



November 2008

Climate Change update

Forestry comes on line

As New Zealand's largest potential carbon dioxide sinks, forests are a vital asset in efforts to mitigate the effects of climate change. Forestry is the first sector entrant in the emissions trading scheme (**ETS**). Obligations applying from 1 January 2008 are now in place. All other industry sectors in New Zealand will enter the scheme by 2013. *Are you ready?*

Developments

- The Climate Change Response (Emissions Trading) Amendment Act 2008 received Royal Assent on 25 September 2008. It amended the [Climate Change Response Act 2002](#) and introduced the ETS.
- The [Climate Change \(Forestry Sector\) Regulations 2008](#) came into force on 29 September 2008. The regulations set out in detail methodologies for calculating emissions.
- Submissions on the [Draft Forestry Allocation Plan](#) are due **28 February 2009**.
- In October 2008 the Ministry of Agriculture and Forestry released [A Guide to Forestry in the Emissions Trading Scheme](#).
- On 8 November 2008 New Zealand elected a new government. The National party-led government has promised to change the ETS, but the scale of the proposed changes is currently unknown.

In addition to the ETS there are other sustainable forestry schemes. These include the the Afforestation Grant Scheme (**AGS**); and the Permanent Forest Sinks Initiative (**PSI**).

The Emissions Trading Scheme

The ETS assists New Zealand in meeting its international climate change commitments. New Zealand has committed under the Kyoto Protocol to reducing its Climate Change emissions to 1990 levels and to otherwise take responsibility for emissions above that level.

The ETS is a market based mechanism. The ETS currency is the New Zealand Unit (**NZU**) which can be traded in New Zealand. The NZU is linked to the international Kyoto Protocol market and can generally be interchanged with international Kyoto Protocol Assigned Amount Units (**AAUs**).

Participation in the ETS is compulsory for pre-1990 forests, and voluntary for post-1989 forests.

Compulsory participants include those deforesting pre-1990 forest land; provided the area deforested is more than 2 hectares in the 5 year-period commencing 1 January 2008, or any subsequent 5 year period. Participants deforesting pre-1990 forest land incur emissions liabilities.

Voluntary participants include persons:

- Owning post-1989 forest land, other than post-1989 forest land that is subject to a forest sink covenant;
- Holding a registered forestry right or being the leaseholder under a registered lease of post-1989 forest land, other than post-1989 forest land that is subject to a forest sink covenant; and
- Who are party to a Crown conservation contract.

Voluntary participants may also enter the scheme from 1 January 2008. Net increases in carbon stocks through afforestation of post-1989 forests can earn NZUs. They remove greenhouse gases from the atmosphere and are described as "removal activities".

In opposition, the National Party has suggested there could be improvements to the ETS. It has promised to amend some aspects of the ETS. In the past it has suggested that it would align "where possible" with the Australian ETS when it is formed, support small to medium sized enterprises in ensuring that they may obtain free allocation of units where eligible and ensure that the ETS is fiscally neutral. Regardless of the proposals, there will be further opportunities to approach the government to influence these changes to the ETS and we can advise you in doing this.

Exemptions

Landowners with less than 50 hectares of pre-1990 forest on 1 September 2007 can apply to be exempt from the ETS. There are also exemptions for the deforestation of tree weeds on pre-1990 forest land. Applications for exemptions must be made by **30 June 2009**. Exemptions remain with the land even if it is subsequently sold. Indigenous forests established before 1 January 1990 are not included in the ETS.

Allocation Plans

The Minister responsible for Climate Change Issues has released a [Draft Forestry Allocation Plan](#). The plan will allocate NZUs free of charge (subject to limits) for pre-1990 forest. Submissions are due on **28 February 2009**. The final allocation decision is due in April 2009. Participants will need to apply for exemptions by 30 June 2009 and allocations by 31 July 2009 (note these dates may change). More information is available on the [MAF sustainable forestry website](#).

Included in these allocation plans will be an allocation for an additional 18 NZUs per eligible forest hectare to future treaty claimants who receive pre-1990 Crown Forest Land.

General Tax Treatment (as outlined by the government)

If you will be trading and surrendering NZUs, you need to make sure you are able to pay the necessary costs. You are liable for tax obligations and need to ensure you are aware of those obligations. Generally:

- **Pre-1990 forests (except forests held on revenue account):** There is no tax payable on units issued in relation to pre 1990 forests when the units are received or still held at the end of the year.
- There is no tax on the sale of the units and no deduction when the units are surrendered to satisfy an emissions liability regardless of whether the units were allocated to the taxpayer by the government or the taxpayer bought the units.
- **Post-1989 forests:** There is no tax payable when emissions units are received in relation to post-1989 forests.
- Gains from the sale of emissions units allocated in relation to 1989 forests will be taxable and the cost of units purchased to replace units previously issued by the government will be deductible when acquired.
- Emissions units purchased but which do not replace units previously issued by the government and which are held a person over an income year will be taxed under modified trading stock rules with a deduction on disposal.
- All transactions in NZ emission units will be zero rated for GST purposes.

For specific tax advice on climate change matters please contact the [Minter Ellison Tax team](#).

Penalties for Non Compliance with the ETS

There are civil penalties for non-compliance with the ETS aimed at supporting the obligations under the ETS of calculating emissions and surrendering equivalent NZUs.

Criminal offences may apply when a person without good reason, knowingly or with intent to deceive, fails to collect information, register as a participant, submit an emissions return or keep information in relation to an activity.

Climate Change (Forestry Sector) Regulations 2008

The regulations contain (amongst other things) carbon assessment methodology to assist with reporting emissions.

Currently the regulations use the **Look-Up Table Approach** (for both pre-1990 and post-1989 forest land) in their carbon assessment methodology. The table based approach uses prescribed pre-calculated values for assessing carbon stocks. These tables are not expected to be precisely accurate for exact measurements of carbon, but are much cheaper to

use than field measurements. It is anticipated that a more accurate "look up table" for certain forests will be introduced in mid-2009.

The **Field Measurement Approach** reflects more accurately the carbon stock in a forest, based on the measurement of a sample of the trees. Details of the field measurement approach have yet to be finalised. This approach is proposed to be introduced via an amendment to the regulations in 2009. The methodology is expected to be available for the emissions return for the period ending 31 December 2009.

Other sustainable forestry programmes

Other schemes encouraging sustainable forestry in New Zealand include the AGS and the PFSI. The AGS and PFSI were developed pre-ETS legislation. The PFSI is intended to be complimentary to the ETS and the AGS an alternative.

The **AGS** is a fund to encourage the planting of trees in small forests and on farms. Foresters can receive a grant for planting Kyoto-compliant new forest. Half the AGS fund is provided to Regional Councils to enable them to meet their sustainable land management objectives, and the other half is available to foresters and the general public through public tender. Those who receive grants are not eligible for NZUs under the ETS.

The **PFSI** aims to promote the establishment of permanent forests on previously un-forested land. Forest owners who participate in the PFSI can earn AAUs for carbon sequestered in permanent forests established after 1 January 1990. The forests must be "human-induced" and all participants will have a covenant registered against their land titles for a minimum of 50 years limiting deforestation. In the future forest owners may be able to surrender "sustainable AAUs" under the ETS. Forest owners are, liable to meet all costs of administration, monitoring, auditing and compliance with the PFSI.

Implications of the ETS for the Forestry Industry

The scheme favours long-term, sustainable, forestry initiatives. That is, forest sinks are required to remain as sinks. For example, owners of pre-1990 forests who elect not to replant post-harvest will be liable for emissions. This may influence the decision of those wanting to convert or sell land for other uses such as agriculture. It may impact on flexibility to deal with changing market conditions and influence what is the most desirable land use. Land value of pre-1990 forest land may decrease. The price of NZUs at any given time will influence the attractiveness of a change in land use.

The forestry sector could potentially benefit long term by being able to trade credits on the domestic or international market.

Reporting obligations will obviously involve paper work.

Participants will need to take care that they are mindful of their reporting obligations and have proper accounting systems in place. There will be financial compliance costs. The legal and reputational consequences of non-compliance could prove high.

For legal advice on how to comply with your obligations under the ETS, making the most of the ETS, and making a submission on the draft forestry allocation plan please [contact us](#).

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Participant Obligations – Are you ready?

Commencement dates

Generally, persons deforesting more than 2 hectares of pre-1990 forests, in a 5 year period, must notify the Chief Executive of the Ministry of Agriculture and Forestry (MAF) that they are a participant, within 20 working days of becoming one. The first 5 year period commences 1 January 2008. Also, persons who have deforested pre-1990 forests between 1 January 2008 and 31 December 2008 must notify MAF by 31 January 2009.

Notification can be completed from December 2008, online or by downloading the forms from the [MAF sustainable forestry website](#).

A person carrying out post-1989 activities may apply to be registered. Voluntary participants can apply to [register online](#).

Do you have a holding account?

At the time of registration, participants must apply to open a holding account, if they don't have one already. Participants must have a holding account to receive and surrender units under the scheme. A holding account can be obtained from the [New Zealand Emissions Register](#). Participants wanting to apply for free allocation will need to have a holding account (see below).

Do you know how to monitor and calculate emissions and removals?

Participants must, for each year they are carrying out pre-1990 or post-1989 activities: collect prescribed data or information, calculate the emissions and the removals activity in accordance with any relevant regulations, and if required, have calculations verified by a recognised person.

Are you aware of the record keeping requirements?

Participants for pre-1990 and post-1989 forests must keep records of the data, information and calculations. Participants must also retain records for 20 years after the end of the period to which they relate.

Do you know how to file annual emissions returns?

A participant with pre-1990 forest activities must, between 1 January and 31 March of each year, submit an annual emissions return. Returns relating to deforestation of pre-1990 forest land for the 2008 and 2009 calendar years are due by 31 March 2010. That return must cover deforestation from 1 January 2008. A person ceasing to carry out activities subject to the scheme or leaving New Zealand must file a final return. "Removal activities" such as afforestation may submit quarterly returns.

It is not compulsory for post-1989 participants to file an annual return. However, they may choose to do so as a registered participant.

Are you aware of the liability to surrender units to cover emissions?

A participant is liable to surrender 1 NZU for each whole tonne of emissions covered by the scheme. After submitting their return by 31 March participants are required to surrender emissions by 30 April of the same calendar year. The participant must make an application to transfer the required number of units from the participant's holding account to a surrender account designated by the Chief Executive of the ETS.

Do you know about entitlements to receive NZUs for removal activities?

For post-1989 forests a participant is entitled to receive 1 NZU for each tonne of carbon dioxide equivalent removed from the atmosphere. Similar application is required to receive this entitlement.

Are you making a submission on the draft allocation plan?

Please refer to the newsletter.