

Our client's SMSF invested in a tree plantation business/profit making venture, with an initial cost of \$300,000. The SMSF leased a block of land for the plantation and engaged a professional forestry service provider to manage the timber plantation. The timber are expected to be harvested in 20 years time. Therefore, no revenue until then. When the trees are ready for harvest, the forestry company will manage the felling of the trees and sale of timber.

## Questions

1. Is this business allowable in the SMSF?
2. Should the initial costs of \$300,000 in growing the trees be capitalised or claimed as an expense?
3. Also, the trees will possibly be harvested in 20 years time. Do we treat the management costs, insurance, planting/growing costs as expenses or are they capitalised? Are these expenses considered as revenue losses? Can the losses be applied against other investment income of the super fund?
4. As the tree plantation are not generating any income at this stage, do we need to apply for a private tax ruling to allow the losses to be expensed or capitalised?
5. How would the income from the sale of timber be treated?

# Our Advice

Remember, having a reasonably argued opinion is a plus with the ATO and provides taxpayers with reassurance they are less likely to suffer any penalties.

## 1. Is this business allowable in the SMSF?

Generally, yes. SMSFs are permitted to invest in a wide range of assets, including business assets. Insofar as Capital Account transactions are concerned ITAA 1997 section 295-85 establishes that which normally the CGT rules are applied when gains and losses are made by complying superannuation funds, even if they would normally be taxed on revenue account to other types of taxpayers.

There are restrictions:

In-house asset rules: The SMSF must meet certain requirements to hold and manage business assets, such as having adequate insurance and complying with record-keeping obligations.

Related party transactions: If any of the fund members or their associates are involved in the forestry business (e.g., as employees or shareholders), strict rules apply to ensure arm's-length dealings.

## 2. Should the initial costs of \$300,000 in growing the trees be capitalised or claimed as an expense?

Capitalised. The \$300,000 initial cost of establishing the tree plantation would generally be considered a capital expenditure. This means it is not deductible in the year it is incurred but is instead added to the cost base of the asset (the trees).

## 3. How to treat management costs, insurance, planting/growing costs?

TR 97/11 provides more general guidance on whether someone is carrying on a business of primary production.

TR 95/6 provides guidance in relation to the tax treatment of primary production and forestry activities.

Generally, capitalised. These ongoing costs are typically capitalised as they contribute to the ongoing development and growth of the capital asset (the trees).

Not considered revenue losses. These costs are not revenue losses in the traditional sense. They are capital expenditures that will be recovered upon the sale of the timber.

Not directly offset against other income. These costs are not directly deductible against other income earned by the SMSF. However, the capitalised costs will reduce the capital gain when the timber is sold.

## 4. Private Tax Ruling?

Potentially beneficial. While not always mandatory, obtaining a Private Ruling from the Australian Taxation Office (ATO) can provide certainty regarding the tax treatment of the tree plantation investment.

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## 5. How would the income from the sale of timber be treated?

Assessable income: The income from the sale of timber will generally be assessable income for the SMSF.

Capital gains tax: The SMSF will generally pay capital gains tax on the profit from the sale of the timber.

Offsetting capital costs: The capitalised costs of establishing and maintaining the plantation (including the initial \$300,000) will reduce the capital gain.

## Conclusion

While we are confident in our advice, in this instance, due to the fact that income is not being presently derived and due to the particular circumstance of your case a Private Ruling request would protect your position.



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