled for plantation forestry where there is a long investment horizons.

AFPA suggests that the expenditure on Site Preparation and Site Establishment be allowed as an add back in the tax EBITDA. Failure to amend this section would mean that the proposed rules would result in higher costs for future plantations. This is likely to mean that many companies may reconsider the financial plans to expand or replant plantations and instead focus on other investments such as agriculture.

Consequences of proposed rules

Without change, the proposed rules will:

- a) reduce the supply of domestic timber in the Australian market.
- b) inhibit Australia's capacity to respond promptly to the global threat of climate change.
- c) limit options to farmers to offset their agricultural greenhouse gas emissions.
- d) result in deforestation events across Australia, harming Australia's ability to uphold the deforestation pledge and increase emissions.

AFPA has spoken to its members and is of the view that the proposed rules will impact a handful of members. Consequently, we are of the view that the modest requests for changes in this submission will have a significant impact on the Australia's sovereign timber capability and the ability to reach Australia's climate change ambitions, without compromising the intent of the changes.

Thank you for providing AFPA with the opportunity to provide feedback on the proposed *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin Capitalisation Interest Limitation*. If you have any queries regarding this submission, please contact Sara Bray, Senior Policy Manager sara.bray@ausfpa.com.au.



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AFPA is the peak national industry body representing the resources, processing, and pulp and paper industries covering the forest products value chain.

AFPA represents all elements of the value chain from the sustainable harvesting of plantations and multiple use natural forest resource including forest establishment and management, harvesting and haulage, processing of timber resources and manufacture of pulp and paper.