

Supplementary Submission by

Forest Enterprises Ltd

to the

The Policy Advice Division of the Inland
Revenue Department

on the officials' issues paper on

**Qualifying Companies:
implementation of flow-through tax
treatment**

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It is acceptable for Inland Revenue and Treasury officials to make contact with the author.

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1. Minimum Alternative Solution

- 1.1. In our Submission dated 5 July 2010, we suggest that providing a transition provision allowing a change of business structure was our preferred outcome to address the serious implementation issues identified.
- 1.2. Following our meeting of 15 July, it is apparent that regardless of whether a transition provision to change business structure is provided for or not, the unreasonable adverse consequences of a deemed disposal would persist for a forestry owning qualifying company.
- 1.3. Trees are unique in that there is a long time between planting and harvest (25 to 30 years). In that time there is no active market for their sale and purchase, so they are generally valued by discounted cashflow analysis. If a deemed disposal occurs mid rotation, such as will occur on a breach of the qualifying company rules following implementation of the changes, the forest owner is faced with an immediate tax obligation.
- 1.4. The forest owner therefore faces the prospect of having to sell part of their standing timber in an inactive market to generate cashflow to fund the tax payable.
- 1.5. As there is no active market, possibly the only way to generate cashflow in time to pay a pending tax obligation is to accept a substantial discount on the sale of the standing timber.
- 1.6. If at the extreme, the forest owner had to accept an offer of 30% of market value to generate a quick sale, the forest owner could be left with nothing after meeting the tax obligation as section GC 2 would deem the forest owner to have sold the standing timber for market value and consequentially the tax payable would equate to the discounted sale price (assuming a tax rate of 30 cents in the dollar).
- 1.7. Similar perverse outcomes are recognised and remedied under the Income Tax Act 2007. In cases where there would otherwise be a disposition of standing timber when there have been no changes in beneficial ownership, there are sections to prevent a disposition from arising until there has been an 'actual' sale, and cashflow has been derived from the transaction.
- 1.8. Sections in the Act preventing a disposition from occurring until there is an "actual" ownership change and cashflow arising are -
 - 1.8.1. a Relationship Property transfer in sections FB 6 and FB 7; and
 - 1.8.2. the granting of a Forestry Right to oneself in section YA 1 under the definition 'dispose' (b)(iv); and
 - 1.8.3. a transfer pursuant to death to close relatives in section FC 6 where 'close relative' is defined as being related within 2 degrees.
- 1.9. We therefore submit that as a minimum (and irrespective of whether the transition to a limited partnership structure requested in our 5 July submission is accommodated), this perverse outcome should be addressed.

- 1.10. One way would be to amend the definition of 'dispose' in section YA 1 by inserting a new subpart, which would provide that where a disposal occurs under section HA [*the specific sections dealing with ceasing to be a qualifying company by election or deemed revocation*], that no disposal of timber occurs.
- 1.11. Alternatively, the definition of 'dispose' in section YA 1 could be amended to capture all situations (not just the new qualifying company situation) giving rise to the same perverse outcome by inserting in relation to the definition of 'dispose' in section YA 1 wording along the following lines -
'Notwithstanding the definition under subpart (b), no disposal of timber occurs if the same persons remain the beneficial owner of the timber'
- 1.12. The same outcomes as in 1.10 and 1.11 above could also be achieved by amending the 'cost of timber' provisions so that the purchaser in these circumstances inherits the sellers cost basis, similar to that which occurs with relationship property.