

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

Sympathies with preservation, but proper use

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.