# Tax Working Group Public Submissions Information Release

## Release Document

## September 2018

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**WELLINGTON CHAMBER OF COMMERCE | BUSINESS CENTRAL | EXPORTNZ CENTRAL**
**SUBMISSION TO THE TAX WORKING GROUP**
**ON THE FUTURE OF TAX**

**APRIL 2018**

## Introduction

This submission is made of behalf of the Wellington Chamber of Commerce, Business Central, and Export New Zealand Central.

Our organisation is a business membership association, representing 3,400 members and their interests throughout central New Zealand from Taranaki across to Gisborne and down to Nelson. We represent three brands, Wellington Chamber of Commerce, Business Central, and Export New Zealand Central. As this submission is made on behalf of these three membership groups we expect that this submission should be weighted accordingly, rather than for each membership group to put in their own repetitious version.

- The **Wellington Chamber of Commerce** has been the voice of business in the Wellington region for 162 years since 1856 and advocates for policies that reflect the interest of Wellington's business community, in both the city and region, and the development of the Wellington economy as a whole, with over 3,500 member businesses. The Chamber has a strong focus on trade and "NZ Inc" issues. The Chamber acts as secretariat for the New Zealand Chambers of Commerce, a network of 29 chambers from across New Zealand.

- **Business Central** is one of the four regional organisations comprising New Zealand's peak business advocacy group, BusinessNZ and represents employers throughout the Central region. Business Central is a recognised leader in employment advice, consultancy and training – regarded as the authority in the fields of employee relations, occupational health and safety, and people management.

- Our organisation also delivers **ExportNZ** to Wellington, the Hawke's Bay and the wider Central region. ExportNZ is the national industry association representing a diverse range of exporters throughout New Zealand. We have exporting members, ranging from emerging exporters to the largest exporters in New Zealand.

Our organisation write in support of Business New Zealand's submission to the Woking Group. We wholly endorses the comments made. We appreciate the opportunity and we look forward to continuing to engage with political leaders, policy-makers and decision makers in the period ahead.

We would like to congratulate the Government on setting up a TWG with direct input from the private sector. As part of our wider Business New Zealand family, we strongly supported the 2009/2010 Tax Working Group and since then have advocated for another broad examination of New Zealand's tax system, particularly in regard to recent international pressures and settings.

We also appreciate the TWG's difficult task in having terms of reference that mean there are significant no-go areas we believe also require examination.

We would point out that with any broad examination of a complex and wide ranging system, there will be parts of the business community that invariably agrees - or disagrees - with the recommendations put forward. So it is important to identify those options that have the business community's broadest support. This is the position BusinessNZ, together with its member organisations (encompassing its regional associations and major companies and affiliated industries groups) has taken in relation to the TWG's work.

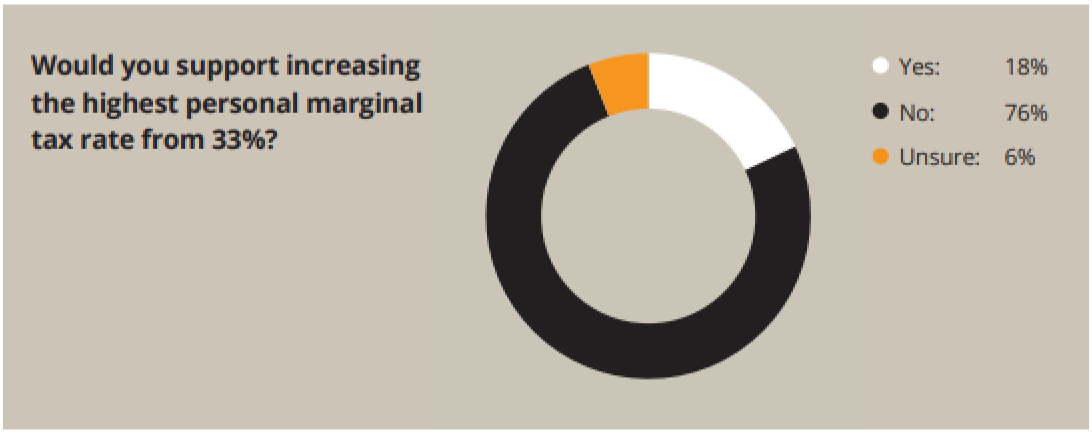
**Topics outside the Scope of the TWG**

As noted above, we would point out that while the TWG process covers a number of tax policy areas, we have been disappointed to find certain areas outside its scope. These include income tax and GST changes, as well as tax applying to the family home. In essence, this hampers the ability of both the TWG and submitters to examine the full tax system and see where trade-offs can be made.

To that end, the recent results of the Deloitte BusinessNZ 2017 Election Survey[1] show how the business community can provide a more nuanced response when presented with different scenarios.

For instance, of the 575 businesses completing the survey, table 1 shows 76% did not support an increase in the highest personal marginal tax rate, while 18% said yes with 6% unsure.

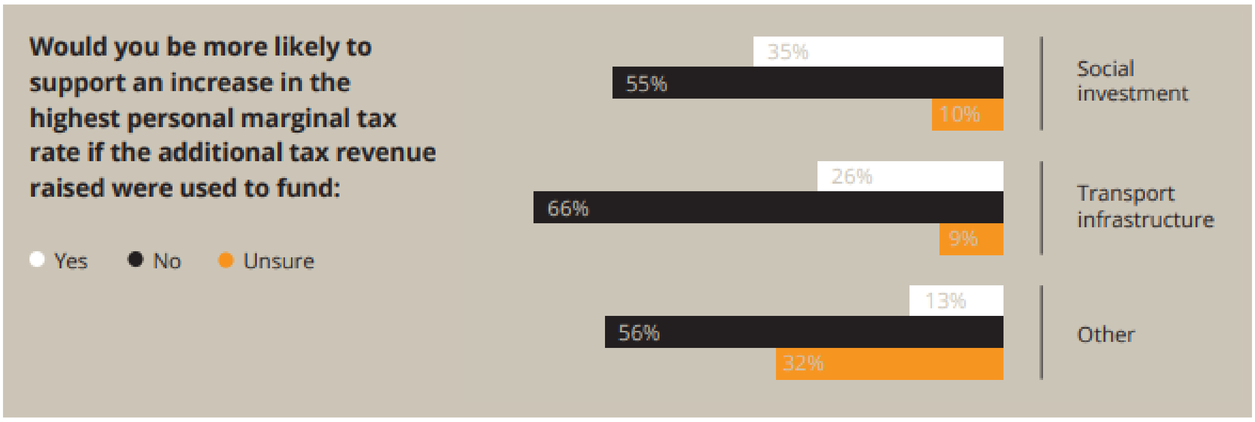
**Figure 1**




However, table 2 shows these percentages moved when businesses were also asked about the use of the additional tax revenue raised from the increase to fund specific areas, such as social investment or transport infrastructure.

**Figure 2**

1 https://www.businessnz.org.nz/__data/assets/pdf_file/0006/129345/Deloitte-BusinessNZ-Election-Survey-2017.pdf




We hope that once submissions for the Future of Tax Paper have been received, these matters can be addressed more fully to ensure the interim report to the Ministers of Finance and Revenue provides enough specificity for submitters to provide their preferences etc. when it comes to potential taxation changes.

**Questions for Submitters**

The Background Paper outlines 20 broad questions relating to the future of New Zealand's tax system. In relation to the point made above, overall, our submission is not as detailed as the submission we would have provided had not the TWG's terms of reference essentially prevented a comprehensive analysis of the tax system as a whole.

Instead, what we have outlined below is our general taxation position and thoughts developed over many years in consultation with our membership across various industries and sizes of business.

**<u>Chapter 2: The future environment</u>**

1. **What do you see as the main risks, challenges, and opportunities for the tax system over the medium-to-long-term? Which of these are most important?**

Overall, we believe that following the major reforms of the 1980s, New Zealand's tax system has generally worked well in meeting the overall needs of the economy. In no small part this has been due to ongoing collaborative efforts between the public and private sectors to ensure the system remains internationally competitive. However, this does not mean improvements cannot be made. Also, future technology changes, offshore developments and the changing face of New Zealand life may dictate the use of different levers to ensure the continuing competence of the New Zealand tax system.

The most obvious risk is that of a sudden decrease in key tax takings placing pressure on areas of government expenditure. Equally, however, we would be concerned if new taxes, popular with some members of the public, were introduced but were poorly thought through from a public policy perspective. As history shows, it is relatively easy to tax something, but whether it should be taxed in the first place and what unintended consequences will stem from taxing it need to be taken into account.

Also, we would not want to see taxes collected for specific purposes, become, to all intents and purposes, general taxation and morph into a slush fund for projects unrelated to what was originally intended.

We believe the main challenge for New Zealand will be to ensure that as a small country, it is sufficiently competitive and that the full suite of taxes, on both individuals and business, is not onerous, curtailing growth and/or risk taking. While we obviously have an interest in taxes affecting the business community, we are also very cognisant of New Zealand's tax system in general, taking into account that taxes fall on both individuals and entities. A tax system that works well as a total system, with minimal distortions, has the best chance of improving economic growth.

The main concern for New Zealand's tax system is that it continues to be broad-based and low-rate, collects taxes in the most optimal way possible, and creates minimal disruption for the general population.

2. **How should the tax system change in response to the risks, challenges, and opportunities you have identified?**

One of the key ways in which all three issues above can be achieved is by examining the issue of base-broadening. This would address some of the existing biases in the tax system, improving its efficiency and sustainability. Base-broadening to maintain tax revenue levels would also be required if certain tax rates were to be reduced. Often, examining each base-broadening and revenue-raising option by itself, without looking at where it would sit in terms of the overall package, can result in no change.

We would also like to point out in regard to maintaining tax revenue levels, that due to its terms of reference, the TWG has only looked at one half of the broader issue. The balance of revenue neutrality means the group has no opportunity to look at where government expenditure might be reduced to free up revenue for further tax changes.

In this regard, we note that in 2018 the Government is expected to collect around $86b in tax revenue, leading us to ask how this could be used more efficiently if spending decisions were properly reviewed. Overall, we would want the Government to make a more concentrated effort to find ways to lower unnecessary expenditure so additional revenue can be passed back to taxpayers via lower tax rates, while revenue required for spending is used in a productive and efficient manner.

**How could tikanga Māori (in particular manaakitanga, whanaungatanga, and kaitiakitanga) help create a more future focused tax system?**

While we have no substantive comment on this question, we would point out that the tax system should not adversely affect or favour any ethnicity, however defined. Within the business taxation context, we would expect all businesses, no matter who they are owned by, to adhere to the same tax rules and structures.

## <u>Chapter 3: Purposes and principles of a good tax system</u>

***Principles for assessment***

**3. What principles would you use to assess the performance of the tax system?**

We believe that page 19 of the paper provides a useful summary of the criteria required for examining the purpose and principles of a good tax system, namely:

- Efficiency
- Equity and fairness
- Revenue integrity
- Fiscal adequacy
- Compliance and administration costs
- Coherence

We note the paper's statement that these are the established criteria used in past reviews both domestically and overseas. Therefore, we see very little reason to change the criteria while any new criteria or adjustments would need to reach a very high threshold to justify change.

***Defining 'fairness'***

**4. How would you define 'fairness' in the context of the tax system? What would a fair tax system look like?**

The term 'fairness" is very subjective and is not readily defined in the tax system context. In a business context, we suggest the tax system should ensure an optimal outcome for all businesses, particularly in relation to their size.

Comparing small with large businesses across not only the tax system but other regulatory systems, there needs to be a pragmatic acknowledgement of the differences in tax compliance responsibilities between small and large businesses. Research over time, including by BusinessNZ, shows small businesses (SMEs) traditionally have much higher compliance costs per employee compared with larger enterprises. And there is a gap in the business capability of small firms versus large firms when dealing with tax compliance issues. Any compliance 'jolts' introduced are more likely to be heavier for smaller firms, as their ability to deal with new or changed regulations is relatively lesser than that of large businesses. The latter often have staff that can be allocated the task of understanding how and when compliance is required. This highlights to us how policies that minimise tax compliance costs for smaller firms can help to minimise any deadweight cost to the economy.

Last, when examining the points above, there needs to be an acknowledgement of the fact that any optimal outcome for smaller sized businesses should accept that close enough is good enough. A drive towards total precision in the tax system creates complexity. Therefore, a more pragmatic view around trying to collect the last dollar of revenue, would help minimise any compliance jolts.

## Chapter 4: The current New Zealand tax system

***Frameworks***

5. **New Zealand's 'broad-based, low-rate' system, with few exemptions for GST and income tax, has been in place for over thirty years. Looking ahead to the future, is it still the best approach for New Zealand? If not, what approach should replace it?**

We believe this is still the best approach for the country and will continue to support a broad-based low-rate (BBLR) framework. A BBLR system is simpler to administer and is fairer, as more people contribute towards the cost of the services available to everyone.

As with our view of the principles relating to the tax system's performance, any move away from the BBLR framework would need to reach a very high threshold to justify change.

***Taxes and behaviour***

6. **Should there be a greater role in the tax system for taxes that intentionally modify behaviour?**

We believe that any taxes introduced to modify behaviour would need to go through a rigorous government policy process to ascertain whether they were required in the first place. This would include establishing whether substantive international evidence shows such taxes having a significant positive effect on behaviour without creating significant distortionary effects elsewhere in the tax system.

***Retirement savings***

7. **Should the tax system encourage saving for retirement as a goal in its own right? If so, what changes would you suggest to achieve this goal?**

Page 26 of the background paper provides a succinct summary of the New Zealand relationship between taxation and retirement savings compared with most other OECD countries. It is certainly true that in comparison with many other countries, New Zealand's retirement savings are highly taxed, as we have a Taxed-Taxed-Exempt (TTE) approach, compared with the Exempt-Exempt-Taxed (EET) approach of most OECD countries - where savings instruments are taxed neither at the investment nor the earning stage but at the withdrawal stage. However, as the background paper rightly points out, the Government provides material support to those in retirement through universal superannuation that is not means tested. Therefore, any switch to a system where income earned on the investment was not taxed would involve a significant fiscal cost.

In addition, KiwiSaver, which is little more than 10 years old, is considered by many to be a key policy helping New Zealanders save for their retirement, while the establishment of Portfolio Investment Entities (PIEs) also contributes to retirement savings.

Overall, from our and the wider BusinessNZ family's point of view, any proposals for change raise questions as to whether the cost of further tax incentives for retirement saving would be affordable and the extent to which they would see retirement savings increase.

## <u>Chapter 5: The results of the current tax system</u>

*Fairness and balance*

**8. Does the tax system strike the right balance between supporting the productive economy and the speculative economy? If it does not, what would need to change to achieve a better balance?**

We do not have any substantive comments on these questions.

*Tax and business*

**9. Does the tax system do enough to minimise costs on business?**

One of the principles of good taxation, mentioned above, involves taking into account compliance and administration costs. Taxpayers are often faced with a variety of compliance costs, with the business community having to administer and pass on a wide range of taxes. As discussed in question 4 above, it is important to recognise that tax compliance costs for businesses fall disproportionately more on SMEs than on larger businesses, particularly when viewed from an FTE measure.

From our perspective, it is difficult to respond to the question of whether the tax system is currently doing enough to minimise costs for business. IRD is the key Government Department taking the lead in finding ways to reduce compliance costs. With that in view, the IRD is currently going through an extensive Business Transformation (BT) process, which includes mechanisms to reduce compliance costs on business. At this stage, the introduction of the Accounting Income Method (AIM) and the general move towards electronic filing – if set up correctly – has the potential to reduce tax compliance costs for many businesses. Related initiatives, such as the introduction of the New Zealand Business Number (NZBN), also have the potential to not only reduce tax compliance costs, but costs across the many government departments business deals with on a day-to-day basis. However, such policies need time to bed down in order to ascertain how successful or otherwise they have been.

While we are strongly supportive of IRD's BT process, our primary concern is that costs could simply be moved from government to business. We have stated to the IRD on many occasions that the process should end up having an overall significant net benefit to the business community by way of reducing tax compliance costs – particularly for the SME sector.

To that end, we note that later this year IRD will again conduct its SME Tax Compliance Cost Survey, run roughly every four years. The survey provides a useful quantitative and qualitative assessment of compliance costs for various areas of the tax system.

Last, if we were to look at the larger end of the business community, BusinessNZ and Deloitte conducted a tax survey of New Zealand's largest companies in May 2017[2]. The purpose of the survey was to identify what fine-tuning was required to make sure New Zealand is performing optimally – both in global competitiveness and tax administration.

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[2] https://www.businessnz.org.nz/__data/assets/pdf_file/0010/129187/170816-Major-companies-tax-survey-2017.pdf

Ten themes were identified, namely:

a) *Provide certainty:* The ability to make business decisions with certain knowledge of the tax implications is important for business. We urge government to consider tax changes with a commercial lens, balancing the integrity of the tax system with long- term certainty for business.
b) *Eliminate black hole expenditure:* Businesses should be able to claim a tax deduction for all business expenditure, either immediately or over time. Currently there are a number of gaps in the law where legitimate business expenditure is not deductible at all – this is known as "black hole" expenditure. The cost of raising capital is a common example.
c) *Help to strengthen buildings:* If government does not compensate for the regulatory taking imposed on building-owners, then the tax system should not add a further barrier.
d) *Restore depreciation for industrial buildings:* As mentioned below, government should restore depreciation deductions for this building class, reversing the 2010 decision to put industrial buildings in the same category as commercial and residential properties given clear differences between their use and long-term utility.
e) *Maintain an internationally competitive rate:* Corporate tax rates around the globe are on a downward trend, with the OECD average now just over 22 percent. While it is important for companies to pay their fair of share of tax, in a world where capital is mobile it is also critical that our headline corporate rate doesn't become uncompetitive – at least compared to our closest competitors such as Australia.
f) *Encourage research and development:* The majority of major companies would support tax policies to further encourage research & development ("R&D"). A lack of NZ business investment in R&D risks our Intellectual Property being developed offshore and skilled labour transferring overseas.
g) *Put New Zealand's interests first:* The Government should develop tax policy that takes into account New Zealand's best interests, based on New Zealand principles, not on what is in other countries' best interests.
h) *Allow taxpayers some flexibility:* In a world where technology will play a greater role in assessing taxpayers, the government should allow the IRD to accept some flexibility, rather than require absolute precision from taxpayers, introducing more safe harbour and de minimis discretions.
i) *Treat commercial information like personal information:* Major companies regularly supply Inland Revenue with commercially sensitive information – the obligation to keep this confidential is fundamental to the integrity of the New Zealand tax system.
j) *Determine policy based on realities:* There is a general perception across society that multinational companies are not paying their "fair share" when compared with regular taxpayers but this is not always an informed view. The Government should take a careful approach to the taxation of multinational companies to ensure any reforms are measured and justified, in the same way other matters of policy are approached.

Obviously, these themes cross-over with other questions asked in the background paper. Together, they provide clear ways for government to pull the significant levers major businesses would like to see pulled, thereby helping to make New Zealand's tax system competitive, efficient to run and of the highest integrity.

**10. Does the tax system do enough to maintain natural capital?**

Given the complex nature of this issue and the multitude of factors at play, we have no substantive comments on this question.

**11. Are there types of businesses benefiting from low effective tax rates because of excessive deductions, timing of deductions or non-taxation of certain types of income?**

While we have no substantive comments to make on this question, it is important for the TWG to recognise that a number of ownership structures exist in New Zealand in order to reduce the impact of tax on decision making,

Also, we believe any significant or excessive deductions benefitting one type of business structure over others would already be clearly identified by IRD's ongoing tax policy programme and therefore already part of its work agenda.

**Chapter 6: Thinking outside the current system**

**12. What are the main inconsistencies in the current tax system? Which of these gaps are most important to address?**

Broadly speaking, we agree there is the potential for challenges to New Zealand's tax revenue base, as well as issues over technology disruption that will have implications for tax revenue collection in the medium to longer term. Improved technology options mean transactions can be carried out that either circumvent the usual tax collection process, or through greater efficiency, result in less tax collected by traditional means. For instance, recent discussions about cryptocurrencies highlight the need for further work on these issues.

Overall, New Zealand needs to be cognisant of both the risks and opportunities when examining the tax base and the inconsistencies that may appear.

**13. Is there a case to consider the introduction of any new taxes that are not currently levied? Should any taxes be reduced if new taxes are introduced?**

The background paper mentions a number of taxes eliminated over time under the BBLR tax system. These include sales tax, land tax, estate duty and gift duty. In addition, we do not levy stamp duties, financial transaction taxes, wealth taxes and a capital gains tax.

While we are not against the introduction of new taxes per se, this does not mean we simply support the introduction of a new tax or the reintroduction of a tax for the sake of it. Such taxes would need to meet the principles discussed above, as well as fit within the BBLR framework.

Whether any taxes were reduced with the introduction of new taxes, we would expect any overall changes in the tax system to be revenue neutral in order not to increase the burden on taxpayers.

Regarding specific tax reductions, we believe an overall reduction in the company tax rate would be a positive step forward in supporting firms. In addition, other tax mechanisms could be examined to ensure New Zealand's tax system is as efficient and effective as possible for the business community. These include:

*Loss continuity rules*
Currently, our wider BusinessNZ family have been formally collaborating with a number of interested business groups to advocate for a change in New Zealand's loss continuity rules. In short, we would like to see an amendment to the law that currently disadvantages many fast growing and innovative companies. Specifically, the proposal is to amend the current rule relating to the carry forward of tax losses by enacting a "same or similar business" test as an alternative to the existing 49% continuity of ownership requirement. Such a change would bring New Zealand's rules into line with those of many comparable jurisdictions, reduce compliance costs, and further the potential for business growth.

*Building depreciation deductions*
We are interested - with a view to where this could be expanded - in knowing how the current range of tax deductible measures for businesses in New Zealand compares with offshore arrangements. To that end (and noted in question 9 above) in 2010 the Government of the day removed tax depreciation on buildings. In our submission to the 2009/10 TWG which examined the issue, we pointed out that any decisions made in the area would most likely have significant effects, not only in terms of taxpayer funds saved, but also on associated residential property investment. While our wider BusinessNZ family did not have a strong view on removing depreciation on residential buildings, we <u>strongly rejected</u> any moves towards extending the removal of tax depreciation on commercial/industrial buildings. Such buildings typically depreciate over time as the specific requirements of the building can rapidly change due to new technology or a shift in focus involving business operations. We also believed care needs to be taken in differentiating between residential and commercial buildings if there is to be any ring fencing.

We would therefore welcome the TWG again considering the reintroduction of depreciation on commercial/industrial buildings.

## <u>Chapter 7: Specific challenges</u>

### ***Housing affordability***

**14. How, and to what extent, does the tax system affect housing affordability for owners and renters? Is there a case to change the tax system to promote greater housing affordability? If so, what changes would you recommend?**

We would again be very wary of using the tax system to improve affordability for owners and renters.

Within the context of housing affordability, it is important to note the tax areas outside the scope of the TWG (namely any other changes that would apply to the taxation of the family home or land under it), as well as the issue of capital gains tax discussed below. From our perspective, the only way we see the tax system assisting potential homeowners through a BBLR framework is by reducing personal tax rates and/or thresholds, so buyers have a greater amount of net income at their disposal to pay rent or save for/pay a mortgage.

More importantly, we see housing affordability as essentially a supply side issue. Changes in the tax system could become a moot point if supply side policies instead assisted homeowners and potential homeowners by way of freeing up land for residential purposes.

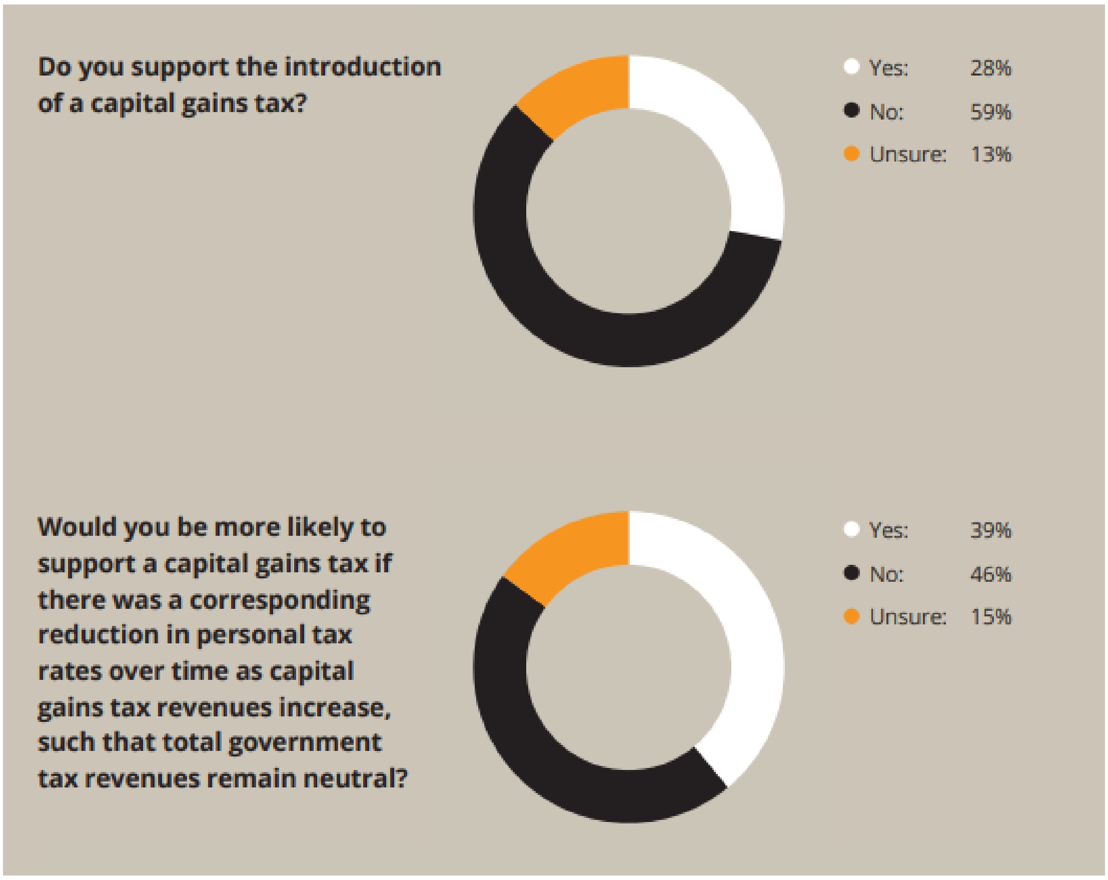
*Capital gains tax*

**15. Should New Zealand introduce a capital gains tax (that excludes the family home)? If so, what features should it have?**

We do not have a formal position on a capital gains tax, as it would depend on the detail of any CGT regime chosen, such as who it would include, who it would affect and how it would be implemented. In essence, the devil would be in the detail of whatever might be proposed.

By way of example, if we again highlight some results from the Deloitte BusinessNZ 2017 Election Survey below, figures 3 and 4 show a capital gains tax would likely receive more support from the business community if accompanied by a corresponding reduction in personal tax rates.

**Figures 3 & 4**




That any capital gains tax, if introduced, automatically should exclude the family home, would erode the comprehensive nature of the tax. Once a tax is eroded by exclusions, its effectiveness in terms of efficiency and revenue collection is called into question.

Moreover, as outlined in question 14 above, there is no conclusive evidence supporting the ability of a CGT to improve housing supply and affordability. To achieve this goal, we would recommend actions to free up land supply for housing construction.

***Land tax***

**16. Should New Zealand introduce a land tax (that excludes the land under the family home)? If so, what features should it have?**

Again, we believe there is an issue of balance. First, we note that a land tax is nothing new. New Zealand had a land tax up until 1992, but the exemptions were considerable and it therefore affected only a small group of taxpayers. We also currently have a form of land tax via the rates charged by Local Government.

Despite the previous use of a land tax, one of our main concerns with its re-introduction is its potential use for other, future, revenue-raising purposes, moving away from the reason for its introduction. The reasons why taxes such as a land tax are introduced are often easily forgotten, and subsequent administrations sometimes use such a tool for other purposes. For example, a future Government might need additional revenue for some elements of social spending, and therefore increase the land tax rate. Alternatively, changes to a land tax could be made by relating the rate paid to the income of the individual/family. It could be argued that in such circumstance existing taxes can also be changed but additional taxes mean there is a greater scope to do so - not the way to ensure government's fiscal prudence.

In addition, land is typically the principle form of equity held by banks to support lending to businesses for use in productive activities. A land tax could therefore undermine banks' security and also their ability to lend to the business community. Last, like a CGT and previous land taxes in New Zealand, the opportunity over time to introduce exemptions is often politically hard to resist, thereby undermining the policy's original intent.

From our wider BusinessNZ family's point of view, unless a land tax means a significant reduction in the company tax rate and/or a much lower/flatter tax structure, we will not support its introduction.

***Environmental taxation***

**17. What are the main opportunities for effective environmental taxation?**

It is extremely difficult to respond to this question in the absence of a compelling case or problem that would inform such a response. In their absence, any response would be guesswork at best. Key to any response is the nature and extent of the externalities to which such a tax might be applied, and an assessment of the gap unaddressed by the application of the emissions trading scheme.

***Progressive company tax***

**18. Should the tax system do more to support small firms? In particular, is there a case for a progressive company tax?**

In general, we support taking steps to assist small businesses through the tax system, whether by lowering compliance costs (as mentioned above) or through lower tax rates. However, we have never supported the concept of a progressive company tax system, whereby smaller businesses pay a lower rate. This would move New Zealand away from the BBLR system we support, and in our view would create a number of unintended consequences.

For instance, businesses on the lower rate would have a natural ceiling barrier to growth with the possibility of some undertaking actions to ensure they stayed under the threshold given the natural disincentive to business expansion. As well, businesses just above the threshold would find themselves at a competitive disadvantage. Last, any threshold – however defined – would be subjective and create winners and losers, thereby curbing productivity and growth.

As mentioned above, beyond a reduction in tax compliance costs for small businesses, other levers to assist such businesses include a reduction in the company and top personal tax rates (given many SMEs are on the top personal rate), together with an examination of how the current range of tax deductible measures for New Zealand businesses compares with offshore arrangements and how this could be expanded.

***GST exemptions for particular goods***

**19. Should the tax system exclude some goods and services from the Goods and Services Tax? If so, what should be excluded? – and what else should be taxed to make up for the lost revenue?**

We strongly support the continuation of a no exemptions policy for GST, which we view as world-leading. We have long held the view that GST should remain a broad-based tax with few if any exemptions. Overseas evidence has consistently shown exemptions lead to gaming and the diverting of resources better used more productively.

Looking more widely, on balance ourselves and the wider BusinessNZ family believes that of the various options for raising revenue and ensuring cost neutrality, increasing the GST rate should be viewed as a primary mechanism. Not only does GST reduce the taxation bias against savings and investment, it also means changes made are part of the existing tax structure, with no need to create another level of complexity in the system.