Investor Preparation for Harvest
Important Taxation Considerations

Important: These Notes are intended as a guide only. Investors are urged to seek advice from their own professional advisers.

Overview of Taxation Issues

It is important that you prepare in advance for the consequences of harvest and be aware of the taxation requirements, plus the opportunities available to minimise taxation liability.

These Notes anticipate that you are a New Zealand resident for tax purposes. The same New Zealand taxation obligations also arise for Investors classified as non-residents for tax purposes. It is important any Investor who is a non-resident checks with their professional adviser what their taxation obligations are in their country of residence.

Harvest gives rise to taxable income and surplus cash. The surplus cash will be distributed progressively with no tax having been deducted. You are responsible for declaring your taxable income arising from harvest in your New Zealand tax return and paying the applicable tax.

The surplus cash distributed will typically be the net after setting aside the funds required by the Investment to meet its ongoing costs (e.g. rates, insurance, management), plus costs anticipated consequential to the harvest (e.g. cash for future roading infrastructure and future replanting obligations). The quantum of the distributions is therefore not a proxy for taxable income.

Allocation of Income Opportunity

As noted above, surplus cash from harvest will be distributed untaxed. Harvest income need not be returned in the year generated. An Investor can elect to have the income allocated over the year of harvest and the three preceding years (Section EI of the Income Tax Act 2007). The income may be allocated over any of the four available income years in whatever proportion you nominate. Allocating back to previous years eliminates the requirement to pay provisional tax.

To take advantage of this provision to pass income back for up to three preceding years, you must give the Commissioner of Inland Revenue written notice of 'allocation election' within 12 months of the end of the income year in which the income is derived. On receiving written notice, New Zealand Inland Revenue will issue a new tax assessment for the years concerned and give one month to pay the additional tax calculated as payable for each year (without use of money interest or penalty).

We would expect Investors to utilise this opportunity because of the convenience of not having to calculate and pay provisional tax, plus doing so can result in less tax to pay (depending upon your marginal tax rate in each allocated year).

During harvest the *Tax Details Statement* circulated each May will include your share of *Harvest Income*, which is the amount which can be allocated. The Tax Details Statement will also separately advise of any *Tax Loss* (share of on-going costs funded out of the harvest income) for deduction, plus *Interest Earned* and *RWT Deducted*.

Provisional Tax

If you decide not to utilise the harvest income allocation opportunity, you may have provisional tax to pay during each tax year. Provisional tax will be payable if your residual income tax for the previous year exceeds $2,500. Assuming you are already paying the correct amount of tax in respect of all other income, harvest related income of as little as $7,600 may require provisional tax to be paid.

In each year's Financial Statements, Forest Enterprises will provide an estimate of the taxable harvest income for the coming year. This estimate can be used to determine your provisional tax liability; however it is an estimate only and variations can and will arise, and these may be material.

In the event that you underpay provisional tax, you can still use the harvest income allocation opportunity to avoid having to pay use of money interest (or any penalties).

Transfer to another Party at a Lower Marginal Tax Rate

Investors should contemplate transfer to another party if doing so will result in the harvest income being taxed at a lower marginal tax rate.

Subject to the value of the shares being transferred falling below the $50,000 deminimis threshold allowed in Section HG5 in the Income Tax Act 2007, shares can be transferred without taxation consequences.

If the value to be transferred exceeds the $50,000 deminimis allowed in section HG5, transfer without tax consequences is still possible under the Property (Relationships) Act 1976 (see below).

Relationship Property Transfer

Investors who are married (or in a civil union or de facto relationship) and currently hold the investment in one name only, have the option to use a Relationship Property Agreement under the Property (Relationships) Act 1976 to transfer any portion (or all) of their investment into their relationship Investor's name without triggering any transfer related taxation consequences (Section HG5 taxation consequences discussed above).

Splitting the investment in this manner would result in the Harvest Income then being derived by, and taxed according to each relationship Investor's tax status.

A Relationship Property Agreement is a legal document which would usually be prepared by a solicitor.

Income Equalisation Account

An Income Equalisation Account provides an opportunity to park harvest income, postponing payment of tax until the parked income is withdrawn.

Investors who are individuals qualify to use the income equalisation scheme for forestry income. Under this scheme you can deposit the quantum (the cash amount) of some or all of any year's forestry income with the New Zealand Inland Revenue for a period of up to 5 years (and subject to a minimum period of 1 year).

Tax is not paid on the quantum of the forestry income deposited, because Section EH7 of the Income Tax Act 2007 allows a deduction for the deposit in the current tax year. Tax is payable in the tax year the deposit is withdrawn under Section CB27. The income allocation provisions do not then apply, and the tax rates will be the then applicable rates. Interest is paid on the deposit balance in terms of Section EH6 at 3% per annum.

Personal and Investment Cost of Timber

Investors who purchased shares other than at the time the Investment was formed, may have a personal 'Cost of Timber' in terms of Sections DP10 and DP11 of the Income Tax Act 2007.

This Cost of Timber can be deducted against the taxable Harvest Income as harvesting occurs on a percentage of completion basis. The allowable percentage for each year will be advised in the Financial Statements.

The Investment itself may have a Cost of Timber. This would have arisen if existing trees were present on the land when purchased. Any Investment Cost of Timber will have been deducted when determining the reported taxable Harvest Income.

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