COMMENT

FORESTRY TAXATION

Editorial comment in last November's issue of this journal expressed anxiety about the decline in new planting rates. Since then the new National Government has shown that it wants to encourage a reversal of this trend by reforming forestry taxation.

Summary of the forestry taxation changes

In lay people's terms the Taxation Amendment Act No. 3, which took effect from the personal income year commencing April 1, 1991, makes the following changes:

(a) It retains the cost of bush system for immature forest sales whereby the sale price is carried forward by the buyer for deductibility purposes until a further sale is made. The only exception to this rule is that where the sale is between two "non-associated" persons and the sale results in a loss, the loss value may be written-off against income from any source by the seller.

(b) It revokes the cost of bush taxation system introduced in 1986 for direct forest expenditure and replaces it with a provision that such costs will be deductible in the year incurred from income from any source. This means that direct forest tree crop costs from seedling purchase to thinning, along with repairs and maintenance and administrative expenditure, will now be deductible expenditure in the year it is incurred.

The exceptions to this deductibility provision are:

land preparation is annually depreciable at 5%

all fencing costs are annually depreciable at 10%

temporary roading is annually depreciable at 20%

permanent roading is annually depreciable at 5%

Short-term implications on forest profitability

Subject to various qualifications the Ministry of Forestry has estimated that the new tax change will increase post-tax profitability of afforestation investment by about 7%.

Anomalies

The costs of fencing and preplanting preparation such as removal of gorse, weeds and scrub are not deductible for forestry although weed control after tree planting is deductible. In contrast, land preparation and fencing is deductible for farming operations.

It would be wise for foresters not to complain too loudly however.

There are two paths Government can take to achieve tax neutrality in this area. One is to make preplanting preparation and fencing for forestry deductible and the other is to remove deductibility for land preparation and fencing for agriculture. You do not have to be a genius to observe that by setting up creative ownership structures and accounting systems it should be possible for forest investors to get around the current anomalies in a satisfactorily legal manner.

Pre-election promises yet to be met

The National Party pre-election policy on forestry taxation stated that "the purchase cost of forests will be fully deductible".

This idea had merit because the transactions and value of immature forests would increase under such a change as the purchase cost of bush component would no longer have a discounting effect on immature forest value. It would also reduce the current risks associated with the long-term nature of forest investment.

Increased exchanges of immature forest would lead to the establishment of a competitive market for them which would help make the forest industry more efficient, but the fiscal cost of adopting this policy would amount to several tens of millions of dollars.

Because of this expense Government has not introduced and is unlikely to introduce full deductibility for the purchase cost of immature forest until the economy is in much better shape.

What is the immediate effect on farm forestry?

The land which is suitable and available for forestry is substantially on farms but ironically farmers previously had a $7500 p.a. preferential tax deductibility. So they are one group in the country that do not benefit directly from the new forestry tax reform.

With the depressed real net revenue from farm products farmers are not in investment mode. However, it will now be easier for farmers to get forestry joint venture schemes going on their land. They should be able to rent land for forestry to some richer city cousins who may have surplus income and be able to take advantage of the new deductibility provisions.

Longer-term effect on rural land owners

The new taxation regime will enhance the quality of the wood coming on stream, since growers will have more of an incentive to undertake silviculture, i.e. they will not have to carry forward the cost of silviculture until the end of the rotation before it becomes deductible.

Andres Katz makes the point (see P. 18) that taxation induced changes to profitability will tend to be capitalised into the value of the land.

This means that current holders of land suitable for forestry will become richer. It also means that it will cost conservation organisations such as the QEII Trust and Nga Whenua Rahui more to secure land of high conservation value where it could be converted profitably to plantation forestry.

It will also eventually result in an increase in rural rating.

What will happen when the Labour Party gets back into power?

Paul Swain MP, forestry spokesman for the Labour party, is non-committal. He refuses to say that if elected Labour would force a return to the old forestry taxation system. Instead he talks about the need for a bipartisan approach. He certainly has a point. (See graph and inset on page 3.) One thing that has been constant about forestry taxation over the last three decades is change.

Psychological effects

Let us not be too scientific. The new forestry taxation regime is overcoming the widely held, although largely unjustified, public perception that the old forestry taxation system was "non neutral". This is sending positive signals to forestry investors, and may in fact be kick starting a new afforestation boom which will reduce unemployment, assist regional development, arrest reversion of hill country to non-productive scrub, conserve hundreds of thousands of hectares of eroding land, and eventually play a major part in curing this country's economic ills.

H.H. Levack

Changes in Forestry Taxation

It is not possible to say that taxation changes or other Government incentives/disincentives were the only cause of changes to private forest new planting rates but it is logical to assume a strong linkage.

Prior to 1962 only re-establishment costs could be deducted from current income. All other costs had to be carried forward in the "cost of bush" account until harvesting. Since then the following changes in forestry taxation incentives/disincentives have occurred. The numbers below relate to the seven points marked on the graph.

1. The regime was modified in 1962 with the introduction of the Forestry Encouragement Loans Scheme. A loan of up to $200 per planted hectare with interest at 5% capitalised was provided to qualified growers. Concessionary treatment was given to forest income by allowing "forward spreading" of the income over a five-year period for taxation purpose.

2. Further concessions were introduced in 1965; full deductibility was allowed on forest establishment and management costs against income from any source.

3. Since these tax concessions generally benefited only the corporate growers, it was decided in 1970 to extend the benefits to small growers through the introduction of the Forestry Encouragement Grants Scheme. Under this scheme up to 50% of qualifying expenditure was refunded by way of an annual grant.

4. In 1980 a cash refund scheme was introduced so companies with insufficient income to offset afforestation expenditure could also benefit (i.e. a cash refund of 45% of qualifying expenditure).

5. All the schemes were replaced in 1983 by the Forestry Encouragement Grants (FEG). Growers were paid a flat 45% grant irrespective of the growers' marginal tax rate. The dollar limit previously set on afforestation costs was abolished.

6. The FEG created major distortions between forestry and other sectors. In 1984, the Government decided to return to full tax deductibility similar to that provided for farm development expenditure. At the same time an overall review of business tax system was being undertaken.

7. A neutral tax regime featuring a "cost of bush" account was introduced in December 1986.

Effect of Tax (or Subsidies) on Private Forest

New Planting rates