Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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FUTURE OF TAX - SUBMISSIONS BACKGROUND PAPER

Thank you for the opportunity to provide comment on the above paper.

Oji Fibre Solutions (OjiFS) is a pulp, paper, packaging and paper recycling company with operations in Australia and throughout New Zealand.

OjiFS has reviewed the Submissions Background Paper (SBP) from the perspective of our NZ-based operations and would offer the following submissions.

ENVIRONMENTAL TAXES

Overview:

Pollution taxes will be costly to implement and collect. They offer less certainty of fiscal income than other revenue collection mechanisms.

Effective targeting of pollution taxes should be assumed to be fiscally neutral; where the change in behaviour elicited though tax avoidance reduces current public expenditure redressing the effects of pollution.

Pollution taxes are a poor substitute for the effective implementation of existing pollution prevention legislation including the RMA. That said, they may offer a more effective mechanism for addressing politically challenging environmental issues that remain unresolved despite decades of direct regulation.

Pollution taxes risk distorting investment in land use and land price if applied on a 'grand parented rights' basis. They risk stranding investment if applied without some ameliorating depreciation mechanism including early signalling and delayed introduction.

Submission

The Discussion Document emphasises the need for NZ's taxation system to operate efficiently and critically, to provide certainty of fiscal revenue.

Preventing pollution through selective and targeted taxes risks (and incentives) 'tax avoidance'. It therefore

reduces certainty of fiscal income, accepting that can be viewed as a positive attribute of making such changes. If 'avoidance' is associated with a genuine reduction in environmental impact there will be a corresponding and compensatory reduction in public expenditure required in addressing the related harm. That benefit can and should be seen as extending to reduced cost of direct regulation at the local government level.

The use of pollution taxes should be limited to where each environmental tax has a clear objective and one that is reasonably applied consistently throughout the country. Improving water quality by taxing diffuse source pollution may be an example, recognising the difficulty of addressing this problem under existing legislation.

Any decision to tax pollution requires a complimentary decision to reduce or eliminate existing regulation of the targeted pollutant. Otherwise, the effect of the new tax will be an increase in compliance costs and uncertain regulatory accountability for achieving desired outcomes.

OjiFS supports the investigation of pollution pricing through the tax system only to the extent that current systems of direct regulation are not achieving "sustainable management of the environment". Where taxes are applied, our expectation would be of a corresponding reduction in other (existing) regulation.

OjiFS's interest as representatives of land users is the equitable treatment of the adverse effects of land use. Whether taxes can achieve equitable treatment is unclear, recognising that the 'pollution potential' of a land use varies with the type of activity, topography, prevailing climatic conditions etc.

Changing from direct regulation of pollution to a system of taxes poses transitional problems. There is a financial 'value' associated with current levels of environmental 'subsidy', where little or no regulation applies now. It is reasonable to assume that those 'subsidies' will accrue or have accrued to inflate the mortgage valuation of the property to which they apply.

The 'artificially high' land price recognised by those enjoying environmental subsidies (in the form of light regulation) discourages a change in land use to alternative and less impactful uses. It is reasonable to suppose that a change to partial or full taxation of activities that had previously gone unregulated will affect the capital and mortgage value of land. We could highlight in this regards that:

- There is significant opposition at regional level to regulation seeking to 'internalise' the cost of some environmental externalities. In instances such as Taupo this opposition resulted in Government 'grand parenting' and then purchasing back excess rights to pollute. This approach contrasts with the regulation and pricing of pollution where (we assume) the assumption will be that tax liabilities apply regardless of past behaviour.
- The prevailing assumption under the RMA is that there is no right to pollution other than that provided for in a Resource Consent, and that right is limited to a maximum term of 35 years, a term that is very rarely granted. The RMA "permits" resource use (including rural land use) only where 'adverse effects

are avoided or mitigated'. There is often allowance made where change from 'established' practice is required, usually in the form of extended periods for adjustment reflective of the reasonable depreciation of existing investment.

- Differential (defined as different uses of the same property) regulation of land by Regional Councils and Central Government imparts a significant sovereign risk to *less intensive* land use, for example best practice dairy, sheep & beef and afforestation as an investment. Regulation such as Waikato Regional Council's "Proposed Plan Change 1" discriminates against less intensive land use by allocating nitrate pollution rights on the basis of land use occurring in the 2014 / 15 year.

OjiFS assumes the TWG recognise duplication of *effective* regulation as undesirable. On that basis we recommend the TWG determine whether current systems for the regulation of pollution are effective before recommending pollution taxes *in place of* ineffective existing regulation.

Our contention (discussed above) is that current regulation is not applied effectively in all instances and justifies consideration of pollution pricing as an alternative in instances of regulatory failure.

Should the TWG come to that conclusion, the Group will need to resolve the transitional issues arising from recommending a change including:

1. Are the fair and logical start dates for pollution pricing of different adverse effects (eg agricultural methane, diffuse source nitrate, excess sedimentation) the same?
2. The legal principle deeming retrospective legislation to be inherently unreasonable. This applies particularly to tax liabilities. Does a change to the capital value of land in response to a new pollution tax contravene this principle, recognising that there are no recognised 'losses' accruing where changes from permissive regulation to a tax liability affect land value?
3. Are existing levels of pollution to be tax exempt, in effect grand parenting 'existing' polluters a valuable / tradable right, and in perpetuity?
4. What is the risk that arbitrage and the incentive to protect the capital value of a grand parented tax exemption results in no net improvement in water quality from the date of a new tax?
5. Is there a risk that pricing such pollution might increase its incidence, where the capital value associated with a grand parented pollution right motivates the individual to maintain existing levels of activity irrespective of market demand in the face of a risk of regulatory presumption of 'use it or lose it'?
6. If an adverse environmental effect is so abhorrent that it is restricted or prohibited, does it become less so where a tax has been paid?
7. If pollution is difficult to quantify such that existing regulation is difficult to apply, how will it be possible to determine the appropriate level of tax?

Recommendation:

The Tax Working Group (TWG) should reflect on the relative merits of environmentally targeted taxes and the current system of direct regulation of applicable 'adverse environmental effects'. Introduction of targeted taxes could be considered where it is deemed existing systems of regulation are ineffective. If so, consideration needs to be given to the potential for interpretation of pollution taxes as establishing a right to existing levels of pollution (in the form of tax-exempt status and reversing the presumption in the RMA against adverse environmental effects. Note in this regard the presumption in legislation such as the Waikato Settlement Act that the existing situation is unacceptable and is required to be improved over time.

CAPITAL GAINS TAX

Overview:

The risk of multiple changes to the tax system interacting in unintended and undesirable ways needs to be considered. In particular the interaction between capital gains taxes and pollution taxes need careful consideration.

Submission:

The Discussion Document discusses various tax options sequentially. It does not discuss in detail the risk that different changes to the tax system being considered could unintentionally interact. Introducing a CGT at the same time or after an increase in environmental tax could have unintended fiscal and other effects. For example, what is the capital value impact of an exemption from liability for pollution taxes? Would a tax rebate be given where a change to a pollution tax devalued the capital value of property, and at what fiscal risk?

Recommendation:

Review the potential of each recommended change to the tax system for synergistic and/or perverse effects on other existing and new taxes. In particular, a review of the risk of interaction between environmental and CGT changes is encouraged.

WASTE MINIMISATION ACT; WASTE LEVY TAXES

Overview:

Strengthen the presumption against the hypothecation of taxes.

Review the waste levy imposed under the Waste Minimisation Act 2008 including the:

- Assumption that the cost of landfilling does not reflect the fair cost of 'waste',
- Relative value of "zero waste" against other Government priorities and the merits and risks more generally of hypothecating the use of waste taxes to specific aspects of Government business.
- Conflict between the actions of the WMA waste tax, the Commerce Act presumption that commercial landfill prices should reflect the fair competitive price of the service and the perverse commercial outcomes of a tax levied on commercial recycling and used to support the non-commercial activities with which they compete.

Submission:

Page 61 of the Discussion Document makes brief mention of the tax on landfilled solid waste, levied under the Waste Minimisation Act 2008. The Discussion Document questionably ascribes a positive environmental benefit to this tax. The waste levy and similar environmental taxes such as 'container deposit' obligations need to be considered in the context of the legislation giving rise to them. . Reconsideration of NZ's waste levy as part of a comprehensive review of the tax system is encouraged.

The waste levy on landfilled volumes assumes waste and the consumption giving rise to it are without compensating benefits. A justification offered for the current (and an increased) waste levy is the idea that "zero waste" is desirable and achievable.

There is no recognition within the concept of 'zero waste' that some 'waste 'arises from the need to prevent breakage or spoilage of goods in transit. There is insufficient acknowledgement that "zero waste" is very likely an unattainable aspiration, especially with an expanding population and a desire for improved standards of living. The socially regressive and wider economic implications of aspirational waste taxes targeting unattainable goals need to be explicitly considered.

The TWG is encouraged to review the effectiveness of the existing waste levy including its hypothecation. Considerations should include:

- Municipal landfills are operated in accordance with Resource Consent conditions imposed by Regional Councils under the RMA. The obligation on all resource users including landfill operators is to avoid or mitigate the adverse environmental effects of their activities. The reasonable assumption is therefore of competent Regional Councils enforcing Resource Consent conditions and of landfills operated in accordance with those consent conditions. Commercially rational behaviour by the landfill operator means the cost of landfilling waste as charged to users of the facility and exclusive of the levy represents the internalised environmental cost of the activity.
- Recycling of those components of the waste stream with a commercial value predates the introduction of a specific waste levy tax. Materials that have commercial value are excluded from the WMA definition of 'waste'. The purpose of the landfill tax is presumably as a source of funds for additional, non-commercial, waste minimising activity. The activities funded are those deemed by local councils and or MFE to have merit, the former by reference to their respective "Waste Minimisation Plans" as being in the public interest. Half the $24(?) million generated from the levy annually is allocated to Councils on an uncontested basis. The long term worth of Councils waste minimising expenditure is unknown. Recent changes in the quality standards applying to 'recyclables' acceptable in the Chinese market have raised questions as to the value of Councils investment in co-mingled collections and highlight the risk of investment in marginal recovery and recycling systems.
- Waste levy funding of the on-going costs of waste minimising activity is reasonably precluded, presumably for anti-competitive and fiscal liability reasons. Levy funds are not available to assist commercial recycling. Commercial recycling can generate 'waste' as a by-product. Therefore the waste levy acts to both increase the cost and decrease the commercial effectiveness of establishing recycling while providing low cost capital to non-commercial operations, including some that compete with those paying the levy. It acts to discourage the recycling of materials 'at the margin', where the cost of waste disposal equals the benefit from the reusable proportion on input materials. There is no capacity within the WMA to exempt or rebate the levy charged on commercial recycling. In that regard the effect of the levy can be to increase the amount of material disposed of to landfill and, at the margin, defeat the purpose for which it was imposed.
- The fund is hypothecated. The arguments raised on page 45 of the Discussion Document therefore apply, including the inability to judge the relative value of waste levy expenditure of even the 50% of the fund allocated by MFE on a contestable basis.

Recommendations:

Review the use of hypothecated waste taxes against measurable rather than aspirational goals.

Remove or rebate waste levy liability arising from waste minimising activities including commercial recycling.

Strengthen the presumption against hypothecation as potentially anti-competitive and contrary to the presumptions underpinning NZ's commerce related legislation.

ACCELERATED DEPRECIATION

Overview:

Accelerated depreciation (AD) is an indirect means of applying fiscal revenue to achieve desirable public outcomes. It is an inherently more uncertain means of generating prescribed public benefits which under certain circumstances can lead to an overall poorer outcome than would occur without it.

AD is used in overseas jurisdictions, with implications for the relative competitiveness of NZ exports and NZ manufactures where import substitution occurs. The risk export of AD affecting competitiveness could be addressed by means other than duplication of such systems, for example through countervailing duties and or procurement preferences.

Submission:

Accelerated depreciation has been suggested as a means of achieving desired and desirable pubic outcomes. It has been used in overseas jurisdictions as a means of encouraging investment in aspects of the low greenhouse gas emissions economy NZ is itself targeting.

While superficially attractive, the assumption that a lower tax rate applicable to some investment for a fixed period of time will lead to a greater preponderance of that investment needs to be examined in detail. In particular accelerated depreciation needs to be recognised as:

- Selectively favouring new investment and therefore posing a risk to existing competing investment already providing the desired benefit(s) to the NZ economy.
- Bringing forward the date at which the depreciated asset providing desirable public benefits is deemed to have little value to the owner. It therefore risks the early abandonment of plant and equipment that might otherwise have continued to generate benefits for the owner and the economy.
- Transferring the cost of depreciation from the private investor to the taxpayer. This may be warranted where a societal benefit arises but one which could be more efficiently achieved through direct investment in the desired outcome by the state.

Recommendation:

Ensure that any examination of accelerated depreciation as a means of delivering desirable societal outcomes offers a greater benefit at lower cost than more traditional deployment of fiscal revenues.

GST AND LOG EXPORTS

Overview:

- NZ's trading partners can and have acted to bolster the value to their economy of domestic processing of imported logs by selective application of domestic taxes including VAT, sales and similar taxes.
- Review NZ's capacity to selectively apply GST to products and services where that is shown to be in the overall interest of NZ and can be achieved without transgressing applicable trade arrangements.

Submission:

NZ operates a simple GST tax system, with obvious benefits including increased certainty of fiscal revenue and reduced costs of compliance. The Discussion Document highlights NZ's relative uniqueness as regards the simplicity of NZ's GST provisions.

NZ wood processors operate in an open, export oriented economy and with a floating exchange rate. It has been established beyond reasonable doubt that many of the world's forest products processing and exporting nations intervene to bolster the competitiveness of their domestic wood processing sectors. The arguments offered in support of such intervention include regional development, local employment and adding export value to returns otherwise limited to the commodity value of exported logs.

In New Zealand's case the justifications listed above can be added too, including the domestic manufacture of paper based packaging that would otherwise need to be imported to "add value" to agricultural commodity exports. The domestic paper and paper-packaging sector adds additional value in the form of providing the scale and infrastructure needed to support a paper recycling capability.

Countries importing raw logs from NZ recognise the public environmental benefits of their standing forests as well as the employment and other benefits of a domestic processing sector. Some log importing countries use tariff and non-tariff measures to facilitate the import of raw logs from other parts of the world to maintain their domestic and processed wood export sector without increasing the harvest from local forests.

MFAT have advised that variability in the rates of VAT charged domestically on different products in some of the countries with which NZ trades is outside the scope of bilateral and multilateral trading arrangements. The effect of such differences can act to bolster the export of logs from NZ, consequently impeding the domestic processing of those same logs for domestic and export markets.

Recommendation:

The TWG is encouraged to consider the value to NZ of the statutory power of selective application of domestic taxes. In particular, the TWG is asked to consider recommending the use of selective rates of GST be applied as a countervailing measure to the use of selective tax rates as a non-tariff trade measure in NZ export markets. Whether differential rates are warranted can be considered on a case by case, taking into account NZ's overall best interest, including trade balances, regional development etc.

MAORI OWNED LAND

Overview:

Many of the recommendations made above with respect to pollution taxes have positive implications for retention of regional employment and existing Maori investment in forested rural land.

Changes to the tax system could act to reward proactive investment in Manaakitanga and Kaitiakitanga. As a minimum, those seeking to deliver such outcomes should not be impeded by the risk of unfavourable tax treatment in the future aimed at securing private investment in Manaakitanga and Kaitiakitanga as a public benefit in perpetuity.

Submission:

Investment and reinvestment in wood processing including pulp, paper and paper-packaging manufacture requires a forest estate from which to derive the raw material. Maori Forest Trusts represent a significant component of NZ's existing commercial estate for numerous historical reasons including financing of investments in land held in trust. The Waitangi Treaty Settlement process has returned significant areas of land in recent years. Maori economic development and investment in the commercial forestry sector are therefore interconnected.

Antecedents of OjiFS have a history of commercial arrangements with Maori forest-owing entities. OjiFS value that history and are actively investigating mechanisms to continue such arrangements, to the mutual benefit of all parties.

Significant reinvestment in domestic processing and the attendant 'value adding' and 'regional development' benefits requires greater security of access to logs than is currently available. Similarly, securing the landowners returns from an investment in afforestation requires some assurance that the value of logs at harvest is not limited to international log export markets at times of cyclically low price. Properly managed, afforestation can help achieve the additional and equally important objectives of Manaakitanga and Kaitiakitanga.

Maori, like all forest owners have been disadvantaged by selective regulation to the detriment of forestry and afforestation in the past. The Climate Change Response Act has had the effect of imposing a carbon tax on all land planted in forests before 1990, including land where the capital value at sale and transfer from the Crown reflected the opportunity returns from a 'higher and better' use. The financial impact of differential treatment of pre-1990 forest land under the Climate Change Response Act is readily apparent in the calculation of forest land lease valuations calculated as a percentage of the land value. Where land conversion is encumbered by regulation, so too is the rental return.

More recently a number of Regional Councils have regulated to the disadvantage of land used for forestry by assuming that the low levels of nitrate pollution associated with forest related land use will be continued in perpetuity.

Equitable regulation could reasonably have assumed that the environmental rights and obligations of all land owners of the same class of land were the same. Equitable regulation of land under forests including forest

lands owned by Maori could have enabled a return on forest land reflective of forestry's environmental benefits.

Based on regulation to date, trustees with a fiduciary duty to the Iwi owners are entitled to assume that exercising Manaakitanga and Kaitiakitanga through investment in afforestation puts at risk the future undisturbed possession of Maori owned land. Regulation including taxation should treat all like parties similarly. Proactive investment in improved environmental outcomes through forest management can be unreasonably discouraged where regulation including taxes applies selectively to that proactive behaviour.

Recommendation

Many of the comments and regulations made above in relation to pollution taxes apply to Maori owned lands and forests. The TWG is encouraged to reflect on the differential impact on the Maori economy of possible and proposed changes to NZ's tax system. Particular attention should be given to whether Manaakitanga and Kaitiakitanga are a particular obligation and benefit to Maori alone or whether the obligation and benefit is one all NZers share equally. If the latter, what is the implication for the development of Maori owned forest land as distinct from the rights accruing to land currently utilised for a more polluting activity. The reasonable assumption is that the pollution rights, taxes and other obligations are at least the same regard as land in any other form of ownership.

Allocation of pollution benefits (or obligations) equitably is strongly recommended, as a means of providing an additional resource base for Maori with forestry assets. If pollution is confirmed as an obligation under the RMA then Maori (and all other land owners) will consider afforestation as an economically rational land use and investment. Existing forests will be more likely to be retained and replanted.

Ideally, existing and new forests should represent a positive environmental return on investment. Those managing for Manaakitanga and Kaitiakitanga could at some level achieve a saleable 'environmental surplus', available for lease by those landowners whose choice of land use gives rise to an environmental deficit, whether quantified in tax or RMA terms.

Yours sincerely

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