Capital gains taxation proposals and forestry

The Consultative Document on the Taxation of Income From Capital (or commonly called capital gains taxation) was released on December 19, 1989. The document makes two main proposals:
- a comprehensive review of tax treatment of income from capital rather than a piecemeal approach to capital gains tax introduction; and
- the introduction of inflation indexation of income from capital.

Implementation of the proposals would mean that certain forms of income from appreciating capital assets (including land, dwellings etc) and trading stocks which are currently not within the "tax net", will be taxable as ordinary income but the exception is that tax will be levied on real income (i.e. inflation-adjusted income). From an efficiency and equity viewpoint, it is desirable to tax capital gains because the current regime encourages "bunching" of investment in non-taxable assets and disadvantages wage earners. But whether it is practical or not is another issue. Because of administrative and compliance problems, taxation on realised income is favoured over taxing accrued income.

The Government has announced that the proposal will not be applied to owner-occupied dwellings.

The concern here is whether the proposals will have a direct effect on forestry. The short answer is no, because realised forestry income is already taxable. The proposals apply only to certain forms of income from capital which are currently exempt from tax. It is interesting to note that the structure proposed to tax capital gains, in some ways, is very similar to that already in place in forestry. For example, it proposes that expenditure related to capital account (including expenditure on purchasing of asset) be capitalised and be deducted against proceeds of asset disposals. This is somewhat similar to the "cost of bush" accounting in forestry. But the subtle difference is that the expenditure will be allowed indexation against inflation so that taxation is levied on real income. This is currently not permitted in forestry and there is no suggestion in the proposals that it should be applied to forestry.

Viewed from this angle, it can be argued that the proposals will disadvantage forestry investors unless indexation is also allowed for the "cost of bush" account. Inflation, even at a low rate, as shown in the document, has a big impact on the effective tax rate, although it affects short-lived assets more heavily than long-lived assets like forests.

Currently, the proceeds from the disposal of forestry land after harvesting are not taxable. They are exempt under section 67(5) of the Income Tax Act. Whether this will change is still unclear. The document discusses some of the problems relating to the exemption. For example, it argues that the economic income of the land consists partly of rents and partly of growth in market value of the land. Because the accretion in the value of land is not taxable while expenditure is deductible, this has resulted in over-investment in land in the past especially in the horticulture area. But the document has not suggested whether transactions involving forestry land should be brought within the tax net.

Conclusion

While the proposed reforms for taxation of capital gains sound ideal in theory as they are consistent with the government objective of a "level playing field", it is doubtful whether they are practical. From a revenue perspective, it is not expected to be a major revenue earner. Contrary to what the document says, the compliance and administration costs could outweigh the benefits. One of the greatest fears is that while the reforms are designed to remove investment distortions, they may well end up creating new ones.

Dennis Lee

I enjoy planting and growing trees, and looking at growing trees, but almost as much, I enjoy cutting them down when they have served their purpose. There is something uniquely satisfying in spending a day using a chainsaw and log-splitter to convert unwanted or otherwise useless logs into a neat – and useful – stack of firewood; a feeling of power, perhaps. Maybe this feeling has coloured the following remarks; I don't think it has.

What happened was that one of the people kind enough to give me a couple of trees for the above-mentioned conversion process asked some questions about "natives". Could they be grown in plantations? Could they be managed for timber production? What species should he select?

The last question was easy to answer: choose something indigenous to the area. And yes, it was possible – not easy, but possible – to grow "native" plantations, and to manage them, using broadly similar techniques to those developed for exotic forests.

For further information, I referred him to an appropriate agency, but not before recalling that a good 10 years ago, two of the top forestry scientists working with native timbers showed me the techniques they were developing to maximise productivity from the regrowth on cut-over beech forests.

Their observations – and what they showed me tended to confirm these – were that a better-balanced forest occurs on the second rotation from land that has been clear-felled of all save a few seed trees than on land that has been selectively logged, and that selective logging, much advocated on the West Coast, causes in the long term greater disruption to the mixture of forest species.

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Forests are an emotive topic, and subject to significant over-emotionalism from elements of the conservation movement. No-one could logically argue against preserving a cross-section of examples of all our indigenous forest ecosystems, and in lumps big enough to sustain the full range of flora and fauna (small, discontinuous reserves may do more harm than good). The lock-up of the South Westland rain forests, for example, was a very important step that clearly enjoyed public support virtually throughout the country.

But not all our forests are so politically and ecologically sensitive. What is wrong with managing some indigenous forests as a renewable resource of hardwood timber?

As a journalist, I have to take a neutral stance and present arguments both for and against locking up, or harvesting, natural forests.

Sympathies with preservation, but proper use

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Privately, I have not disguised the fact that my sympathies lie with preservation, rather than with wholesale exploitation. However, there is a difference between exploitation and utilisation.

Certain key areas of scrubland, tussock land, wetland, forest and mountain lands need conservation to maintain species, habitat, or soil and water values.

There also remain areas of forest, some of them privately-owned, which are not critical to the survival of species or to soil and water values. What on earth is wrong with managing these for a sustained yield of timber, and harvesting the timber they hold while it is still in marketable condition?

I can't go along with arguments that all exports of indigenous woodchips ought to be banned. I get more upset about seeing sawlogs turned into chips or pulp than I do about a few loads of chips going to Japan.

It seems to me as a (financially) disinterested observer, that if an area is being logged it makes sense to sell as much as possible of the wood from it. Logs are of no use or value lying on the ground to rot. They consist mainly of cellulose and lignin (some of the nutrients are in the bark, but most are concentrated in the foliage) and make a negligible contribution to the forest nutrient cycle. If non-millable logs can be sold as chips, then sell them. If there isn't a chip buyer, then turn them into firewood, for heaven's sake.

A few loads of beech chips going to Japan are no different, really, from exports of meat or wool. Like the latter, wood is a renewable resource if managed properly. Of course, if forests are being felled wholesale and not managed for appropriate regeneration, the situation becomes different and undesirable.

The knowledge and expertise are available in this country to manage our harvestable forests so that they retain all, or effectively all, of their natural values, and have much higher economic value.

I can see most of the "green" lobby lining up to attack me over these remarks, but I'm not worried about it. It's not as if I am suggesting we should knock down most of our forests.

What I'm saying - and I know there are a lot of people out there who agree with this - is that instead of worrying about the despatch of a few hundred, or a few thousand, tonnes of woodchips to Japan to provide much-needed regional employment in otherwise depressed areas of this country, we ought to be looking to use the knowledge and expertise accumulated over the last century and a half to maintain and, where possible, enhance such of our forests as remain.

Harvesting and regenerating non-critical parts of these forests to provide a sustainable supply of hardwood timber and regional employment could well be a part of this.

I digress. What I was going to say when I rudely interrupted myself is that I was able to direct my inquirer to the results of a survey, made by the Forest Research Institute three years ago, of native trees growing in plantations in different parts of the country.

The survey was prompted partly by the imposition of restrictions on the logging of native forests and partly by the increasing need for specialty timbers.

More than 200 individuals and organisations contributed data, and more data were obtained from a search of Forest Service records of early plantings of native trees. The survey team visited more than 50 plantations between Kaihoe in the north and Dunedin in the south.

What emerged from their researches was a picture that might not satisfy cost-plus advocates, and might not come within a bull's roar of an "economic" internal rate of return. But it does prove that it is possible to grow indigenous timber in a plantation regime, and in a fraction of the time that nature might otherwise take to do it.

Puriri, widely regarded as a slow-growing and very long-lived tree (there is one in Pukekura Park, New Plymouth, that is reputed to be 2000 years old, and standing underneath it at dusk is a rather memorable experience), showed the fastest average growth rate in the survey, attaining 62cm diameter at breast height after 60 years. Red, silver, and black beech attained between 45cm and 49cm diameter within the same time. The best stands of black beech averaged 58cm, and the best puriri 72cm.

Among the indigenous conifers, totara was outstanding, with an average diameter of 61cm at age 60, and a best stand averaging 78cm. Kahikatea averaged 53cm, kauri 42cm, and rimu 40cm. These figures are not conclusive. A great deal more data need to be assembled about such aspects as the effects of form pruning and the rate of formation of heartwood in indigenous timber trees.

However, the results of the survey do show that while it may not be "economic" to grow indigenous trees in a plantation situation, it is possible to grow high-quality indigenous sawlogs in 80 to 100 years. Admittedly, during this time it would be possible to grow two rotations of Douglas fir and three or four of pines, but the indigenous timber occupies a niche in the market that is going to be harder and harder to fill as time passes.

Indigenous trees, as the survey team noted, have one advantage over exotic ones: they can be grouped in small, mixed woodlots or mini-forests which can fill multiple roles, including the rehabilitation of degraded forest areas, beautification, enhancement of indigenous wildlife habitat, and the provision of shelter.

Derrick Rooney