

In the ETS, is safe carbon really that safe?

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Many tree growers may have a vague notion that their carbon liabilities at harvest will in fact be less than the total amount of carbon they have claimed in their emissions returns up to harvest. The Ministry for Primary Industries provide residual carbon tables to calculate the carbon left in the branches and roots which stay on site after harvest. Residual carbon is, in effect, a delayed surrender of the carbon remaining on site.

The safe carbon point is where this decreasing line crosses the next rotation's increasing growth. But, depending on when you joined the ETS and the age of the trees at the time, you may or may not be eligible for any of it. Our recent experience is that the safe, or our preferred term 'enduring', carbon calculation is complex.

The main points

Enduring carbon is made up of the carbon that remains after harvest, less what will continue to rot down between the periods of harvest and when the new forest crop starts to sequester more carbon than is rotting. This happens approximately eight to ten years after harvest. The enduring carbon does not disappear and the perception is that it can be sold with no need to surrender it. But this is only true as long as the ETS registered land stays registered and stays in forest use.

After the surrender of harvest related units, the carbon accounting record for that enduring carbon stays attached to the land, signalling that there is an obligation for the safe units which need to be surrendered if that land is deforested in the future. Therefore, a registered obligation exists, but one that will never be triggered as long as the land stays as forest land.

In terms of practical implications for growers, most trees being harvested now were planted in the early 1990s. There is no enduring carbon in these stands that can be sold and growers will be liable for the total volume of carbon claimed in emissions returns.

A carbon accounting record exists for every unit of carbon which has been allocated to an ETS participant and not surrendered. This includes their enduring carbon. When land is transferred, the purchaser may or may not be willing to accept the obligation that comes with the enduring carbon previously allocated but long since sold by the vendor believing it to be safe carbon.

To date, most transactions we have been involved with have seen the vendor leaving the ETS, surrendering all units allocated and wiping the carbon accounting record clean so that the land transfer has no obligations.

This is not so easy in a Permanent Forest Sink Initiative (PFSI) which is a 100-year covenant.

An interesting example

The following example explores the implications of attempting to transfer units to the purchaser to ensure the new landowner has the required units to surrender should leaving the ETS become necessary.

A farm is owned by a family member who is an advocate for afforestation on land that is best in vegetation as a long-term land use. They entered substantial plantings into the PFSI and the ETS with the hope of creating a long-term asset. As part of a succession plan the property is about to change ownership within the family. The financial and legal ramifications that such transfers produce are –

- The need to ensure no credit obligation is passed on
- The corresponding tax implication which occurs when credits are transferred to cover the obligation.

Although they entered the ETS with the best of intentions, they now find they are in a negative position. As far as I understand, the tax implications on a transfer of wealth are unavoidable when PFSI or ETS accrued credits are transferred. This will be further accentuated in the next succession or land sale.

For example –

- After eight years from 2008 to 2015 a total of 50,000 units are allocated
- If the registered land is transferred by sale or by succession, the credits to cover the land obligation will transfer as well
- Therefore 50,000 units at \$18 a unit is \$900,000, with the tax on this sum around \$300,000.

They can leave the ETS before transfer, but then they will only have had costs with no financial benefit from being involved. Although some might point out this was always the case, neither scheme was sold to the public this way, nor was it well understood in general that this would be the result.

The current ETS review may adopt harvested wood products accounting or averaging. This could see the carbon accounting record obligations not decreasing at harvest as long as the land stays in forest use. But for now, the above seems to be the case and should be understood by all participants who have heard or believe in a 'safe' carbon philosophy.

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