Hon Dr Michael Cullen
Treasurer, Minister of Finance, Minister for Accident Insurance, Minister of Revenue, Leader of the House

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Address to the PricewaterhouseCoopers Annual National Tax Conference

DR MICHAEL CULLEN SPEECH TO THE ANNUAL NATIONAL TAX CONFERENCE, WAIRAKEI RESORT HOTEL, TAUPO

Thank you for inviting me to address your conference today on the Government's tax reform programme.

The timing is appropriate. It was just under a year ago that the new Government took office. You will remember that in the lead-up to the election, tax rates had become a key issue.
Throughout that period we had made our position on tax rates clear: under a Labour Government the better paid would be expected to contribute more to the country's wellbeing.

Therefore one of our first actions as part of the Labour Alliance Coalition Government was to legislate for the increase in the top personal tax rate to 39 percent on income over $60,000 a year. We had to work fast, and within a tight timeframe, so the change would be enacted in time to take effect from the start of present income year.

We were well aware that the increase would act as an incentive to some to avoid the top tax rate. For this reason I announced at the same time, in December, that complementary legislation would be introduced as soon as possible.
Its purpose would be to counter avoidance of the top rate, and to lower the tax on fringe benefits paid to low-income employees.

That has been largely achieved by means of three bills introduced into Parliament this year, two of them already enacted. It has been a busy year on the legislative front, but the big changes have been implemented and our election commitment has been met. We are now in a position to concentrate on the wider tax policy programme and to focus more on the policy development process itself.

The generic tax policy process builds public consultation into key stages of tax policy development on major issues. Thus the practical experience and expertise of those who must eventually work with a proposed law change are drawn upon at an early stage.

Where consultation shows it to be necessary, the proposal is amended, well before any of it is incorporated into a bill. The results are better, more workable tax law.

The Government endorses the generic tax policy process. Even when we were under pressure to deal with issues related to the 39 percent tax rate, we took as much time as we could to talk the changes over with tax practitioners and others. I appreciate that the consultation time was not as much as desired. From now on I will ensure that we use the process fully so that we all get maximum advantage from it.

The proposal for the tax treatment of research and development expenditure outlined in the discussion paper released last week has already benefited from this approach.
The final form of the proposal reflected the comments and observations of a number of tax practitioners, among them John Shewan of this firm. I would like to thank them for their contribution.

We have built a policy work programme that takes into account both the Government's priorities, and the observations and concerns of members of the business and tax communities. We have listened to those observations and concerns, and we will continue to listen. In many cases they are reflected in items that have been included in the work programme.

I shall now briefly outline the contents of the work programme over the next two years.

Considerable policy resources will be needed to support the Ministerial Review into the Tax System. From a structural perspective the review is important, but it will not yield results until some time in 2003. The review will report to the Government in September next year, and that report will form the basis of proposals that we will take to the electorate for the 2002 election. Clearly, there will not be any big structural reforms in the meantime.

Revenue base maintenance is always part of the work programme. Its presence reflects the importance of maintaining stable revenue flows to fund Government expenditure. Part of our efforts are directed at the tax avoidance arena, where, for example, a response is needed to certain schemes targeted at high-income individuals. These schemes, incidentally, date back to when the top personal tax rate was 33 percent.
Also as part of base maintenance, we are looking to close loopholes in the law. For example, we recently amended the accrual rules to ensure that gifts of financial arrangements did not give rise to a deduction for the donor. This amendment was the result of the Court of Appeal decision in relation to the Auckland Harbour Board case, which is currently being heard at the Privy Council.

Many of the issues on our work programme are organised under three main themes. One of these themes is "tax in a changing world economy". The wider purpose of projects in this group is to ensure that our tax system is appropriate to a small, open economy that is a net capital importer.

We also need to ensure that, while our tax system raises the necessary revenue, it also minimises the costs on the New Zealand businesses that compete internationally.

For example, more New Zealanders are investing their funds internationally, and our tax system should ensure that offshore investments are treated on a comparable basis to investments within New Zealand. It could be argued that investors in New Zealand unit trusts are disadvantaged compared with investors in certain UK investment funds. This needs to be considered from a policy perspective, as do a number of associated problems.

There was some discussion earlier in the year about whether the Government should remove the tax advantage enjoyed by UK unit trusts.
I considered it but decided we needed to look at this issue taking into account private sector views. And we need to look at it in the wider context of the overall tax regime that best suits us.

Therefore we will be undertaking a general review of the foreign investment fund rules over the next two years. I do not expect proposals to be developed until after the Tax Review has reported in September next year. This will allow for the necessary discussions with the private sector on what you see the issues as being.

Those of you who are aware of the policy rationale underlying the foreign investment fund rules will also be aware that there are no easy solutions to the various problems that the regime is reckoned to have.
The present rules represent a delicate balance -- or compromise, if you wish -- between policy rationale, compliance costs, and potential taxpayer reaction. The review will consider this compromise, as well as focusing on more detailed issues.

GST and imported services is another work programme issue relating to the theme of our tax system in a changing world economy. This project is looking at whether the GST system needs to be modified in light of the growth of electronic commerce. This will be the subject of a discussion document to be released next year.

And there is the perennial issue of trans-Tasman imputation issues.

Indeed, it was John Shewan who pointed out in a radio interview that the press statement that Peter Costello and I issued on the subject recently bore a strong resemblance to one issued by Peter Costello and Bill Birch on the subject four years ago. I think the similarity indicates that the previous government did not score many points in this area, which admittedly is hard to do, given the bilateral nature of any solution to the triangular taxation problem. However, I have hopes that we will do better.

Tax simplification is high priority area of the tax policy work programme. The recent business forum in Auckland, as well as discussions I have held with business people, have emphasised business's frustration with high tax compliance costs. We all want quick action in this area. Paul Swain has been appointed associate Minister of Revenue, and part of his job is focused on tax simplification and compliance costs.
You can also expect to see discussion documents in the first part of next year on tax simplification for small business and as part of the review of the compliance and penalty legislation.

I also expect to be able to announce proposals for clarifying and simplifying the rules on interest deductibility for companies shortly.

A third major theme of the work programme is the taxation of savings and the entities through which individuals invest and save. One of the objectives here is to make the tax rules more consistent between different types of entities. A particular concern of mine is our poor savings record, a situation not helped by the number of disincentives to private savings found in the tax system. We are going to be looking at whether the current tax treatment of savings should be changed in line with this thinking and whether different tax rules will encourage long-term savings.

I will conclude by mentioning what the tax community can expect in the way of policy developments over the next six months.

There will be numerous opportunities to consult on policy. You will be seeing the release of issues papers on the tax treatment of monetary remuneration -- relating to transfers of holiday pay provisions from one employer to another.

A number of discussion documents on other tax topics are also planned. They include the publications on the review of the compliance and penalty legislation, tax simplification for business, and GST and imported services -- as well as the taxation of charities and the tax treatment of Maori authorities.

You can expect to see the draft, for public comment, of the rewritten Parts C, D and E of the Income Tax Act, along with a commentary. The rewrite is a massive project whose purpose is to simplify the language and structure of the Act as much as possible, to make the Act more accessible and easier to use. The release of the draft of the first parts to be rewritten will be the culmination of several years' work.

Finally, you can expect to see the passage through Parliament of the taxation bill introduced in October, and the introduction of the first of the usual two or three annual taxation bills covering a wide range of topics on the work programme.

I am looking forward to hearing your views on these matters of policy and legislation, and to working with you and other members of the tax community. Thank you.