

Tax Working Group Public Submissions Information Release

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SUBMISSION ON FUTURE OF TAX

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About DairyNZ

Thank you for the opportunity to submit on the Future of Tax Background Paper.

DairyNZ is the industry good organisation representing New Zealand's dairy farmers. Our purpose is to secure and enhance the profitability, sustainability and competitiveness of New Zealand dairy farmers and their local communities.

Comments

The *Future of Tax Background Paper* presents ideas in general terms so our comments here are mainly at an 'in principle' level. As the Tax Working Group (TWG) will be well aware when it comes to tax, the devil is in the detail. We anticipate that the interim report to the Minister of Finance and the Minister of Revenue due to be released for public consultation later in the year will contain sufficient detail to enable DairyNZ to model and submit the likely impacts of the proposals on the Dairy farming industry.

DairyNZ has read and supports submissions by Horticulture NZ, Federated Farmers of New Zealand, and Irrigation NZ.

DairyNZ is happy to meet with the Tax Working Group to discuss our submission.

Principles of a good tax system

DairyNZ supports the principles of a good tax system espoused by the TWG convened by Victoria University of Wellington in 2010 and articulated in the *Future of Tax Background Paper*. A broad-based, low-rate tax system that balances the principles of Efficiency, Equity and Fairness; Revenue Integrity; Fiscal Adequacy; Compliance and Administration costs and has Coherence is a solid foundation for the tax system.


In making the inevitable trade-offs between these guiding principles a broad-based low-rate tax system should apply to a wide range of activities; avoid individual taxes on specific sub-sectors of the economy; rates of taxation should be as low as possible, while still meeting revenue needs and equity concerns; and taxes should be seen as a system, not a collection of individual measures designed to meet specific policy objectives.

While we expect the TWG to make recommendations to Government on whether and how the tax base might be broadened, we suggest that the TWG also consider mechanisms to discipline the government to adhere to the principle of setting low-rates. Any transition to a broader tax base should be fiscally neutral, i.e. if there was to be a new form of taxes introduced a corresponding reduction in the rate of existing taxes would be expected also.

Fairness and Balance

There is little doubt that the current tax system does not strike the right balance between supporting the productive economy and the speculative economy.

Taxing and conversely the non-taxing or under-taxing of specific sub-sectors of the economy should be avoided. The tax system should in principle be neutral, having little influence on the flow of capital between the productive and speculative parts of the economy.




The different treatment of one class of asset from others (e.g. housing) distorts savings and investment decisions and has no doubt contributed to higher costs of capital to the productive sector.

The current tax system incentivises free capital gains while taxing productivity gains, undermining the long-term competitiveness of the productive sector. There is an inherent unfairness in taxing the productive sector while not taxing capital gains made in investment housing. DairyNZ has no objection to addressing speculative behaviour in investment housing through the bright-line test.

On the other hand, the introduction of a comprehensive Capital Gains Tax (CGT) presents significant challenges both in transition and practical implementation. While in the long-run the inevitable reduction in the value of land may improve opportunities for farm ownership for the next generation, may reduce the cost of capital, and increase focus on productivity gains on-farm, there is significant risk for those already heavily invested in the industry. The transition arrangements from the current tax arrangements to a comprehensive CGT are therefore key when considering the desirability of broadening the tax base in this manner. Should the TWG propose a comprehensive capital gains tax it should also articulate the likely transition arrangements so that stakeholders can better assess the merits of the proposal.

Specific implementation issues that would need to be resolved include:

- The treatment of double taxation or double losses caused by capital gains and losses in a company being reflected in the company's share price if both bases are subject to a comprehensive CGT.
- The treatment of Livestock Herd Scheme gains and losses that are currently treated as being on the capital account. This could cause the herd scheme to be abolished and this itself would create issues as farmers have paid taxation on entry to enjoy the benefits of the herd scheme.
- The treatment of the primary residence when it is a component of a larger land-owning activity, such as farming and treatment of the primary residence when it is situated on a farm owned by a company?
- Where there is no change in ownership, the treatment of houses that move in and out of the CGT tax base as their usage changes from being a home to a rental house and vice versa. Will this require valuations at the point of the change, or apportionment or some other arrangement?
- Indexing asset cost base so the inflation component is not taxed will be an issue (the same issues currently exists with income tax on revenue account property and monies on deposit for interest and this would have to be addressed at the same time);
- Dealing with roll-over relief for intra-family and intra-group company transactions and for transactions involving Maori land and its owners will be essential;
- The same roll-over relief problem exists for transactions within a group of companies. This is of particular relevance where the group is a wholly-owned group of companies as in an intra-group transaction there is no change of the ultimate owners; and
- The question of which assets should be included in the CGT base will have to be considered. For example, almost all cars depreciate over time, but some appreciate. There are timing consideration here also, a car may not be an appreciating asset until



it has been owned for a (large) number of years – if cars that appreciate are included in the base, when is this appreciation determined and how is their CGT cost ascertained. If this is not handled carefully there could be considerable compliance costs.

In keeping with the broad-based low-rate principle, any broadening of the tax base through the introduction of a capital gains tax should be fiscally neutral with a commensurate reduction in, say, personal and company income tax rates.

Taxes and Behaviour

Targeted taxes to incentivise behaviour change are best considered alongside other regulatory options and current and/or planned voluntary efforts pertaining to the specific issue of concern. The best package of interventions to impact, for example, environmental concerns may or may not include an environment tax - there may be better options to influence change in behaviour.


While in theory the adoption of an environment tax might incentivise behavioural change, in practice it will be difficult to identify what rate that tax would need to be set at to incentivise the change in behaviour. As demonstrated in the application of excise tax for cigarettes, the rate would most likely have to be very high to encourage behaviour change by outliers. In contrast, regulation is compulsory and will better deal with laggards.

A nationally applied environmental tax is a blunt instrument unable to account for regional variation in performance, for example some regions, districts or catchments may be managing water quality very effectively.

Deciding what to tax is also challenging, for example taxing inputs that result in risk of nitrate reaching groundwater and surface water does not take into account the measures individual farmers may have taken to mitigate impacts on water quality.

There has been an indication that environmental taxes may be reinvested back onto farms to accelerate the transition to a more sustainable footing. We question whether the government would be well placed to re-allocate that resource any more efficiently than had that resource stayed with those farmers already engaged in improving their environmental practices. If an environmental tax was to be introduced it is likely those farmers that are motivated to invest in improving environmental performance will have resource diverted. That would at face value seem to be a demotivator, potentially resulting in behavioural change in the wrong direction, slowing if not stalling progress. In addition, the cost of administering the reallocation of the resource would inevitably absorb resource that may otherwise have been focused on getting on with implementing the change process on farm, for example, to meet regional council water quality or water quantity limits under the National Policy Statement for freshwater management (NPS-FM).

It is DairyNZ's preference that the TWG do not make specific recommendations on the merits of environmental taxes as this would be out of context of the other regulatory and voluntary efforts of the farming community to address environmental impacts. For Green House Gases, for example, that issue should be addressed by the Interim Climate Change Commission which is specifically charged with dealing with GHG. A premature conclusion that a particular environment tax is the right option risks more effective options at a catchment scale, being passed over. Examples of other existing and planned regulatory and voluntary interventions to address environmental impacts are attached, Appendix 1.



The TWG group could usefully provide general guidance to support those working on specific issues, e.g. water quality or Green House Gases (GHG), to assess the merits of adopting a targeted tax over alternate interventions. For example, how would an input tax score against the principles of Efficiency, Equity, Revenue Security, Compliance and Administration, and Coherence, as was attempted by NZIER in its recent report to the agriculture sector¹.

Land Tax

The tax system should in principle be neutral. Decisions about where to invest capital should not be influenced by different treatment of assets under the tax system.

A targeted tax on land alone could, for example, incentivise farmers to shift from an extensive pasture based system to a smaller plot with intensive barn stored animals fed through supplements – ‘factory farming’. The tax system should not unduly influence farmers’ farm systems choices.

A Land Tax would unevenly fall on those industries with land intensive modes of production, and as a consequence increase the relative attractiveness of investing in mechanised intensive industries, like manufacturing, that would have less land tax liability. Farmers already pay a disproportionate amount of tax through rates compared to other modes of production. According to DairyNZ’s 2015/16 Economic Survey, the average Dairy Farm pays around \$16,000 per annum in rates. This is inherently unfair and unduly influences investment decisions.

Land tax has the potential to turn highly geared enterprises into equity-negative enterprises, potentially with a flow on effect to banks and other financiers. Further, developing businesses, or businesses whose annual income fluctuates may not have sufficient cash flow in any one year to pay a land tax. This is a particular concern for farming where there is significant and unpredictable volatility in revenue due to international commodity process, exchange rates, interest rates and the weather.

Cash flow problems are also likely to be an issue for owners of fallow land, and this could particularly affect Maori land owners. Then there is a question over the treatment of QE II covenants – would an exemption apply?

GST Exemptions for particular goods

GST is a world leading consumption tax because there are no exemptions. Businesses do not find it difficult to comply with GST obligations. Introducing exemptions will only add to complexity, and consequently reduce compliance and add administrative burden.

If the government has an interest in facilitating greater access to certain goods and services for lower socioeconomic groups, if it were to broaden the tax base it may look at lowering the GST rate for all to benefit or alternatively target transfers such as increases in family assistance payments.

Submission Ends

¹ See Attached, *Taxing Times, Assessing proposed taxes on the primary sector, NZIER report to a group of agriculture sector organisations, NZIER, March 2018.*

APPENDIX 1

Current and Planned regulatory and voluntary responses to environmental impacts

Water Quality

DairyNZ is proactively working with regional councils and other sector and farmer groups, on options to increase the rate of behaviour change on dairy farms in accordance with the refreshed strategic direction set out in the Dairy Tomorrow Strategy (www.dairytomorrow.com).

DairyNZ works with regional councils who are setting targets in plans under the NPS-FM, and who acknowledge that information will be gathered through the process to enable more targeted policy instruments in future plan changes. In Waikato, Hawkes Bay and Canterbury Regional plans, a Farm Environment Plan is required as a regulatory tool that seeks to manage risk of diffuse contaminants entering waterbodies, using guidelines and expert certified advisors. In the absence of clear links between on-farm mitigations to reduce contaminants and the community-desired values such as swimmability, this approach is seen as a practical and effective way of improving environmental outcomes. DairyNZ supports these sorts of approaches and offers expert advice and partnership approaches to science research to look ahead to achieving long term and challenging limits in waterbodies.


In relation to water quantity, DairyNZ has commissioned work to better understand how much water is used on farms and how this can be used more efficiently. Some of this work has been used by councils such as Bay of Plenty Regional Council. In a recent regional plan change, the council is requiring water to be metered at source, and has volume guidelines for efficient water use in the milking shed. DairyNZ has offered to work with council and milk company staff, as happened in the Waikato Region over the last five years, to ensure farmers know their environmental obligations and are making changes on farm to use water efficiently.

Green House Gases

There is a comprehensive policy development process underway to strengthen New Zealand's response to climate change and examine whether introducing a price on biological emissions (methane and nitrous oxide) will incentivise on farm behaviour change. DairyNZ believes this process is the most appropriate mechanism for examining whether an environmental tax is an appropriate means of driving on farm behaviour change to reduce or offset biological emissions. In addition to this, dairy farmers are already undertaking actions to address on farm greenhouse gas emissions.

The Government is proposing to introduce a similar framework to the United Kingdom which is comprised of a Zero Carbon Act, a legislated net zero 2050 emissions target, and an Independent Climate Change Commission which develops five year rolling carbon budgets outlining how each sector of the economy will contribute to meeting the greenhouse gas reduction targets. This framework would then be supported by an array of policy mechanisms including the Emissions Trading Scheme, under which biological emissions must be reported by the processor but do not face a price. Consultation on the Commission, the Zero Carbon Act, and the 2050 target is due to commence on 31 May 2018 for six weeks.

An Interim Climate Change Committee has been established in parallel to the development of a Zero Carbon Act to build an evidence base on agriculture's role in meeting New Zealand's greenhouse gas targets. The Committee will examine whether biological emissions should face a price in the Emissions Trading Scheme or whether an alternative mechanism should be adopted to incentivise on farm behaviour change to reduce on farm emissions. This evidence base will be provided to the Independent Climate Change



Commission which is scheduled to be established in mid-2019 who will make a recommendation to Government on whether to price biological emissions.

Despite the absence of a policy framework to reduce agricultural methane and nitrous oxide emissions, dairy farmers are undertaking actions to address their on-farm emissions as a result of the actions underway to improve water quality. This is being accelerated by the Dairy Action for Climate Change. The action plan is a partnership between DairyNZ and Fonterra, and is supported by the Ministry for the Environment, and the Ministry for Primary Industries. It is focused on building an understanding of why action is required by dairy farmers, the mitigations that are available now and the options that could be adopted in the future.

On average individual dairy farmers have spent over \$90,000 on the environment over the past five years, with many farmers investing far more than this. This equates to a \$1 billion-dollar investment on initiatives such as effluent management, stock exclusion, riparian planting, upgrading systems, investing in technology, retiring land, and developing strategic wetlands.

By managing the farm's nitrogen surplus through improved farm practices, wetlands, and effluent management systems both nitrate leaching to water and nitrous oxide emissions entering the atmosphere will reduce. Practices undertaken to improve the efficiency of the farm system through managing total feed intake, reducing replacement rates, and increasing production per cow will result in a slight reduction in methane emissions.

Case Study

Wairarapa dairy farm Kaiwaiwai Dairies, a 425 hectare farm with a 1400 animals, has seen its greenhouse gas footprint drop by a third from the 2012-13 season due to a change in farm practices and adopting new technology. The farm has implemented a man-made wetland which removes around 600kg of nitrogen (both nitrate leaching and nitrous oxide) per year, this cost around \$55,000. The farm has invested \$800,000 into a state of the art effluent management system which provides 30/30 years storage and allows the effluent to be spread on pasture under the right conditions, reducing the nitrogen leached to water and the nitrous oxide emissions. The farm has also invested in planting marginal land, which sequesters carbon and improves biodiversity.