Hon Stuart Nash, Minister of Revenue

Information Release

Mycoplasma bovis tax issue

August 2020

Availability

This information release is available on Inland Revenue's Tax Policy website at http://taxpolicy.ird.govt.nz/publications/2020-ir-cab-dev-20-sub-0045/overview

Documents in this information release

#	Reference	Type	Title	Date
1	IR2020/035	Tax policy report	Mycoplasma bovis tax issue	12 February 2020
2	DEV-20-SUB-0045	Cabinet paper	Mycoplasma bovis tax issue	18 March 2020
3	DEV-20-SUB-0045	Regulatory impact assessment	Mycoplasma bovis tax issue	26 February 2020
4	DEV-20-MIN-0045	Minute	Mycoplasma bovis: tax issue	18 March 2020

Additional information

The Cabinet paper was considered by the Cabinet Development Committee on 18 March 2020 and confirmed by Cabinet on 23 March 2020.

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

9(2)(a) to protect the privacy of natural persons, including deceased people

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POLICY AND STRATEGY

Tax policy report: Mycoplasma bovis tax issue

Date:	12 February 2020	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2020/035

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	18 February 2020
Minister of Revenue	**Agree** to recommendations and **refer** a copy of the report to the Minister of Agriculture	18 February 2020

Contact for telephone discussion (if required)

Name	Position	Telephone
Chris Gillion	Policy Lead	s 9(2)(a)
Geoff Leggett	Principal Policy Advisor	

12 February 2020

Minister of Finance
Minister of Revenue

Mycoplasma bovis tax issue

Executive summary

1. Some farmers have significant unexpected taxable income through their herds being culled following a primary sector/government decision to eradicate Mycoplasma bovis in New Zealand. Although this income should in effect be reversed over the next five to seven years, there are potential cash flow and interest costs for the farmers in the meantime, inhibiting their ability to restock.

2. This tax outcome undermines a core principle of the Biosecurity Act 1993 that no person should be any better or worse off because of the Crown's use of its powers under that Act. Accordingly, Federated Farmers have requested an amendment to ensure there are no income tax implications from culling and replacing dairy and beef cattle impacted by Mycoplasma bovis. They cite the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes as a precedent.

3. The issue arises for farmers who have used the national standard cost scheme (NSC) to value their breeding stock on hand for tax purposes (the income equalisation scheme is adequate for other situations). Of the around 200 properties that have had herds culled to date, probably up to 50 will have sizeable upfront taxable income. These are likely to be predominantly dairy operations but some beef breeding operations have also been affected. Further culls are expected.

4. A quick solution to this issue is needed as tax returns for the 2018/19 income year are due soon (by 31 March this year) with payment due shortly thereafter.

5. Officials have been discussing this issue with Federated Farmers and Chartered Accountants of Australia and New Zealand (CA ANZ). We all agree that the best immediate solution is to allow the additional income to be spread over the subsequent six income years. This would require amending the Income Tax Act. We recommend that the amendment apply retrospectively, from the 2017-18 income year, as the first culls began in late 2017. Standard tax rules would continue to apply to the farmers' other income.

6. This solution has minimal fiscal and administrative impact. There is a minor change in the timing of tax payments so that there is an estimated upfront fiscal cost of $1.5 million with a balancing fiscal gain over the following five or so years. We recommend that this cost and subsequent gains be booked against the tax policy scorecard. Any administrative impact can be absorbed by Inland Revenue within its baseline.

7. If you agree in principle to this solution, officials will continue to work with Federated Farmers and CA ANZ on the detail and will prepare a draft Cabinet paper for your consideration. The aim is for that paper to be considered by the Economic Development Committee at its meeting on 18 March 2020. Any legislative change could then be made through a supplementary order paper to the omnibus tax bill planned for introduction in April.

Recommended action

8. We recommend that you:

(i) **Agree** that income arising from the culling of livestock as a result of Mycoplasma bovis be able to be spread evenly over the subsequent six income years provided the stock is replaced after the cull with substantially equivalent stock and the farm has been valuing its female breeding stock under NSC.

Agreed/Not agreed　　　　　　　　Agreed/Not agreed

(ii) **Agree** that the amendment apply retrospectively from the 2017/18 income year.

Agreed/Not agreed　　　　　　　　Agreed/Not agreed

(iii) **Note** that agreeing to recommendation (i) and (ii), will have the following impact on tax revenue, with the final year of impact being 2025/26:

	$m – increase/(decrease)			
Vote Revenue Minister of Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24 & outyears**
Tax Revenue	(1.500)	0.300	0.300	0.300
Total Operating	**(1.500)**	**0.300**	**0.300**	**0.300**

Noted　　　　　　　　Noted

(iv) **Agree** that the estimated fiscal impact identified in recommendation (iii) be accounted for on the tax policy work programme scorecard.

Agreed/Not agreed　　　　　　　　Agreed/Not agreed

(v) **Direct** officials to prepare a draft Cabinet paper which Ministers can take to Cabinet's Economic Development Committee meeting on 18 March 2020.

Directed　　　　　　　　Directed

(vi) **Refer** a copy of this report to the Minister of Agriculture for his information.

Referred　　　　　　　　Referred

Geoff Leggett
Principal Policy Advisor
Policy and Strategy

Hon Grant Robertson
Minister of Finance
/ /2020

Hon Stuart Nash
Minister of Revenue
/ /2020

Background

9. Federated Farmers have requested an amendment to tax legislation to ensure there are no income tax implications from culling and replacing dairy and beef cattle impacted by the Mycoplasma bovis response. They argue that the disease is an unexpected event and reasonably draw parallels with the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes. They consider that a quick response is required because there are affected farmers with sizeable increases in income in the 2018/19 income year, the returns for which need to be filed by 31 March 2020 and the tax paid in early April 2020.

10. The request was sent to the Minister of Revenue and copied to the Minister of Agriculture on 18 December 2019.

11. The Biosecurity Act 1993 provides the Government with powers for the purpose of eradicating or managing an organism. The Government, in partnership with the dairy and beef sectors has decided to try to eradicate the organism Mycoplasma bovis from New Zealand. As a result, Biosecurity New Zealand can require all the stock on a farm where Mycoplasma bovis has been found to be culled[1]. In exchange, the Government pays compensation at market rates to the affected farmers, designed to leave farmers in no better or worse position than a person whose property is not directly affected by the exercise of the powers. This compensation does not have to be used to purchase replacement stock, but the expectation is that farmers will use it for that purpose.

12. To date, around 200 properties have been cleared of stock with a similar number under surveillance. These have been predominantly dairy farms although Mycoplasma bovis is increasingly being found on beef farms that acquired young stock from affected dairy farms before the disease was identified. Of the total 90,000 stock culled and compensated for by the end of January, 52,000 were dairy cattle and 38,000 were beef cattle, with the bulk of the beef cattle being from fattening operations rather than breeding operations.

Income tax implications

13. For income tax purposes livestock is trading stock and, like all traditional trading stock, must be valued annually to establish its opening and closing values as part of determining the cost of sales. An increase in the value of livestock can be taxable income. A farmer has the choice of several valuation options, but the main ones used are national standard cost (NSC) and the herd scheme.

14. The NSC scheme values the animals at, if the animal is homebred, a standard cost for the respective age and type of animal that reflects average home breeding costs, or at its purchase cost if the stock is purchased.

15. Under the herd scheme stock is valued annually using published national average market values, with tax being paid on entry into the scheme based on the difference between the market value and the stock's cost. Unlike other trading stock valuation options, under the herd scheme subsequent changes in value generally have no tax implications. Dairy farmers predominantly use the herd scheme whereas beef farmers predominantly use NSC, although many farmers also use both schemes.

16. If the culled animals were valued under the NSC scheme, the difference between the cost of the animals and the market value is income even when the farmer immediately restocks their farm with equivalent stock. The stock value is, if it includes breeding cows, written down over the next five or so years as the stock ages

[1] There have also been instances where only part of the herd has been culled because it was isolated from the rest of the herd.

and is itself gradually replaced from homebred animals. There are potential cash flow and interest costs for the farmer in the meantime.

17. For fattening stock valued under the NSC scheme, the tax issue is less acute as the livestock turn-over much more regularly, and in that case the income equalisation deposit scheme should provide sufficient flexibility to manage any tax issues. In contrast, the income equalisation scheme will not provide sufficient flexibility to deal with the tax issues created by the culling of breeding cows that are valued under the NSC scheme.

18. Overall, possibly up to 50 farmers could have unexpected tax liabilities because they value their dairy and/or beef breeding animals under the NSC scheme. The impact is most severe for those with a high proportion of mixed-age cows as, under normal circumstances, they would be relying on holding those animals for several years and on using them to breed replacement stock. Sharemilkers would be particularly hit as their main asset is livestock.

Officials' recommendations

Spreading the additional income

19. Although it could be argued that Mycoplasma bovis is a business risk, we are mindful that the decision to eradicate the organism from New Zealand, and the resulting culling of herds is a government administrative decision. Its impact on individual farms is far more significant than say a destocking as a result of a drought or flood.

20. At the same time the tax outcome needs to be fair relative to farmers who have used other valuation methods, and to those farmers affected by Mycoplasma bovis who have already filed their tax returns for earlier years in which compensation has been provided. Compensation has been paid out since 2017.

21. We have discussed this issue with both Federated Farmers and Chartered Accountants of Australia and New Zealand (CA ANZ). We all agree that the policy issue should be addressed, and that the best immediate solution is to allow the additional income to be evenly spread over subsequent income years. Depending on the assumed herd profile, that spread could be between five and seven years. Therefore, for simplicity, we recommend a six-year spread. The income would then be offset each year by the increased deductions arising from the reducing cost of the stock on hand.

22. Certain requirements would need to be met for the income to be spread:

- The farm would need to be subject to Biosecurity Security New Zealand requiring a cull of Mycoplasma bovis affected stock.
- Stock would need to be substantially replaced with equivalent stock within a reasonable timeframe.
- The farm would need to be a dairy operation or a beef breeding operation, with the female breeding stock valued under NSC.
- Only the income derived from the culling of the stock valued under NSC or the self-assessed cost scheme[2] could be spread.

[2] The self-assessed cost scheme is another cost-based valuation option. Very few farmers use the scheme because of its complexity, so it may be that none of the affected farmers are using it, but if they have there would be a tax liability as a result of the animal cull.

- The replacement stock must continue to be valued using, as relevant, NSC or self-assess cost. (This is to ensure that farmers cannot enter the herd scheme on more advantageous terms than those not affected by Mycoplasma bovis).

23. An amendment to the Income Tax Act 2007 will be required to provide this spread. It cannot be handled administratively.

24. This recommended solution has parallels with the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes. In those cases the recovery income was suspended until a replacement property was purchased.

Tax returns for 2018/19 income year

25. It is possible that this amendment can be included in the tax bill planned for introduction in April, at the Select Committee stage, which would enable a quick response for those farmers immediately affected by having additional income in the 2018/19 income year. Inland Revenue will then be able to apply discretion in relation to the timing of tax payments. The farmers will still be required to file their tax return and to pay tax at the standard times on income that has not been derived from the culled animals.

Already filed returns

26. Although the bulk of the impact to date will be in relation to 2018/19 income tax, we are also recommending that the amendment be backdated to include the effects in the 2017/18 income year as the culls began in late 2017. We are suggesting that those who have already filed have the option of having their returns reassessed or leaving them as is as there may be some impact on farmers social assistance entitlements and liabilities if the additional income is now spread.

Implications for farmers using the herd scheme

27. The additional income from culling the Mycoplasma bovis affected animals is far less of an issue for those using the herd scheme. In their case, as with fattening stock valued under the NSC scheme, the existing income equalisation scheme can be used to neutralise any income that does arise. For example, when the additional income arises in one income year and the stock is replaced in the following income year, the income can be deposited into the income equalisation scheme in the meantime to defer the tax liability to the next year when the deductions for the replacement stock can offset the income. This is a standard and expected use of the income equalisation scheme.

Longer term solutions

28. It may be possible longer-term to have a more generic process/provision for handling severe adverse events and future biosecurity incursions affecting livestock. To date the responses have been specific to the events. However, given the timeframe for addressing the current issue, a specific solution is recommended.

Consultation

29. As well as CA ANZ and Federated Farmers, we have consulted the Ministry for Primary Industries on this issue.

30. Officials, CA ANZ and Federated Farmers have established a working team to work through the detail of the spreading option.

Financial implications

31. The expected fiscal cost is confined to situations where returns have been filed, tax has been assessed and the tax liability would now be spread. This is essentially 2017/18 income tax returns and some 2018/19 income tax returns. Officials estimate the upfront fiscal cost to be $1.5 million as there were relatively few culls and compensation pay-outs in the 2017/18 income year and many income tax returns for the 2018/19 income year will not be filed until closer to the 31 March 2020 deadline. There will be offsetting fiscal gains over the subsequent five or so income years as the higher stock values are gradually written down. This produces the following out-turn over the forecast period, with the final year of impact being in 2025/26:

	$m – increase/(decrease)			
Vote Revenue Minister of Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24 & outyears**
Tax Revenue	(1.500)	0.300	0.300	0.300
Total Operating	**(1.500)**	**0.300**	**0.300**	**0.300**

32. We recommend that this estimated cost and subsequent gains be accounted for on the tax policy work programme scorecard. The current scorecard balance to the end of the 2023/24 fiscal year is $53.036 million. The implementation of this policy would reduce the cumulative scorecard balance to $52.436 million.

33. Given the relatively limited number of cases involved, the costs associated with administering the spread should be minimal. The costs will be absorbed within Departmental baselines. Farmers intending to spread the additional income will be required to advise Inland Revenue when filing their returns so that their files can be manually adjusted. The aim will be to keep the additional compliance costs to a minimum.

Next steps

34. If you agree that there should be a law change, a draft Cabinet paper and Regulatory Impact Statement will be prepared for your consideration in early March so that the final Cabinet paper can be considered by Cabinet's Economic Development Committee at its meeting on 18 March, before the Budget moratorium.

35. If agreed by Cabinet, we recommend including the legislative change in a supplementary order paper to the tax bill planned for introduction in April. At the same time, we recommend that the Minister of Revenue issue a press release advising of Cabinet's decision and the process for the affected 2018/19 income tax returns due by 31 March 2020. This will help to provide farmers and their tax advisers with some certainty.

36. That release should also indicate that deposits into the income equalisation scheme for income arising from the Mycoplasma bovis response can be withdrawn early. That statement will enable Inland Revenue to simplify withdrawals by treating them as a "class of case".

37. We recommend you refer a copy of this report to the Minister of Agriculture for his information.

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

MYCOPLASMA BOVIS TAX ISSUE

Proposal

1. This paper seeks Cabinet Economic Development Committee's agreement to an amendment to the Income Tax Act 2007 to enable, under certain circumstances, the income arising from the culling of livestock as a result of Mycoplasma bovis to be spread over six years, to negate an unexpected income tax liability.

Executive Summary

2. Some farmers have significant unexpected taxable income through their herds being culled following a primary sector/government decision to eradicate Mycoplasma bovis in New Zealand. Although this income should in effect be reversed over the next five to seven years, there are potential cash flow and interest costs for the farmers in the meantime, inhibiting their ability to restock.

3. This tax outcome undermines a core principle of the Biosecurity Act 1993 that no person should be any better or worse off because of the Crown's use of its powers under that Act. Accordingly, Federated Farmers have requested an amendment to ensure there are no income tax implications from culling and replacing dairy and beef cattle impacted by Mycoplasma bovis. They cite the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes as a precedent.

4. The issue arises for farmers who have used the national standard cost scheme (NSC) to value their breeding stock on hand for tax purposes (the income equalisation scheme is adequate for other situations). Of the around 200 properties that have had herds culled to date, probably up to 50 will have sizeable upfront taxable income. These are likely to be predominantly dairy operations but some beef breeding operations have also been affected. Further culls are expected.

5. A quick solution to this issue is needed as tax returns not already filed for the 2018/19 income year are due soon (by 31 March this year) with payment due shortly thereafter.

6. Officials have been discussing this issue with Federated Farmers and Chartered Accountants of Australia and New Zealand (CA ANZ). Officials and key stakeholders all agree that the best immediate solution is to allow the additional income to be spread over the subsequent six income years. This would require amending the Income Tax Act. As the first culls began in late 2017, the amendment should apply retrospectively, from the 2017/18 income year. Standard tax rules would continue to apply to the farmers' other income.

7. This solution has minimal fiscal and administrative impact. There is a minor change in the timing of tax payments so that there is an estimated upfront fiscal cost of $1.5 million with a balancing fiscal gain over the following five or so years. I recommend that this cost and subsequent gains be booked against the tax policy scorecard. Any administrative impact can be absorbed by Inland Revenue within its baseline.

8. If Cabinet agrees to this solution, any legislative change would be made through a supplementary order paper to the omnibus tax bill planned for introduction in April this year.

9. It is recommended that you authorise the Minister of Revenue to make decisions on the detail of the spreading amendment.

Background

10. Federated Farmers have requested an amendment to tax legislation to ensure there are no income tax implications from culling and replacing dairy and beef cattle impacted by the Mycoplasma bovis response. They argue that the disease is an unexpected event and reasonably draw parallels with the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes. They consider that a quick response is required because there are affected farmers with sizeable increases in income in the 2018/19 income year, the returns for which need to be filed by 31 March 2020 and the tax paid in early April 2020.

11. The request was sent to the Minister of Revenue and copied to the Minister of Agriculture on 18 December 2019.

12. The Biosecurity Act 1993 provides the Government with powers for the purpose of eradicating or managing an organism. The Government, in partnership with the dairy and beef sectors has decided to try to eradicate the organism Mycoplasma bovis from New Zealand. As a result, Biosecurity New Zealand can require all the stock on a farm where Mycoplasma bovis has been found to be culled[1]. In exchange, the Government pays the farmer compensation for the difference between the normal market value of the stock and the amount received when the stock is slaughtered. This compensation is designed to leave farmers in no better or worse position than a person whose property is not directly affected by the exercise of the powers. The compensation does not have to be used to purchase replacement stock, but the expectation is that farmers will use it for that purpose.

13. To date, around 200 properties have been cleared of stock with a similar number under surveillance. These have been predominantly dairy farms although Mycoplasma bovis is increasingly being found on beef farms that acquired young stock from affected dairy farms before the disease was identified. Of the total 90,000 stock culled and compensated for by the end of January, 52,000 were dairy cattle and 38,000 were beef cattle, with the bulk of the beef cattle being from fattening operations rather than breeding operations.

[1] There have also been instances where only part of the herd has been culled because it was isolated from the rest of the herd.

Analysis

Income tax implications

14. For income tax purposes livestock is valued annually to establish its opening and closing values as part of determining the cost of sales. An increase in the value of livestock can be taxable income. A farmer has the choice of several valuation options, but the main ones used are national standard cost (NSC) and the herd scheme. A few farmers also use self-assessed cost.

15. The NSC scheme values the animals at, if the animal is homebred, a standard cost (determined by the Commissioner of Inland Revenue) for the respective age and type of animal that reflects average home breeding costs, or at its purchase cost if the stock is purchased.

16. Under the herd scheme stock is valued annually using published national average market values, with tax being paid on entry into the scheme based on the difference between the market value and the stock's cost. Unlike other trading stock valuation options, under the herd scheme subsequent changes in value generally have no tax implications. Dairy farmers predominantly use the herd scheme whereas beef farmers predominantly use NSC, although many farmers also use both schemes.

17. If the culled animals were valued under the NSC scheme, the difference between the cost of the animals and the market value is income even when the farmer immediately restocks their farm with equivalent stock. The stock value is, if it includes breeding cows, written down over the next five or so years as the stock ages and is itself gradually replaced from homebred animals. However, there are potential cash flow problems and interest costs for the farmer in the meantime.

Simplified example

> Cow A with a market value of $1,500 is culled because of Mycoplasma bovis. The farmer receives $1,500 for the cow from a combination of compensation and slaughter receipts.
>
> For tax purposes, as cow A was valued under the NSC scheme at $700, there is taxable income of $800 from its cull.
>
> The $1,500 is used to buy replacement cow B. Under NSC, cow B is valued at its purchase price of $1,500.
>
> Cow B remains in the herd for five years before being slaughtered and is replaced by a cow bred up through the herd (cow C) which has a NSC of $700 (its homebred cost). There is a tax deduction of $800 at that point, being the difference between the cost of cow B and the cost of cow C.
>
> If there had been no Mycoplasma bovis cull, cow A would have remained in the herd and been replaced by the equivalent of cow C with no NSC implications given that both cow A and cow C have a NSC value of $700.

18. For fattening stock valued under the NSC scheme, the tax issue is less acute as the livestock turn-over much more regularly, and in that case the income equalisation deposit scheme should provide sufficient flexibility to manage any tax issues. That scheme enables the recognition of income to be deferred by up to five years if the

income is deposited into the scheme. In contrast, the income equalisation scheme will not provide sufficient flexibility to deal with the tax issues created by the culling of breeding cows that are valued under the NSC scheme because the deposit would need to be withdrawn to pay for the replacement stock, at which point the income is recognised.

19. Overall, possibly up to 50 farmers could have unexpected tax liabilities because they value their dairy and/or beef breeding animals under the NSC scheme. The impact is most severe for those with a high proportion of mixed-age cows as, under normal circumstances, they would be relying on holding those animals for several years and on using them to breed replacement stock. Sharemilkers would be particularly hit as their main asset is livestock.

20. The self-assessed cost scheme is another cost-based valuation option. It involves farmers using their own farm costs rather than standard costs. Very few farmers use the scheme because of its complexity, so it may be that none of the farmers affected by Mycoplasma bovis are using it, but if they have there would be a tax liability as a result of the animal cull, so the same tax issues would arise as with NSC.

Spreading the income

21. Although it could be argued that Mycoplasma bovis is a business risk, we are mindful that the decision to eradicate the organism from New Zealand, and the resulting culling of herds is a government administrative decision. Its impact on individual farms is far more significant than say a destocking as a result of a drought or flood.

22. At the same time the tax outcome needs to be fair relative to farmers who have used other valuation methods, and to those farmers affected by Mycoplasma bovis who have already filed their tax returns for earlier years in which compensation has been provided. Compensation has been paid out since 2017.

23. Officials have discussed this issue with both Federated Farmers and Chartered Accountants of Australia and New Zealand (CA ANZ). Officials and these stakeholders all agree that the policy issue should be addressed, and that the best immediate solution is to allow the additional income to be evenly spread over subsequent income years. Depending on the assumed herd profile, that spread could be between five and seven years. Therefore, for simplicity, the spread would be over six years. The income would then be offset each year by the increased deductions arising from the reducing cost of the stock on hand.

24. Certain requirements would need to be met for the income to be spread:

    24.1 The business would need to be subject to Biosecurity Security New Zealand requiring a cull of Mycoplasma bovis affected stock.

    24.2 Stock would need to be substantially replaced with equivalent stock within a reasonable timeframe, say twelve months.

    24.3 The business would need to be a dairy or a beef breeding operation, with the female breeding stock valued under NSC or self-assessed cost.

24.4 Only the income derived from the culling of the breeding stock valued under NSC or the self-assessed cost scheme could be spread. For this purpose, breeding stock would include immature stock intended for future breeding.

24.5 The replacement stock must continue to be valued using, as relevant, NSC or self-assessed cost. This is to ensure that farmers cannot enter the herd scheme on more advantageous terms than those not affected by Mycoplasma bovis.

25. An amendment to the Income Tax Act 2007 will be required to provide this spread. It cannot be handled administratively.

26. This recommended solution has parallels with the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes. In those cases, the recovery income was suspended until a replacement property was purchased.

Tax returns for 2018/19 income year

27. It is possible that this amendment can be included in the tax bill planned for introduction in April, at the Select Committee stage, which would enable a quick response for those farmers immediately affected by having additional income in the 2018-19 income year. The farmers will still be required to file their tax returns, and to pay tax at the standard times on income that has not been derived from the culled animals.

Already filed returns

28. Although the bulk of the impact to date will be in relation to 2018-19 income tax, I am also recommending that the amendment be backdated to include the effects in the 2017-18 income year as the culls began in late 2017. We are suggesting that those who have already filed have the option of having their returns reassessed or leaving them as is as there may be some impact on farmers social assistance entitlements and liabilities if the additional income is now spread. For this to be effective, the Commissioner of Inland Revenue will have to be allowed to make associated adjustments to the farmers' tax positions.

Implications for farmers using the herd scheme

29. The additional income from culling the Mycoplasma bovis affected animals is far less of an issue for those using the herd scheme. In their case, as with fattening stock valued under the NSC scheme, the existing income equalisation scheme can be used to neutralise any income that does arise. For example, when the additional income arises in one income year and the stock is replaced in the following income year, the income can be deposited into the income equalisation scheme in the meantime to defer the tax liability to the next year when the deductions for the replacement stock can offset the income. This is a standard and expected use of the income equalisation scheme.

Consultation

30. Tax officials consulted with CA ANZ and Federated Farmers and a joint team has been established to work through the detail of the spreading option. Treasury was also consulted.

31. The Ministry for Primary Industries was also consulted on the issue, particularly to obtain data on the type of dairy and beef cattle culled as part of the Mycoplasma bovis response culls, their market values and compensation paid.

Financial Implications

32. The expected fiscal cost is confined to situations where returns have been filed, tax has been assessed and the tax liability would now be spread. This is essentially 2017/18 income tax returns and some 2018/19 income tax returns. Officials estimate the upfront fiscal cost to be $1.5 million as there were relatively few culls and compensation pay-outs in the 2017/18 income year. There will be offsetting fiscal gains over the subsequent five or so income years as the higher stock values are gradually written down. This produces the following out-turn over the forecast period, with the final year of impact being in 2025/26:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24 & Outyears**
Tax Revenue:	-	(1.500)	0.300	0.300	0.300
Total Operating	**-**	**(1.500)**	**0.300**	**0.300**	**0.300**

33. We recommend that this estimated cost and subsequent gains be accounted for on the tax policy work programme scorecard.

34. Given the relatively limited number of cases involved, the costs associated with administering the spread should be minimal. The costs will be absorbed within Departmental baselines. Farmers intending to spread the additional income will be required to advise Inland Revenue when filing their returns. For those that have already filed, Inland Revenue will need to do a retrospective manual adjustment. The aim will be to keep the additional compliance costs to a minimum.

Legislative Implications

35. Implementing these proposals requires changes to the Income Tax Act 2007.

36. If approved, I propose including the legislative changes resulting from these recommendations in a Supplementary Order Paper (SOP) to the omnibus taxation Bill scheduled to be introduced in April 2020. The SOP would be released at the Finance and Expenditure Committee stage in time for submissions to be made on the proposed amendments.

Impact Analysis

Regulatory Impact Assessment

37. The Quality Assurance reviewer at Inland Revenue has reviewed the *Mycoplasma bovis tax issue* RIA and considers that the information and analysis summarised in it meets the quality criteria of the Regulatory Impact Analysis framework.

Climate Implications of Policy Assessment

38. The Ministry for the Environment has been consulted and confirm that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Human Rights

39. There are no human rights implications.

Gender Implications

40. There are no gender implications.

Publicity

41. If Cabinet agrees to the amendment, I will make an announcement advising of Cabinet's decision and the process for the affected 2018-19 income tax returns due by 31 March 2020. This will help to provide farmers and their tax advisers with some certainty.

42. That release can also note any statement from Inland Revenue regarding the Commissioner's acceptance of early withdrawals of deposits from the income equalisation scheme for income arising from the Mycoplasma bovis response, including whether withdrawals will be treated as a "class of case", which will reduce farmers' compliance costs.

Proactive Release

43. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that the Committee:

1. agree that income arising from the culling of breeding livestock as a result of Mycoplasma bovis be able to be spread evenly over the subsequent six income years provided the stock is replaced after the cull with substantially equivalent stock and the farming operation has been valuing (and continues to value) its female breeding stock under the national standard cost scheme or self-assessed cost.

2. agree that the amendment in recommendation (1) apply retrospectively from the 2017/18 income year.

3. note that agreeing to recommendation (1) and (2) will have the following impact on tax revenue, with the final year of impact being 2025/26.

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24 & Outyears**
Tax Revenue:	-	(1.500)	0.300	0.300	0.300
Total Operating	**-**	**(1.500)**	**0.300**	**0.300**	**0.300**

4. agree that the estimated fiscal impact identified in recommendation (3) be accounted for on the tax policy work programme scorecard.

5. authorise the Minister of Revenue to make decisions on the detail of the spreading amendment.

6. note that if recommendations (1) and (2) are agreed, the Minister of Revenue proposes including the necessary legislative changes in a Supplementary Order Paper to the omnibus taxation Bill scheduled to be introduced in April 2020, with that SOP being released at the Finance and Expenditure Committee stage in time for submissions to be made on the proposed amendments.

7. invite the Minister of Revenue to issue a press release on Cabinet's decisions.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue

Impact Summary: Mycoplasma bovis tax issue

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Impact Summary, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing key policy decisions to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
Range of options considered A more long-term generic process or provision for handling severe adverse events and future biosecurity incursions affecting livestock has not been considered. Given the timeframe for addressing the current Mycoplasma bovis issue (taxpayers that are clients of tax agents with a valid extension of time are due to file tax returns for the 2018/19 income tax year by 31 March 2020) a specific solution is required as it would not be possible to fully consider a longer-term solution. **Consultation** Consultation has been focussed on discussing the issue and potential solutions with Federated Farmers and Chartered Accountants Australia and New Zealand (CA ANZ). Given the timeframe for addressing this issue other groups have not been consulted at this stage. Officials will consider whether other groups should also be consulted as we work through the detailed design of the proposal before legislation is introduced and at the select committee stage.
Responsible Manager (signature and date):
Geoff Leggett Principal Policy Advisor Policy and Strategy Inland Revenue 26 February 2020

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Inland Revenue
Quality Assurance Assessment:
The Quality Assurance reviewer at Inland Revenue has reviewed the *Mycoplasma bovis tax issue* RIA and considers that the information and analysis summarised in it **meets** the quality criteria of the Regulatory Impact Analysis framework.
Reviewer Comments and Recommendations:
The reviewer's comments on earlier versions of this RIA have been incorporated into this version.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Overview

Some farmers that have had their livestock culled owing to the Government's attempts to eradicate Mycoplasma bovis from New Zealand have faced an unexpected and significant tax liability as a result. This tax liability may impede their ability to replace their culled herd and is contrary to a key principle of the Biosecurity Act 1993 that no person is made better or worse off owing to the Crown's use of its powers under that Act.

Background

Mycoplasma bovis is a bacterium that can cause a range of serious conditions in cattle. The disease may be dormant in an animal – causing no symptoms at all. But in times of stress (for example, calving, drying-off, transporting, or being exposed to extreme weather), the animal may shed bacteria in milk and nasal secretions. As a result, other animals may be infected and become ill or carriers themselves.

The presence of Mycoplasma bovis in New Zealand was first detected in 2017. The Government, in partnership with the dairy and beef sectors, has decided to try to eradicate Mycoplasma bovis from New Zealand. As a result, Biosecurity New Zealand can require all the stock on a farm where Mycoplasma bovis has been found to be culled. In exchange, the Government pays compensation to the affected farmers for the difference between the normal market value of the stock and the amount received when the stock is slaughtered. This compensation is intended to leave farmers in no better or worse position than a person whose property is not directly affected by the exercise of the powers.

To date, around 200 properties have been cleared of stock with a similar number being monitored for the presence of Mycoplasma bovis. These have been predominantly dairy farms although Mycoplasma bovis is increasingly being found on beef farms that acquired young stock from affected dairy farms before the disease was identified. Of the total 90,000 stock culled and compensated for by the end of January 2020, 52,000 were dairy cattle and 38,000 were beef cattle, with the bulk of the beef cattle being from fattening operations rather than breeding operations.[1]

For income tax purposes livestock must be valued annually to establish its opening and closing values as part of determining the cost of sales. A farmer has the choice of several valuation options. Many use the national standard cost (NSC) scheme which values the animals at:

- a standard cost (determined by the Commissioner of Inland Revenue), if the animal is homebred, for the respective age and type of animal that reflects average home breeding costs; or
- at its purchase cost if the animal is purchased.

[1] Fattening operations involve the growing of animals for meat. Such operations have much quicker turnover of stock than breeding operations as the stock will be slaughtered within 1-2 years. Conversely, breeding operations involve the rearing of animals for the ultimate replacement of existing herd animals and the sale of any excess. The quicker turnover of stock for fattening operations means the tax issue discussed in this impact summary is less significant for fattening operations.

A few farmers also use the self-assessed cost scheme which involves farmers using their own farm costs rather than standard costs.

Policy problem in detail

When breeding livestock has been valued under either the NSC scheme or the self-assessed cost scheme, culling the herd can result in a significant and unexpected tax liability that can impede a farmer's ability to restock their farm. This is because the compensation payments plus slaughter receipts are income, and there is no immediate comparable deduction in relation to the replacement stock to offset that income. The replacement stock value for NSC and self-assessed cost purposes is its purchase price and this stock value is only gradually written down (over the next five or so years) as the stock ages and is itself replaced from homebred animals.

Although this is a tax timing issue, there are potential cash flow problems and interest costs for farmers in the meantime that can impede the recovery process.

Simplified example

Cow A with a market value of $1,500 is culled because of Mycoplasma bovis. The farmer receives $1,500 for the cow from a combination of compensation and slaughter receipts.

For tax purposes, as cow A was valued under the NSC scheme at $700, there is taxable income of $800 from its cull.

The $1,500 is used to buy replacement cow B. Under NSC, cow B is valued at its purchase price of $1,500.

Cow B remains in the herd for five years before being slaughtered and is replaced by a cow bred up through the herd (cow C) which has a NSC of $700 (its homebred cost). There is a tax deduction of $800 at that point, being the difference between the cost of cow B and the cost of cow C.

If there had been no Mycoplasma bovis cull, cow A would have remained in the herd and been replaced by the equivalent of cow C with no NSC implications given that both cow A and cow C have a NSC value of $700.

As farmers will have a herd made up of different age cows that will be progressively slaughtered the single $800 deduction in this example will result in a deduction each year when considered on a whole of herd basis.

For fattening stock valued under the NSC scheme or self-assessed cost scheme, the tax issue is less acute as the livestock turn-over much more regularly so that normal tax rules should apply. In that case, or when other valuation methods (such as the herd scheme) are used to value the herd, the income equalisation deposit scheme should provide sufficient flexibility to manage any tax issues.

The income equalisation scheme enables the recognition of income to be deferred by up to five years if the income is deposited into the scheme. The income equalisation scheme will not provide sufficient flexibility to deal with the tax issues created by the culling of breeding animals that are valued under NSC or self-assessed cost because the deposit would need to be withdrawn to pay for replacement stock, at which point the income is recognised.

2.2 Who is affected and how?

The affected parties are farmers that use the NSC scheme or the self-assessed cost scheme to value their breeding stock on hand for tax purposes and have had their herds culled and replaced because of Mycoplasma bovis. Overall, possibly up to 50 farmers to date could have unexpected tax liabilities because they value their dairy and/or beef breeding animals under the NSC or self-assessed cost schemes. The impact is most severe for those with a high proportion of mixed-age cows as, under normal circumstances, they would be relying on holding those animals for several years and on using them to breed replacement stock. Sharemilkers would be particularly affected as their main asset is livestock.

Since very few farmers use the self-assessed cost scheme, because of its complexity, it may be that none of the farmers affected by Mycoplasma bovis are using it. However, if they have there would be a sizeable tax liability as a result of the cull.

Federated Farmers wrote to the Minister of Revenue in December 2019 asking for this issue to be addressed. Chartered Accountants Australia and New Zealand (CA ANZ) also supports the proposals.

2.3 What are the objectives sought in relation to the identified problem?

A core principle of the Biosecurity Act 1993 is that no person should be any better or worse off because of the Crown's use of its powers under that Act. The objective of the proposal is to ensure that farmers are not made worse off because of a tax liability arising from the culling of Mycoplasma bovis infected livestock.

Section 3: Options identification

3.1 What options have been considered?

The following criteria have been used to assess the options:

- Equity – the option should result in farmers using the NSC or self-assessed cost scheme not being made worse off as a result of their herds being culled or better off than farmers who have used other valuation methods.
- Timeliness – the option should be able to be enacted as soon as possible to provide certainty to farmers with culled and replaced herds
- Compliance and administration costs – the option should be as simple as possible.

Option 1: No law change (Status quo)

The status quo would not be an equitable option as farmers using the NSC scheme would face a significant and unexpected tax liability owing to their herds being culled because of the presence of Mycoplasma bovis. This is contrary to the principle of the Biosecurity Act 1993 that no person should be made better or worse off owing to the Crown's use of its powers under that act.

Option 2: Spreading the additional income (preferred option)

Under this option, the additional taxable income arising from culling and replacing a herd would be able to be spread evenly over subsequent income years. This would allow the income to be offset each year by the increased deductions arising from the reducing cost of the stock on hand.

The ideal length of this spread for farmers would be between 5 and 7 years depending on the profile of their herds. Therefore, for simplicity the length of the spread would be 6 years, starting from the income year after the income originally arose.

Certain requirements would need to be met for the income to be spread:

- The business would need to be subject to Biosecurity Security New Zealand requiring a cull of Mycoplasma bovis affected stock.

- Stock would need to be substantially replaced with equivalent stock within a reasonable timeframe, say twelve months. Farmers that choose not to replace their stock after a cull are in a similar position to a farmer that sells their stock to exit the industry.

- The business would need to be a dairy or a beef breeding operation, with the breeding stock valued under the NSC or self-assessed cost schemes.

- Only the income derived from the culling of the breeding stock valued under the NSC or the self-assessed cost schemes could be spread. Income derived from culling fattening stock would not be able to be spread as the tax issue is less acute owing to the more frequent turnover of stock.

- The replacement stock must continue to be valued using, as relevant, NSC or self-assessed cost. This is to ensure that farmers cannot enter the herd scheme on more advantageous terms than those not affected by Mycoplasma bovis.

Analysis of option

This option increases equity as it would ensure affected farmers do not suffer from an unexpected tax burden and associated cash flow issues. This is consistent with the core principle of the Biosecurity Act 1993 that no person should be made better or worse off owing to the Crown's use of its powers under that act.

This option would also be a more timely solution to the problem as it could be announced by the Minister of Revenue prior to the 31 March 2020 due date for 2018/19 income tax returns for clients of tax agents with a valid extension of time. This will help to provide certainty to farmers and their tax advisers.

This option is not expected to have a significant impact on compliance costs for affected farmers. Farmers intending to spread the additional income will be required to advise Inland Revenue when filing their returns so that their files can be manually adjusted.

Given the relatively low number of affected farmers, the costs associated with administering this option for Inland Revenue should be minimal and could be absorbed within existing baselines.

Option 3: Offset the taxable income against the cost of replacement stock

This option would involve offsetting the taxable income against the cost of the replacement livestock, which would essentially write down the purchase price to what the NSC would have been had the incident not occurred.

While this option would conceptually achieve the desired outcome, it would be complex to achieve in practice as it would require an exact matching of the culled stock with the replacement stock, and rules about adjustments where that did not arise. Therefore, this option was not preferred as the option of spreading the income evenly over a number of income years is simpler.

Option 4: Amending the income equalisation scheme

This option would involve enabling deposits made in relation to Mycoplasma bovis to be withdrawn from the income equalisation scheme without being treated as income. This option would compromise the integrity of the scheme and is, therefore, not preferred.

3.2 Which of these options is the proposed approach?
The proposed approach is spreading the additional income arising from culling and replacing a herd affected by Mycoplasma bovis. Spreading the income over the six subsequent income years offsets the income against the expected increased deductions, in effect leaving the farmer in a similar position to if no unexpected income had arisen. This is the proposed approach as it is the only option that can be implemented in a timely manner and is consistent with the principle of the Biosecurity Act 1993 that no one is made better or worse off owing to the Crown's use of its powers under that Act. The proposed approach is compatible with the Government's "Expectations for the design of regulatory systems".

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks	**Impact** *\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Regulated parties (Farmers)	Additional compliance costs from informing Inland Revenue that they are spreading the additional income	Low
Regulators (Inland Revenue)	Minimal administration costs that will be absorbed within existing baselines.	Low
Wider government	Upfront fiscal cost of \$1.5 million offset by fiscal gains over the following years from already filed returns being adjusted. There will also be a small but unquantified fiscal cost arising from affected taxpayers that have not yet filed returns for the tax year in which the cull occurred, spreading the additional income. This fiscal cost is already included in forecast baselines.	Already filed returns: PV_{2021} = \$0.236 million Returns not yet filed: Low but unquantified
Total Monetised Cost		PV_{2021} = \$0.236 million
Non-monetised costs		*Low*

Expected benefits of proposed approach, compared to taking no action		
Regulated parties (Farmers)	Cash flow benefit from spreading taxable income over 6 years	Already filed returns: PV_{2021} = \$0.236 million Returns not yet filed: Low but unquantified
Total Monetised Benefit		PV_{2021} = \$0.236 million
Non-monetised benefits		*Low*

NB. Monetary impacts are calculated by assuming the proposal will result in a fiscal loss of \$1.5 million in 2020/21 offset by a gain of \$300,000 in each of the following 5 years (as returns are being adjusted the fiscal loss and first year of income being spread will occur in the same fiscal year). A 6% discount rate has been used.

4.2 What other impacts is this approach likely to have?
No other impacts have been identified from the proposed option. Federated Farmers and Chartered Accountants Australia and New Zealand (CA ANZ) will continue to be consulted on the detailed design of the proposal to ensure there are no unintended impacts.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
This issue was raised by Federated Farmers in a letter sent to the Minister of Revenue in December 2019. Since then officials have worked with Federated Farmers and CA ANZ on developing a solution to the issue. Federated Farmers and CA ANZ both consider that an immediate solution is required and support the proposed income spreading option. Officials, CA ANZ and Federated Farmers have established a working team to work through the detailed detail of the proposed spreading option. Given the urgent timeline for addressing this issue the focus has been on consulting with Federated Farmers and CA ANZ. However, officials will consider whether other groups should also be consulted as we work through the detailed design before legislation is introduced and at the select committee stage.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

The proposal will require amendments to the Income Tax Act 2007. These amendments would be included in a Supplementary Order Paper (SOP) to an omnibus taxation Bill scheduled to be introduced in April 2020. The SOP would be released at the Finance and Expenditure Committee stage in time for submissions to be made on the proposed amendments. Guidance material will be published on the amendments following the Bill's enactment.

Following Cabinet approving the proposed option the Minister of Revenue will issue a press release advising of Cabinet's decision and the process for affected 2018/19 returns due by 31 March 2020. This will help to provide certainty for farmers and their tax advisers.

Already filed returns

Although the bulk of the impact to date will be in relation to 2018/19 income tax, as the culls began in late 2017, this option would be backdated to include the effects of the cull in the 2017/18 income year. Affected farmers who have already filed returns for 2017/18 or 2018/19 would have the option of applying the spread retrospectively and having their returns reassessed. However, some may instead choose to leave their returns as is as there may be some impact on farmers social assistance entitlements and liabilities if the additional income is now spread. For this to be effective, the Commissioner of Inland Revenue will have to be allowed to make associated adjustments to the farmers' tax positions.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Inland Revenue will monitor the outcomes to confirm that they match the policy objectives. This will be facilitated by farmers who choose to spread their additional income being required to advise Inland Revenue of their intention to do so.

The proposed option has been developed alongside Federated Farmers and CA ANZ. Officials expect that, once the proposals are enacted, these two groups will raise any concerns affected farmers are having with the rules in practice. Any necessary changes identified as a result would be recommended for addition to the Government's tax policy work programme.

7.2 When and how will the new arrangements be reviewed?

The review will be the monitoring described in section 7.1 above.

Cabinet Economic Development Committee

Minute of Decision

Mycoplasma Bovis: Tax Issue

Portfolio Revenue

On 18 March 2020, the Cabinet Economic Development Committee:

1 **noted** that some farmers have significant unexpected taxable income through their herds being culled following a primary sector and government decision to eradicate Mycoplasma bovis in New Zealand, which has potential cash flow and interest cost for farmers;

2 **agreed** that income arising from the culling of breeding livestock as a result of Mycoplasma bovis be able to be spread evenly over the subsequent six income years, provided the stock is replaced after the cull with substantially equivalent stock, and the farming operation has been valuing (and continues to value) its female breeding stock under the national standard cost scheme or self-assessed cost;

3 **agreed** that the decision in paragraph 2 above applies retrospectively from the 2017/18 income year;

4 **noted** that the decisions in paragraphs 2 and 3 above will have the following impact on tax revenue, with the final year of impact being 2025/26:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24 & Outyears**
Tax Revenue:	-	(1.500)	0.300	0.300	0.300
Total Operating	**-**	**(1.500)**	**0.300**	**0.300**	**0.300**

5 **agreed** that the estimated fiscal impact identified in paragraph 4 above be accounted for on the tax policy work programme scorecard;

6 **authorised** the Minister of Revenue to make further minor and technical decisions on the detail of the spreading amendment;

7 **noted** that the Minister of Revenue proposes including the necessary legislative changes in a Supplementary Order Paper to the omnibus taxation Bill scheduled to be introduced in April 2020, with that SOP being released at the Finance and Expenditure Committee stage in time for submissions to be made on the proposed amendments;

8 **invited** the Minister of Revenue to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above decisions.

Vivien Meek
Committee Secretary

Present:
Rt Hon Winston Peters
Hon Grant Robertson (Chair)
Hon Phil Twyford
Hon Dr Megan Woods
Hon David Parker
Hon Nanaia Mahuta (via phone)
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Jenny Salesa
Hon Damien O'Connor
Hon Shane Jones
Hon James Shaw
Hon Eugenie Sage

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

Hard-copy distribution:
Minister of Revenue