MEMORANDUM

Date: 12 December 2018

To: Tax Working Group

From: Chartered Accountants Australia and New Zealand

Subject: Submission on Tax Working Group Interim Report – Rural tax issues

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Thank you for the opportunity to provide you with feedback on your Interim Report.

Following our workshops on 23 October and 2 November 2018 we summarise our key recommendations below.

Key principles

- Simplicity – increases productivity; increases voluntary compliance.
- Farming business structures – farming businesses operate through a variety of structures. Any policy decisions must take the variety of structures into account.

Overall comments

- Owner operated farms operate efficiently in the New Zealand economy and the tax system should not become a barrier to owner operators continuing and encouraging a younger innovative generation to become involved.
- For this reason, succession planning is very important and should be consciously considered in the implementation of any capital gains tax.
- If a capital gains tax is introduced, it should be on a realisation basis rather than a deemed return basis, as farmers would not have the cash to pay the tax.
- If a capital gains tax is introduced, the herd scheme should be either modified or disestablished.
- If the Government is concerned about the impact of farming on the environment, it should consider reinvestment of tax revenue into farming technologies and compulsory farming environmental plans.

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915

Farming business structures and succession planning

- Alternative land ownership structures used:
  - Sole trader or partnership (becoming less common)
  - Trust
  - Company
  - Limited partnerships
  - All of the above ownership structures maybe with land separate or in conjunction with the farming operation

- Farming business
  - Partnerships still common (but becoming less so).
  - Companies with employees for corporate farmers; or shareholder-employees for family businesses.
  - Some trading trusts still exist.

- Intergenerational succession challenges
  - As a result of the above, succession planning occurs in a variety of ways to reflect the variety of ownership structures
  - Intergenerational transfer of land is often financed by an interest free (or low interest) loan from parents to children regardless of structure, in order to make succession affordable.
  - The land is not always transferred to the next generation at the same time as the farming business.

- Succession planning
  - The tax system should not create a barrier to the owner-operator farm models because, generally speaking, these farms are the most profitable.
  - A key element for the ownership of farms by owner-operators (as opposed to corporates) continuing is the ability to pass the farm to the next generation.
  - A tax on the capital gains on farmland will make farm succession unaffordable for many individuals and push farm ownership into corporate hands. This issue is equally important for any family business.
  - If farmland is to be included in a capital gains tax, we believe it should be subject to rollover relief.
  - This rollover relief should extend to family members, ideally in as broad a way possible.
  - One suggestion would be to allow rollover relief for additional generations subject to an ownership timeframe requirement. For example, rollover relief is dependent on the recipient holding the land for a period of time (say, 15 years). Further inter-generational transfers would also qualify for relief but, again, the recipient would need to meet the ownership timeframe before the transferor was relieved from the tax.
  - We would be happy to have further discussions with officials regarding any other ideas.

Herd scheme

The purpose of the herd scheme was to align breeding animals with widget-producing assets. Thus the increase in value of the livestock is not taxable. This is contrary to the purpose of a capital gains tax, which seeks to tax increases in value of capital assets.

If a capital gains tax were to be introduced, we see two options for the herd scheme.

- Disestablish herd scheme
    - Would require all taxpayers to transfer to the National Standard Cost scheme or the market value scheme.
    - There is already rules in place that facilitate the movement between schemes.
    - This is our preferred option

- Retain modified herd scheme as optional
    - Farming businesses have the option to exit the herd scheme, or remain in the modified scheme.
    - Issue is how to treat annual capital movements if herd scheme is retained.
    - We suggest the change in value of the livestock revaluation reserve from the time of introduction of CGT until the time of exit be treated as taxable income upon decreasing the number of animals on the herd scheme.
    - We do not favour this option. However, we would support an optional transitional measure (for a maximum time-frame of perhaps five years) for a taxpayer to remain in the herd scheme provided that they would be exiting farming during that time.

If the herd scheme is abolished, we recommend that Government make changes to market value scheme to give farming businesses an alternative model of livestock taxation.

- Amendments to market value scheme
    - Requirement to get a livestock agent's valuation should be optional, with the other option being to use National Average Market Values (NAMVs). The use of NAMVs would mitigate the high compliance costs.
    - Issue of volatility could be addressed by allowing the livestock value to be the average value over the last five years for the class of animal being valued. This would mitigate the peaks and troughs in taxable income.
    - This is our preferred option.

Environmental taxes

- Greenhouse gas emissions
  - Regulation is a more effective tool to change behaviour than the tax system.
  - Any scheme should be levied at the farm level, rather than the processor level, so that the farmer has the opportunity to mitigate the consequences. A levy at the processor level is just another tax.

- Water taxes
  - Would disproportionately affect farmers and would not necessarily encourage strategic environmental management.
  - We do not favour this option.

- Fertiliser taxes
  - Environmental outcomes best managed outside the tax system
  - A fertiliser tax would be fairer and more sustainable than a water tax. However, fertiliser taxes would not encourage strategic environmental management because, for most fertilisers, there is not scientifically supported economic alternative.
  - Any fertiliser tax, if implemented, should be limited to urea because urea is optional and arguably the most environmentally damaging.
  - Notwithstanding the above, we do not favour this option.

- Nutrient leaching taxes
  - We do not favour taxes on nutrient leaching because there is no scientifically proven or reliable means of measurement.

- Farming environmental plans
  - Currently optional, but could be made compulsory.
  - A much more effective option than environmental taxes and is supported by the Governments Chief Science Adviser
  - Renewable every three years
  - Self-assessment model (same as income tax) with risk of audit
  - If any fertiliser taxes are imposed, there should be an abatement for having a working farm environmental plan.

- Reinvestment
  - Revenue raised from additional taxes on farmers should be reinvested into the agricultural sector as much as possible and should be used to develop technology to improve productivity and environmental outcomes.

We would like to continue our involvement with the Tax Working Group and to provide further input as required. Please contact Jolayne Trim in this regard.

Yours sincerely

Trudi Ballantyne
Chair – Rural Advisory Committee

Jolayne Trim
Senior Tax Advocate