Creating Jobs in the Forest Sector and Stimulating Rural Community Development Through a Personal Silvicultural Savings & Investment Plan for Canadian Woodlot Owners

Canadian Federation of Woodlot Owners

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Canadian Federation of Woodlot Owners
Maison de l'UPA 555, boul. Roland-Therrien
Bureau 565
Longueuil, Québec
J4H 4E7

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Summary

Canada's private family woodlots belong to 450,000 Canadian families. The management of these private family forests provides numerous socio-economic benefits by supporting a range of industries, and generates environmental benefits by protecting biodiversity as well the quality of water and air.

Various factors, including the low profitability of forest management activities, have discouraged many woodlot owners from actively managing their woodlots.

The Government has a number of tools available to encourage woodlot owners to more intensively manage their woodlots. Historically, direct subsidies were the favoured means. Today, income tax measures can be used as an additional tool to encourage active management by greater numbers of woodlot owners and increase supplies of forest products as well as the environmental services expected by Canadian society.

While intensive management of woodlots provides these major benefits to society, the lack of adequate support will prevent private woodlots from reaching their potential since most woodlot owners will not see sufficient personal benefits to justify pursuit of these activities.

We therefore propose the creation of a *Personal Silvicultural Savings and Investment Plan* which would allow woodlot owners to place a portion of their forestry revenue in a tax shelter for the purpose of future investments in silviculture and other forms of forest management.

The Canadian Federation of Woodlot Owners represents the economic and social interests of the 450,000 woodlot-owning families who together own 8% of Canada's productive forests. These woodlot owners live in rural areas in Canada, meet 14% of the raw material needs of Canada's forest industries, manage an exceptional land base in terms of biodiversity, contribute to air and water quality across rural Canada, and provide leisure areas near urban centres.

Background: The Potential

Managing forests for their full potential requires investment of both financial and human resources. Without government assistance, these investments won't always be made by woodlot owners since the costs of silviculture and other forest management investments often exceed the revenues from the sale of goods and services generated by the forest. In all cases, revenues are long-term and uncertain in nature, factors which lessen the appeal of silvicultural investments. The choice by many owners to forego investment in their woodlots is a rational choice based on the following considerations:

1. The return on investment is low considering the time it takes to grow a forest and it is uncertain due to the risk of natural disasters damaging or destroying forest stands;

2. Many other less risky investments exist that offer better and quicker returns;

3. Due to their weak bargaining position in the market place, the share of income from processing of forest products that woodlot owners pocket for their products is generally what is left over when all the other players involved in the process (contractors, truckers, manufacturers, wholesalers and retailers) have been paid for their labour and capital; and

4. Except in some exceptional cases, markets don't pay for the environmental services provided by managed forests.

For these reasons, Governments in industrialized countries have been called on to support investments in enhanced management of private woodlots. Typically, the aim of Government support programs is to reduce forest management costs for forest owners by directly covering a portion of the costs of silviculture. In Canada, several provincial governments provide such assistance, Studies have shown that these financial incentive programs generate positive impacts on private investments and on forest management and rarely lead to substitution of public investments for private investments[1,2].

The globalization of timber and wood fibre markets has made it more difficult to adequately cover the costs of forest management activities. Increasingly, the price of wood is influenced by production costs in plantations growing in countries with better growing conditions than in Canada and with less stringent environmental requirements. This puts pressure on the markets to lower prices offered to woodlot owners. These days, logging companies regularly use the price from other jurisdictions during negotiations to establish the price of wood. Provincial and Federal Governments must continue to play a role if even the limited existing levels of forest management activities on private woodlots are to be maintained.

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[1] Linden, M. Leppänen, J. 2005. *Government Investment Cost-Sharing for NIPF in Finland 1963-2000 : An Econometric Analysis In Evaluating Forestry Incentives and Assistance Programmes in Europe*. EFI Proceedings 54: 155-165

[2] Beach, R.H. et al. 2005. *Econometric Studies of NIPF: A Review and Synthesis*. Forest Policy & Economics 7 (3): 261-281

Nature of the Challenge: Motivating Woodlot Owners

Little use has been made of income tax policy in Canada to encourage woodlot owners to invest in the management of their forests. In particular, Canadian income tax policy does not take into account:

An uncertain and long-term expectation of profit.

The decades-long production period is unique to the forest sector. The discounting of revenues over 40 or more years reduces (or eliminates) the profitability of silvicultural activities. Furthermore, the odds of damage or destruction of the forest due to natural disasters increase with the length of the production period. For tax authorities, woodlot silviculture activities do not have a «commercial feel».

Most forestry revenue tends to be sporadic rather than regular and sustained in nature.

Very few woodlot owners draw any revenue from the sale of wood every year. Harvesting is carried out only in occasional years. In those scattered years, the woodlot owner may see a large increase in overall revenue and is taxed accordingly.

Costs and revenues occur in widely separated years.

The costs associated with silviculture (e.g., planting, tending plantations, and thinning young stands) are incurred at the beginning or early in the production period, while the revenues arise from harvesting mature trees.

- At the start of the production period, revenues are insufficient to cover the costs of forest management.

- At the end of the production period, the deductible expenses are low compared to the revenue from the sale of wood. This leads to high taxable revenue in a single tax year.

Existing provincial cost-shared programs are an important tool, but have a number of limitations.

- Not all provinces have these programs;

- Budgets for these programs are limited and subject to uncertainty from one year to the next;

- Many woodlot owners do not have the financial assets needed to cover the owner share of the costs;

- The programs provide important support for a portion of active owners but provide little incentive for inactive owners to become active managers; and

- Depending on the province, existing programs may be quite limited in scope and do not provide assistance for the full range of essential forest management activities.

Can a conventional RRSP or TFSA address these issues?

The Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA) are not adapted to the tax situation of woodlot owners. First, most woodlots owners are older than 60 years but continue to manage their forests. Forest revenues put into their RRSP will need be converted to a retirement income vehicle at age 71.

Second, forest harvesting is generally carried out in occasional years. In those scattered years, the woodlot owner may see a large increase in overall revenue and is taxed accordingly. The TFSA doesn't provide a shelter from taxes for those revenues; but the investment earnings are exempt from tax upon withdrawal. Moreover, the TFSA rules limit the contribution to $5,500 a year.

Also, most woodlot owners have other sources of revenues which in many cases are already being used to invest in RRSP's and TFSA's.

Would this proposal create inequities among taxpayers?

Under existing tax regulations, woodlots owners pay higher taxes than other taxpayers because the revenues from their forests are concentrated in one year and added to the revenues from other sources. This circumstance has the consequence of reducing the level of forest management carried out on woodlots, with significant economic repercussions for the economy as a whole. In the case of natural disasters, the mismatch in time between revenues and expenses is especially acute. We believe these two factors provide a justifiable distinction from other groups of taxpayers.

For these reasons, Income tax policy as it currently stands does little to encourage woodlot owners to actively manage their forests. This is an unfavourable situation since harvested wood leads to significant socio-economic activity in the forest products industry, and is especially important in rural communities with few other industries. Woodlots which are not actively managed generate socio-economic activity that is far below the potential.

In response to this reality, the Standing Committee on Natural Resources of the House of Commons[3] and the Standing Senate Committee on Agriculture and Forestry[4] both recommended in 2008 that the Federal Government encourage woodlot owners to practice sustainable forest management through changes in income tax policy.

[3] Standing Committee on Natural Resources of the House of Commons 2008. Canada's Forest Industry: Recognizing the Challenges and Opportunities: 64 p. (p.41)

[4] Senate Committee on Agriculture and Forestry. 2008. Beyond Freefall: Halting Rural Poverty: 397 p. (p.96)

A Promising Solution: The Creation of a Personal Silvicultural Savings and Investment Plan

Income tax policy can be judiciously used to encourage increased productivity of private woodlots, to contribute to the development of forestry-related industries, to enhance environmental services sought after by society, and generally to favour the growth of rural communities. To that end, we recommend adjusting tax treatment to reflect the reality of small woodlots: a long production period, an expectation of profit that does not easily meet current tax requirements [IT-373R2 Woodlots (Consolidated)], and a pattern of substantial expenses incurred at the start of the production period and revenues incurred much later.

In other words, tax authorities need to take into account the fact that forest management requires a lot of work and time before it can produce the quality forest goods and environmental services that are needed to develop our country's rural communities.

We therefore request that the Government and the Department of Finance consider the implementation of a personal silvicultural savings and investment plan.

Objective

The plan's aim is to stimulate investments in intensive management of private woodlots using revenues generated by woodlot owners themselves.

Investments include all expenses required to improve the quality of forest stands and to ensure their sustainable management, as well as to harvest forest stands following prescriptions developed by forestry professionals. These prescriptions will be described in a forest management plan that meets the requirements of the Income Tax Act Regulations section 7400.

The term "woodlot owner" designates all taxpaying Canadians who own in whole or in part a woodlot consisting of over four (4) hectares.

Description of the approach

Tax authorities would allow a taxpayer to protect part of his/her revenue from taxation in anticipation of woodlot management investments through the creation of a personal tax shelter: "the personal silvicultural savings and investments plan".

Using this approach, part of a person's forestry revenue from the sale of wood or other non-timber products could be placed in the tax shelter for future use in silvicultural activities. Spending these funds for silvicultural purposes or other non-forestry purposes would render them taxable in the year they are withdrawn from the account.

Personal silvicultural savings and investment accounts could be managed by any financial institution that provides services directly to individuals. Administration fees would be paid by the contributors.

Advantages of the approach

This approach would have the effect of:

1. Persuading woodlot owners to harvest wood that will, in turn generate additional economic activity. The harvest constitutes extra income for most woodlot owners, which is taxable at a higher marginal tax rate, reducing the financial incentive for many to carry out silviculture. Many woodlots that are currently neglected would thus be actively managed and boost economic activity in rural communities. It is important to remember that private woodlots already supply 14% of the wood processed in Canadian mills.

2. Investing money from the sale of wood in planting and improving forest stands, rather than on current consumption which involves considerable loss of money by rural communities in favour of urban centres where most goods and services are purchased.

3. Synchronizing forest management expenses with revenues from forests.

4. Persuading more affluent woodlot owners to invest in forest management. The possibility of avoiding being taxed on their extra income from the sale of wood will give a boost to their forest management initiatives.

5. Reducing the uncertainty of reasonable expectation of profit from silvicultural investments and increasing recognition of the deductible nature of silvicultural expenses.

6. Supporting the forest management industry that provides silvicultural services to woodlot owners by increasing the amount of work carried out.

7. Transferring revenues from urban to rural communities through the additional silviculture undertaken by woodlot owners who make a living in the city.

8. Increasing the value of the woodlot asset, and eventually capital gains and personal investments.

9. Reducing tax avoidance from revenues from the sale of wood since woodlot owners would have additional incentive to in declare all of their forest revenues in order to benefit from this program.

Method of application

Each tax year, a woodlot owner who is a tax payer with more than four hectares and a forest management plan that meets the requirements of Income Tax Act Regulations section 7400, could place up to 100% of his/her forestry-related revenue in a tax shelter (a personal silvicultural savings and investment account) set up in a financial institution. The investment must be made on or before February 28th following the year in which the forestry revenue was generated. The maximum amount

deposited would correspond to the net forestry revenue from the sale of the wood after expenses incurred during harvesting operations.

The investment could be made in investment vehicles similar to those of an RRSP. The fees and administrative requirements of the financial institution would apply. Taxes would apply to funds withdrawn from the plan, as is the case with RRSPs. The interest earned by funds in the plan would also be taxable in the year of withdrawal. Funds removed from the plan and used for non-forest management purposes would be required to pay interest on the taxes owed, back to the year when the revenue was placed in the account.

The invested funds could be withdrawn at any time and would be taxable in the year they are withdrawn. The taxpayer can deduct the forest management expenses incurred in his/her woodlot against the funds withdrawn. Admissible forestry activities would be those that are currently recognized by the tax authorities and described in a recognized forest management plan (Income Tax Act Regulations, section 7400). Income taxes would therefore be better synchronized with the timing of forest management expenditures. A woodlot owner would withdraw money from his/her personal silvicultural savings and investment account in the year he/she plans on incurring expenses related to forest management.

The forest management expenses would be linked to the woodlots owned by the taxpayer. The expenses would have to be linked to the contents of the owner's recognized forest management plan, which has been approved by a forestry professional.

In the case of transfer of the woodlot through a sale or bequest, the funds placed in the silvicultural savings and investment account would be withdrawn and taxed. This provision would provide a termination-point for the plans, avoiding a situation where the money would sit indefinitely in a silvicultural savings and investment account and lead to indefinite tax avoidance.

Tax costs of the program

The following calculation is based on wood production in Quebec where woodlot owners' forest revenues are well documented. The total figure for Canada as a whole is about three times greater.

In Quebec, the gross income stemming from wood sales is approximately $300 million per year[5]. Expenses make up about 70% of this figure. The net taxable income is therefore $90 million per year. If all woodlot owners were to invest to the full extent in silvicultural savings and investment accounts, $90 million would not be taxed in the tax year in question which would represent a maximum reduction in tax receipts of $36 million (using a tax rate of 40%) for the two levels of government.

In fact, the level of participation will be considerably less than 100%. Not all taxpayers are subject to the higher marginal tax rate and many woodlot owners depend on revenue from wood sales as substantial or

[5] This amount corresponds to 30-35% of the Canadian total.

significant subsistence revenue. They will not be able to “freeze” all of their revenue for a few years.

The following table provides an overview of the gross revenues from the sale of wood from private land in Quebec. We can see that only 8% of wood producers receive revenues exceeding $20,000 per year and that they account for approximately 60% of total sales. It is reasonable to believe that these producers are active on a yearly basis, that they regularly carry out both silviculture and harvesting in the same year, and that they will therefore not be interested in personal silvicultural savings and investment accounts.

Table 1 : Gross revenue (excluding transportation) from the sale of wood from private woodlots in Quebec (2005)[6]

Revenue (2005 $)	Number of producers		Sales (2005 $)	
1 – 5,000	13,000	65%	46,884,045	15%
5,001 – 10,000	3,600	18%	37,507,236	12%
10,001 – 20,000	1,800	9%	40,632,839	13%
20,001 – 40,000	800	4%	34,381,633	11%
40,000 and more	800	4%	153,154,547	49%
Total	**20,000**	**100%**	**312,560,300**	**100%**

Taking these two factors into account, it is plausible to estimate that an upper limit of about $36 million per year[7] could be invested in personal silvicultural savings and investment accounts, which would represent an estimated maximum reduction in tax revenue of $14 million. In fact, the carry forward will most surely be less and would take many years to materialize, enough time for woodlot owners to become familiar with this program.

Tax revenue

Processing forest products provides substantial tax returns for the two levels of government.

Quebec receives $20.92 and Canada $22.24 in taxes per m^3 of wood produced. The lion’s share of these tax revenues comes from processing wood (50%) and indirect economic effects (37 %)[8]. A European study has shown that a $1,000 reduction in wood production leads to a $2,200 to $3,000 decrease in economic activities[9]. Another study has shown that forest management subsidies generate tax revenues 1.85 times greater than the initial investment[10]. Experts may not agree on the exact level of revenues generated from operations in private forests, but their multiplier effect in the economy of rural communities is not disputed.

[6] Internal compilation from la Fédération des producteurs forestiers du Québec
[7] $300 millions/year X 40% ($20,000/year and less) X 30% (net revenue) = $36 M.
[8] Poulin, H. Nadeau, J.P. 1996. *Retombées économiques attribuables à la forêt privée et rentabilité de l’aménagement* In Manuel de foresterie, Presses de l’Université Laval : 791-794 (data from 1993)
[9] San Cristobal, J.R. 2007. Effects on the Economy of a Decrease in Forest Resources: an International comparison. Forest Policy & Economics 9: 647-652
[10] Bouthillier, L. 2001. L’impact des investissements publics en forêt privée. Rapport de la Forêt modèle du Bas-St-Laurent. 24 p.

The Government will recover its tax revenues through the economic activities generated by the program. Both forest management operations and harvesting activities on woodlots and economic activities further along the forestry products chain will increase.

If we accept the hypothesis that tax returns for the two levels of government are $43.16/m^3 of wood products, woodlot owners in Québec will have to produce 324,000 m^3 more wood to compensate for the tax losses of $14 million from implementing this program. This amounts to a 5% increase their current annual production. We can realistically expect that personal silvicultural savings and investment accounts will lead to increased levels of silviculture.

Appendix A

Norway: Forest Management Incentive Program[11,12]

Norway has 9.6 million hectares of forest lands mostly belonging to 120,500 woodlot owners who own 78% of this forested land base. The annual allowable cut is 17.6 million cubic meters and has been increasing since 1925.

When wood is harvested, the woodlot owner must place between 4 and 40% of the value of the wood in a personal forest fund. This percentage varies from one tax year to another depending on his/her financial situation or investment projects. The woodlot owner does not pay any taxes on the portion of revenue from the sale of wood that is placed in the personal forest fund, which encourages its use. The woodlot owner can withdraw money from his/her personal forest fund to invest in forest management activities. He/she is then able to benefit from tax deductions. This system has been in place since 1932. Money set aside in the forest fund is linked to a particular property and not to the owner. However, these funds can be used by the owner to improve another woodlot. In 1995, 45% of the investments made in forest management were financed using the funds.

The woodlot owner does not recover the interest accumulated on the money in the personal forest fund. The Department of Forests receives the interest and reinvests it in the forest sector in various activities, including consulting services.

Taxes on forest revenue are calculated using the average of the sales during the previous five years. The costs related to forest management are then deducted from the mean revenue.

France: The Forest Savings Fund[13]

The Forest Savings Fund was set up on January 1st, 2006 seeks to encourage forest-owning "territorial communities" to save part of their revenue from wood sales for forest-related investments (building infrastructure, plantations) in a more consistent manner and to a greater extent than would otherwise be done.

This arrangement has two phases :

A savings phase: between 6 years (minimum) and 15 years (maximum), territorial communities can deposit a portion of their forest revenues in a forest savings account managed by the *Crédit Agricole-SA*. This lending institution was selected as the exclusive agency for the program following a public call for proposals. The funds set aside in the forest savings account grow thanks to a fixed and guaranteed earning schedule using a rate calculated each year (it was set at 3.30% in 2006 and 4.30% in 2007).

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[11] Lindstad, B. H. 2002. *A Comparative Study of Forestry in Finland, Norway, Sweden, and United-States*. General Technical Report PNW-GTR-538, Portland, USDA: 35 p.

[12] Norwegian Ministry of Agiculture. 2006. *Norwegian Forests: Policy and Resources.* www.odin.dep.no: 24 p.

[13] République Française, Ministère de l'agriculture et de la pêche. 2009. *Le fonds d'épargne forestière*. www.agriculture.gouv.fr

An investment phase: at the end of the savings phase, the territorial communities can use the capital and the capitalized interest to fund forestry investment projects. When a loan is needed to fund a project, the territorial communities are eligible for a subsidy paid by the State, amounting to 85% of the interest accumulated during the savings phase, to a maximum of 7,500 €. This subsidy that rewards the savings efforts of territorial communities aims to multiply the effects of this program on forest production and employment in rural areas.

Initially reserved for timber resources, the fund can now also be used to develop other products from their forests such as leasing hunting and fishing rights, as well as other non-timber forest products.