Tax Working Group
Te Awheawhe Tāke

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The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

Coversheet: **Environmental tax concessions raised by submitters**

Briefing Note for Session 13 of the Tax Working Group
June 2018

Purpose of briefing note

This note summarises tax concessions with positive environmental impacts raised by submitters to the Tax Working Group requested by the Group at Session 12 (29 June 2018). It also includes appendixed material from *Tax and the Environment – Paper 1: Frameworks* presented at Session 8 (4 May 2018) overviewing environmental tax concessions.

Recommended actions

We recommend that you:

a **note** the various concessions highlighted by submitters.

Environmental tax concessions raised by submitters

Briefing Note for Session 13 of the Tax Working Group

July 2018

Prepared by the Inland Revenue Department and the New Zealand Treasury

Summary

1. This note summarises the views raised by submitters on the use of tax concessions relating to the environment, as requested by the Group at Session 12 (29 June 2018). For completeness, we also provide a summary of views on hypothecation of environmental taxes.

2. This note does not provide the Secretariat's assessment of the various proposals. The Secretariat's general thoughts on the use of tax concessions relating to the environment were outlined in *Tax and the Environment – Paper 1: Frameworks* presented at Session 8 of the Tax Working Group (4 May 2018). We have included the relevant section as an appendix to this report.

3. Of the 88 submissions from organisations and academics received on environmental issues, 15 expressed support for using the tax system to incentivise or reward actions with positive environmental impacts, with one submitter expressly opposed. Specific concessions suggested included deductions for maintenance of QE II covenanted land, environmental expenditure on farms (including riparian planting), electric cars, and environmentally-related R&D expenditure.

4. This note attempts to summarise the views of submitters on a best-efforts basis in limited time, and may therefore not have accurately captured the views of all submitters.

Tax concessions with positive environmental impacts

Issue: Environmental expenditure

Submitters in favour: Agcarm; CNI Iwi Holdings Limited; CPA Australia; Federated Farmers; Rural Women New Zealand; Te Rūnanga o Ngāi Tahu; Waikato Tainui; Young IFA Network

A number of submitters recommended more concessional tax treatment for environmentally friendly investments. Agcarm, Federated Farmers and Tainui specifically recommended allowing immediate deductibility for riparian planting, and CPA Australia recommended greater concessions for investment designed to reduce pollution run-off into water courses.

Note, there are currently special deduction rates for environmental expenditure, where environmental expenditure is defined as remedying, or mitigating detrimental effects on the environment – see Table 1 below.[1] Some of these deductions could be considered concessional. For example, feasibility expenditure is typically capitalised (for successful projects) meaning costs are claimed over the life of the asset. For environmental projects, feasibility expenditure is immediately deductible. As noted in the *Effective Tax Rates* paper, there are also special deduction arrangements for some types of agricultural expenditure.

Table 1: Existing special deduction rates for environmental expenditure

General description of expenditure	Rate
Testing and feasibility expenditure	100%
Construction/improvement expenditure	Default rate based on the lesser of 35 years (1/35) or the length of the applicable resource consent granted 1/life of resource consent).
Restoration expenditure	100%
Monitoring expenditure	100%

[1] Section DB 46 along with Schedule 19 of the Income Tax Act 2007. See http://www.ird.govt.nz/business-income-tax/expenses/environmental/bit-exp-env-deductionrates.html

Issue: Environmental tax credit

Submitters: EY

EY raised the idea of an "environmental tax credit," possibly targeting environmentally-related R&D (a further enhancement to the R&D tax credit regime currently being introduced), or investments in, or production from, renewable and alternative energy assets.

Issue: Maintenance of QE II land

Submitters: Federated Farmers, ECE Consultants

Two submitters suggested that costs incurred in looking after land subject to a QE II covenant be treated as deductible expenses. Federated Farmers notes, "if this deductibility was made expressly enacted it may short-cut discussions between famers and Inland Revenue about the nature and purpose of the costs. It would confirm present treatment and therefore come without a fiscal cost." As alluded to by Federated Farmers, some QE II expenses are already deductible in practice. For example, fencing expenditure incurred in keeping stock on the remaining farm land and out of the QE II land could be treated as a farming fencing expense, and therefore deductible.

Issue: Electric vehicles / hybrid vehicles

Submitters: Corporate Taxpayers Group; EY; Justice and Peace Commission

Two submitters suggested more favourable tax treatment for electric or hybrid vehicles. Low emission vehicles already enjoy some favourable treatment. Electric vehicles are currently exempt from road user charges until the number of electric vehicles becomes 2% of the national fleet. Hybrid vehicles do not pay road user charges and pay relatively little petrol excise duties. EY raised the idea of extending the exemption beyond 2%, as well as reducing excise taxes on alternative fuels.

Issue: Conservation

Submitters: Environment and Conservation Organisations of NZ (ECO NZ); Wise Response

Two submitters recommended concessions directed towards conservation. ECO NZ suggested ensuring that any potential capital gain tax, land tax or wealth tax excluded public and private conservation land, noting that many councils exclude conservation land from rates. They also recommended exempting measures to protect ecosystems from income tax. Both submitters recommended greater assistance for conservation measures such as weed and pest control.

Issue: Feasibility expenditure

Submitters: Corporate Taxpayers Group

The Corporate Taxpayers Froup highlighted potential environmental benefits of allowing deductibility for feasibility expenditure. They raise the point that "Many examples of feasibility expenditure arise in the energy generation sector, where new and more environmentally friendly alternatives are explored by businesses, or, to consider a different industry, this feasibility expenditure could be towards researching less detrimental ways of farming." As outlined in Table 1, some feasibility expenditure is already immediately deductible where it fits the definition of "environmental expenditure" (remedying, or mitigating detrimental effects on the environment). Feasibility expenditure was included in the revenue negative options paper considered at Session 12 (29 June 2018).

Issue: Environmental footprint tax

Submitters: Environmental Defense Society, EY, Forest and Bird

Three submitters suggested adoption of, or consideration of, an environmental footprint tax (or environmental consumption tax) which could take the form of a tax credit for land with

environmental value. The tax would be levied on a land area basis, with the rate set by categorical assessments of land use. Land use with high negative environmental impacts would attract a high tax rate, while land use with low environmental impacts would attract a low or negative tax rate.

Hypothecation of environmental tax revenue

A number of submitters commented on hypothecation of environmental tax revenue. Hypothecation does not reduce revenues in itself. However, by earmarking funds for a particular use, it reduces the amount of funding available for general government expenditure and we have therefore included submitters views on it here for completeness.

Issue: Hypothecation to environmental causes
Submitters: Association of Salaried Medical Specialists, Christchurch East Labour Electorate Committee, Dr Jonathan Barrett, Environmental Defence Society, Forest and Bird, Ministry for the Environment, Infrastructure New Zealand, Moana New Zealand, Ngati Whatua Orakei Whai Rawa Limited, Public Health Association of New Zealand, Rural Women New Zealand, Salvation Army, Te Ohu Kaimoana, Te Putahitanga o Te Waipounamu, Te Ropu Pakihi, Te Runanga o Ngai Tahu, Te Tumu Paeroa, Temperzone, University of Otago Department of Public Health, Venture Taranaki Trust, Waikato Tainui, Wise Response

23 submitters were in favour of hypothecation of environmental taxes to environmental projects. Submitters cited improved public acceptability, and reinforcement of their purpose.

Issue: Hypothecation to Māori groups
Submitters: Ngai Tuahuriri, Te Au Rangahau, Te Au Pakihi, Te Ropu Pakihi, Waikato Tainui

Three submitters argued for hypothecation to Māori groups. One further submitter was in favour of revenue raised from environmental taxes being spent within the rohe that it was raised.

Issue: Against hypothecation
Submitters: CDHB, DairyNZ, EY, Greenpeace, New Zealand Automobile Association, New Zealand Initiative, Oji Fibre Solutions, Packaging NZ, Taxpayers' Union, Young IFA Network

10 submitters were either against strong hypothecation, or called for environmental taxes to be introduced in a revenue neutral way. Several submitters highlighted that hypothecation can lead to under- or over-funding of the service for which it is hypothecated. Two submitters called for targeted tax reductions for low income people to address distributional concerns from environmental taxes *(CDHB, Greenpeace).* Two submitters highlighted concerns with use of the waste minimisation levy, including the lack of accountability for funds going to councils, and the exclusion of commercial recyclers *(Oji Fibre Solutions, Packaging NZ).*

Appendix: Tax concessions with environmental impacts

Extract from TWG Secretariat paper "Tax and the envrionemnt – Paper I: Frameworks" presented at TWG Session 8 (4 May 2018)

96. Tax concessions can be used to encourage positive environmental outcomes. For example, recycled goods could be exempted from GST, electric cars can be exempt from fringe benefit tax, or accelerated depreciation rates can be applied to investment in green investments. There are also tax concessions with other objectives that can encourage negative environmental outcomes.

97. In this section, we review the rationale for tax concessions; outline limitations with their use; suggest alternative approaches; and identify existing tax concessions in New Zealand that the Group may wish to receive further advice on.

Rationale of tax concessions

98. The underlying rationale for using tax incentives is similar to that of negative externality taxes. They can correct for market failure from externalities, but in this case, they are positive externalities. However, there are significant practical issues arising from the use of tax incentives that typically don't arise when using negative externality taxes (OECD, 2017). This suggests a more cautious approach.

Potential limitations and concerns with tax concessions

99. Tax incentives can struggle to encourage a diversity of cost effective actions. They often involve subsidising a particular type of mitigation measure, disadvantaging other potentially more cost effective alternatives. An exemption of fringe benefit tax for electric vehicles, for example, does not provide an incentive for commuters to consider other types of low-carbon transport. A fuel or carbon tax avoids this problem.

100. Tax incentives can also indirectly increase environmentally damaging behaviour by lowering the cost. A subsidy for hybrid electric vehicles, for example, could encourage people to drive more. Again, a fuel or carbon tax avoids this problem.

101. Tax incentives are often poorly targeted. The OECD reports that "tax incentives are frequently found to provide subsidies to actions that would have been taken in their absence while resulting in limited additional investment" (OECD, 2017). It is difficult to limit an electric vehicle tax exemption to only those households that would have not bought it without the subsidy. Tax incentives can also suffer from pricing problems. The tax benefit provided by exempting electric cars from fringe benefit tax is unlikely to align with the value of the positive externalities, or be at a tipping point for encouraging electric car purchases.

102. Like negative externality taxes, tax incentives can also raise distributional concerns. The OECD finds that tax incentives often accrue disproportionately to more affluent households.

103. International experience with tax concessions suggests they can be vulnerable to lobbying, potentially undermining the coherence of the tax system. Tax concessions can potentially be directed towards causes with the loudest voice, as opposed to causes with the greatest positive environmental externality.

104. Finally, unlike negative externality taxes, tax incentives do not raise revenue. Instead, tax incentives are a form of government spending.

Alternatives to tax concessions

105. This is not to say the Government shouldn't incentivise positive environmental behaviours. However, tax incentives may be a relatively blunt and expensive way to do it.

106. Direct payments for environmental services is one alternative approach – for example, payments for ecosystem services. There is also scope for some tax instruments to operate as both taxes and incentives – for example, foresters can claim carbon credits through the emissions trading scheme for engaging in abatement activity.

Current tax concessions with environmental impacts

107. A review of tax expenditures has identified several tax concessions in New Zealand that are likely to have negative environmental impacts:
   - Carparks – fringe benefit tax exemption for carparks provided to employees on the employer's premises
   - Petroleum mining – seven-year deprecation rule
   - Farming – accelerated depreciation and immediate write-offs for some types of expenditure

108. We have also identified some tax expenditures which could be having positive environmental impacts, but may be subject to some of the concerns outlined above:
   - Forestry – accelerated depreciation (expenditure related to the planting and maintenance of forest trees are immediately deductible)
   - Environmental expenditure – there are special deduction rates for environmental clean-up expenditure

109. Further review may be warranted to establish if the benefits of these tax exemptions are justified by the foregone revenue and efficiency costs of potential overinvestment in certain activities.