Tax Working Group Information Release

Release Document

February 2019

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Some papers contain draft suggested text for the Final Report. This text does not constitute the considered views of the Group. Please see the Final Report for the agreed position of the Group.

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Coversheet: **Tax Concessions and Environmental Impacts**

Position Paper for Session 22 of the Tax Working Group
9 November 2018

Purpose of discussion

This paper provides advice to the Group on tax provisions that potentially have adverse environmental impacts.

Key points for discussion

a Does the Group agree with the findings on the various tax provisions?

b Are there additional tax provisions the Group would like to comment on?

c Does the Group agree with the proposed text for the final report (see Appendix A)?

Recommended actions

We recommend that you:

a **note** that we have reviewed a range of tax provisions and support measures with potential environmental impacts, as the Group said it would do in the interim report.

b **indicate** if you agree with the recommended actions in the table below:

Sector	**Tax provisions**	**Recommended actions**
Energy	Petroleum exploration and development expenditure (accelerated deductions)	Remove 7 year rule
Energy	Non-resident oil rig and seismic vessel operator (tax exemption)	None proposed
Agriculture	Farming business expenditure (accelerated deductions)	Detailed review of deduction rates.
Agriculture	Income equalisation schemes: deductions (forestry, fishing, or farming)	None proposed
Transport	Motor-spirits excise duty refund	None proposed
Forestry	Forestry encouragement grant (accelerated deductions)	Review with a view to replace current forestry expensing rules.
Forestry	Forestry expenditure (accelerated deductions)	

c **agree** to the proposed draft text being included in the Final Report.

Tax Concessions and Environmental Impacts

Position Paper for Session 22
of the Tax Working Group

November 2018

Prepared by Inland Revenue and Treasury

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Executive summary

This paper has reviewed a broad range of potential tax concessions in environmentally industries to establish if there is a case for their removal.

Three tax concessions have been identified where the Secretariat recommends either their removal or further review:

- Seven-year depreciation rule for petroleum mining – recommend removal.
- Forestry expense deduction rules – recommend further review to establish rules that better reflect fair treatment, combined with complementary measures to support positive externalities in the forestry sector (e.g., measures to promote carbon sequestration, erosion control, and biodiversity protection)
- Farming-specific deduction and depreciation rules (including schedule 20) – recommend detailed review to establish if these provisions reflect fair treatment.

In many cases, specific provisions examined were found not to be clearly concessionary – the rules reflected fair treatment of expenses. This applied to some activities which could be harming natural capital – for example, some types of fertilizer application. The fact that no concession has been found does not indicate that there is not a case for greater use of pricing and other regulatory tools to better protect natural capital. Rather, it is simply a finding that current tax rules are not distorting the playing field in favour of these activities.

In some other cases, provisions were found to be concessionary, but the environmental effects were likely to be positive (e.g., immediate deductibility for fencing).

1. Introduction

1.1 Purpose

1. This paper provides advice to the Group on tax provisions that potentially have adverse environmental impacts.

2. In the interim report, the Group indicated it would further examine tax concessions which degrade natural capital – see Box 1 below.

Box 1: Scope of work signalled in the interim report

Chapter 9 – Environmental and ecological outcomes

Agricultural concessions

108. The Group is aware of a number of existing tax concessions for agriculture in the Income Tax Act. Where a tax concession is shown to be degrading natural capital, there may be grounds for its removal. In these instances, there may be a case for Government support to manage the transition. There may also be a case to consider incentives for activities that generate environmental benefits.

109. The Group will explore these issues further in the Final Report.

3. The Group commissioned the Secretariat to undertake an audit of tax concessions – see Box 2 below.

Box 2: Scope of work commissioned by TWG on tax concessions

Broader audit of tax concessions and subsidies (e.g., review of the tax expenditure list) to identify and evaluate concessions on other industries having a negative (or positive) impact on the environmental and ecosystems (e.g., petroleum mining, forestry, fisheries, energy, etc.). This picks up on the Secretariat's recommendation for further review in their paper on tax concessions and the environment

1.2 Approach taken

4. This paper identifies a number of tax provisions based on their potential to have an environmental impact. The process for evaluating these provisions consists of four steps:

- Step 1: Review tax provisions that have been identified as potentially concessionary to assess whether: (1) the tax provision is active (requiring a taxpayer to have benefited from the concession within the last year) and, (2) the provision relates to an environmentally industry or activity.

- Step 2: Assess if the identified tax provisions are concessionary or reflect fair treatment (i.e., the costs are expensed in a way that reasonably approximates their economic use).

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- Step 3: Assess measures identified as concessionary for their impact on natural capital.

- Step 4: Assess measures identified as concessionary for their impact on the other capitals in the Living Standards Framework (social, human, and physical/financial).

1.3 Consultation

5. This paper was prepared by Secretariat officials from Treasury and Inland Revenue (IR), in consultation with officials from the Ministry of Business, Innovation and Employment (MBIE), the Ministry of Transport (MoT), and the Ministry of Primary Industries (MPI) and the Ministry for the Environment (MfE).

2. Identification of relevant tax provisions

2.1 Tax provisions identified for analysis

6. We have identified a number of tax provisions for analysis, based on their relevance to environmentally- industries. These provisions are listed by sector in Table 1 below, and generally relate to specific sections of the Income Tax Act.

Table 1: Tax provisions identified for analysis

Sector	Tax provisions
Energy	Petroleum exploration and development expenditure (accelerated deductions)
Energy	Non-resident oil rig and seismic vessel operator (tax exemption)
Agriculture	Farming business expenditure (accelerated deductions)
Agriculture	Income equalisation schemes: deductions (forestry, fishing, or farming)
Transport	Motor-spirits excise duty refund
Forestry	Forestry encouragement grant (accelerated deductions)
Forestry	Forestry expenditure (accelerated deductions)

7. These provisions were identified by a review of:

- The Treasury's Tax Expenditure Statement (2018);
- OECD work on fossil fuel support measures;
- A peer review report on fossil fuel subsidy reform in New Zealand (APEC 2015);
- Interim reform feedback focus groups and discussions with officials.

2.2 Measures not further analysed

8. The sources above identified other possible concessions and support measures that we have not analysed further because either they are (1) not relevant to tax or revenue collection; (2) clearly non-concessionary; (3) appear to be defunct or no longer applicable; or (4) the Group has already considered them.

Energy measures:

- Temporary reduction in royalty rates: this relates to the temporary reduction in royalty payments for discoveries made between 30 June 2004 and 31 December 2009.
- Acquisition of petroleum exploration data: an initiative to improve the quality and availability of pre-commercial geological information about New Zealand's off-shore petroleum basins.
- Financial restructure of Solid Energy and indemnity for mining land remediation
- Funding of international treaty obligations to hold oil stocks.
- Petroleum related research and development expenditure.
- Promotional activities such as international petroleum conferences.

- *MBIE note:* New Zealand does not subsidise fossil fuels and therefore does not feature in either the International Energy Agency (IEA) or Global Subsidies Initiative (GSI) estimates of global fossil fuel subsidies (see Appendix D).

Agriculture measures:

- Herd improvement bodies (Section CW 51): Herd improvement bodies were once considered nationally significant. However, in 1988, these merged into LIC New Zealand, a co-operative business owned by approximately ten thousand farmers. It is unlikely that this entity benefits from the tax concession, and it appears that no others do.
- Payments of interest on farm mortgages: exempt income (Section CW 6). To qualify for this tax concession, a young farmer had to receive approval from the Rural Banking and Finance Corporation of New Zealand.
- The tax deductibility of some types of agricultural expenses was also highlighted as a major concern by participants at one interim report feedback focus group. For example, participants argued that the tax system subsidised environmentally destructive practices by allowing some types of drainage and clearance works to be tax deductible (as is the case with other expenses incurred in providing assessable income). This paper does not comment on this issue as it does not relate to concessionary treatment of expenses.

Transport measures

- Fringe Benefit Tax exemption on employer-provided carparks: The Group has already considered this issue in the interim report where it recommended extending the FBT exemption to employer-provided public transport.

Other measures

- Emissions Trading Scheme – Exclusion of agriculture and free allocation rules for other emitters: This does not relate to measure in the Income Tax Act, but is a policy measure which has the effect of significantly reducing revenue to the Government. The Group has already recommended agriculture face a carbon price, and that the Government auction New Zealand Units (NZUs). We have not found estimates of cost of these concessions. However, as noted in the interim report, if agriculture was fully included in the ETS and all free allocation was removed, total revenue raised over the period 2021-30 is estimated to be $2.1 billion per annum. This assumes no change in emission volumes from current carbon budget forecasts, and emission prices increasing from $20/t-CO2e in 2021 to $50/t-CO2e in 2030.

3. Evaluation of tax provisions

9. This section assesses tax provisions identified in the previous section to evaluate whether or not they are concessionary, and their impact on natural and other capitals. Table 2 below provides a summary of the Secretariat's assessments and recommended actions.

Table 2: Assessment of tax provisions

			If concessionary…		
Sector	**Tax provisions**	**Is it concessionary?**	**Impact on natural capital?**	**Impact on other capitals?**	**Recommended actions**
Energy	Petroleum exploration expenditure, and Petroleum development expenditure (7 year rule)	Not significantly Yes	Unclear Unclear	Physical/ financial: Likely –ve	**Remove 7 year rule**
Energy	Non-resident oil rig and seismic vessel operator (tax exemption)	No	Unclear	Physical/ financial: Likely +ve	**None proposed**
Agriculture	Farming business expenditure (accelerated deductions)	Some provisions	Likely +ve (concessionary provisions)	Physical/ financial: Likely -ve	**Detailed review of deduction rates**
Agriculture	Income equalisation schemes: deductions (forestry, fishing, or farming)	Potentially	Unclear	Social: Likely +ve	**None proposed**
Transport	Motor-spirits excise duty refund	No	n.a.	n.a.	**None proposed**
Forestry	Forestry encouragement grant (accelerated deductions)	Yes	Mixed	Physical/ financial: Likely –ve	**Review with a view to enhance forestry expensing rules**
Forestry	Forestry expenditure (accelerated deductions)	Yes	Mixed	Physical/ financial: Likely –ve	

3.1 Petroleum exploration and mining expenditure (accelerated deductions)

10. New Zealand has several specific provisions for the tax treatment of petroleum exploration and development expenditures. Some of these appear to reflect fair treatment. However, one provision (the seven year rule) appears to be concessionary, and there is a case for its removal.

Immediate deductibility of all exploration expenditure

11. Section DT 1 of the Income Tax Act 2007 allows for immediate deductibility of exploration expenditure in the year in which it is incurred, even where the expenditure is of a capital nature. However, if an exploration well is successful and leads to commercial development, then all of the exploration expenditure with that particular well is clawed back and depreciated over the useful life of the field under the reserve depletion method, or in a straight line over seven years.[1]

12. There is a reasonable case that the current tax treatment is a fair reflection of economic reality. Most exploration expenditure does not create an asset – we understand roughly 90 per cent of wells drilled do not become producing wells. An immediate deduction can thus be justified as fair treatment as it is not clear that all of the expenditure is of a capital nature, since it is more likely than not that a particular exploration well will not result in a revenue generating asset.[2]

Amortization from the date expenditure is incurred

13. Producers have the ability to amortize a development expenditure from the date it is incurred. In general, tax deductions for capital assets are made in the year when they are incurred and amortized over the life of the asset. This rule applies to petroleum development expenditures and virtually all other sectors of the New Zealand economy.[3] As a result the tax treatment is in line with general tax practices and not deemed a concession.

7 year depreciation rule

14. There is an option for development expenditures to be either deducted in a straight line over seven years, or in line with a field's production profile. This rate was chosen in 1991. We understand this was primarily to make New Zealand's petroleum industry competitive with Australia. The tax effective life of these assets in Australia is now capped between 15 and 20 years.[4]

15. Petroleum miners are able to deduct petroleum development expenditure in equal amounts over an accelerated seven-year period rather than over the life of the asset. Petroleum development expenditure is expenditure incurred by a petroleum miner that directly concerns a permit area and is for acquiring, constructing, or planning petroleum-mining assets.[5]

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[1] APEC, 2015.

[2] In 2008, amendments to the Income Tax Act allowed the deduction for development expenditure to begin from the date at which the expenditure is incurred. Previously this had been only available to offshore petroleum development, with onshore development expenditure deductible only from the date that commercial production starts. This distinction has been removed to align the rules between onshore and offshore activities.

[3] See New Zealand Income Tax Act 2007: Section DT.

[4] Australian Tax office (2018). Available at: https://www.ato.gov.au/law/view/document?LocID=%22TXR%2FTR20184%2FNAT%2FATO%2FatTABLEA%22&PiT=99991231235958#TABLEA

[5] MBIE, 2018. Aide Memoire: Meeting with the Minster for Climate Change on fossil fuel subsidy reform.

16. The seven-year depreciation method for development expenditure is concessionary if used for petroleum fields with a production life greater than seven years. The life of New Zealand's petroleum fields in recent decades has, in almost all cases, been longer than 7 years, and in many cases, significantly longer.[6]

17. This measure does not necessarily act as a concession in all circumstances. If an asset owner selects the seven-year depreciation treatment, but the field has a life shorter than seven years, income could be over-taxed. However, as noted above, New Zealand fields have generally had an asset life of longer than seven years. Asset owners can also select to depreciate assets in line with a field's production profile.

18. The net environmental impact of the provision is not clear cut. Insofar as the provision potentially encourages greater investment at the margin into oil and gas in New Zealand, it potentially increases the global supply of fossil fuels. However, greater domestic production of fossil fuels might also displace imported fuels which likely have a higher carbon footprint than domestically produced fuels.

19. The net impact on physical and financial capital is likely to be negative. This is because the concession distorts investment signals, in favour of oil and gas investments, and away from potentially more productive uses.

20. Given this concession is likely to be distorting investment signals, and may be having a negative impact on natural capital, the Secretariat recommends its removal. MBIE (the energy sector regulator) also believes its removal would be consistent with good tax policy.

21. The fiscal benefit of removing the 7 year depreciation rule is likely to be modest, as no major new oil fields have commenced production since 2009 (see Appendix C), and the Government has announced it is issuing no new offshore oil and gas exploration permits.

3.2 Non-resident oil rig and seismic vessel operator (tax exemption)

22. No New Zealand companies own off-shore rigs or seismic vessels, so any company wishing to explore in New Zealand waters needs to use a rig or seismic vessel provided by a overseas owner. In 2005, the Government provided a temporary five-year exemption for non-resident off-shore drilling rig and seismic ship operators from paying tax on their profits, which was subsequently extended through to 2014 and again to 2019. This provision is found at section CW 57 of the Income Tax Act 2007. It was introduced to prevent rig operators leaving New Zealand before 183 days in order to avoid being subject to tax in New Zealand. Unless the Government agrees to an extension, this provision will expire 31 December 2019.

23. This provision creates special tax rules for non-resident oil rig operators. However, there are grounds for it being considered not concessionary, as oil rig operators are unlikely to pay New Zealand tax with or without this exemption. This is because

[6] Many assets will have a much shorter life than the overall field, as these assets are surrounded by saltwater, that has a damaging impact on machinery.

without exemption, oil rig operators are expected to "churn" their rigs. Churning is when an oil rig operator leaves New Zealand waters before reaching the 183 day threshold for being subject to tax. There is evidence to support this expectation of churning. Before the exemption (2000 – 2004), no rigs stayed in New Zealand waters beyond six months. However between 2009 and 2012, there were three non-resident off-shore rigs operating in New Zealand, with an average length of stay of around eight months.[7]

24. Removing the concession could potentially reduce tax revenues if it results in increased churn of rigs, and therefore increased costs and reduced taxable profits.

25. The net environmental impact of the provision is not clear cut. Insofar as the provision results in more efficient operations, it supports (marginally) greater development of oil fields in New Zealand. The environmental impact of this is not obvious – greater New Zealand production adds to global supply of fossil fuels, but it also displaces imported fuels which likely have a higher carbon footprint than domestically produced fuels. A more direct effect of the concession is that it likely reduces churn of oil rigs, thereby reducing the environmental cost from mobilizing and demobilizing oil rigs.

3.3 Farming business expenditure (accelerated deductions)

26. *Sections DO 1 to 11* of the Income Tax Act 2007 details specific rules for farming-related expenses. It includes immediate deductions for minor expenditures, as well as accelerated deductions for more major improvements to horticultural land, such as those detailed in schedule 20, Part A (see a list of these deductions in Appendix B). The nature of these deductions range from enhancements to land, the planting of trees for erosion and shelter, and others that aim to increase the productive capacity of existing farms.

Provisions that reflect fair treatment

27. Most of the provisions do not appear to be significantly concessionary. Rather, the provisions are intended to provide fair treatment of expenses by providing rules that reflect the economic life investments. For example, Section *DO 1 Enhancements to land* details expenses which are immediately deductible. Most of these expenses would likely be treated as being immediately deductible in the absence of this provision – for example, the destruction of weeds.

Provisions that appear to be concessionary

28. There are some provisions which do appear to be concessionary. However, the impact on natural capital of these provisions would generally appear to be either positive or at least not clearly negative. For example, *Section DO 1* specifies that fencing costs are immediately deductible, and *Section DO 2* specifies that costs for plantings for erosion, shelter, and water protection purposes are immediately deductible.

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[7] APEC 2015.

Further work

29. There are a large number of deductibility rules laid out in Section DO. The Secretariat has not been able to review them all in detail. Significantly more work would be required to assess if these provisions for deduction (including the depreciation rates in schedule 20) are appropriate. Apart from minor changes to rates (e.g. depreciable land improvements), there has not been a comprehensive review of agricultural deduction rules in the last thirty years and as such a review of these provisions would be timely.

3.4 Income equalisation schemes: deductions (forestry, fishing, or farming)

30. As a result of subpart EH of the Income Tax Act 2007, persons working in forestry, fishing, or farming entities may reduce their taxable income in a year by depositing taxable income with Inland Revenue. The schemes allow taxable income to be transferred between years thereby smoothing taxable income.[8]

31. Historically the first iteration of this scheme was announced as a support measure that aimed to not only provide income smoothing, but also to dampen inflation and to promote farm development in years where incomes have fallen.

32. In addition the scheme also provides farmers with a buffer in the case of "adverse events" such as droughts and or floods. Normally income equalisation deposits are not available for refund until 12 months after the deposit is made. However IR has discretion to allow for early refunds in the case of "adverse events" or when the person is suffering serious hardship (e.g. recent floods in Gisborne).[9]

33. This provision can be argued to be concessionary to farming, forestry and fishing sectors – it allows people to smooth their taxable income in a way which is not available to people in other industries. However, it is not clear it that results in significant additional investment into these sectors, or that it results in significantly reduced natural capital.

34. From a Living Standards Framework perspective, there also appears to be social capital benefits. It helps smooth the income of people in highly weather and climate dependent industries, reducing the stress and disruption caused by adverse events.

3.5 Motor-spirits excise duty refund

35. The Government allows a refund of the excise duty and the GST charged on motor spirits excise duty (e.g., gasoline, CNG, and LPG) for fuel consumed in off-road

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[8] The money is paid into a special account and earns interest at 3% per annum on amounts left on deposit for more than 12 months. The interest paid becomes part of the deposit for tax purposes. The deposit is held for a maximum period of five years.

Deposits are tax deductible in the year for which they are made. And withdrawals (including interest) are generally assessable in the year the application for withdrawal was made. In normal circumstances an amount may not be withdrawn unless it's been on deposit for at least 12 months.

[9] Accessed from: https://www.ird.govt.nz/business-income-tax/income-equalisation/special-provisions/assistance-farmers-gisborne-floods.html

usage. Examples of eligible uses for refunds would include agricultural vehicles (e.g., tractors and harvesters), commercial vessels, and certain licensed vehicles. Work is currently underway to review the list of vehicles (or machinery) exempt from paying motor spirit excise duty.

36. Considered as part of the transportation tax framework in New Zealand, this provision is not concessionary. Government spending on transport (essentially, road building and maintenance, and public transport subsidies) is primarily funded out of revenue collected from transport sources. This reflects an underlying policy position that transport infrastructure should be funded by those who use it.

37. One such source of revenue is Fuel Excise Duty (FED), which is levied on petrol when it leaves the Marsden Point refinery or is imported already refined. The rate of fuel excise duty is currently 63.024 cent per litre. Where a person can provide evidence that they have purchased petrol that has been used for non-road purposes in ways specified in legislation, then a refund reflecting the underlying FED can be claimed. This reflects that FED is a mechanism under which transport infrastructure is funded by road users. The Ministry of Transport is currently reviewing the entitlement to claim FED refunds, with a focus on ensuring the rules are internally consistent and fit-for-purpose in a modern environment. As such, providing refunds of FED for non-road uses of fuel is not a tax concession, rather, it is a way of ensuring that the underlying policy intent of FED is delivered.

3.6 Forestry encouragement grant (accelerated deductions) and forestry expenditure (accelerated deductions)

37. These provisions permit forestry businesses to deduct expenditures sooner than might otherwise be permitted, and to deduct expenditures that might otherwise be of a capital nature (section DP 1 & 5).

38. Clear deduction and depreciation rules for forestry are helpful for reducing tax compliance and administration costs, and forestry can have a particularly long timing mismatch between expenses are incurred (e.g. pruning cost) and income is realised (when the trees are harvested). Nonetheless, the measures in DP 1 & 5 do appear to be concessionary, and New Zealand has had previous provisions for the taxation of forestry which appear to have been less concessionary.

39. The net impact of these provisions on natural capital is less clear. The measures encourage greater investment into forestry and the planting of new trees. Where this results in afforestation of previously cleared land, this can bring environmental benefits such as afforestation to meet New Zealand's greenhouse gas emission reduction targets. It can also ensure slope stability to reduce erosion, improved water quality and provide habitat for indigenous biodiversity. There are, however, potential negative environmental impacts. For example, increased sedimentation of waterways following harvest, and some exotic trees can increase the acidity of soils.

40. Overall, the natural capital benefits of plantation forestry depends on the activity it is displacing. Where it displaces pasture-based agriculture the benefits are likely to be

great (e.g. carbon sequestration, reduction in soil erosion, improved water quality), though the impacts at harvest can be negative (increased sedimentation, and increased risk of landslides on steep, erosion-prone land). Quantifying these costs or benefits depend on the value judgements that are assigned to different environmental effects (e.g. do we care more about carbon sequestration or biodiversity gains).

41. Even where forestry can be shown to have a positive impact on natural capital, tax concessions are often not the best tool for encouraging positive externalities – see previous Secretariat paper *Tax and the environment: Frameworks*. If the objective of forestry tax provisions is to reduce carbon emissions, reduce soil erosion, or stem biodiversity loss, there are likely to be more targeted, cost effective measures the Government could adopt. For instance, the emissions trading scheme creates a market for New Zealand Units (NZUs), which are provided to greenhouse gas absorbers such as forestry businesses.[10] Higher NZU prices (as the Group has recommended) could be a more effective and efficient approach for encouraging carbon sequestration.

42. The Secretariat recommends these provisions be further reviewed with a view to their replacement with rules that better reflect fair economic treatment. If provisions are changed, careful consideration should be given to avoiding negative environmental outcomes from the change. Rule changes should therefore be done together with consideration of complementary measures to promote the positive externalities of forestry, for example carbon sequestration, erosion control, and biodiversity protection.

43. The Secretariat has not investigated in detail alternative schemes, other than to note that in the late 1980s and early 1990s a 'cost of bush' approach applied. This tax treatment was more neutral by requiring certain planting and tree maintenance expenditure to be carried forward to the time that income from the forest was realised (i.e. at harvest or sale of the forest).

[10] The Ministry for Primary Industries also runs an Afforestation Grant Scheme (AGS) to support foresters.

4. Conclusion and recommendation

44. This paper has reviewed a broad range of potential tax provisions in environmentally industries to establish if there is a case for their removal. The outcomes reached in this report are similar to that found in other reviews of tax concessions and support measures.

45. Three tax provisions have been identified where the Secretariat recommends either their removal or further review, these are:

    1. Removing the seven-year depreciation rule for petroleum development expenditure, as it provides unnecessary favourable tax treatment to petroleum fields with an expected production life longer than seven years.
    2. Further review of forestry expenditure deductions to establish rules that better reflect fair treatment, combined with complementary measures to support positive externalities in the forestry sector (e.g., carbon sequestration, erosion control, biodiversity protection).
    3. Further review of farming expense deduction and depreciation rules (including schedule 20) to establish if these provisions reflect current fair treatment.

References

OECD, 2018. OECD-IEA analysis of fossil fuels and other support. Available at: http://www.oecd.org/site/tadffss/

APEC, 2015. Peer Review on Fossil Fuel Subsidy Reforms in New Zealand. Available at: https://www.mbie.govt.nz/info-services/sectors-industries/energy/international-relationships/pdf-document-library/peer-review-fossil-fuel-subsidy-reforms-nz.pdf

The Treasury 2018. Tax Expenditure Statement. Available at: https://treasury.govt.nz/publications/tax-expenditure/2018-tax-expenditure-statement

Appendix A: Proposed text for final report

Tax concessions

Removing environmentally harmful tax concessions

1. The Group has done a high level review of potentially concessionary tax provisions which could be negatively impacting on natural capital. Petroleum mining currently benefits from a provision allowing assets to be depreciated over seven years, even when the economic life of those assets is longer. The Group recommends removal of this provision.

2. The Group recommends further review of two other sets of provisions. Forestry currently benefits from concessionary tax rules allowing expenses to be deducted earlier than fair treatment would suggest. The Group recommends these rules be reviewed with a view to their replacement, combined with complementary measures to support positive externalities provided by forestry, including for carbon sequestration, erosion control, and biodiversity protection.

3. The Group also recommends a review of farming-specific deduction rules and depreciation rates in the Income Tax Act to establish if they reflect fair treatment.

Care of the land

4. Several submitters suggested that costs associated with the care of land subject to a QEII covenant should be treated as deductible expenses. The submitters argued that deductibility would support the purpose of the QEII covenant regime, as well as reduce compliance and administration costs. The Group agrees with this suggestion. The Group also recommends that privately incurred costs associated with the care of Ngā Whenua Rāhui should also be tax deductible.

Car parking and public transport

5. The Group has also considered the treatment of car parks and public transport. At the moment, the provision of free car parking to employees is not subject to fringe benefit tax. Yet any contributions made to an employee’s public transport costs *are* taxed. This treatment has the perverse impact of discouraging the use of public transport.

6. The Group acknowledges the practical difficulties involved in applying fringe benefit tax to employee car parks. In recognition of this constraint, the Group suggests that the Government examine the possibility of allowing employers to subsidise public transport use by employees without incurring fringe benefit tax.

Appendix B: Examples of allowable expenditure deductions

Farming

DO 1 Enhancements to land

Deduction

(1) A person is allowed a deduction for expenditure that they incur on the following in carrying on a farming or agricultural business on land in New Zealand:

(a) the destruction of weeds or plants detrimental to the land:

(b) the destruction of animal pests detrimental to the land:

(c) the repair of flood or erosion damage to the land:

(d) the destruction of scrub, stumps, or undergrowth on the land:

(e) the clearing or removing from the land of scrub, stumps, or undergrowth:

(f) the construction on the land of fences for farming or agricultural purposes, including buying wire or wire netting for the purpose of making new or existing fences rabbit-proof:

(g) the regrassing and fertilising of all kinds of pasture, if the expenditure is not incurred in the course of a significant capital activity.

Link with subpart DA

(2) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

Defined in this Act: business, capital limitation, deduction, general limitation, general permission, New Zealand, significant capital activity

Compare: 2004 No 35 s DO 1

Section DO 1 heading: amended (with effect on 1 April 2011), on 17 July 2013, by section 31 of the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013 (2013 No 52).

Schedule 20
Expenditure on farming, horticultural, aquacultural, and forestry improvements

ss DO 4, DO 5, DO 11, DO 12, DO 13, DP 3, DZ 17, DZ 18, YA 1

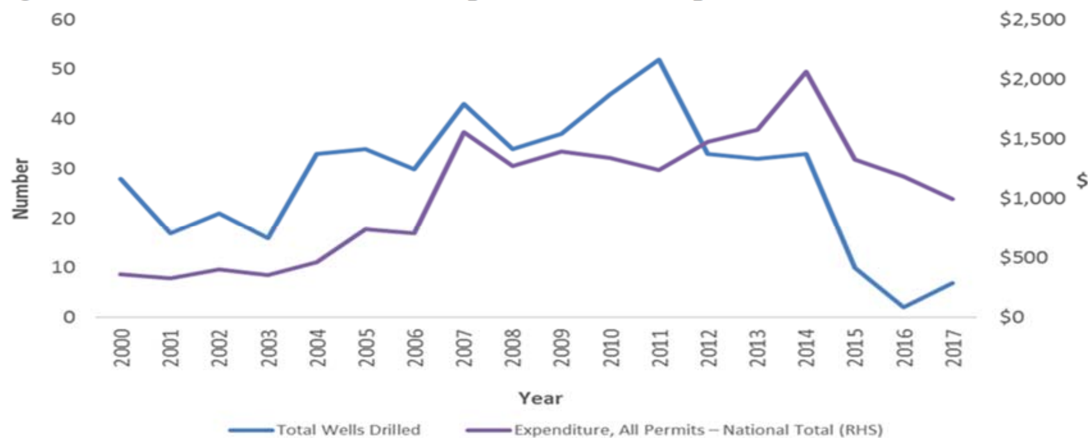
	Improvement	Percentage of diminished value of improvement allowed as deduction
	Part A **Farming**	
1	unless clause 2 applies, preparation of the land for farming or agriculture, including cultivation and grassing	5
2	regrassing and fertilising all types of pasture in the course of a significant capital activity that relates to a type of pasture with an estimated useful life of more than 1 year	45
3	draining of swamp or low-lying lands	5
4	construction of access roads or tracks to or on the land	5
5	construction of dams, stopbanks, irrigation or stream diversion channels, or other improvements for the purpose of conserving or conveying water for use on the land or for preventing or combating soil erosion, other than planting or maintaining trees, whether or not on the land, for the purpose of providing shelter to the land	5
6	construction of earthworks, ponds, settling tanks, or other similar improvements mainly for the purpose of the treatment of waste products in order to prevent or combat pollution of the environment	5
7	sinking of bores or wells for the purpose of supplying water for use on the land	5
8	construction of aeroplane landing strips to facilitate aerial topdressing of the land	5
9	planting of non-listed horticultural plants on the land (see section 44C of the Tax Administration Act 1994)	10
10	erection on the land of electric power lines or telephone lines	10
11	construction on the land of feeding platforms, feeding yards, plunge sheep dips, or self-feeding ensilage pits	10
12	construction on the land of supporting frames for growing crops	10
13	construction on the land of structures for shelter purposes	10

Appendix C: Oil production, number of wells drilled

Thousand tonnes (kt)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016		2017
Indigenous Production	**2,000.86**	**2,809.89**	**2,647.70**	**2,615.58**	**2,272.97**	**2,032.38**	**1,783.05**	**1,994.67**	**2,063.77**	**1,753.37**		**1,581.03**
Crude, Condensate, Naphtha and Natural Gas Liquids	*1,890.50*	*2,724.58*	*2,574.44*	*2,466.92*	*2,124.82*	*1,866.59*	*1,605.47*	*1,788.25*	*1,869.66*	*1,584.63*		*1,404.49*
Maui	256.85	220.14	224.98	231.22	151.64	150.85	171.46	198.02	146.26	132.44		138.99
Kapuni	76.99	65.42	51.30	55.12	61.87	52.63	48.49	70.29	50.41	38.36		33.84
Pohokura	580.16	566.90	532.15	522.30	484.80	497.22	512.04	512.88	407.14	398.25		333.50
Tui	818.97	1,738.51	810.17	447.70	339.68	250.76	181.08	157.57	214.13	146.69		108.61
Maari	-	-	763.88	803.44	692.15	475.99	256.11	375.66	596.15	449.44		392.94
Kupe	-	-	11.43	237.06	221.04	196.57	201.38	191.22	180.31	157.81		143.23
Mckee	35.98	24.90	22.97	18.39	16.31	16.86	12.67	8.83	5.24	2.35		0.17
Mangahewa	10.92	14.44	32.76	26.78	26.53	44.52	58.82	88.63	98.15	110.36		110.67
Turangi	31.20	28.27	46.56	35.39	28.01	38.17	37.52	37.08	37.42	41.07		42.53
Kowhai	-	-	15.59	29.62	20.75	14.77	16.68	25.68	22.66	15.54		11.88
Ngatoro[1]	29.45	24.85	26.51	24.51	23.00	27.35	19.09	17.77	23.63	24.48		21.95
Rimu	14.45	9.39	12.38	11.65	19.04	23.84	15.28	5.78	7.37	7.80		10.62
Cheal	18.71	24.78	18.39	17.79	34.48	49.17	52.12	69.10	61.93	45.40		37.78
TarikiAhuroa	6.31	1.83	0.00	-	0.07	0.23	-	-	-	-		-
Waihapa	7.61	2.83	2.86	3.45	1.55	0.03	3.10	7.46	5.75	4.53		4.48
CopperMoki	-	-	-	-	1.42	24.30	9.29	6.12	2.67	5.78		2.86
Surrey	2.14	2.07	2.39	2.41	2.02	1.75	1.05	0.51	-	-		0.47
Others	0.77	0.25	0.11	0.11	0.47	1.58	9.29	15.67	10.45	4.34		9.95
LPG	*110.35*	*85.31*	*73.27*	*148.66*	*148.14*	*165.80*	*177.58*	*206.42*	*194.11*	*168.74*		*176.54*
Maui	44.08	37.08	40.27	41.52	26.38	29.23	36.87	47.52	32.46	33.32		33.49
Pohokura	-	-	-	-	-	20.03	21.25	27.68	29.91	26.75		23.01
Kapuni	52.06	42.53	30.07	36.57	37.79	35.12	28.83	37.04	31.26	25.41		24.77
Kupe	-	-	1.06	69.55	83.36	79.95	90.69	95.29	99.99	82.25		94.65
TAWN	11.32	3.22	-	-	-	-	-	-	-	-		-
Rimu/Kauri	4.44	2.45	1.86	1.01	0.90	1.47	0.86	0.46	0.99	1.00		0.66
Cheal	0.02	0.33	-	-	-	-	-	-	-	-		-
Injected to gas sales	(1.58)	(0.29)	(0.00)	(0.00)	(0.28)	-	(0.91)	(1.56)	(0.49)	(0.00)		(0.04)

Source: MBIE (2018) Annual oil and oil products update.

Figure 1: Total wells drilled and expenditure on all permits



Source: MBIE (2018) Petroleum exploration activity data

Appendix D: Fossil fuel support measures in New Zealand

Fossil fuel subsidies or support measures are in most cases used to describe any kind of financial assistance to certain activities or industries that have direct negative environmental consequences. While there are various definitions of what constitutes a fossil fuel subsidy or support measure, these measures are known for encouraging wasteful consumption, distorting markets, affecting investment and operational decisions, and placing the long-term competitiveness for renewable energy sources at a disadvantage.

The Organisation of Economic Development (OECD) uses a broader definition of "support measure" which includes both direct budgetary support and tax expenditures that in some way provide a benefit or preference for fossil-fuel production or consumption relative to alternatives.

Through the OECD 2009 Declaration on Green Growth, 34 countries, including New Zealand, declared that they would encourage domestic policy reform, with the aim of avoiding or removing environmentally harmful policies that might thwart green growth, such as subsidies directed at fossil fuel consumption or production.[11]

New Zealand further supported these commitments when in 2010 it established an informal "Friends" group of non-G20 countries to encourage G20 and Asia-Pacific Economic Cooperation (APEC) leaders to take action on their commitments to phase out inefficient fossil fuel subsidies as soon as possible. The country has also been credited for not having any support measures that encourages wasteful consumption of fossil fuels.[12]

Measuring support measures

New Zealand does not subsidise fossil fuels and therefore does not feature in either the International Energy Agency (IEA) or Global Subsidies Initiative (GSI) estimates of global fossil fuel subsidies. Although there are different ways of measuring fossil fuel subsidies[13], this task is made more difficult when extended to other forms of targeted tax concessions for specific activities or sectors.

For this reason, the following sections will focus on determining the concessionary nature of these tax concession and then the fiscal and environmental impact associated with those concessions that are deemed to be concessionary.

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[11] OECD, 2009. Declaration on Green Growth Adopted at the Meeting of the Council at Ministerial Level - 25 June 2009.

[12] APEC, *2015.*

[13] Such as the price gap between national and international benchmark prices, measuring support relative to domestic alternatives and comparing prices against the full social cost of the subsidy or fuel source.