

Submission on:
Mass Marketed Tax Schemes
'an officials' issues paper on suggested
legislative amendments'
January 2002

From:
Forest Enterprises Ltd
P O Box 128
Masterton

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Contact Person
Mr Steve A R Wilton
Business Director
Direct Dial 06 370 5067
Facsimilie 06 370 5069
Email swilton@forestenterprises.co.nz



Submission Summary

Forest Enterprises Ltd supports the thrust of the officials' issues paper and supports the suggested legislative amendments subject to the comment below in respect of the proposed registration criteria set out in clause 4.8.

Forest Enterprises Interest in this Matter

Forest Enterprises Ltd was established in 1972.

Forest Enterprises' business is the co-ordination and on-going forest management and investment administration of Pinus radiata forestry investments for private individuals. Each investment entails the establishment, maintenance and management of one forest rotation.

Today the company manages 73 such forestry investments encompassing 22,000 hectares of established forests on behalf of more than 6,300 private individuals.

Forest Enterprises is the largest participant in its market and as such is recognised within the industry as a market leader.

Our investors are predominantly domiciled New Zealanders and therefore New Zealand tax payers.

The majority of our investments by forest area and number of investors are structured as partnerships of loss attributing qualifying companies (LAQC).

Our partnership of LAQC investments conform to the Example 3 investment structure set out on pages 22 and 23 of the issues paper and described in clause 5.1 as 'a structure to which neither the deferred deduction nor the scheme registration rules would apply, even though it incorporates scheme specific finance'.

Registration Criteria – Clause 4.8

Clause 4.8 set out on page 14 of the issues paper is as follows –

The promoter must sell or anticipate selling the arrangement, or arrangements with the same generic features, to five or more investors and:

- the arrangement results in the deferred deduction rule applying **because the expected income in the first three years is insufficient to cover tax deductions**; or
- if the arrangement is commercially unsuccessful, net tax losses available to the investor could exceed the money the investor has risked in the arrangement; or
- a tax-exempt person, as part of the arrangement, sells an asset other than in the ordinary course of its business that it acquired in anticipation of or as part of the arrangement that causes the investors to derive tax deductions; or
- the investor claims GST input credits if the vendor is not registered for GST in respect of the transaction.

Our concern is in respect of the words '*because the expected income in the first three years is insufficient to cover tax deductions*' highlighted above.

It is our submission that these words are

1. in conflict with the deferred deduction rule; and
2. could defeat the objective expressed throughout the paper and specifically in clause 5.1 that investments structured in terms of Example 3 are in '*a structure to which neither the deferred deduction nor the scheme registration rules would apply, even though it incorporates scheme specific finance*'



Words are in conflict with the deferred deduction rule

We believe the words conflict with the deferred deduction rule because it is our interpretation of the thrust of the registration criteria set out in the clause that the first 'trap' requiring registration is as expressed namely 'that the arrangement results in the deferred deduction rule applying'.

The deferred deduction rule set out in clause 3.3 on page 9 contains three elements that are cumulative, hence the arrangement must satisfy all three.

The words in 4.8 'because the expected income in the first three years is insufficient to cover tax deductions' are a different expression of element two which reads 'incurs or expects to incur aggregate net tax losses in the first three years of the arrangement'.

The wording in clause 4.8 therefore conflicts with the deferred deduction rule in that as expressed it requires only part of the rule to apply in respect of registration criteria.

Words could defeat the objective expressed

Our forestry investments, structured in terms of Example 3 in the paper described as '*a structure to which neither the deferred deduction nor the scheme registration rules would apply, even though it incorporates scheme specific finance*' could be trapped by the registration criteria as currently expressed.

A greenfields forestry investment has no income for more than the first three years and therefore with no income would always fail the test 'that the expected income in the first three years is insufficient to cover the tax deductions'.

Without the offending words, our investments would survive the full cumulative deferred deduction rule test in 3.3 because the investors have money at risk in the arrangement therefore fall outside of element three of the test.

Suggested Solution

Delete the words '*because the expected income in the first three years is insufficient to cover tax deductions*' in clause 4.8.

