Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

30 April 2018

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Tēnā tatou

Future of Tax – The Tax Working Group

Thank you for the opportunity to contribute and provide our thoughts to the Tax Working Group on the future of New Zealand's tax system.

By way of background, Te Ohu Kaimoana is a statutory organisation dedicated to the future advancement of Māori interests in the marine environment.

Te Ohu Kaimoana was established by the Māori Fisheries Act 2004 to allocate to mandated iwi organisations fisheries assets held in trust through the 1989 and 1992 Māori Fisheries Settlements and provide an advisory service to its iwi constituents. Our mission is to work for iwi to spearhead the growth and development of seafood in New Zealand while recognising the need to protect Māori fisheries assets for future generations. Additionally, Te Ohu Kaimoana undertakes a similar role in respect of commercial aquaculture assets to be provided to iwi pursuant to the Māori Commercial Aquaculture Claims Settlement Act 2004.

Te Ohu Kaimoana is owned and run by Māori. It was created out of the agreement between Māori and the Crown for recognition of Māori fishing rights and the settlement of Māori commercial fishing claims. These fishing rights span the customary, recreational and commercial sectors.

Te Ohu Kaimoana beneficiaries consist of a variety of members often being Māori authorities or charitable organisations.

Our submission focusses on four key areas:

1. Taxation of Māori authorities
2. Charities tax regime
3. Capital gains tax
4. Environmental taxes

We also comment briefly on the role of tīkanga Māori in the design of New Zealand's tax system.

Our key submission points are as follows:

- We consider the policy rationale for having a separate tax regime for Māori authorities remains sound and therefore we strongly support the continuance of the current regime. However, we consider a number of refinements can be made to the Māori authorities tax regime to make it more effective. Any enhancement to the regime will further support the continued growth of the Māori economy and the realisation of benefits to Māori communities, who we know continue to lag negatively in most socio-economic indicators vis a vis the general population.

- We are also supportive of the maintenance of the charities tax regime generally and note that care should be taken when considering any changes in this area to ensure that Māori organisations are not inadvertently adversely impacted.

- As noted in the Future of Tax paper, we consider that specific consideration should be given to Māori assets if a capital gains tax is to be introduced including the unique constraints that surrounds the transfer of Māori assets.

- Further work is required to better understand the role of environmental taxes in New Zealand including the effectiveness of such taxes as a mechanism to incentivise certain behaviours.

Our comments are provided in more detail in the attached Appendix.

Please feel free to contact us should you wish to discuss our comments further.

Noho ora mai, rā

[1]

Dion Tuuta
CHIEF EXECUTIVE

1. *Taxation of Māori authorities*

Te Ohu Kai Moana Trustee Limited (Te Ohu Kaimoana) is a Māori authority (being specifically included in the relevant definition in the Income Tax Act 2007). We strongly support the continuance of the current Māori authorities tax regime. This is on the basis that the policy rationale which supported the implementation of the current regime in the first place continues to be sound and relevant.

Specifically, Māori authorities generally have unique structures and constraints which are applicable to Māori organisations and businesses only including restrictions on the ability of members of a Māori authority to sell their interests in the assets of the authority.

Furthermore, Māori authorities are not homogenous and they can differ in a number of ways including their legal structure, size, types of activities undertaken, the range of benefits they provide, membership of the group and the mix of objectives.

These wide-ranging characteristics mean that it would be impractical to require Māori authorities to be taxed in the same manner as other companies or trusts. For example, an iwi or hapū would generally not have a defined members list and as a result it would be near impossible for a Māori authority to apply the technical requirements of shareholder continuity (in the case of company taxation) or to attribute income to individual members (as the case under trust rules).

As such, our view is that the current regime should remain in place as it continues to be the most efficient mechanism in ensuring members are tax appropriately. Specifically, the current regime achieves the following:

- Ensures that members who receive distributions are taxed on that income at their respective marginal rates.
- Minimises the costs for Māori authorities in complying with their tax requirements.
- Minimises the compliance costs for members who receive financial benefits from Māori authorities by reducing the need for them to file an income tax returns as a result of overpayment or underpayment of tax.
- Recognises the specific characteristics, structures and conditions of Māori authorities, and also the activities they undertake.

While we support the continuation of the Māori authority regime, we consider there are some areas where refinement can be made to help ensure the regime better achieves its intended tax policy outcomes. In our view, any enhancement to the current regime will further support the continued growth of the Māori economy and the ability for them to benefit Māori communities.

Wholly-owned subsidiaries of Māori authorities

The current definition of a Māori authority is relatively prescriptive and largely relies on the company or trust having had the assets it holds and manages being transferred from the Crown. This means any subsidiary that is subsequently set up to hold or manage the assets by the initial company or trust which received the asset directly from the Crown (the Māori authority) will not be able to elect into the Māori authority tax regime. The result is that there is a mismatch between the tax rate applicable to that subsidiary (28%) and the Māori authority (17.5%).

This mismatch in tax rates means that the Māori authority accumulates excess imputation credits as a result of the subsidiary being taxed at 28% but the Māori authority is only able to effectively pass on 17.5% the benefit of those credits to its members (in the form of Māori authority tax credits). We note that although the excess imputation credits will convert to Māori authority tax credits, those tax credits are unable to be attached to a distribution by the Māori authority as the amount of Māori authority tax credits that can be attached is capped at 17.5%.

This issue is exacerbated by the fact that there are various restrictions on the ability for Māori authorities to interact with other non-Māori authority entities in the tax regime. For example, Māori authorities are unable to offset losses with other companies, amalgamate with other companies or be members of a tax consolidated group with non-Māori authorities.

In our view, this restriction undermines the basis of the Māori authority regime as it effectively results in the over-taxation of income of the Māori authority. In particular, as Māori authority and subsidiary is a single economic unit, there is no reason to have a different tax rate applying between the two if the policy rationale is to ensure any income derived through a Māori authority is to be effectively taxed at the members' marginal tax rate.

We consider there are two possible solutions which would resolved the issue outlined above:

1. Expanding the definition of Māori authority to include wholly-owned subsidiaries of the Māori authorities. We see no issue with expanding the definition in this manner as the subsidiary will effectively be subject to the same restrictions as its parent in relation to its assets.

2. Allowing a Māori authority to get a refund of imputation credits that are in excess of 17.5% rather than having them convert to Māori authority tax credits. This will eliminate the issue of the economic unit of the Māori authority bearing a 28% tax rate on its income due to it being unable to distribute excess Māori authority tax credits to its members.

Either of these solutions would ensure consistent tax treatment across the entities in a Māori authorities' wholly-owned group. It also removes any tax barriers that could prevent a Māori authority from dealing with its assets in the most appropriate commercial manner (e.g. it may make commercial sense for the Māori authority to limit its risk by setting up a subsidiary to manage a particular asset).

We also consider there is merit in removing some of the current restrictions on the ability for Māori authorities to interact with other non-Māori authority entities in the tax regime. We are unclear of the policy rationale which support such current restrictions.

Administrative simplification

Our experience would suggest that the Māori authority regime is often not well understood by accountants or members of Māori authorities. This, in our view, also undermines the effectiveness of the regime and is also preventing it from fully achieving its intended purposes. For example, the fact that Māori authority tax credits are refundable and the process of how a refund may be obtained is not always well understood.

We would recommend Inland Revenue provide further guidance to ensure those affected by the regime understand how the regime operates in a practical sense.

Another administrative issue that often arises for Māori authorities is the requirement that a Māori authority must deduct resident withholding tax up to a rate of 33% if it does not know the IRD number of the recipient (an additional 15.5% if the Māori authority distribution has Māori authority tax credits attached at 17.5%). This provides a challenge for Māori authorities as it is not unusual that they are unable to identify every one of its members. This results in over-taxation of the income if there is an acceptance that recipients of Māori authority distributions are generally taxed at 17.5%.

We therefore submit that the requirement to withhold resident withholding tax at 33% is reduced to 17.5% even where the Māori authority does not know the IRD number of the recipient.

Finally, the current refund process for obtaining refunds of Māori authority tax credits is cumbersome. We recommend that a Māori authority tax credit refund form that is similar to the resident withholding tax deducted in error form is developed so that non-taxable recipients of Māori authority distributions are able to quickly and efficiently obtain a refund of any Māori authority tax credits received.

2. Charities tax regime

We understand that the Tax Working Group is considering how the tax regime applies to charities, particularly where the charity operates a business activity.

Te Ohu Kaimoana is a registered charity and its profits are subject to the charitable tax exemption. We generally support the maintenance of the current charities tax regime. Specifically, we support the policy rationale that the tax system should support organisations that have a charitable purpose and assist in those organisations' purposes of doing public good. We consider the business activity exemption supports the underlying policy of providing tax relief to charitable organisations, especially in the context of iwi.

Furthermore, we continue to support the maintenance of a deduction for Māori authorities for donations made to donee organisations or to Māori associations.

In the event where changes are to be made to the charities tax regime, we strongly recommend that specific consideration be given to Māori organisations as most iwi groups have charitable organisations that are members or are associated with them. Care should be taken to ensure any changes to the charities tax regime do not result in any adverse or unintended consequences for iwi, including any additional compliance costs that could result from such change.

We understand that in addition to the Tax Working Group considering how charities operate within the tax environment, Government is also undertaking a broader review of the Charities Act 2005. The definition of 'charitable purpose' for income tax purposes draws heavily on general legal concepts of charities. That said there may be times when it is appropriate for the scope of what is considered to be charitable in the context of the tax exemption to be broadened (or narrowed) if there is a sound tax policy basis to do so. A good example of where this has occurred in the past is the broadening of the concept of 'charitable purpose' for income tax purposes by relaxing the 'blood ties' restriction, which was done in 2004, in parallel with a review of the Māori authorities tax regime. This was done with Māori organisations and iwi in mind which recognised that the previous definition was overly restrictive. This difference between common law and tax law concepts is important and in our view remains appropriate. Therefore, it is important to consider the impact of any changes to the legal concept of charity arising from the broader review and assess whether the changes affect the tax construct of what is appropriate for charities.

3. Capital gains tax

We appreciate that fairness is a key focus for the Tax Working Group and capital gains tax is a specific area that is being considered. We support a tax system that is fair, balanced and equitable. Therefore we submit that if a capital gains tax is to be introduced, concessions should be made for 'settlement assets' to recognise their unique characteristics as, in our view, it would be inequitable for such assets to be subject to a capital gains tax. Our view is consistent with the sentiment conveyed in the Future of Tax paper which recognises the unique nature of settlement assets.

Specifically, we note that settlement assets represent compensation from the Crown to iwi to settle historic wrongs. It would be contrary to the sentiment of compensation if Māori authorities are required to pay tax on any future transfer of these special assets.

Furthermore, settlement assets are already subject to significant legislative restrictions on how they may be transferred. Fisheries settlement assets for example are only able to be transferred between Mandated Iwi Organisations or Aotearoa Fisheries Limited (trading as Moana New Zealand). These settlement assets are therefore not subject to normal 'market' conditions which generally results in a negative impact on the value of those assets. Imposing a capital gain tax on those transfers will further dilute the value of those assets to iwi.

Finally, practical issues can also arise if a capital gains tax is introduced and applied to settlement assets. For example, it would be difficult to ascertain the market value of such assets, especially taking into account the restrictions referred to above. It will also be difficult to determine the cost of such assets given they are a form of compensation to iwi and not purchased.

We therefore strongly submit that settlement assets should be outside the scope of any capital gains tax and 'settlement assets' should be given a commercially relevant definition which for Te Ohu Kaimoana should include both settlement quota and shares in its subsidiaries (e.g. Moana New Zealand).

4. Environmental taxes

We understand that the application of environmental taxes is a specific area that is being contemplated by the Tax Working Group. We note that New Zealand's current tax system has generally adopted the approach of having minimum incentives or distortions and therefore the introduction of taxes to discourage certain behaviours would be relatively novel in the context of the current tax policy settings.

On this basis, we urge the Tax Working Group to fully examine the policy rationale and potential impact of any environmental taxes. Specifically, issues that we consider should be addressed by the Tax Working Group include:

- Whether there is sufficient evidence to support that the environmental tax will affect behaviours in a way that will result in better outcomes for the environment on a holistic basis.

- Whether taxes are the most effective and cost efficient way to achieved the desired environmental outcome – for example, regulation such as New Zealand's fisheries quota management system has been effective in helping manage New Zealand's fisheries stocks in a sustainable manner for future generations. The key question is whether tax is the best mechanism in achieving the desired state.

- A clear framework should be established to provide clarity as to the purpose and outcome of any resulting environmental taxes. Specifically, we do not consider environmental taxes should be used as a mechanism to raise additional revenue for general government spending. Rather, any revenue raised must only be directed to achieving better environmental outcomes for New Zealand.

5. General comments

We are pleased to see the Tax Working Group's recognition of the importance of hearing the Māori voice in the design New Zealand's future tax system. We also recognise the importance of ensuring the New Zealand tax system is one which supports the growth in the Māori economy and one that strives for more equality across all New Zealanders.

We support the general direction of travel of incorporating a more diverse way of assessing what constitutes a good tax system for New Zealand. In particular, we can see elements of the Living Standards Framework resonating with te ao Māori and the recognition of the tīkanga Māori are important steps in ensuring New Zealand's future tax system is more fit-for-purpose.

Tīkanga is about doing the right things in the right way and keeping things in balance. If this is done then the right outcomes for everything else should follow including things such as intergenerational sustainability (kaitiakitanga) and how we can look after our people (manākitanga). Recognition of such tikanga would align with Te Ohu Kaimoana's own values and vision which include protecting Māori fisheries assets for future generations.