

**EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA
- MŌ TE TĀKUPU ME TE MATAPAKI ANAKE**

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INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Income Tax and GST – forestry activities registered in the Emissions Trading Scheme

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This interpretation statement considers the tax consequences for forestry activities registered in the Emissions Trading Scheme (ETS). The statement considers the tax consequences of receiving, selling and surrendering emissions units (NZUs), as well as the tax treatment of specific transactions involving NZUs. For general information on the ETS, see Ministry for Primary Industries [Forestry in the Emissions Trading Scheme](#).

Legislative references are to the Income Tax Act 2007 (ITA 2007) unless otherwise stated.

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Key terms used in this statement

- Figure | Hoahoa 1 summarises terms from the Climate Change Response Act 2002 (CCRA) that are used in this statement when considering the application of the tax provisions to forestry activities registered in the Emissions Trading Scheme (ETS). For the full definitions, see s 4 of the CCRA. For ease of reference, this statement refers to emissions units as NZUs.

Figure | Hoahoa 1 – Summary of key terms

Term	Summary
Clearing	includes felling, harvesting or killing trees; and for an area, when the forest species on the land are cleared
Clear-felled	when trees in permanent post-1989 forestry are cleared by human activity in an area of at least 1 hectare resulting in each hectare of land having less than 30% tree crown cover
Deforestation	occurs when forest land is either converted to non-forest land, or when a forest is cleared and not replanted or regenerated within relevant timeframes (in many cases, 4 years) (see s 179 of the CCRA)
Forest land	is land of at least one hectare with tree crown cover from forest species of more than 30% in each hectare
Forest species	are trees capable of reaching five meters in height at maturity where it is located (but excludes trees grown for fruit or nut crops)
Forestry activity	for post-1989 forest land, includes owning the forest land, holding a registered forestry right for the land, being a leaseholder under a registered lease of the land or being a party to a Crown conservation contract in respect of the land

New Zealand Unit (NZU)	means an emissions unit issued by the Registrar and designated as a New Zealand unit
Participant	is a person who is required or elects to be a participant in the ETS, and includes a person who acquires ETS registered post-1989 forest land
Post-1989 forest land	is primarily land that was not forest land on 31 December 1989, subsequently become forest land, and where foresters have elected to participate in the ETS. Status as post-1989 forest land is determined at the time a person applies to participate in the ETS.
Pre-1990 forest land	is land that was forested on 31 December 1989, remained forested on 31 December 2007, that was predominantly exotic forest (it does not include land that has been deforested and where NZUs were surrendered)

Introduction | Whakataki

2. Emissions trading is a tool to encourage and enable the reduction of greenhouse gas emissions contributing to climate change. The ETS is a market managed by the government with the objective of assisting New Zealand to meet its international obligations and its 2050 target and emissions budgets. The ETS covers about half of all emissions in New Zealand including from fossil fuel, industrial processes and waste.
3. Participants that generate greenhouse gases need to surrender one NZU for each whole tonne of carbon emissions from their relevant activities.¹ The number of NZUs available to the market reduces over time, which should cause prices to rise, incentivising participants to find ways to reduce their emissions. Participants can decide whether to cut their own emissions or effectively pay others to reduce emissions by buying NZUs.
4. NZUs can be bought at government auctions or through the secondary market, including from people or entities with forestry activities (referred to in this statement as foresters) that earn NZUs for removal activities.
5. Foresters with post-1989 forest land are not required to participate in the ETS, but they may choose to do so. Where a forester chooses to participate, their forestry activities generate NZUs for removal activities. They may have obligations to report emissions and surrender NZUs when they clear a forest, deforest forest land or deregister from the ETS.²

¹ Section 63 of the CCRA.

² Sections 54, 56, 57, 64, 186A, 186C of the CCRA.

6. This statement considers the income tax and GST issues that arise for foresters who have their forestry activities registered in the ETS. This statement is limited to considering tax issues arising from participating in the ETS and does not consider other tax issues that arise for the forestry sector more generally, or general issues with the ETS.

Note for submitters – an accompanying statement is also being prepared for other industries registered in the ETS, focusing on those who receive free NZUs from industrial allocation.

Further information

7. For general information on the ETS, see the following resources:
 - Environment Protection Authority webpage [Emissions Trading Scheme](#)
 - Ministry for the Environment webpage [New Zealand Emissions Trading Scheme](#)
 - Ministry for Primary Industries webpage [Forestry in the Emissions Trading Scheme](#)
 - Leining, C [A Guide to the New Zealand Emissions Trading Scheme: 2022 update \(Motu, 2022\)](#).

Guide to using this statement

8. This statement first summarises how the ETS applies to forestry activities and introduces the ETS concepts relevant for tax purposes. This includes the types of forests that may be registered, which give rise to different types of NZUs for tax purposes. For a summary, see Figure | Hoahoa 2.
9. The statement then explains the general income tax treatment of NZUs in the forestry context. This includes the tax treatment of NZUs when received, held, sold or surrendered for emissions liabilities. The statement also discusses what deductions may be available for different types of NZUs. For a summary, see Figure | Hoahoa 3.
10. The statement also considers specific events or transactions involving NZUs:
 - forestry rights agreements including the transfer of NZUs (see from [81]);
 - deregistering from the ETS or changing forestry activities (see from [88]);
 - sales of ETS registered forests including purchase price allocation (see from [112]); and
 - arrangements involving NZUs (see from [140]).

11. Finally, the statement briefly comments on GST (see from [163]).

How the ETS applies to forestry activities

12. To understand the income tax consequences for NZUs earned by foresters, it is important to first be aware of how the ETS applies to forestry activities. Concepts in the CCRA and the ITA 2007 are linked.
13. Under the CCRA, a person with a forestry activity:
 - **must** be a participant if they deforest pre-1990 forest land (sch 3, part 1 or 1A) or if they acquire post-1989 forest land that is ETS registered; or
 - **may** choose to be a participant for a forestry activity that is standard forestry or permanent forestry on post-1989 forest land (schedule 4, part 1 or 1A).
14. The concepts of pre-1990 forest land and post-1989 forest land are vital to how the ETS applies to the particular forest land, and in turn to how the ITA 2007 applies to the NZUs.

Pre-1990 forest land

15. The ETS uses 1 January 1990 as a starting point for measuring changes in forest growth, so a distinction exists in the treatment of forest land established before or after that date. This was a result of New Zealand adopting international climate change agreements.³
16. Land that qualified as forest land on 31 December 1989, remained forest land on 31 December 2007 and was predominately exotic forest on that date is known as “pre-1990 forest land”. It does not include certain types of land (such as land that was deforested and any emissions liability met).
17. When the ETS was introduced with effect from 1 January 2008, foresters with eligible pre-1990 forest land could apply for the forest land allocation plan and received NZUs in two tranches (on approval and in 2013). These foresters do not receive any further

³ United Nations Framework Convention on Climate Change (UN Doc A/AC.237/18 (Part II)/Add.1; 31 ILM 849, 1992), the Kyoto Protocol (UNFCCC, Kyoto Protocol to the United Nations Framework Convention on Climate Change (UN Doc FCCC/CP/1997/7/Add.1, December 1997)), and the Paris Agreement (UNFCCC, Adoption of the Paris Agreement (UN Doc FCCC/CP/2015/L.9/Rev/1, 12 December 2015)).

NZU entitlements for the growth of the forest and are not liable for surrendering NZUs unless their forest land is deforested.⁴

Post-1989 forest land

18. Post-1989 forest land is land that is currently forest land and is primarily land on which forest was first established after 31 December 1989. It includes land that:
- was not forest land on 31 December 1989;
 - was forest land on 31 December 1989 but was deforested before 31 December 2007; or
 - was pre-1990 forest land but was deforested after 1 January 2008 and a liability to surrender NZUs was satisfied.⁵
19. Forestry activities on post-1989 forest land do not have to be ETS registered. A forester that chooses not to participate does not receive any NZUs for removal activities but also does not have to surrender NZUs.

Standard forests

20. Post-1989 standard forests (eg, forests intended to be harvested) have two different treatments:
- Standard forests registered in the ETS before 1 January 2023 use the stock change method for carbon accounting. These foresters earn NZUs based on the forest growth and must surrender NZUs to cover emissions if the carbon stock declines (eg, from harvesting).
 - Standard forests registered in the ETS from 1 January 2023 use the averaging method for carbon accounting.⁶ These foresters earn NZUs as the forest grows on its first rotation, up to the long-term average age.⁷ They do not earn further NZUs for subsequent rotations. These foresters usually only need to surrender NZUs if the land is deforested or if they deregister from the ETS.
21. The difference between the two methods is essentially that averaging accounts for emissions and removals by reference to the expected long-term average level of

⁴ Foresters had an option to apply for an exemption from deforestation liabilities if they owned less than 50 hectares of forest. Otherwise, deforestation liabilities arise under Part 5, subpart 2 and sch 3, part 1 and 1A of the CCRA.

⁵ Section 4 of the CCRA.

⁶ There was an opportunity for forests registered between 1 January 2019 and 31 December 2022 to change to averaging.

⁷ This depends on the forest type and clearance age.

carbon stock over multiple rotations rather than by referring to short term changes in the actual carbon stock which is the method used in stock change accounting.

Permanent forests

22. From 1 January 2023, new permanent forest rules were introduced. These rules replaced the previous Permanent Forest Sink Initiative (PFSI) under the Forests Act 1949, which was removed on 1 January 2024.
23. Permanent forestry uses the stock change carbon accounting method, so NZUs are earned based on the ongoing growth of the forest.
24. When registered as a permanent forest, the land must not be clear-felled or deforested. Limited clearing of permanent forests is permitted but NZUs must be surrendered for any carbon stock loss. There are also restrictions on changing from registration as a permanent forest, and approval must be sought. Pecuniary penalties apply under the CCRA for clear-felling or deforesting permanent forests.
25. The permanent forestry period is an initial period of 50 years. After the initial 50-year period ends, the forester must choose whether to:
 - remain in permanent forestry for a further 25-year period (and continue to earn NZUs); or
 - remove the land from permanent forestry either by deregistering from the ETS or moving the forest into standard forestry and use averaging accounting.
26. If the option is taken to move the forest into standard forestry, the forester needs to surrender any NZUs earned above the long-term average. If the option is taken to deregister from the ETS, the forester needs to surrender the NZUs earned for the forest land.

Permanent forest sink initiative (now discontinued)

27. Under the PFSI, a covenant was registered against the land title and provided foresters a right to terminate after a certain number of years (with surrender of NZUs).
28. Until 1 January 2024, PFSI participants could either opt into the ETS as a standard post-1989 forest using averaging accounting, or permanent post 1989-forest. If no decision was made the participants were moved into permanent forestry. If the PFSI participant moved to standard forestry and if they had carbon stock above the average, they needed to surrender any excess NZUs.

Difference between clearing and deforestation

29. As noted above, surrender liabilities can arise in some cases on clearing (post-1989 forests that use stock-change accounting) and for all deforestation (pre-1990 forests and post-1989 forests).
30. Clearing occurs where the forest species are killed over an area of land. Under stock-change accounting, an emissions liability arises if the carbon stock declines (which needs to be met when the emissions return is submitted). There are exclusions for temporary clearing arising from adverse events. While a permanent forest may not be clear-felled, limited clearing is permitted but NZUs must be surrendered for any carbon stock loss (reported in an emissions return).
31. Generally, deforestation occurs when forest land is converted to another land use, or if a forest is cleared and not re-established in time. Deforestation is deemed to occur on the date that the first action is taken that is inconsistent with the land being forest land or when re-establishment tests are not met (4, 10, or 20 years after clearance).⁸
32. However, both pre-1990 and post-1989 forest land is treated as not being deforested in some cases. For example, land is not treated as being deforested if cleared land is contiguous with the edge of the forest land, is less than 1 hectare or 30 metres wide, and is required to be cleared as part of New Zealand's best practice forest management.
33. Example | Taura 1 illustrates the different NZU earning and surrender liabilities that arise for different types of forests.

Example | Taura 1 – NZU surrender obligations for different types of forests

Tony's Timber Ltd owns several ETS registered forests.

Forestry Block A is pre-1990 forest land. Tony's Timber Ltd received NZUs in a forest land allocation plan. The timber was harvested, and the forest was replanted for a second rotation. Tony's Timber Ltd did not need to surrender NZUs at the time of harvest but would need to surrender NZUs if the land is subsequently deforested.

Forestry Block B is ETS registered as a standard post-1989 forest using stock change carbon accounting. Tony's Timber Ltd earns NZUs in accordance with the growth of the forest. When this forest is harvested, Tony's Timber Ltd must surrender NZUs. If Forestry Block B is replanted for a second rotation, those trees will earn NZUs as they grow.

⁸ Section 179 of the CCRA.

Forestry Block C is ETS registered as a standard post-1989 forest using averaging carbon accounting on its first rotation. Tony's Timber Ltd will earn NZUs up to the nominal average carbon stock, but after that date no further NZUs will be earned, including for subsequent rotations. Generally, an NZU surrender liability will only arise if Tony's Timber Ltd deforests or deregisters from the ETS.

Forestry Block D is ETS registered as post-1989 permanent forestry using stock change accounting. Tony's Timber Ltd will earn NZUs in accordance with the growth of the forest. This forest may not be clear-felled for at least 50 years. There will be NZU surrender liabilities if the carbon stock declines. Following the end of the 50-year period, Tony's Timber Ltd will need to decide whether to continue in permanent forestry for another 25 years, move to averaging which triggers surrender liabilities or exit the ETS, which will also have surrender liabilities.

Types of NZUs earned from forestry activities

34. NZUs that are generated by foresters for removal activities are classed as "forest land emissions units" under s YA 1 of the ITA 2007 (forest land NZUs). A forest land NZU is a:
 - pre-1990 forest land emissions unit (pre-1990 forest land NZU);
 - post-1989 forest land emissions unit (post-1989 forest land NZU); or
 - forest sink emissions unit (now discontinued).
35. These types of NZUs have special rules for income tax purposes.
36. Under the ITA 2007, a pre-1990 forest land NZU is an NZU that is transferred to the person under part 4, subpart 2 of the CCRA and must remain held continuously by that recipient or a party to a forestry rights agreement.
37. Other than in two specific contexts (forestry rights agreements and arrangements subject to s EW 52B of the ITA 2007) no rollover relief is provided for any transfers of these types of NZUs to other parties (including transfers to partners of a partnership). This means that, other than in the two situations mentioned, if pre-1990 forest land NZUs are transferred by a forester to another party, they will lose that status for income tax purposes and be treated the same as standard NZUs (like those acquired at auction or from the secondary market).
38. Under the ITA 2007, a post-1989 forest land NZU is an NZU that is transferred to the person under s 64 of the CCRA for growing trees on post-1989 forest land and must be held continuously by that recipient or a party to a forestry rights agreement. Other than in the context of a forestry rights agreement, no rollover relief is provided for

transfers of these types of NZUs to other parties. If post-1989 forest land NZUs are transferred to another party, they will lose that status for tax purposes and be treated the same as standard NZUs (like those acquired at auction or from the market).

39. A specific category of NZUs is referred to in the ITA 2007 (s YA 1) as “replacement forest land emissions units”. This is an NZU that the person acquired if they:
 - previously disposed of a post-1989 forest land NZU (other than through surrender under the CCRA); and
 - have not acquired another NZU to replace the NZUs that were disposed of.
40. There is no specific timing requirement for an acquisition of an NZU to qualify as a replacement forest land NZU. That is, the NZU does not have to be acquired to satisfy an imminent liability. The forester must simply have sold (or disposed of other than by way of surrender) post-1989 forest land NZUs and not have acquired another NZU that replaces it. In that case, an NZU acquired by the forester is a replacement forest land NZU.
41. Given the different types of forest land NZUs for tax purposes, foresters are advised to keep records of the types of NZUs they hold for tax purposes, and for example, could use separate inventory records for each type of NZU. The emissions unit register does not separately identify some types of NZUs held (because some of these are tax concepts).
42. The above discussion is summarised in Figure | Hoahoa 2.

Figure | Hoahoa 2 – Features of NZUs from forestry activities

Type of NZUs	Features
<p>Pre-1990 forest land NZUs</p>	<p>Pre-1990 forest land is land that was forested on 31 December 1989, remained forested on 31 December 2007, and was predominantly exotic forest at that later time. (It does not include land that has been deforested).</p> <p>These NZUs were allocated to foresters under the Forest Land Allocation Plan. No further allocations are made for future growth of these forests.</p> <p>These NZUs must remain held continuously by the original recipient (or a party to a forestry rights agreement) otherwise they lose their tax status.</p>
<p>Post-1989 forest land NZUs</p>	<p>Post-1989 forest land is primarily land that was not forest land on 31 December 1989.</p> <p>These NZUs are transferred to a forester under s 64 of the CCRA for removal activities. The NZUs are allocated to foresters over time (depending on the carbon accounting method used).</p> <p>These NZUs must remain held continuously by the original recipient (or a party to a forestry rights agreement) otherwise they lose their tax status.</p>

Replacement forest land NZUs	These NZUs are acquired by a forester who has previously sold post-1989 forest land NZUs and has not previously acquired other NZUs to replace the post-1989 forest land NZUs that were sold.
Standard NZUs	All other NZUs a forester acquires, or any of the above types of NZUs that have lost their status (eg, because they have been transferred to another person).

General income tax treatment of NZUs

43. This part of the statement explains how the ITA 2007 applies to a forester's receipt and disposal of NZUs.

Receipt of forest land NZUs for removal activities

44. Where an ETS registered forester receives NZUs for removal activities (whether using the stock change or averaging accounting method), those NZUs would generally be income derived from the forestry activity. However, there are no tax consequences for the forester in the year of receiving the NZUs for removal activities. Instead, taxable income is delayed until the forester sells the NZUs.
45. Where pre-1990 forest land NZUs were previously allocated to foresters, at the time of allocation the receipt of those NZUs was exempt income under s CW 3B provided the land was held on capital account.
46. The matching rules in subpart ED apply to revenue account property that is an excepted financial arrangement. Revenue account property is defined in s YA 1 as property that if disposed of for consideration would produce income, and specifically includes an emissions unit. An emissions unit is an excepted financial arrangement under s EW 5(3B) (so is not subject to the financial arrangements rules). Therefore, NZUs are subject to subpart ED.
47. When a person has an NZU, its value at the end of the income year is income under s CH 1 and its value at the beginning of an income year is deductible under s DB 49. Section ED 1(1) is the general rule for determining that value. That section provides that NZUs are generally valued at cost at the end of each income year. However, there are specific rules that apply to forest land NZUs.
48. Section ED 1(7B)(b) applies to forest land NZUs and specifies a value at the end of the year of zero. This includes the year in which the NZUs were received.
49. Where foresters hold their forest land NZUs over several income years, there are no income tax consequences. As noted above, s ED 1(7B) provides that the value of a forest land NZU is zero at the end of the income year. This value is relevant for determining an amount of income at the end of the year (s CH 1) which would be zero,

and the amount of deduction at the beginning of the next income year (s DB 49) which would also be zero.

50. Therefore, there are no income tax consequences for a forester in the income year in which they earn NZUs for removal activities, or when they continue to hold those NZUs at the end of an income year.

Sale of NZUs

51. Under s CB 36, amounts derived from the disposal of NZUs are income. Therefore, if a person sells an NZU, the amount received from that sale is generally taxable.
52. Recent amendments to s GC 1 mean there is generally no requirement that the NZUs must be treated as sold for market value if the transaction occurs in the course of carrying on a business and does not occur between associated persons.⁹
53. However, the amount derived from a sale is not taxable in certain situations involving pre-1990 forest land NZUs. This is where:
 - the NZU is a pre-1990 forest land NZU and the forest land is held on capital account (the amount is excluded income under s CX 51B); or
 - the amount is derived from a transfer of a pre-1990 forest land NZU under a lending arrangement subject to s EW 5(11C) (the amount is excluded income under s CX 54B).
54. In the context of a forest land NZU, because no cost was incurred in acquiring the NZU, the full amount received on a sale is taxable income and no deduction is available. Foresters are specifically disallowed a deduction for their emissions liabilities under ss DB 60 and DB 60B, discussed below.

Surrender of NZUs

55. When a disposal of NZUs occurs through surrender under the CCRA, rather than a sale, s CB 36 contains a series of rules deeming what the amount of income is treated as being in each situation.
56. Under s 63 of the CCRA, an ETS participant is liable to surrender one NZU for each whole tonne of emissions from the relevant activity, as calculated under the CCRA. For example, foresters will have emissions liabilities where they:
 - deforest pre-1990 forest land;
 - use averaging accounting and deforest post-1989 forest land;

⁹ Associated persons are defined in ss YB 1 to YB 16 of the ITA 2007.

- use stock change accounting and clear a forest on post-1989 forest land; or
- have reductions in the carbon stock in a permanent post-1989 forest.

57. For present purposes, if a person disposes of their NZUs by way of surrender under the CCRA, they are treated as having sold the NZU for a value specified under s CB 36. If no specific provisions apply, the value is treated as being the cost of the NZU.

Specific types of surrender

58. A forester is treated as selling an NZU for a value of zero if they surrender the NZU:

- in relation to post-1989 forest land; or
- for deforestation of pre-1990 forest land where the land is held on revenue account (where the land is held on capital account any disposal of the NZU is exempt).

59. A forester is treated as selling an NZU for market value if a post-1989 forest land NZU is surrendered other than for emissions relating to post-1989 forest land. This is discussed in more detail when considering the consequences of deregistering from the ETS.

Surrender of pre-1990 forest land NZUs for post-1989 forest land liabilities

60. If pre-1990 forest land NZUs are surrendered to meet a post-1989 forest land liability, special rules apply (s DB 61). In this situation, the person is treated as having:

- disposed of the pre-1990 forest land NZUs to an unrelated person immediately before the surrender; and
- having then reacquired the NZUs immediately before the surrender;

in both cases for an amount equal to the NZU's market value at the time.

61. The result of s DB 61 applying is as follows:

- Pre-1990 forest land NZUs are treated as being sold to a third party for market value immediately before surrender. This market value amount will be exempt income if the land was held on capital account, or taxable income if the land was held on revenue account.
- The person is treated as having reacquired the NZUs at market value at the same time. This deemed amount would form the cost of the newly acquired NZUs.
- The person then surrenders the NZUs in relation to post-1989 forest land. Section CB 36 treats this as occurring for zero value, so there is no income.

- The surrender of the NZUs is a disposal of the NZUs. This event triggers the available deduction for cost under the revenue account property rules.
62. Therefore, if the land in respect of which the pre-1990 forest land NZUs were granted was held on capital account, the person has no income on the deemed sale at market value, no income on the surrender of the NZUs, and a market value deduction for the cost of the new NZUs on disposal. Ultimately, the forester in this situation receives a net deduction, similar to any other person who has to acquire NZUs for surrender.
63. If the land in respect of which the pre-1990 forest land NZUs were granted was held on revenue account, this treatment results in income on the deemed sale at market value, no income on the surrender of the NZUs, and then a market value deduction for the cost of the new NZUs on disposal. Ultimately this forester is in a neutral tax position (because the deductible cost of the new NZUs is deemed to be the same value as the income on deemed disposal).

What deductions are available

64. The availability of a deduction for the acquisition of an NZU depends on the type of NZU acquired.

Forest land NZUs

65. Under s DB 60, where NZUs are transferred to foresters for removal activities, pre-1990 forest land, or under a permanent forest scheme, the forester is not allowed a deduction for any expenditure or loss incurred as consideration (if any) for the NZU. Therefore, the 'cost' of acquiring these NZUs (if any) is not deductible.¹⁰
66. Section DB 60B provides that a forester who is liable for emissions (eg, due to clearing or deforestation) is denied a deduction for that liability.
67. Therefore, a forester does not have any deductions in respect of NZUs earned for removal activities. They do not receive a deduction for the cost of the NZU on sale or surrender because the NZUs are valued at zero for tax purposes. They also do not receive a deduction for any emissions liabilities.

Purchased NZUs

68. Generally, under the matching rules in subpart ED, a deduction is not available for the acquisition cost of NZUs until the NZUs are disposed of (eg, by way of sale or

¹⁰ Section 64 of the CCRA applies in relation to the issue of NZUs to foresters for removal activities. Part 4, subpart 2 of the CCRA related to pre-1990 forest land units.

surrender). However, different treatment applies for purchased NZUs that are replacement forest land NZUs.

Replacement forest land NZUs

69. A “replacement forest land emissions unit” is an NZU that the person acquired if they:
- previously disposed of a post-1989 forest land NZU (other than through surrender under the CCRA); and
 - have not previously acquired another NZU to replace the NZUs that were disposed of.
70. Deductions for the cost of these NZUs are available at the time of acquisition. Effectively, this recognises that the disposal of the post-1989 forest land NZUs (other than by way of surrender) would have resulted in taxable income to the forester. The key factor is that the NZUs are acquired to replace post-1989 forest land NZUs that were disposed of, and no previous replacements have been acquired since the disposal.
71. If a forester has acquired replacement forest land NZUs, the deductibility of the acquisition cost of these NZUs would fall under ordinary principles. Generally, this would be deductible as an expense incurred in carrying on a forestry business for the purpose of deriving income under s DA 1.
72. A replacement forest land NZU is valued at zero at the end of the year (s ED 1(7B)). The difference with other forest land NZUs is that in this case the forester has paid an amount to acquire the replacement NZU (and a deduction for that cost is not disallowed under s DB 60). Therefore, the revaluation of the replacement NZU to zero at the end of the year means the deduction is generated in the year of purchase under the matching rules. That is, the deductible cost is the amount the person paid to acquire the NZU, and the income at the end of the year to offset that cost is zero. This treatment applies only for NZUs that meet the definition of a replacement forest land NZU.
73. For example, the following scenarios would not qualify as a replacement forest land NZU:
- purchasing more NZUs where post-1989 forest land NZUs had not been sold or where replacement NZUs have already been acquired;
 - acquiring land or a forest with an emissions liability, where the forester is required to purchase NZUs for that emissions liability; or
 - the sale of pre-1990 NZUs and acquisition of NZUs to satisfy an emissions liability.

Summary of general tax treatment of NZUs

- 74. There is no tax liability in the year of receipt of forest land NZUs (or while they remain on hand) as these NZUs are treated as being valued at zero while they are held by the forester.
- 75. There is a tax liability for the sale of any forest land NZUs on the full amount received for the sale. There is no deduction for the cost of the forest land NZU (as it is held at zero), so the full sale proceeds are taxable.
- 76. There is no tax liability when NZUs are surrendered for emissions liabilities under the CCRA. Generally, this is deemed to occur for a value of zero (when surrendered in relation to post-1989 forest land).
- 77. Generally, no deductions are available to foresters for any costs of forest land NZUs they earn for removal activities, or for their emissions liabilities. A forester can receive a deduction in the year of purchase only if they acquire replacement forest land NZUs. In other cases where a forester buys NZUs, but which are not replacement forest land NZUs, the deduction is delayed until disposal.
- 78. A summary of the general tax treatment is provided in Figure | Hoahoa 3.

Figure | Hoahoa 3 – Summary of tax treatment of NZUs for forestry activities

Type of NZUs	Acquisition and year end	Surrender	Sale or transfer	Timing of deductions
Pre-1990 forest land NZUs	On allocation, NZUs were exempt income. Valued at zero at the end of the income year.	Generally, no income tax consequences on surrender, as valued at zero when surrendered. If surrendered for post-1989 forest land, special rules apply (see from [60]).	If the land is held on capital account, the amount received from the sale of NZUs is excluded income. If the land is held on revenue account, the amount received from the sale of NZUs is taxable.	No deductions are available.

<p>Post-1989 forest land NZUs</p>	<p>No income tax consequence in the year of receipt.</p> <p>Valued at zero at the end of the income year.</p>	<p>No income tax consequences on surrender, as valued at zero when surrendered for post-1989 forest land.</p>	<p>The amount received from a sale is taxable.</p>	<p>No deductions are available.</p>
<p>Replacement forest land NZUs</p>	<p>These NZUs are purchased.</p> <p>Valued at zero at the end of the income year.</p>	<p>No income tax consequences on surrender, as valued at zero when surrendered for post-1989 forest land.</p>	<p>To qualify as replacement forest land NZUs these are acquired to replace post-1989 NZUs and would be required for surrender</p> <p>However, if sold the amount received is taxable.</p>	<p>The cost of purchasing NZUs is deductible.</p> <p>A deduction for the cost of these NZUs is available in the income year in which purchased.</p>
<p>NZUs acquired on the market or at auction</p> <p>includes forest land NZUs that lose their status due to transfer</p>	<p>These NZUs are purchased.</p> <p>Valued at cost at the end of the income year.</p>	<p>Valued at zero when surrendered for post-1989 forest land</p>	<p>The amount received from a sale is taxable.</p>	<p>The cost of purchasing NZUs is deductible.</p> <p>A deduction for the cost of NZUs is available only at the time of disposal (surrender or sale).</p>

79. The above concepts are illustrated in Example | Tauria 2 and Example | Tauria 3.

Example | Tauria 2 – Harvest of post-1989 forest (stock change accounting)

Flo’s Forestry Ltd owns an ETS registered standard post-1989 forest and uses stock change carbon accounting. The forest is 28 years old and is harvested in January 2024.

Flo’s Forestry Ltd received 10,000 NZUs for removal activities. The receipt of these NZUs is valued as being zero at the end of each income year up until the year of disposal.

Flo’s Forestry Ltd was required to surrender 8,000 NZUs for emissions liabilities at the time of harvest. The 8,000 NZUs surrendered are deemed to be sold for zero. No deductions are available in respect of the cost or surrender of the NZUs or for any emissions liabilities.

The remaining 2,000 NZUs were sold on the market. An NZU had a market value of \$64 at the time of sale.

Flo's Forestry Ltd will have an income tax liability for the year ended 31 March 2024 for the amounts received from the sale of 2,000 NZUs on the market, which was \$128,000. The full amount received is taxable because no deductions are available for the cost of the NZUs.

Example | Taura 3 – Replacement forest land NZUs

Ray's Radiatas Ltd owns an ETS registered standard post-1989 forest and uses stock change carbon accounting. The forest is 18 years old as at February 2024 and is not due to be harvested for several years.

Ray's Radiatas Ltd received 16,000 NZUs for removal activities. The receipt of these NZUs is valued as being zero at the end of each income year up until the year of disposal.

Ray's Radiatas Ltd needed funds, so sold half the NZUs on the market. An NZU had a market value of \$64 at the time of sale.

In March 2024, 8,000 NZUs were sold for \$512,000. Ray's Radiatas Ltd will have an income tax liability for the year ended 31 March 2024 for this amount. The full amount received is taxable because no deductions are available for the cost of the NZUs.

Before harvest, Ray's Radiatas Ltd needs to acquire a sufficient amount of NZUs to fund its emissions liability. Those NZUs will be replacement forest land emissions units. In the income year of acquiring those NZUs, a deduction is available for the cost of those units.

In the income year of surrender, the NZUs surrendered (whether they are post-1989 forest land NZUs or replacement forest land NZUs) will be treated as being sold for an amount of zero and no income tax liability will arise.

Specific events or transactions

80. This part of the statement considers common transactions and events that may arise for foresters who have ETS registered forestry activities. These transactions and events are:
- forestry rights agreements;

- deregistering from the ETS and changing forestry activities;
- sales of ETS registered forests, along with NZUs; and
- sale and repurchase agreements for NZUs and off-take arrangements.

Forestry rights agreements

81. Under the Forestry Rights Registration Act 1983, a landowner can grant a forestry right to themselves or a third party.
 82. The forestry right may be to establish, maintain and harvest a crop of trees on the land. The forestry right may also grant access rights and the use of tracks and bridges. It may also provide for charges, payments, royalties or division of the crop, including the right to receive and obligation to surrender NZUs.
 83. Under these agreements, only one party (either the landowner or the rights holder) can register under the ETS and receive the NZUs generated by the forest and be liable for any emissions. The parties to such an agreement should ensure the rights and obligations regarding NZUs are covered in that agreement. Section 182A of the CCRA specifies that only the landowner of the land, the holder of a registered forestry right or the leaseholder of a registered lease may be registered as an ETS participant. Where a forestry rights agreement exists, both parties must agree in writing which relevant party is to register as the participant.
 84. Where a person is a rights holder under a forestry rights agreement, they can receive a transfer of NZUs from the other party in accordance with the agreement without tax consequences. The s YA 1 definition of a “post-1989 forest land emissions unit” includes an NZU that is transferred by one party to the other party to a forestry rights agreement, where the transfer occurs under a provision of the forestry rights agreement relating to the allocation of income or emissions units between the parties. This means that, unlike other disposals, a post-1989 forest land NZU retains its status when transferred in accordance with a forestry rights agreement. Therefore, the provisions applying to post 1989 forest land NZUs (as discussed earlier) also apply to transferees under a forestry rights agreement.
 85. The disposal of an NZU under a forestry rights agreement is subject to s CB 36. Generally, any amount received for that disposal is income to the transferor of the NZU. However, if the NZUs are transferred for no amount in accordance with the forestry rights agreement, no deemed income arises under s GC 1. This is because s GC 3B excludes from s GC 1 the transfer of a forest land NZU to a party to a forestry rights agreement as required by that agreement.
 86. For completeness, entering into forestry rights agreements has income tax consequences more generally (other than in relation to ETS issues) and parties to such agreements should seek advice.
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Example | Tauria 4 – Forestry rights agreement

Farmer Frank Ltd has three farms across the North Island that contain several hectares of marginal farmland unsuitable for grazing. Farmer Frank Ltd enters into a forestry rights agreement with Cara's Carbon Farm Ltd, under which Cara's Carbon Farm Ltd will establish, maintain and harvest the forests on that land. The agreement specifies that Cara's Carbon Farm Ltd is the relevant ETS participant.

Under the forestry rights agreement, Cara's Carbon Farm Ltd will pay Farmer Frank Ltd for the grant of the forestry right, and Cara's Carbon Farm Ltd will receive all NZUs and be liable for any ETS obligations.

If any NZUs are transferred in accordance with the forestry rights agreement for no consideration, they retain their status as post-1989 forest land NZUs and no income tax obligations arise from the transfer of those NZUs.

Deregistration and changing forestry activities

87. Various surrender obligations arise under the CCRA when a forester changes their activity, whether they deregister all or part of their land from the ETS, change the type of forestry activity they are undertaking, or change their carbon accounting methods.

Deregistering from the ETS

88. Section 186 of the CCRA applies when a person ceases participation in a forestry activity. This section applies whether the person is ceasing to be a participant in the ETS altogether or is removing a particular area of land or part of an area from the ETS.¹¹ The person is liable to surrender the number of NZUs equal to the unit balance of the area that is removed from the ETS.¹²
89. Section CB 36 explains how to value a surrender of NZUs under the CCRA. Under s CB 36(4), the surrender of an NZU for post-1989 forest land is valued at zero. However, if a post-1989 forest land NZU is surrendered for something other than an emissions liability, it is treated as having been sold for market value (s CB 36(6)).
90. Sections 186, 186A and 186B of the CCRA provide for the surrender liability where a person ceases participation in the ETS (for either the whole or part of the land). These provisions do not deem that surrender to be for an emissions liability on the forest

¹¹ A participant could remove a whole carbon accounting area (CAA) or part of a CAA (s 186B and 186D CCRA). Where there is a part removal, there may be emissions liabilities and also a requirement to surrender the unit balance for that area.

¹² Section 186A of the CCRA.

land. As a comparison, a person transferring between forestry categories (eg from standard forestry to permanent forestry) is specifically deemed to have an “emissions liability” from the land under s 189G(4) of the CCRA.

91. Therefore, if a person deregisters from the ETS, the surrender of post-1989 forest land NZUs that arise from deregistration is treated as being sold for market value under s CB 36(6). This means that, despite not receiving anything for that deemed sale, the person has to account for tax as if they had sold those NZUs.
92. It is important to note that a deregistration liability is different to an emissions liability that arises if a forest is cleared (and NZUs must be surrendered) prior to deregistration.
93. Ultimately, the surrender liability for deregistering from the ETS is tax neutral. As noted earlier, foresters are specifically denied a deduction for emissions liabilities under s DB 60B. This includes liabilities for surrendering NZUs from clearing a forest or for deforestation. As noted above, the liability to surrender NZUs for deregistering from the ETS is separate to a surrender liability for clearing or deforestation and is not deemed to be for an “emissions liability”. This means foresters can deduct the liability for surrendering NZUs on deregistration. This liability will arise at the time the forester deregisters the land from the ETS.
94. The fact deductions are expressly disallowed for this expenditure under s DB 60B for emissions liabilities relating to post-1989 forest land indicates that in other cases such amounts are permitted as deductible expenditure. The exclusion for emissions for post-1989 forest land was put in place because the surrender liability for those NZUs is treated as occurring at a price of zero (s CB 36(4)). This deduction on deregistration would arise under the general permission in s DA 1, as being an amount of expenditure for which the forester is definitively committed (at the time the liability arises – that is, when the forester gives notice that they are removing the land or ceasing to be a participant in the ETS) in the course of carrying on a business for the purpose of deriving income.
95. Therefore, foresters who deregister from the ETS and have a surrender liability for NZUs as a result of deregistering will, ultimately, have a neutral tax liability. While they are deemed to receive income equivalent to the market value of the NZUs surrendered, this is offset by the deduction for the liability to surrender those NZUs.
96. As noted, any liability to surrender NZUs that arises for deregistration is separate to a liability that arises on clearing or deforestation. No deductions are available for liabilities that arise on clearing or deforestation that occurs prior to deregistering.

Transferring interests

97. If an ETS registered participant transfers their forestry interest to another person, the transferor is liable for any obligations that arose while they were participant in respect

of the transferred interest.¹³ They must submit a final forestry emissions return up until that date.¹⁴ The transferee will become the relevant participant from the date of transfer and will be liable for any obligations after that time.

98. Figure | Hoahoa 4 summarises the main types of transfers of interests of ETS registered forestry activities that could occur and the effect for the new participants.

Figure | Hoahoa 4 – Transfers of interests under the ETS

ETS participant	Interest transferred	New ETS participant	New forestry activity
Landowner of post-1989 forest land	Sale of post-1989 forest land	New landowner	Owning post-1989 forest land
	Grant of registered forestry right	Forestry right holder (if parties agree and MPI is notified) ¹⁵	Holding a registered forestry right over post-1989 forest land
	Grant of registered lease	Lessee (if parties agree and MPI is notified)	Being a lessee under a registered lease of post-1989 forest land
Holder of a registered forestry right over post-1989 forest land	Transfer of registered forestry right	New forestry right holder	Holding a registered forestry right over post-1989 forest land
	Termination of registered forestry right	The landowner of the post-1989 forest land	Owning post-1989 forest land
Leaseholder under a registered lease of post-1989 forest land	Transfer of interest in registered lease	New lessee	Being the leaseholder under a registered lease of post-1989 forest land
	Termination of registered lease	The landowner of the post-1989 forest land	Owning post-1989 forest land

99. As stated previously, transfers of forest land NZUs that may occur during transfers of forestry interests generally lose their status for tax purposes (except in accordance with

¹³ This may be referred to as a transfer of participation.

¹⁴ Section 187 of the CCRA

¹⁵ MPI administers the forestry section of the ETS under delegated authority from the EPA.

a forestry rights agreement) and are required to be treated by the new participant in the same way as NZUs acquired from the market or at auction.

Changing forestry activities

100. In addition to deregistering from the ETS or transferring interests to another person, participants can also apply to change their activity.
101. Under s 189 of the CCRA, a participant with an initial activity of standard forestry or permanent forestry can apply to become a participant in standard forestry or permanent forestry. A change in activity carries over the unit balance from the initial activity to the final activity and a final emissions return needs to be submitted. Different liabilities arise depending on what the initial forestry activity was and what the new forestry activity will be.
102. However, there are restrictions in a change of activity if a person is registered for carrying out permanent forestry activities. The permanent forestry period is initially 50 years with an option to renew for a further 25 years (or further consecutive periods). This does not change if the land is transferred to another person. Examples of when a person can cease being registered for a permanent forest include:
 - if the Minister of Climate Change approves;
 - because of certain natural events;¹⁶ or
 - if a transferee takes over that permanent forestry registration.
103. After the 50-year permanent forestry period ends, the person can extend the period for 25 years or can apply to be removed from the ETS or to transfer to standard forestry. On removal from the ETS or transfer to standard forestry, there are emissions liabilities the forester must meet.
104. Emissions liabilities may also arise in other cases, for example if the type of trees grown changes (because different trees sequester carbon at different rates). This may occur if, for example, a permanent exotic forest is being transitioned into indigenous forests.
105. In these cases, there will be liabilities to surrender NZUs for emissions. As previously noted, under s CB 36, where NZUs are surrendered in relation to post-1989 forest land they are treated as being sold for zero.

Changing accounting methods

106. While most foresters with post-1989 forest land currently use stock change accounting, the averaging accounting method applies to forests registered after 31 December

¹⁶ Section 182G of the CCRA.

2022. This carbon accounting method accounts for emissions and removals by reference to the expected long-term average level of carbon stock of the land over multiple rotations rather than by referring to short term changes in the actual carbon stock which is the method used in stock change accounting.¹⁷

107. Prior to 30 June 2023, a participant using stock change accounting could opt into averaging accounting for carbon accounting areas where the first ETS registration had occurred after 1 January 2019.¹⁸ These participants needed to file an emissions return specifying the emissions and removals during the period and calculating the liability or entitlement as if they had used averaging during the period. If the difference was positive the person received additional NZUs. If the difference was negative the person must surrender those NZUs.
108. Permanent forests that move into standard forestry are required to apply averaging accounting.
109. As with the above, there will be liabilities to surrender NZUs for emissions resulting from any change in carbon accounting treatment. As previously noted, under s CB 36, where NZUs are surrendered for emissions for post-1989 forest land they are treated as being sold for zero.

Summary

110. The CCRA establishes the consequences for a forester deregistering from the ETS, transferring interests, swapping between categories, or changing accounting methods. In these cases, often a final emissions return is required with the CCRA specifying calculations for the amount of NZUs that may need to be surrendered (and in some cases any penalties).
111. In these cases, where NZUs are surrendered because of a change in activity, they are classed as an emissions liability for post-1989 forest land and this is deemed to occur for a value of zero under s CB 36. Whether the NZUs surrendered are forest land NZUs, replacement forest land NZUs or standard NZUs determines what deductions may be available and the timing of those deductions (as discussed earlier in this statement).

Sales of forests – purchase price allocation rules

112. The purchase price allocation rules in ss GC 20 and GC 21 require parties to a sale and purchase of a forest along with other assets to adopt the same allocation of the purchase price to the various classes of assets sold. These rules do not apply if the sale

¹⁷ Section 191A of the CCRA.

¹⁸ Clause 33 of schedule 1AA of the CCRA.

of the forest does not contain different classes of assets (for example if there was a sale of a forestry right with the only asset sold being standing timber).

Summary of the purchase price allocation rules

113. Section GC 20 applies where the parties have agreed how the consideration will be allocated. Section GC 21 applies where the parties have not agreed on allocation and a unilateral allocation is made.
114. Sections GC 20(1) and GC 21(1) provide that the sections apply when, for consideration, a vendor disposes of items of property to a purchaser that fall into two or more classes of purchased property. Those classes are:
- (i) trading stock, other than timber or a right to take timber
 - (ii) timber or a right to take timber
 - (iii) depreciable property, other than buildings
 - (iv) buildings that are depreciable property
 - (v) financial arrangements
 - (vi) purchased property for which the disposal does not give rise to assessable income for the vendor or deductions for the purchaser.
115. Under s GC 20, the parties agree and record the consideration allocated to each class of purchased property. This must occur before either party files a return in relation to the property. Each class of purchased property is treated as disposed of and acquired for the relevant allocated amount.
116. Section GC 21 applies where there has not been agreement before the relevant dates. The amounts are allocated as follows:
- The vendor may notify the purchaser and the Commissioner of the allocated amounts within 3 months of the change in ownership of the property. The amounts allocated must be the greater of the relative market value of the class of property proportional to the other classes or property, or their tax book value for the relevant class of property.
 - If the vendor does not notify the allocated amounts, the purchaser may notify the vendor and the Commissioner of the relevant allocated amounts within 6 months of the change of ownership of the property. An allocated amount must reflect the relative market value of the relevant class of purchased property proportional to the other classes of property.
117. Section GC 20(2) and s GC 21(7) provide that a class of purchased property is treated as disposed of and acquired for the allocated amount.

118. Under s GC 20(2)(b), the Commissioner may treat a class of property as disposed of and acquired for an amount that reflects the relative market value of the class of purchased property, proportional to the other classes of purchased property, if the Commissioner considers the allocated amount does not reflect that value.

Interaction with s GC 1

119. The purchase price allocation rules operate to allocate the agreed purchase price between the relevant classes of purchased property. The rules do not apply to substitute a new purchase price.
120. Section GC 1 applies to disposals of trading stock for less than market value and deems the vendor to have derived market value consideration. However, the section applies only if the parties are associated, the trading stock is taken for the vendor's own use, or the disposal of trading stock is not made in the course of carrying on a business for the purpose of deriving income.
121. Section GC 1(5) further provides that the section does not apply to a disposal of trading stock to which s GC 20(2) or s GC 21(7) apply. Therefore, when those sections apply, it is the allocations made under the purchase price allocation rules that are relevant and no further amounts of consideration need to be accounted for.
122. However, there are exclusions to this where the transaction occurs between associated persons. Section GC 20(2B) and s GC 21(11B) specifically provide that ss GC 20(2) and GC 21(7) do not apply where property in class (i) trading stock or in class (ii) timber or a right to take timber are sold:
- between associated persons; and
 - the allocated amount for the class of purchased property is less than the total market value of the items of purchased property in the class of property at the time of the disposal.
123. Therefore, a transaction between associated persons must allocate market value to all items of trading stock or timber or a right to take timber. If not, s GC 1 will apply to deem there to be market value consideration. Associated parties to a forestry transaction that is subject to the purchase price allocation rules should obtain a valuation to support their allocation of value to each class of purchased property.

Meaning of trading stock

124. For the purposes of s GC 20 and GC 21, "trading stock" is defined in s YA 1 as including:
- anything acquired for the purposes of manufacture or disposal;

- land whose disposal would produce income under any of sections CB 6A to CB 15 and CZ 39 (which relate to income from land);
 - anything for which expenditure is incurred and would be trading stock if possession of it were taken.
125. NZUs are not ordinarily “trading stock”. They are explicitly excluded from being trading stock for the purposes of the trading stock rules in subpart EB. However, the definition of trading stock is broadened in some cases.
126. Section GC 3B provides that NZUs are treated as if they were trading stock for the purposes of s GC 1. This could imply that otherwise NZUs are not trading stock (given the exclusion in subpart EB). However, the definition in s YA 1 includes “anything acquired for the purposes of ... disposal”. In most cases, NZUs would be acquired by a forester for the purpose of disposal. The relevant purposes generally being for surrender for emissions liabilities or for sale on the market.
127. Therefore, generally, the parties to a sale and purchase of a forest need to agree an allocation of a purchase price between (where relevant):
- NZUs (trading stock in asset class (i));
 - timber or a right to take timber (asset class (ii)); and
 - capital account land (asset class (iv)).

NZUs acquired for surrender

128. Issues arise regarding the allocation of part of the purchase price to NZUs that are acquired for surrender. The surrender obligation may only be a contingent liability at the time of sale.
129. Generally, a forest’s fair value would be reached by calculating the discounted future cashflows from the forest. This could involve including the future NZU entitlements and the obligation to surrender NZUs on harvest (if applicable) in the value of the timber. If this valuation methodology is used, then the future obligation to surrender NZUs is accounted for in the value of the timber and cannot be used to value NZUs on hand as being nil. Those NZUs must be allocated market value.
130. However, it is not so clear how to account for NZUs when the valuation of the trees excludes any NZU entitlements and liabilities. A purchaser of a forest with NZUs may not want to pay anything to acquire NZUs that must soon be surrendered on harvest. This would factor into the agreed purchase price for the transaction.
131. Several different situations can apply in the context of the sale of a forest, generally depending on what the purchaser intends to do with the forest, including the following examples:

- If the purchaser acquires or plans to register a forest as a permanent forest, the only income generated from the forest is the NZUs. Whether any emissions liability exists depends on whether the trees will be cleared after the 50 years of being in the permanent forest regime.
 - If the purchaser uses averaging accounting and the land remains forest land, there will be no emissions liability (at least until the time where the land becomes unviable for further rotations).
 - If the purchaser uses averaging accounting and intends to deforest, then the liability will arise on deforestation.
 - If the purchaser uses stock change accounting, they will have a liability when they clear the forest.
 - Where a forest is sold shortly before harvest, the surrender liabilities may be considered to no longer be contingent (if the forest uses stock change carbon accounting). If a future surrender liability is sufficiently certain to be an actual liability at the time of the purchase, for the purposes of s GC 20, the liability amount may be taken into account in the total amount of consideration payable for the forest.
132. There is no single correct answer to what an appropriate purchase price allocation may be for the sale of a forest because there are many variables. It is recommended that parties obtain tax advice when undertaking a purchase price allocation and that they have sufficient supporting evidence (such as valuations) to support their allocation of value to each class of purchased property. However, where the parties to a transaction are associated, they will need to allocate market value to purchased property that is timber, a right to take timber and trading stock (such as NZUs) under ss GC 20(2B), GC 21(11B) and GC 1.
133. Examples of what may be considered appropriate allocation methods of the purchase price in particular fact situations are set out below. For the avoidance of doubt, the transactions in these examples occur between arm's length parties, and reflect commercially negotiated terms.

Standing timber is valued on a discounted cash flow basis and full market value is attributable to NZUs

134. One possible allocation method would have standing timber valued on a discounted cash flow basis and full market value attributable to NZUs. Under this method, the NZUs to be surrendered on harvest are included in the cost of harvest (ie, it would be accounted for as a reduction in the value of the timber when the value at harvest is being calculated). If so, it would not be appropriate to value the NZUs at nil because the cost of surrender is included in the value of the timber.

Example | Tauria 5 – Emissions liabilities accounted in value of timber

Flo's Forestry Ltd was planning to increase its forestry interests and entered a series of sale and purchase agreements to buy forestry blocks.

The first agreement was for the purchase of a standard forestry block from Timmy's Trees Ltd for total cash consideration of \$100. The forest was registered using stock change accounting and would be harvestable in 10 years' time. The standing timber had been valued by a registered valuer, with reference to the emissions liability at harvest on a discounted basis.

Flo's Forestry Ltd and Timmy's Trees Ltd agreed to a purchase price allocation of the \$100 purchase price among the classes of purchased property as follows:

- class (i) trading stock (NZUs) 10
- class (ii) timber 70
- class (vi) capital account land 20

The NZUs must be attributed a market value because the value of the timber already takes into account the emissions liability at harvest.

Timmy's Trees Ltd will have income tax obligations for \$80 on sale (timber and NZUs). Flo's Forestry will be able to deduct the purchase price allocated to the timber (\$70) and the NZUs (\$10) at the time of disposal.

Allocate nil value to NZUs to the extent that they need to be surrendered at harvest due to purchase price negotiations

135. Another allocation method that may be available in some situations may be to allocate nil value to NZUs to the extent that they need to be surrendered at harvest. This is where the purchaser is unwilling to pay for the NZUs that would be required for surrender, which are effectively offset by the future liability on the purchaser to surrender those NZUs.
136. This option may be available in some situations where, as part of the commercial negotiations, the purchaser is not willing to pay an amount for the NZUs required for surrender and this is reflected in the purchase price paid. The parties will need to be able to provide sufficient evidence supporting their allocations. This could include details of the negotiations, the valuations of the land and timber and may be supported by accounting treatment. In this situation, the purchase price amount would need to be consistent with the valuation of the timber and land excluding NZUs.

Example | Tauria 6 – Imminent liability offset against NZU value

Flo's Forestry Ltd entered a second sale and purchase agreement with Timmy's Trees Ltd to acquire a second standard forestry block for total cash consideration of \$120.

This forestry block was also registered as a standard forest using stock change accounting. This forest was harvestable in 1 year's time. Flo's Forestry Ltd planned to harvest and then replant with indigenous species and register the forest in the permanent forestry regime.

The valuer for this forest did not take into account ETS obligations when valuing the timber. Flo's Forestry required the transfer of a sufficient number of NZUs for surrender as part of the negotiations, but was not prepared to pay anything for these NZUs.

Flo's Forestry Ltd and Timmy's Trees Ltd agreed to a purchase price allocation of the \$120 purchase price as follows:

- class (ii) timber 100
- class (vi) capital account land 20

Timmy's Trees Ltd will have income tax obligations of \$100 for this sale (attributable to the timber). Flo's Forestry Ltd will be able to deduct the same purchase price allocated to the timber at the time of disposal. Flo's Forestry Ltd will not be able to deduct anything at the time of surrender of NZUs.

Timmy's Trees Ltd and Flo's Forestry Ltd should keep records of their negotiations and the valuations to support their agreed allocation.

137. If there is no clear surrender obligation (for example for a permanent forest or a forest using averaging accounting) the market value of NZUs should always be taken into account. Similarly, for a forest using stock change accounting, NZUs should be allocated value unless there is a clear surrender obligation and the amounts are reflected in the negotiated purchase price, accounting treatment and in a valuation.

Example | Tauria 7 – NZUs with no clear surrender obligation

Flo's Forestry Ltd and Timmy's Trees Ltd entered a third sale and purchase agreement where Flo's Forestry Ltd acquired a standard forest that uses averaging accounting for \$150.

Flo's Forestry Ltd planned to replant the forest after harvest for at least three rotations so would not have surrender liabilities.

Due to there being no surrender obligation under averaging accounting, Flo's Forestry Ltd is prepared to pay a higher purchase price and utilise the NZUs in repurchase arrangements.

Flo's Forestry Ltd and Timmy's Trees Ltd agreed to a purchase price allocation as follows:

- class (i) trading stock (NZUs) 30
- class (ii) timber 100
- class (vi) capital account land 20

Timmy's Trees Ltd will have income tax liabilities of \$130 on the sale of timber and NZUs. Flo's Forestry Ltd will be able to deduct the purchase price allocated to the timber (\$100) and the NZUs (\$30) at the time of disposal.

138. It can be seen from the above that there is no particular method that must be applied for allocating the purchase price among the assets in a sale of a forest. It is fact dependent.
139. The Commissioner generally accepts purchase price allocations that follow generally accepted industry treatment or valuation methodologies. However, it is acknowledged that in the forestry context there may not be generally accepted treatment. The important point is that both parties are consistently allocating the same amount to the same assets and that appropriate values are allocated between (for example) capital and revenue amounts.

Note for submitters – we are particularly interested in hearing about how you apply the purchase price allocation rules to sales of forests, and any practical issues. For example, how do you apply the market value requirement for sales between associated persons?

Repurchase arrangements involving NZUs and offtake arrangements

140. NZUs may be used in a variety of different arrangements and parties may structure these arrangements in different ways. This part of the statement provides general information on repurchase and offtake arrangements.
141. Due to the differing fact situations that exist, the Commissioner cannot provide general advice on these arrangements. Foresters who would like certainty on their tax treatment should seek advice and may wish to consider applying for a private ruling or

a short process ruling to confirm their tax treatment. For information on applying for a ruling, see: [short-process-rulings](#).

Repurchase arrangements

142. Some common transactions are NZU repurchase arrangements, which can occur through:
- a transfer of NZUs as a loan with the payment of a fee and repayment of NZUs in the future (a lending transaction), or
 - a sale with a specified buy-back in the future (a repurchase transaction).
143. In either situation, the initial transfer (whether this occurs as a sale or a loan) is treated as a disposal of the NZUs for tax purposes.
144. Section CB 36 provides that amounts derived from the disposal of emissions units are income. The ordinary meaning of "disposal" means to get rid of something. The High Court of Australia in *McGain v FCT* (1966) 14 ATD 190 held that a loan of cash involves the disposal of property. The court said that gifts, loans and sales all involve a disposition. This decision was approved by the New Zealand Court of Appeal in *Rossiter v CIR* (1976) 2 NZTC 61,197.
145. In the context of share lending, in an Australian case (*Lift Capital Partners Pty Ltd v Merrill Lynch International* (2009) 253 ALR 482 (NSWSC)) it was similarly said:
- [84] The concept here is that one person "disposes" of securities to another person and later either "re-acquires" those securities from that other person or "acquires" identical securities from that other person. In either case, there is an initial transfer of ownership by the "lender" to the "borrower" and a subsequent transfer of ownership (of either the same or identical securities) by the "borrower" to the "lender". ...
146. Therefore, with either a lending or repurchase transaction involving NZUs, there is a disposal and then a subsequent reacquisition of NZUs. The share lending rules in the ITA 2007 do not apply to treat the sale and repurchase as a loan, because NZUs are not shares.

Pre-1990 forest land NZUs

147. Specific rules apply to transactions involving pre-1990 forest land NZUs but these rules are restricted to only those types of NZUs.
148. Section EW 5(11C) provides that an arrangement is an excepted financial arrangement that is subject to s EW 52 where it involves the use of pre-1990 NZUs as security for a lending arrangement. That is, as part of a financial arrangement that is a loan to the holder by the other person, there is:

- the assignment of a pre-1990 forest land NZU by the holder to a non-associated person, and;
 - the later assignment of an NZU back to the original holder by that other person.
149. Section EW 52B provides that the holder is treated as continuing to hold a pre-1990 forest land NZU during the arrangement. The returned NZU is treated as being the original pre-1990 forest land NZU and its cost is treated as the cost of the original NZU. This provision overrides subpart ED in respect of allocating values to the NZUs. However, the rules require a timely return of the NZU to the holder and a failure to do so will result in these rules not applying.
150. The effect of these provisions is that where a person lends pre-1990 forest land NZUs as security, no income tax consequences arise from any disposals and reacquisitions of those NZUs. The original holder is treated as remaining the holder of a pre-1990 forest land NZU (and it does not lose that status when NZUs are returned to the holder).
151. Any fees payable to the holder for the transaction are taxable income under ordinary principles (s CA 1(2)).

Other types of NZUs

152. There are no rules similar to s EW 52B that apply to other types of NZUs. Any amounts received for the disposal are taxable under s CB 36. If no amounts are received for the disposal, s GC 1 may apply to deem a market value amount to be derived, unless the exception applies where the transaction occurs in the course of carrying on a business and the parties are not associated.
153. Any fees payable to the person lending the NZUs are income to the lender under s CA 1(2) when derived. These amounts are not “interest” for tax purposes because they are not paid for money lent. The disposal of the NZUs also crystallises any deduction available to the lender (although if the NZUs lent were forest land NZUs then the available deduction is zero).
154. Importantly, the disposal of NZUs under such an arrangement will mean that, on receiving equivalent NZUs back in the future, they will not be classed as “post-1989 forest land emissions units”. The NZUs lose their status, which may have tax consequences.
155. The other party to the transaction (the borrower) will be entitled to an upfront deduction for the cost of acquiring the NZUs under the arrangement to the extent that an amount is paid for the NZUs and to the extent that the NZUs are a replacement forest land NZU for that person (that is, they are acquired for surrender for an emissions liability as a replacement for a forest land NZU).

156. In summary, foresters who enter NZU repurchase arrangements need to carefully consider the consequences of such arrangements. The consequences depend on the particular contractual terms the parties have entered into. Most relevantly, the NZUs will lose their status as post-1989 forest land NZUs which may have tax consequences.
157. Any amounts paid under the arrangement to acquire NZUs are taxable to the recipient and deductible to the payer (the timing of deductions depend on the type of emissions units being purchased).
158. For completeness, because NZUs are excepted financial arrangements under s EW 5(3B), the financial arrangements rules do not apply to any gains or losses resulting from the change in value of the NZUs over the period of an NZU repurchase arrangement that are solely attributable to the NZUs. This would also turn on the terms of the contractual arrangements.
159. The following example illustrates the above concepts. How the tax rules apply to any particular arrangement depends on the particular facts and contractual terms the parties enter into. Due to the differing fact situations that may exist, the Commissioner cannot provide general advice on how the tax laws apply to these arrangements.

Example | Taura 8 – Sale and repurchase of NZUs

Ray's Radiatas Ltd from Example | Taura 3 needed NZUs for surrender in May 2024. Ray's Radiatas Ltd expected to earn NZUs in the future from a younger forestry block.

Flo's Forestry Ltd had excess NZUs available and agreed to provide these to Ray's Radiatas Ltd under a sale and repurchase agreement.

In April 2024, Flo's Forestry Ltd agreed to provide Ray's Radiatas Ltd 500 NZUs in return for Ray's Radiatas Ltd providing 500 NZUs in 3 years' time. Ray's Radiatas Ltd paid a fee for the use of the NZUs.

Any gain or loss attributable to the value of the NZUs is solely attributable to the NZUs and is not taken into account under the financial arrangements rules. The fee is taxable income. Depending on how the arrangement is structured the fee may be income from a financial arrangement, or may be subject to ordinary principles.

The lending arrangement was a deal between non-associated parties made in the course of carrying on their respective businesses. Therefore, s GC 1 does not apply.

NZU off-take arrangements

160. Foresters may also undertake NZU off-take arrangements. An off-take arrangement involves a person who requires NZUs for surrender agreeing with a forester to acquire a certain amount of NZUs at a particular time for a payment. These agreements could

be structured in different ways, for instance this could involve a forester agreeing to provide NZUs as they are earned, or a certain amount per year, or in lump sums at certain times.

161. The tax treatment of these arrangements depends on the particular facts. The financial arrangements rules may apply (although any changes in value of the NZUs is solely attributable to an excepted financial arrangement). There may be issues with the timing of derivation of income, depending on the relationship between when payments are made and when NZUs are provided.
162. This statement cannot provide general guidance on these arrangements because the tax consequences depend on how the deals are structured. Foresters undertaking these arrangements should seek advice about the tax consequences.

GST consequences

163. GST obligations for supplies of NZUs made by a GST registered person are reasonably settled. NZUs are services and not goods for GST purposes. Supplies of NZUs are subject to GST. However, most supplies of NZUs are zero-rated for GST purposes under s 11A(1)(s) – (w) of the Goods and Services Tax Act (GSTA).
164. Section 11A of the GSTA zero rates:
 - the transfer of NZUs (other than certain transfers by the Crown that are not relevant in the forestry context);
 - the surrender of NZUs under s 63 of the CCRA (ie, for emissions);
 - the supply of services to or by the Crown in consideration for which there is no payment of a price and that is zero rated above; and
 - a disposal of similar types of units that are issued by reference to the sequestration or avoidance of emission, of human-induced greenhouse gases and verified to an internationally recognised standard.
165. Therefore, the transfer or surrender of NZUs is zero rated for GST purposes. This means the relevant supplies are subject to GST but at a rate of 0%.

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, or practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

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Legislative references | Tohutoro whakatureture

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Forestry Rights Registration Act 1983

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Income Tax Act 2007, ss CA 1(2), CB 36, CH 1, CX 51(B), CX 54B, DA 1, DB 49, DB 60, DB 60B, GC 1, GC 3B, GC 20, GC 21, ED 1, ED 1(7B), EW 5(3B), EW 5(11C), EW 52B, and s YA 1 (definitions of “forest land emissions unit” “forest sink emissions unit”, “post-1989 forest land emissions unit”; “pre-1990 forest land emissions unit” “replacement forest land emissions units”, “revenue account property”, “trading stock”).

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About this document | Mō tēnei tuhinga

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