

PRODUCT RULING – BR PRD 18/07

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Persons who applied for the Ruling

This Ruling has been applied for by:

- Millwood Forest LP
- Glenwood Forest LP
- Goodwood Forest LP
- Homewood Forest LP
- Longwood Forest LP
- Majestic Pine Forest LP

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BD 3(2), BG 1, CB 24, CB 25 and GC 2.

For the avoidance of doubt this Ruling does not consider or rule on the application of ss DP 11 or EI 1 to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is the formation of an unincorporated joint venture by six limited partnerships (Millwood Forest LP, Glenwood Forest LP, Goodwood Forest LP, Homewood Forest LP, Longwood Forest LP and Majestic Pine Forest LP) (Forestry Partnerships) who each own a forest in the Emerald Hills Forest Estate in order to facilitate the efficient and effective harvest of their timber. Prior to the commencement of the harvest the land owned by each of the Forestry Partnerships will be transferred to a new limited partnership to allow the planting of the second rotation of trees on that land.

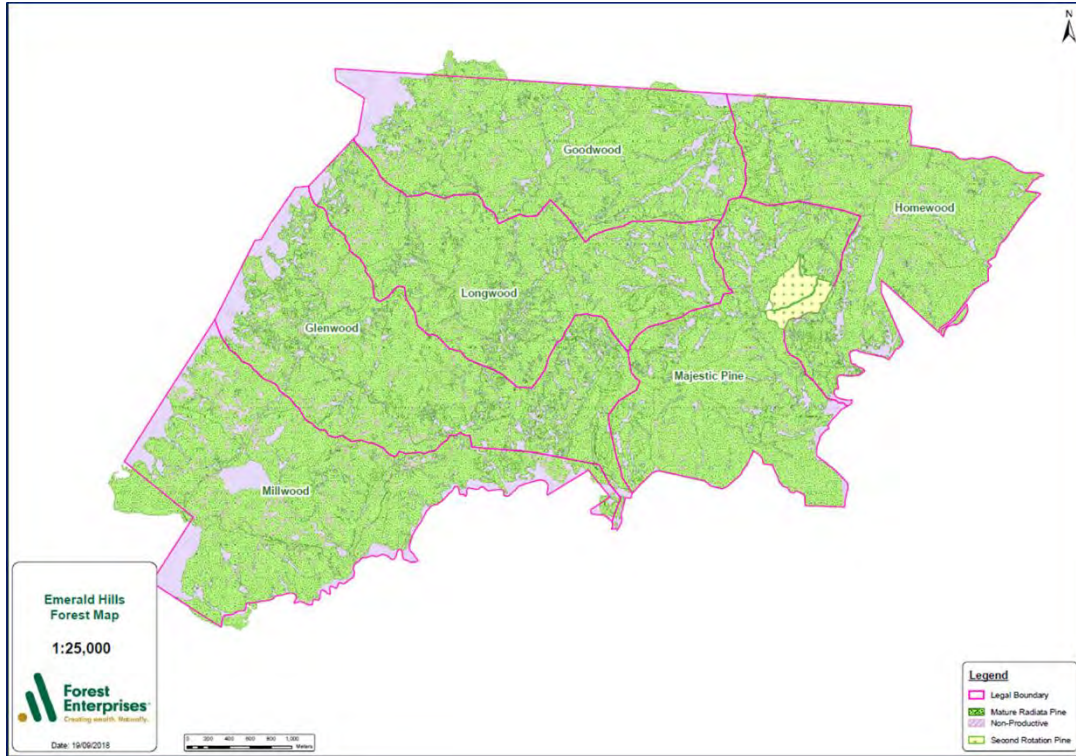
Further details of the Arrangement are set out in the paragraphs below.

Introduction

1. The Forestry Partnerships each own an adjoining parcel of land in the Emerald Hills Forest Estate (Emerald Hills Forest) situated southwest of Gisborne, which

was planted with Radiata pine in the early 1990s. These parcels combine to make a total forestry block of approximately 2,379 net stocked hectares.

2. The following map shows the total forestry block and the boundaries between the land parcels owned by the individual limited partnerships.



3. Each of the Forestry Partnerships is a separate managed investment scheme (MIS) registered under the Financial Markets Conduct Act 2013 and regulated by the Financial Markets Authority. Forest Enterprises Limited (FEL) is the manager of the six forestry blocks as well as being the licensed manager (under the Financial Markets Conduct Act 2013) of each MIS.
4. FEL has commenced, or is ready to commence, harvesting the six forests owned by the Forestry Partnerships. It is anticipated that the harvest will extend over a period of nine to ten years.
5. For reasons detailed below (see paras 18 to 20), the Forestry Partnerships and FEL consider that it is almost impossible (both practically and commercially) to harvest the six forests individually. For that reason FEL is proposing the collective harvest of all six forests (Collective Harvest). Practically this means disregarding the boundaries between the six component forestry blocks and undertaking the harvest as a single commercial venture.
6. Any collective arrangement entered into to achieve the harvest must respect each **Forestry Partnership's discrete stand**-alone status as a MIS and also respect the investment objectives set out in the original Prospectuses. Undertaking the Collective Harvest by way of a joint venture will maintain the stand-alone status of each MIS. Therefore, it is proposed that the Collective Harvest will be undertaken

as an unincorporated joint venture (UJV) governed by a joint venture agreement (JVA).

7. The UJV will preserve the following fundamental characteristics of the Forestry Partnerships' investment:
 - A single rotation investment with harvest occurring at the end of the investment period;
 - A boutique investment primarily for personal investors, family trusts and closely held companies;
 - An investment which provides personal ownership and control by the investors; and
 - An investment which can be visited and enjoyed first hand, rather than being only on paper.
8. To effect the Collective Harvest, each of the Forestry Partnerships will authorise the collective harvest of their mature trees by entering into the UJV by signing the JVA.
9. The Collective Harvest will necessitate each of the Forestry Partnerships to grant themselves a forestry right (Forestry Right), which will separate the ownership of trees from the underlying land on which the trees are planted. Prior to the Collective Harvest the land owned by each of the Forestry Partnerships will be transferred into a new limited partnership.
10. The draft JVA was provided to Inland Revenue on 8 October 2018. The terms and conditions of the final signed version of the JVA will not differ in any material respect from the version provided to Inland Revenue.
11. The parties to the JVA are the Forestry Partnerships and FEL as the manager. The relationship between these entities is that of contracted parties. Under the JVA each Forestry Partnership will continue as an autonomous investment entity but will agree to exchange the revenue arising from the harvest of 100% of the forest on their land for the right to an agreed percentage share of the revenue arising from the Collective Harvest by the joint venture.
12. The JVA sets out the background to the joint venture as follows:

BACKGROUND

- A. Each of the Participants is a limited partnership registered under the Limited Partnerships Act 2008 which owns the land (the "Land") and approximate area of mature radiata pine forest as set out in Schedule 1. These areas of mature radiata pine forest are identified in the forest maps in Schedule 2. The areas of mature radiata pine forest are referred to individually as their "Participant Forest" and collectively as the "Participant Forests".
- B. Each of the Participants is also a managed investment scheme registered under the Financial Markets Conduct Act 2013 with the name and registration number set out in Schedule 1. Forest Enterprises Limited is the licensed manager of each Participant's managed investment scheme.
- C. Each Participant has been authorised (by special resolution passed by the shareholders of its general partner, as set out in Schedule 3 (the "Special

Resolutions”) to enter into and perform this joint venture for the benefit of their on-going managed investment scheme.

- D. The Participants now wish to implement the actions authorised by the relevant Special Resolutions by entering into this joint venture for the collective harvest of their Participant Forests by the Manager which will result in each Participant receiving an agreed share of the proceeds from the harvest of the Participant Forests. The Participant Forests are collectively known as the Emerald Hills Group of forests; therefore, the joint venture is named the Emerald Hills Group Harvest Joint Venture (or the “Joint Venture”).
- E. The Joint Venture is exclusively for the collective harvest of the Participant Forests and distribution of the proceeds of sale of such collective harvest to the Participants in the agreed shares set out in this Agreement. Therefore, to secure the financial interests of the Participants in the Joint Venture separately from their financial interests in their Land they have agreed to create forestry rights with identical terms and to allow an encumbrance in favour of the other Participants over their forestry right.
- F. The Participants have agreed to cooperate for the benefit of their separate businesses by entering into this Joint Venture the basis and terms of which are set out in this Agreement.

History of Emerald Hills

13. FEL contracted to purchase Emerald Hills Station, a 2,836-hectare property, in 1992. Settlement was in three equal tranches:
- 17 December 1993: title for the Glenwood and Millwood blocks transferred;
 - 31 March 1994: title for the Longwood, Pinewood (later renamed Majestic Pine) and Goodwood blocks transferred; and
 - 30 June 1994: title for the Homewood block transferred (as well as titles to the residual blocks).
14. Settlement related to the release of the six forestry blocks (which became investments) which were subdivided from the total property. Various houses and related station improvements (woolshed, yards etc) which were not included in the investments were sold off separately by FEL.
15. The Prospectuses for the six investments were registered progressively as follows:

Investment name	Prospectus registration date
Millwood	24 September 1993
Glenwood	15 October 1993
Longwood	3 December 1993
Majestic Pine	25 February 1994
Goodwood	18 March 1994
Homewood	6 May 1994

16. Each of the six investments was fully subscribed for in relatively quick succession, as reflected by the close sequence of prospectus registration dates.
17. The Forestry Partnerships all commenced as partnerships of qualifying companies and subsequently transitioned to limited partnerships (as a result of the

enactment of the Taxation (GST and Remedial Matters) Act 2010, which repealed the Loss Attributing Qualifying Company regime).

Background to undertaking the forest harvest

18. In planning for the harvest, FEL has taken account of the significant other areas of 1990's planted forest outside of FEL's management that will also require harvesting. The Forestry Partnerships and FEL consider it is likely that all 1990 forest areas (not just those managed by FEL) are going to be competing for:
- Harvest infrastructure - including logging, roading and cartage contractors.
 - Access to sensitive roads - some roads are not able to be used in winter or have restricted access in winter.
 - Limited domestic market options in the Gisborne area. There is a mill located outside of Wairoa that requires small volumes of logs, but this mill is better serviced from the harvest of other forests. The large Juken New Zealand mill on the outskirts of the city of Gisborne seldom buys third party logs as they own a substantial forest resource. Consequently, almost all the logs from the Collective Harvest of the Emerald Hills Forest will be exported.
 - Limited port space for the large percentage of logs that must be exported. FEL's harvest program scheduling in the Gisborne region is predicated on the second berth development proposed for the Eastland Port occurring. Following this development, FEL estimates that it will then be able to export a maximum of 750,000 tonnes per annum through the Eastland Port. Based upon the port's expected maximum capacity, the Collective Harvest of the Emerald Hills Forests will take nine to ten years starting when the oldest trees are 24 years old (in 2018) and finishing when the trees will be 34 years old (in 2028).
 - Potentially limited market uptake.
19. FEL is also mindful of the increasing impact of changing legislative requirements including:
- Resource Management Act 1991—the prospect of harvest quotas per river catchment, and maximum continuous clearfell areas per annum.
 - Health and safety regulation - incentivising more machinery and less labour requiring different relationships with harvest contractors who have more capital invested.
20. FEL also needs to resolve the impact of the following factors that will affect the **harvest of the Forestry Partnerships' forests**:
- Each Forestry Partnership has a relatively large forest area in just two or three age classes - consequently it is not possible to harvest each age class at the selected optimum age (historically around age 28 years).
 - The Forestry Partnerships' forest areas are contiguous. This arose from the historical consequence of the legislative environment necessitating the subdivision of farms purchased for investments into multiple MIS. However, this gives rise to material boundary issues and it is recognised that the most efficient harvest will be achieved by ignoring these artificial boundaries.

- Vulnerability to access from one public road. However, by collective harvesting, FEL will have the choice of three major and two minor road connections and therefore the ability to operate via any of these depending upon weather, status of the internal roads and other circumstances.
21. The circumstances described in paras 18 to 20 mean that it is extremely impractical (nearing practically and commercially impossible) to harvest the six forests individually. However, a Collective Harvest will mean that the combined operation will be of sufficient scale to attract the interest of major contractors across the whole gamut of harvesting and log sale service providers. This means that FEL will be able to interact with the service providers in a way that translates into further economies and value to the Forestry Partnerships.
22. This larger scale also enables FEL to attract top forestry professionals to manage the harvest, plus enter into logistics solutions in conjunction with transportation providers and the ports.

FEL's role and responsibilities

23. **FEL's obligation in respect of the Forestry Partnerships is to act in accordance with the Financial Markets Conduct Act 2013, the governing documents, and the Statement of Investment Policy and Objectives (SIPO).**
24. The investment objective for the Forestry Partnerships is expressed in the SIPO as follows:

Investment Objectives - Primary Assets

The investment focus is on the Primary Assets as they contribute most to the investment return.

Treecrop

Of the two Primary Assets, the Treecrop is projected to contribute the largest portion of the investment return. The return generated from the harvest of the TreeCrop is enhanced by the silviculture operations performed on the trees (pruning and thinning operations), plus the quality of the harvest management.

The investment objectives for the Treecrop are -

1. To maximise the eventual return from the TreeCrops harvest by undertaking industry best practice silviculture operations identified as being able to add value to the Treecrop; and
 2. To maximise the return at harvest by using industry best practice harvest methods identified as being able to add value; and
 3. To contract with quality service providers able to add value to the silviculture and harvest activities; and
 4. To harness the scale and common interests of the investment with those of other investments managed by the Manager to maximise the investment return.
25. FEL has a legal responsibility to act to resolve any known challenges, in addition to its underlying business focus to achieve the best investment outcome for investors. Clause 24.1(h) of the Deed of Scheme Management states that FEL may:

- (h) ... enter into any arrangement to profit sharing union of interest, amalgamation, co-operation, joint venture, reciprocal concessions, licensing, distribution or otherwise with any person which is consistent with the Plan [The Plan means the plan for planting, tending, maintaining, managing, harvesting trees on the land and carrying away any forest produce set out in the Prospectus] and the objects of the Limited Partnership and which will directly or indirectly benefit the Limited Partnership and to take or otherwise acquire or deal in choses in action, choses in possession, shares in securities of any such person and to sell, hold, reissue with or without guarantee or otherwise deal with the same and to grant licences and rights to any property of the Limited Partnership to any such person;

Collective Harvest by Unincorporated Joint Venture

26. Collective harvesting as a UJV means there will be no regard to each Forestry Partnership's forest boundaries. Harvesting will be focused on the most cost-effective harvest of the entire area of joint venture forest, regardless of which of the Forestry Partnerships is the legal owner of the trees.

Details of the Collective Harvest

27. While the typical harvesting age of Radiata pine is 28 years, harvesting of the Emerald Hills Forest will begin early (before the oldest trees are 28 years) and finish late (after the youngest trees are 28 years). All other factors being equal, the quantum of stumpage per hectare will be less but early for the younger trees harvested and more but later for the older trees harvested. The balance between early and late harvest is targeted to achieve an average age of the trees at harvest of the original Prospectus target of around 28 years.
28. Collective Harvest in this manner over nine to ten years creates the environment for each Forestry Partnership to resolve as best possible the known harvesting challenges and achieve the targeted objectives.
29. The objective of the Collective Harvest joint venture is specifically:
- To ensure the forest of each Forestry Partnership is able to be harvested;
 - To maximise the opportunity for a better (more profitable) harvest outcome for each Forestry Partnership;
 - To minimise all risks for each Forestry Partnership, including crop, access to domestic markets and access to port;
 - To aim to achieve an average age at harvest of approximately 28 years (reflecting the original expectation in the relevant Prospectus for each Forestry Partnership).
30. The objective is also to endeavour to meet the investors' expectations around timing of harvest, and therefore the timing of payment of the investment return. To a degree this objective has to be compromised to achieve the other objectives. However, the UJV will finish the Collective Harvest no later than four years after the harvest conclusion expectation set out in the relevant Prospectus. Directly or indirectly, achieving the targeted objectives should translate into increased return or less risk of reduced return from the harvest.

Terms of the joint venture

31. Each of the Forestry Partnerships will enter into the JVA to facilitate the Collective Harvest and will accordingly be a joint venturer.
32. Under the JVA the Forestry Partnerships will agree to collectively harvest their forests. Conditions precedent to the commencement of the UJA are that:
- Each of the Forestry Partnerships will grant themselves a forestry right (Forestry Right) under the Forestry Rights Registration Act 1983 (FRR Act), which has the effect of separating the mature first rotation trees from the land on which the trees stand, as the joint venture is specific to the Collective Harvest of the trees. Clause 1 of the JVA states:

1 Forestry Right

1.1 Creation of Forestry Right

It is a condition precedent prior to this Agreement coming into effect that each Participant creates a forestry right in favour of the Participant over its **own Land in respect of the Participant's Forest** in accordance with section 2A of the Forestry Rights Registration Act 1983 and to register the forestry right **against the title of the Participant's Land in accordance with the Land Transfer Act 1952.**

1.2 Form of Forestry Right

The forestry right to be created under clause 1.1 shall be in the form set out in in Schedule 5.

1.3 Variation or Surrender of Forestry Right

No forestry right created under clause 1.1 may be varied, surrendered or transferred without the prior written consent of the other Participants.

- Each of the Forestry Partnerships will execute an encumbrance (Encumbrance) that will be registered under the Property Law Act 2007 over **that Forestry Partnership's Forestry Right in favour of the other five Forestry Partnerships** to secure its obligations under the JVA. Clause 2 of the JVA states:

2 Encumbrance

2.1 Encumbrance over Forestry Right

It is a condition precedent prior to this Agreement coming into effect that each Participant executes and registers an encumbrance under the Property Law Act 2007 over **that Participants' forestry right, in favour of the other Participants, to secure performance of that Participant's obligations under this Agreement. The Manager will ensure that each Participant's authorised encumbrance is registered.** Each Participant covenants that it will not permit any prior third party security interest to subsist in relation to the **Participant's forestry right.**

2.2 Form of Encumbrance

The encumbrance to be created under clause 2 shall be in the form set out in in Schedule 6.

33. Clause 3.2 of the JVA sets out the purpose of the joint venture as follows:

3.2 Purpose of Joint Venture

The purpose of the Joint Venture is to -

- (a) enable the Manager to undertake the harvest of all the Participant Forests as one integrated harvesting operation in order to maximise the financial return from harvest and minimise the risks associated with harvest for the shared benefit of the Participants ("Collective Harvest"); and to
- (b) undertake all business activities incidental to the Collective Harvest.

34. Clause 3.3 of the JVA sets out the joint venture interests (Percentage Share) of each of the Forestry Partnerships as follows:

3.3 Joint Venture Interests

The Joint Venture Interests of the Participants are -

Participant	Percentage Share
Glenwood Forest LP	17.3%
Goodwood Forest LP	14.9%
Homewood Forest LP	18.4%
Longwood Forest LP	15.1%
Majestic Pine Forest LP	16.0%
Millwood Forest LP	18.3%

35. Clause 3.4 of the JVA states that each Forestry Partnership retains ownership of **their forest as grantee under that Forestry Partnership's Forestry Right:**

3.4 Participants Scheme Property

Subject to clause 3.5, each Participant retains ownership of its Participant Forest as grantee under that Participant's forestry right subject to the encumbrance registered in terms of clause 2 for the benefit of the other Participants, and all other Scheme Property of that Participant's managed investment scheme whether those assets were acquired or accrued before or after the Commencement Date.

36. **Clause 3.5 of the JVA states that each Forestry Partnership's ownership of their forest continues until the point of sale of the harvested logs by FEL, at which time the Forestry Partnership contributes the proceeds of sale of the logs to the UJV as "Joint Venture Property":**

3.5 Participants Joint Venture Property

Each Participant's ownership of their Participant Forest as expressed in clause 3.4 continues until the point of sale of the harvested logs by the Manager at which time, the Participant contributes the proceeds of sale of the logs to the Joint Venture as Joint Venture Property.

37. **The JVA defines "Joint Venture Property" as follows:**

Joint Venture Property means any assets of the Joint Venture from time to time, and includes:

- (a) cash and amounts receivable;
- (b) **the proceeds of sale of harvest of all Participants' forests and all rights and receivables** in respect of such proceeds;
- (c) each encumbrance over the forestry right given by each Participant under clause 2.1; and
- (d) choses in action which may give rise to a debt, revenue, claim or any other right or remedy under this Agreement,

- such assets to be held by the Participants as tenants in common according to each **Participant's** Percentage Share.

38. Clause 3.6 of the JVA states that all Joint Venture Property is held by the Forestry Partnerships as tenants-in-common in proportion to their joint venture interest:

3.6 Participants Entitlement to Joint Venture Property

All Joint Venture Property is held by the Joint Venture Participants as tenants in common in proportion to their Joint Venture Interest. Each Participant is entitled to its Percentage Share of the Joint Venture Property after deduction by the Manager of all Harvest Costs arising from the Collective Harvest. No Participant may claim that it has an entitlement to more than its Percentage Share of the Joint Venture Property after deduction of all Harvest Costs.

39. Clause 3.7 of the JVA states that each Forestry Partnership undertakes to allow FEL with full and unrestricted access to their land for the purpose of the joint venture:

3.7 Unrestricted Access for Collective Harvest

Each Participant undertakes to provide the Manager with full and unrestricted access to their Land and Participant Forest for the Purpose of the Joint Venture and authorises the Manager **to construct all necessary roads and related infrastructure on the Participant's Land.**

40. Clause 4 of the JVA sets out the relationship principles of the UJV as follows:

4 Relationship Principles

4.1 Principles

The Participants recognise that the following relationship principles are important and intend these principles to guide them in their dealings with each other under this Agreement. All Participants are expected to observe the following principles at all times:

- (a) work together in good faith to enable the Joint Venture (through the **Manager**) **to achieve the Purpose while recognising each other's separate** business and investment interests;
- (b) work together cooperatively and constructively to give effect to the terms and conditions set out in this Agreement; and
- (c) observe high standards of integrity and fair dealing with each other.

4.2 Covenants

Each Participant covenants and agrees with the other Participants:

- (a) To diligently observe and perform its obligations and commitments in respect of the Joint Venture and pursuant to this Agreement;
- (b) To make their Participant Forest available for the Purpose of the Joint Venture.

41. Clause 5 of the JVA sets out the term (Term) of the joint venture as follows:

5 Term of Joint Venture

5.1 Term

Unless the Participants unanimously agree otherwise, the Joint Venture shall commence on the Commencement Date and remain in effect until:

- (a) completion of Collective Harvest of the Participant Forests subject to the discretion of the Manager not to harvest any areas which do not contribute to the Purpose of the Joint Venture; and
- (b) distribution by the Manager of all the Joint Venture Property arising from the Collective Harvest to the Participants in their Percentage Shares after deduction of all Harvest Costs.

42. Clause 15 of the JVA states that the JVA concludes at the end of the Term:

15 Winding Up

15.1 Winding Up at End of Term

This agreement concludes at the end of the Term.

43. Clause 6.1 of the JVA provides for the equitable treatment of any harvesting undertaken by any of the Forestry Partnerships prior to commencement of the JVA (noting that harvest may be required to commence before the JVA is practicably able to be executed):

6.1 Harvesting Prior to Commencement

The Participants agree that where harvesting has occurred in a Participant Forest prior to the commencement of this Agreement the Manager will adjust the payments and accounting for the Participant Shares such that at the earliest possible date following the Commencement Date the Percentage Share of each Participant will be correctly aligned.

44. Clause 8.1 of the JVA states that the agreement does not create or constitute a partnership between the Forestry Partnerships:

8 No Partnership

8.1 No Relationship of Partnership or Agency

Nothing in this Agreement shall create or constitute or be deemed to create or constitute a partnership between the Parties, nor to constitute or create, or be deemed to create or constitute a Participant as an agent of any other Participant for any purpose whatsoever.

Terms of the Forestry Rights

45. Each of the Forestry Partnerships (as grantor) will grant themselves (as grantee) a Forestry Right under the FRR Act.
46. Schedule 5 of the JVA contains the terms and conditions of the Forestry Rights and relevantly provides:

WHEREAS:

- A. The Grantor is the registered proprietor of the Land described in Schedule 1.
- B. The Grantor wishes to create a forestry right in favour of itself over the area **delineated on the plan in Schedule 3 ("the Forestry Block") on the terms of this forestry right instrument.**

...

1 GRANTEE'S RIGHTS

- 1.1 In consideration of the covenants and conditions on the part of the Grantee and the Grantor expressed or implied in this Forestry Right the Grantor transfers and grants to the Grantee for the term specified in Schedule 2 a Forestry Right within the meaning of the Forestry Rights Registration Act 1983 being the rights to:
- (a) Manage, harvest, carry away, sell or otherwise utilise all mature (or soon to be mature) trees, timber and logs growing on the Forestry Block for the exclusive benefit of the Grantee.
 - (b) Make install and use roadways, cableways, tracks, skids, gates, landings and other facilities on the Forestry Block (whether existing or otherwise) as may be necessary or convenient for the full enjoyment of this Forestry Right and leave the same in place at the end of the Term unless required to be removed pursuant to a resource or similar consent, or requested to be removed by the Grantor;
 - (c) By itself or by its agents, employees, contractors, licensees and invitees from time to time enter and pass and repass on the Land with or without powered equipment and tools, machinery, vehicles and plant of all kinds.
 - (d) Place and stack on any part of the Forestry Block as may be necessary or convenient any trees, timber or logs harvested pursuant to this Forestry Right.
 - (e) Use any roadway on the Land for the purpose of the haulage of trees, timber and logs grown on the Forestry Block.
 - (f) Generally, to do whatever the Grantee shall in its sole discretion determine may be necessary or convenient for obtaining the full benefits of the rights and privileges granted by this Forestry Right.
- 1.2 Roads and landings for the purposes of harvesting under this Forestry Right will be built at the sole discretion of the Grantee and to the standard the Grantee reasonably determines.
- 1.3 The Grantee shall be under no obligation on the expiry or termination of this Forestry Right to replant trees on the Forestry Block.

...

4 MUTUAL COVENANTS

4.1 The rights agreed to be granted to the Grantee are expressly declared to be in the nature of a profit a prendre over the forest established on the Forestry Block.

...

4.3 The rights recorded in this document shall constitute a Forestry Right within the meaning of the Forestry Rights Registration Act 1983 and both the Grantor and the Grantee shall perform such acts as may be necessary to complete registration of this Forestry Right **against the title to the Grantor's land of which the Forestry Block** forms part and to maintain registration until expiry or termination.

47. Prior to the transfer of the land to the new limited partnership both the grantor and the grantee of the Forestry Right will be the relevant Forestry Partnership.

Terms of the Encumbrances

48. Each of the Forestry Partnerships will execute an Encumbrance that will be **registered under the Property Law Act 2007 over that Forestry Partnership's** Forestry Right in favour of the other five Forestry Partnerships.

49. Schedule 6 of the JVA sets out the terms and conditions of the Encumbrances which are contained in the Encumbrance Instrument which relevantly provides:

Encumbrancer

Goodwood Forest LP

Encumbrancee

Glenwood Forest LP
Homewood Forest LP
Longwood Forest LP
Majestic Pine Forest LP
Millwood Forest LP

Estate or interest to be encumbered

Forestry Right

...

Encumbrance

The Encumbrancer encumbers for the benefit of the Encumbrancees the Forestry Right in the above computer register(s) with the above sum of money, annuity or rent charge, to be raised and paid in accordance with the terms set out in the Annexure Schedule and so as to incorporate in this Encumbrance the terms and other provisions set out in the Annexure Schedule for the better securing to the Encumbrancees the payment(s) secured by this Encumbrance, and compliance by the Encumbrancer with the terms of this encumbrance.

...

ANNEXURE SCHEDULE

BACKGROUND

A. The Encumbrancer is the grantee under a Forestry Right registered against the Land.

- B. The Encumbrancer has entered into a Joint Venture Agreement dated [] with the Encumbrancees to enable collective harvest of the first rotation trees on the respective parcels of land over which the Encumbrancer and Encumbrancees have been granted Forestry Rights.
- C. The Encumbrancer enters into and registers this Encumbrance to secure its obligations under the Joint Venture Agreement.

COVENANTS AND CONDITIONS

...

2. Encumbrance

The Encumbrancer encumbers the Forestry Right for the benefit of Encumbrancees for a term of 20 years with an annual rent charge of \$10.00 to be paid on 1st June each year if demanded by that date. If, during the period preceding 1 June 2019 and each successive 12 months there shall have been no breach of the covenants contained in this Encumbrance, then the annual rent charge payable in respect of that twelve-month period shall be deemed to have been paid.

3. Covenants

The Encumbrancer acknowledges and covenants with the Encumbrancees that it will comply with its obligations under the Joint Venture Agreement.

4. Implied terms

- a. Sections 301 to 307 (inclusive) of the Property Law Act 2007 and section 154 of the Land Transfer Act 1952 shall apply to this Encumbrance.
- b. The Encumbrancees shall be entitled to the rights, powers and remedies given to encumbrancees by the Land Transfer Act 1952 and the Property Law Act 2007 except that the Encumbrancees shall not be entitled to the power of sale in Subpart 7 of Part 3 of the Property Law Act 2007.

5. First Charge

This Encumbrance shall rank as a first charge in respect of the Forestry Right and the Encumbrancer shall enter into a priority with any charge-holder or mortgagee to ensure that state of affairs.

6. Discharge

Under no circumstances shall the Forestry Right be released from the provisions of this Encumbrance unless any of the following occurs:

- (a) The Encumbrancees release the Encumbrancer by deed from the provisions of the Encumbrance;
- (b) The covenants expressed in this Encumbrance become obsolete; or
- (c) The covenants expressed in this Encumbrance are no longer enforceable.

For the avoidance of doubt the Encumbrancees agree to discharge the Encumbrance upon the occurrence of any of the events in (a) – (c) above.

Calculation of Collective Harvest Percentage Share

50. Income derived by the limited partners of the Forestry Partnerships from the sale of timber as part of the Collective Harvest will be based on each Forestry Partnership's share of the joint income (Percentage Share) received from the harvest for the year.
51. The underlying principle behind sharing the total revenue from the Collective Harvest is that the Forestry Partnerships will be better off receiving a Percentage Share of the total revenue from the Collective Harvest of the Emerald Hill Forests, rather than 100% of the revenue from the harvest of their individual forest.
52. The Percentage Share that each of the Forestry Partnerships will receive of the net **harvest proceeds is calculated based on the relevant Forestry Partnership's "Forest Crop Value" (Forest Crop Value)** - which is prescribed by *IAS 41: Agriculture* as it relates to biological assets. Each Forestry Partnership will agree to share the total revenue and expenditure from the Collective Harvest in accordance with the relevant Forestry Partnership's Forest Crop Value, as a percentage of the total Emerald Hills Forest, Forest Crop Value.
53. Specifically, the Percentage Share will be calculated as follows:

$$\text{Percentage share} = \frac{\text{Forest Crop Value of the relevant Forestry Partnership}}{\text{Total Forest Crop Value for all Forestry Partnerships}}$$

54. To illustrate, the table below estimates the Percentage Share for each of the Forestry Partnerships using approximate Forest Crop Values from September 2017:

Forest	Approx Forest Crop Value (Sept 2017)	Percentage Share
Goodwood	\$7,333,093	14.9%
Majestic Pine	\$7,880,138	16.0%
Millwood	\$8,979,432	18.3%
Glenwood	\$8,521,282	17.3%
Longwood	\$7,441,028	15.1%
Homewood	\$9,044,131	18.4%
	\$49,169,104	100.00%

55. The benefit of using Forest Crop Value is because the methodology is:
- Prescribed by *IAS 41: Agriculture*, the accounting standard for valuation of biological assets.
 - Complies with the New Zealand Institute of Forestry valuation standard.
56. The final calculation will use a subset of each Forestry Partnership's projected cashflow (gross of tax) to which an appropriate discount rate will be applied.
57. In terms of the process used to come up with the Forest Crop Value, FEL will prepare the forestry and other inputs and enter these into each Forestry **Partnership's cashflow to calculate the resulting shares** for each Forestry

Partnership in the joint venture. The assumptions for the forestry inputs are reviewed by the Forestry Auditor, and the cashflow amounts (being the calculated Forest Crop Value and the resulting shares of the Collective Harvest joint venture revenue) are reviewed by the Financial Auditor.

58. Following this, FEL will prepare and circulate a report to the investors to enable them to vote on the Collective Harvest joint venture proposal.
59. The key measure against which the calculated harvest shares is reported is a comparison with the percentage of net stocked areas of each Forestry Partnership in the joint venture. This is because, all other factors being equal, the percentage allocation of harvest to each Forestry Partnership should be the same percentage as the net stocked area. The differences in the calculated Percentage Shares is then explained and rationalised with reference to the actual hard data relating to **valid actual differences between each Forestry Partnership's forest in the joint venture.**
60. The expected timing of the Collective Harvest is a period of around nine to ten years. Accordingly, in each of those years, the Forestry Partnerships will harvest and dispose of timber to third parties. Each Forestry Partnership will be required to calculate and return their Percentage Share of the joint income arising from the sale of timber (net of their share of allowable deductions). Under the JVA, the Percentage Share of joint income and deductions for the year will be based on the **respective Forestry Partnership's Forest Crop Value percentages.**
61. The amount of the Percentage Share paid to each Forestry Partnership in a tax year will be a net amount after deduction by FEL of all Harvest Costs (as defined in the JVA) arising from the Collective Harvest.

Transfer of land

62. While the original Prospectuses only contemplated the land being planted and harvested once (ie, a single rotation), once the Collective Harvest has been completed it has been acknowledged that a replant of the areas harvested (the "cut- over") must occur for the following reasons:
 - The consent received from the Gisborne District Council to harvest the mature trees requires the cut-over to be replanted within 18 months of harvest;
 - The Climate Change Response Act 2002 requires the forest areas defined as **"Pre-1990 Forest" to be replanted in forest or the deemed pollution** consequences (carbon emissions) accounted for and paid by the surrender of New Zealand Units (NZUs). The Forestry Partnerships do hold Pre-1990 Forests, and therefore if they are not replanted, NZUs would have to be surrendered; and
 - The value of the land is enhanced by replanting the second rotation as soon as possible – ie, the best and most economic land use is a crop of plantation Radiata pine trees, not the regrowth pine and weed species which will otherwise naturally regenerate.
63. This Collective Harvest may result in changes in the value and options available in respect of the underlying land which may favour certain Forestry Partnerships

over others. This is because the Collective Harvest will affect the order in which the subsequent replant for the second rotation occurs.

64. To ensure all Forestry Partnerships are treated equitably, the land will be transferred at market value to a new limited partnership after the Forestry Rights have been granted, but before the Collective Harvest begins. The new limited partnership will grant rights of way over its land, which will authorise FEL passing over the land as required to complete the harvest.
65. The original investors are not required to participate in the second rotation planting. This is consistent with the expectation set out in the original Prospectuses (and in each Annual report), which prescribed that the investment can be wound up at the conclusion of harvest and the investors paid out in full.
66. This Ruling does not consider or rule on:
 - the transfer **of the Forestry Partnerships' land to the new limited partnership** and subsequent planting and harvesting of the second rotation tree crop on the land, or
 - the entry and exit of partners into and out of the new limited partnership.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- a) The creation of the Forestry Rights does not give rise to income for the limited partners of the Forestry Partnerships under s CB 24.
- b) The registration of Encumbrances over the Forestry Rights does not give rise to income for the limited partners of the Forestry Partnerships under s CB 24.
- c) The pooling of the Forestry Rights in the UJV does not give rise to income for the limited partners of the Forestry Partnerships under s CB 24.
- d) The Arrangement does not give rise to income for the limited partners of the Forestry Partnerships under s CB 25.
- e) Income from the disposal of timber as part of the Collective Harvest is derived by **the Forestry Partnerships' limited partners under s BD 3(2) during the year in** which the proceeds from the disposal of the timber become due and payable to the Forestry Partnerships.
- f) Section GC 2 does not apply to the Arrangement.
- g) Section BG 1 does not apply to vary or negate the conclusions above.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 January 2018 and ending on 31 March 2028.

This Ruling is signed by me on the 27th day of November 2018.

Howard Davis
Director (Taxpayer Rulings)