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Emissions Trading Scheme

Implications for owners of forestry blocks

New Zealand's Emissions Trading Scheme (ETS) was established by the Climate Change Response Act 2002. The ETS was created as the vehicle for New Zealand to meet its obligations for the reduction of greenhouse gas (GHG) emissions under the Kyoto Protocol. The purpose of the ETS is to achieve a reduction in GHG emissions through emissions trading. Emissions trading is the exchange of carbon credits between those parties with surplus credits and those who are required to contribute credits as compensation for their production of GHG emissions.

Although the ETS affects nearly all New Zealanders in some way, it has significant impact if you are buying or selling forestry blocks, and/or own a forestry block. The first part of this article focuses on the implications of buying and selling of forestry lots, or land destined to be planted in forests. The second part gives you some background on the ETS, New Zealand's obligations under the Kyoto Protocol and this country's acceptance of the Doha Amendment.

Buying land with trees

Buying land with forestry lots is a serious business. As well as the usual due diligence you would undertake in buying any rural property, you need to determine the status of the trees under the ETS. There are a number of tree-type issues you need to think about.

Were the trees planted pre-1990 or post-1989? Do the tree lots fall within the ETS? If so, are the accumulated carbon credits included in the purchase? Are there any forestry rights on the land? Is there a replanting obligation, if or when the trees are harvested? Can the trees be replanted with similar cropping trees or must the land, due to its nature, be removed from production and be planted in permanent forest with trees such as natives like totara, or exotics such as redwoods? As the future landowner, all these obligations are likely to fall on you to manage.

Tax

You will also need to think about the taxation implications relating to your purchase of a forestry lot.

Planting established for shelter purposes, beautification, or erosion control, is likely to be incidental tax-wise and does not bear special consideration.

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Established tree lots planted for harvest, however, create special tax considerations and you will need some professional advice on how to deal with this.

Trees planted for harvest, called 'standing timber', create a taxable activity on realisation, for example, harvest or sale. On harvest, the profit – after the deduction of expenses – is taxed.

Deductible costs include the purchase cost of the trees if the land the trees are on has been purchased after planting. As a result, as the purchaser you will want to ensure that the value of the trees on purchase is as high as possible.

If you're the vendor, however, you will want to have the market value of trees as low as possible as this profit is taxable on settlement. Vendors must note that the sale triggers an immediate tax liability.

It's vital to understand the implications of tree lots in the negotiation of any sale and purchase from both a taxation viewpoint and to ensure all the legal i's are dotted and the t's are crossed. The sale and purchase agreement must address the trees and their agreed values, or the valuation mechanism. If this is not done satisfactorily, the vendor or purchaser could be left with an unforeseen tax problem.

Inherent risks of forestry

Harvesting forestry lots brings its own challenges. It is one of New Zealand's most hazardous occupations requiring specialist machinery and skills. Health and safety during harvest is of major concern.

Forestry harvest may result in land slips or water runoff, including soil or prunings and harvest debris (called slash). Environmental and infrastructure damage may result downstream as a result of systematic clearing of the land, particularly in light of the violent weather extremes that New Zealand is now experiencing. It may take some years before the roots of new plantings mature to sufficiently bind the land that the original trees have been harvested from.

The National Environmental Standards for Plantation Forestry (NES-PF) came into effect on 1 May 2018 and aim to address these environmental risks of forestry. Under the NES-PF harvesting your tree lot may require resource consent due to the risk to the environment of land instability post-harvest. The NES-PF applies to any forest of at least one hectare that has been planted for commercial purposes and will be harvested. There may also be additional resource consent requirements associated with forestry activities; you should check with your local authority.

Why bother with forestry?

Having read the above, you may ask yourself why you would invest in a forestry block? To put it simply, planting and owning eligible forestry allows the forest owner to collect and sell carbon credits, effectively providing an ongoing income stream.

As well, you can satisfy yourself that you are helping New Zealand (and indeed the world) reduce its GHG emissions under its obligations under the ETS, about which we have some broad brushstroke background below.

New Zealand's role

The United Nations Framework Convention on Climate Change (UNFCCC) was ratified in 1994. This was followed by the Kyoto Protocol in 1997 that established legally binding obligations on participating signatories to reduce their GHG emissions; its first commitment period ran from 2008–2012. The second period runs until 2020 and was established under the Doha Amendment, which New Zealand accepted in 2015.

Each UNFCCC signatory country elected limits for their emissions and has determined goals within their capacities, known as Nationally Determined Contributions (NDCs). New Zealand's NDC target is to reduce its GHG emissions by 30% below 2005 levels by 2030 by:

1. Reducing greenhouse emissions
2. Planting more trees, and
3. Buying surplus reductions from other countries to offset New Zealand's GHG emissions.

The ETS puts a price on carbon to act as a disincentive to emit – the incentive is to plant trees.

The measurement of carbon emissions is the New Zealand Unit (NZU); one NZU is the equivalent of one tonne of GHG. At the time of writing, the government caps one NZU at NZ$25.

The objective is that carbon producing industries must reduce or minimise their production. If these industries cannot achieve a significant reduction in gas emissions, they must purchase and contribute sufficient NZUs to offset their carbon production – the outcome being that each producer is carbon neutral. Currently agriculture is not included in the ETS (although it has a reporting requirement). Its participation (or lack of) is currently a topic for much discussion as agriculture is estimated to contribute nearly 50% of New Zealand's GHG emissions.

In the forestry sector, NZUs produced annually from eligible forest areas may be sold to those GHG-producing industries that are obligated to compensate for their GHG emissions. Planting and owning eligible forestry allows a forest owner to collect and sell the carbon credits, effectively providing an ongoing income stream from mature trees. To assist New Zealand in meeting its GHG reduction obligations and boost regional economies, the government has instigated the One Billion Trees Programme, with a goal of planting one billion trees by 2028.

Forests are good for us

We all need to play our part in reducing this country's GHG emissions and making our environment better for ourselves and our children. Planting trees goes a long way to help New Zealand meet its international agreements.

If you are considering buying a forestry block, intending to establish a plantation, or are selling your trees, do talk with us and your accountant early on. *

People and the right information are vital for effective governance

Kirsten Patterson, CEO, Institute of Directors

The damage from governance failure can be profound, and can attract significant unwelcome media and public scrutiny. Focusing on the learnings from these cases is how we can get some real benefit and continuous improvement in corporate governance.

He tāngata – it is the people

Governance is, above all, about people. It's a team game and, like any team, the board's composition, and its culture and dynamic, are all critical to its effectiveness. Boards need a broad mix of skills and experience now and for the future. Individual attributes of directors are also highly relevant such as integrity, courage, judgement, emotional agility, energy and curiosity. Other factors relating to board composition include diversity, new membership and tenure. Getting the right mix and balance can be as much art as science. Putting time and thought into developing a skills matrix to determine the board's needs is worth the investment.

While a balanced board is necessary, it is not sufficient to create an effective team. It is board culture that allows directors to work together to make the most effective decisions for the benefit of the organisation's stakeholders.

What does this look like? It should be one where the board supports open debate, diversity, thoughtful challenge and constructive dissent. While the chair may lead this, all board members have responsibility for creating an inclusive culture that enables contribution with respect.

But a board is not an island. Management is part of the wider governance team and this relationship must be nurtured and valued. It is essential that a healthy and effective relationship exists. A board exists to support and guide management, as well as to hold them to account for performance and compliance matters.

Be clear about roles and responsibilities

The roles and responsibilities of individual directors, the board and management should be clearly understood and recorded. A lack of clarity can lead to conflict and dysfunction so getting this right is critical. The company's constitution, a board charter and letters of appointment are all key tools to help set out roles, responsibilities and expectations.

The board's role in holding management to account was emphasised earlier this year in the Final Report of the Australian *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry:*

> "Boards must … use the information that they have to hold management to account. Boards cannot, and must not, involve themselves in the day-to-day management of the corporation … The task of the board is overall superintendence of the company, not its day-to-day management. But an integral part of that task is being able and willing to challenge management on key issues, and doing that whenever necessary".

Quality over quantity in board reporting

We're hearing more and more about board packs exceeding 1,000 pages. This presents a real challenge for directors to focus on material issues and risks, and to balance time spent in board meetings on strategy and performance, with time on compliance.

What is the right information for board papers? A key criticism of boards and management by the Australia Royal Commission was that boards of financial services entities often did not receive the right information. It said that the quality, not the quantity, of information provided to a board was vital in order for a board to discharge its function.

A board must make decisions based on sufficient, accurate, relevant and timely information. It must define its information requirements so that reporting is meaningful, with management providing thoughtful interpretation about key matters. Measuring what matters, and providing trend information, has never been more important for an organisation's core financial and non-financial performance indicators.

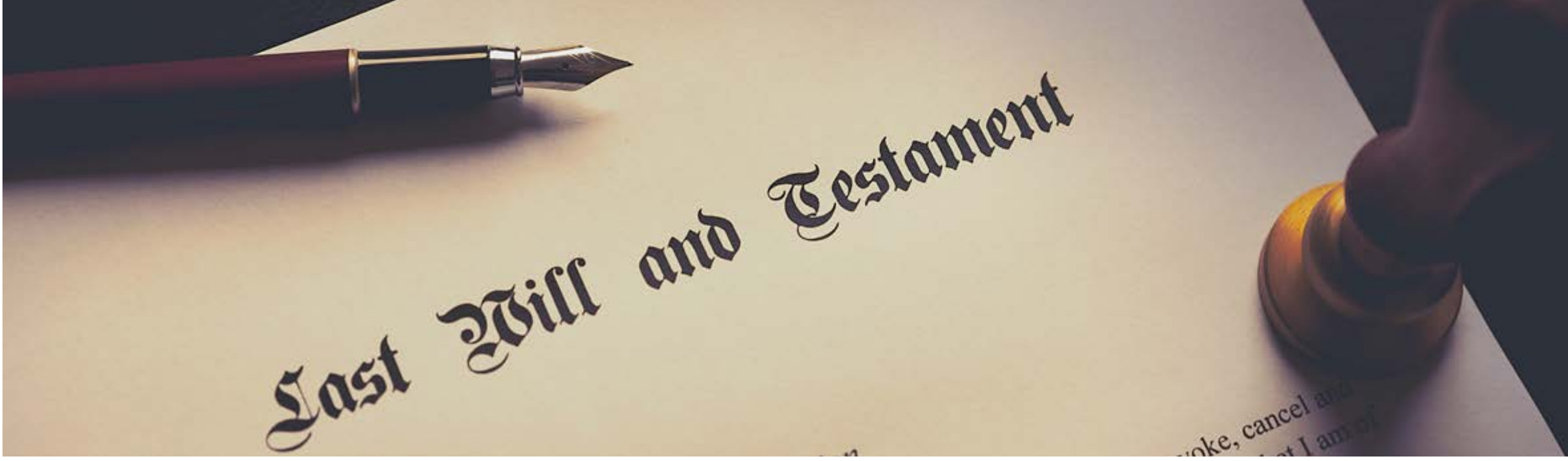
If the board's information requirements aren't being met by management, this should be raised as a priority.

The learning board

A board, like any team, must focus on continuous improvement to ensure ongoing effective corporate governance. Board and director evaluations help hold the board accountable and improve individual director and whole-of-board performance. Evaluation, formal and/or informal, should be undertaken regularly to help boards and directors identify their strengths and weaknesses, assess their performance and determine opportunities to improve.

Ongoing director development is a core focus for the Institute of Directors, through resources, courses and events. Our Continuous Professional Development (CPD) requirements emulate those of other professions, such as law, and help drive directors to keep up-to-date on governance developments.

At the end of each meeting, all boards should also be able to answer, 'Did we add value today?' ✱



The executor of your will

Making a good choice

Having an executor of your will is like having a manager of your affairs (your estate) after your death. Your executor is named in your will; it is his or her role to carry out the terms of your will. Many people have more than one executor; it spreads the load and it's also good to have another executor to discuss things with.

Who do you choose?

You can choose anyone to be your executor, but they do need some special qualities. You should consider:

- **Age:** you want them to have the energy, ability and maturity to deal with your affairs. Sometimes this can be a fine balance – if you have someone older there's a risk they could die before you or could become incapable of fulfilling their duties. However, someone younger may not have sufficient life experience to cope with the role.
- **Temperament:** dealing with an estate can be quite emotional. You want your executors to be calm, steady, decisive and with loads of common sense.
- **How well they know you:** it's good to have an executor who knows you and, in general, understands how you run your affairs. A large part of an executor's role can be information gathering, and having some prior knowledge can help them know how to go about this.

You can appoint anyone to be an executor; many people choose their spouse or partner and/or some of their children. Sometimes, people name someone independent as an executor, such as a long-standing friend. This can be especially useful when there are blended families or a disharmonious family situation.

Executors don't have to manage your estate alone; your estate's lawyer will guide executors through each step of the way.

What do executors do?

One of the executors' first duties is making sure they have a clear understanding of the contents of your will.

Working with your family, executors are responsible for arranging burial or cremation. They must ensure that, if necessary, your home is secured, all insurable assets insured, pets are taken care of, deliveries cancelled, outgoings paid (electricity, rates, insurances) and the insurers advised if the house is empty.

If you were still working at the time you died, final paperwork and your personal items at work will need to be sorted. If you were a business owner, it may be necessary to get a trusted employee to step in, for the short term, to keep on top of things such as wages, bills, suppliers and customers.

To help wind up your estate, your executors must gather information about your assets such as bank accounts and investments, KiwiSaver and superannuation, insurances, benefits, property and motor vehicles.

It is important for executors to identify any jointly held property and any debts, such as mortgages, credit card bills and so on.

Through the estate's lawyer, the executors must ensure that all the estate's debts are paid. Executors are personally liable to meet these debts, unless they satisfy specific legal requirements.

When they have the complete picture of the estate, the executors can then manage the distribution of your assets to your beneficiaries in accordance with your will. This usually requires an application for probate, a court order confirming the will. The estate's lawyer will help the executors with this.

When does an executors' role end?

The executors' role is completed when all taxes and expenses have been paid, and all distributions to adult beneficiaries have been made. If there are underage beneficiaries then the trustees nominated by the will step in to hold that benefit for those children until they are old enough. In practice, the trustee and executor are almost always the same person, but they do have slightly different obligations and responsibilities.

Should your executors live locally?

Your executors can live anywhere, but it does make it much easier logistically if they are in the same region, or at least close, to where you were living. This is becoming less of an issue with technology, but it's still something to take into account.

Choosing executors is important when you are making, or reviewing, your will. They have significant obligations and responsibilities in making sure your assets are managed in the way that you intended.

If you have any queries about appointing or changing an executor, or you are an executor and have some queries, please don't hesitate to call us. ✱

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The importance of good recordkeeping

Risk of hefty penalties if you don't

There are plenty of war stories about recordkeeping blunders. Think of offices crammed with paper, 'lost' documents, fireplace filing systems and online voids.

Section 194(1) of the Companies Act 1993 requires boards to keep correct accounting records. Records are supposed to 'speak for themselves'[1] and allow the company's financial position to be determined at any time with reasonable accuracy. Failure to keep proper records can badly hurt your business.

In 2018, a director was found personally liable for nearly $500,000 as a result of his 'egregious' failure[2]. The court found that 'not only were proper records not kept … bank accounts were intermingled and monies that were the assets of one entity were … paid into the bank accounts of another entity'[3]. The judge also confirmed that delegation to an unqualified and inexperienced third party is unacceptable.

Not meeting minimum employment standards

Many employers have faced fines for failing to meet minimum employment standards; a number of these offenders are working in small to medium enterprises.

In 2018, labour inspectors found that 28% of inspected farms were not meeting their recordkeeping obligations; this resulted in total fines of $11,000. Employees did not have agreements and employers had missing wage, time, holiday and leave records.

Every employee must have an employment agreement. There is no substitute for a professionally-drafted agreement. At business.govt.nz the Employment Agreement Builder can generate free standardised agreements designed to reflect key factors. While this is a useful tool and is a good starter, we strongly recommend asking us to help draft your employment agreements as they will be custom-made to your particular organisation.

Last year, Aulack Enterprises Ltd faced liability of up to $320,000 for breaches, ultimately paying wage/holiday arrears, $30,000 penalties and court costs[4]. This figure does not include the costs of the advice from Aulack's professional advisors or the time, stress and inconvenience of the litigation.

Tax

Businesses must keep records of invoices, receipts, wage books, petty cash, banking records, asset registers, depreciation schedules, vehicle mileage and claimed business expenses.

A tax invoice for expenses under $50 is not needed, but if you are GST-registered, you must keep records that can support an expense claim. At the very minimum, you should record the date, description, cost and supplier for everything you buy. Inland Revenue also recommends retaining any calculations used to complete your tax return, such as for working out a home office claim.

Keeping good records should be part of your day-to-day business activities, otherwise you risk some hefty fines – and that's simply not worth it. ✱

1 *Maloc Construction Ltd (in liq) v Chadwick* (1986) 3 NZCLC 99,794 at 22

2 *TGM Trading Limited (in liq) & Anor v Drever* [2018] NZHC 1788 [18 July 2018]

3 *Drever* at para 13

4 *Thomas v Aulack Enterprises Ltd* [2017] NZERA Auckland 156

Postscript

Companies Office helping amalgamation customers 'get it right first time'

The Companies Office is reminding its customers who are amalgamating or closing down companies to 'get it right first time' when filing documents.

To help applicants tick all the boxes, the Companies Office now provides additional online resources, including a comprehensive pre-submission checklist. These resources can be found here: https://bit.ly/2WRoRaR ✱

Tax Working Group – capital gains tax scrubbed

It is said that timing cannot always be perfect. We published *Fineprint's* Autumn edition in early April with a commentary on the Tax Working Group's proposal to introduce a capital gains tax.

However, just before Easter and only 10 days or so after we published *Fineprint*, the government announced that the proposed capital gains tax would not proceed. The Prime Minister, Jacinda Ardern, stated that the government was unable to find a consensus and there was no mandate for such a tax. She has ruled out the introduction of a capital gains tax under her leadership.

The government still believes there is much unfairness in New Zealand's tax system. The Prime Minister said, "Work will continue to cut red tape for business and crack down on multi-nationals avoiding paying their fair share of tax in New Zealand." On 4 June the government released a discussion document on options for introducing a digital services tax.

We will keep you up to date with any developments from the Tax Working Group. ✱

Claiming legitimate business expenses

With the recent media coverage about the claiming of business expenses, we thought it timely to remind you to always keep in mind what expenses are tax-deductible and what are not.

If you're self-employed, there is very useful information here at Business NZ: https://bit.ly/31WdFgS

For those of you who work in a corporate environment, your organisation will no doubt have an expenses policy to ensure all claims are legitimate.

It is worth remembering that you should keep all receipts so you can easily validate your claims. ✱

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