# Tax Working Group Public Submissions Information Release

## Release Document

## September 2018

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

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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.

Beautiful accounting software

Tax Working Group Secretariat
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By email: Submissions@taxworkinggroup.govt.nz

30 April 2018

Dear Secretariat

**Submission on Future of Tax Background Paper**

We are writing to submit on the background paper issued by the Tax Working Group ("the Working Group") entitled *Future of Tax*. Xero appreciates the opportunity to contribute to the conversation on the design of New Zealand's future tax system.

We have sought to provide comments in two broad categories, which we have addressed is two separate submissions:

1. Tax issues impacting Xero as a large, innovative organisation (addressed in this submission), noting that the matters raised have broad application across both large and small business in New Zealand.

2. Tax issues impacting small business in New Zealand. At Xero, we believe that small business makes the world go round - it's at the heart of the economy. Our mission is to make small businesses thrive.

**About Xero**

Founded in 2006 in New Zealand, Xero is one of the fastest growing software as a service companies globally. We lead the New Zealand, Australian, and United Kingdom cloud accounting markets, employing a team of more than 2,000 people in 20 offices around the world.

Our cloud-based accounting software connects people with the right numbers anytime, anywhere, on any device. We're proud to be helping over 1 million subscribers worldwide transform the way they do business.

Forbes identified Xero as the World's Most Innovative Growth Company in 2014 and 2015. Among other recent awards, Xero won Product of the Year at the British Accountancy Awards 2017 in the UK, and was rated by Canstar Blue as Australia's best accounting software three consecutive years from 2015-2017. It is with this focus on innovation that Xero provides comments on features we would like to see in New Zealand's future tax system.

### Research and development tax credit

Xero supports the introduction of a research and development (R&D) tax credit along the lines of that recently announced by the Government in the discussion paper, *Fuelling Innovation to Transform Our Economy*.

An OECD paper published by the Productivity Commission in 2014 estimated that up to 40% of New Zealand's productivity gap compared with the OECD average is the result of weak investment in knowledge-based assets such as innovation[1]. Further, New Zealand has one of the lowest spends on R&D as a percentage of GDP in the OECD. It is clear that New Zealand needs to increase investment and spending in innovative R&D to grow a prosperous economy for all New Zealanders.

Innovative companies are employing and training the innovators, scientists and engineers of tomorrow, and they are vital to addressing challenges New Zealand faces such as growing GDP to support an aging population and environmental concerns. Given the broader economic benefits of R&D spending beyond the owners of an innovative business, it is appropriate and necessary to depart from New Zealand's broad base, low rate approach to tax policy design to incentivise R&D activity.

From Xero's perspective it is of critical importance that businesses are left no worse off than under the Growth Grant scheme administered by Callaghan Innovation. Specifically, the credit needs to be refundable to those organisations in losses if it is to properly support and incentivise R&D activity. If the credit is not refundable, this will be detrimental for New Zealand business, which will negatively impact New Zealand's ability to be competitive on the world stage. Businesses in a tax loss position will miss out on real-time cash funding, that is critical to fund their ongoing R&D activities and keep New Zealanders employed.

If the credit is not fully refundable, it should not be subject to traditional shareholder continuity requirements for the carry-forward of losses (as expanded below).

### Shareholder continuity

A tax issue that disproportionately impacts innovative companies is the current shareholder continuity requirements for the carry forward of tax losses.

The natural lifecycle of an innovative start up is well known. It starts with an idea. The creators pour all of their resources into developing this idea, incurring tax losses (sometimes significant) throughout this time. Rapid expansion can often exacerbate the creation of tax losses. However, at some point the start-up will need outside capital (and sometimes a broader skill set driving the business) to continue to develop and commercialise the idea. However, this puts at risk those accumulated tax losses. Additional capital will generally need to be equity funded because debt funding will not be available for a loss making business. Business owners must therefore choose between raising much needed capital to continue to fund growth and innovation and maintaining tax losses, which are often of significant value to the business. This disincentives entrepreneurial risk taking and innovation as businesses are not able to realise the value of tax losses.

[1] de Serres, Yashiro & Boulhol (2014), "An international perspective on New Zealand's productivity paradox", NZPC Working Paper 2014/01.

Xero believes this is not a choice we should be asking our innovators to make and that the shareholder loss continuity rules need to be reformed. The current rules draw an arbitrary line at 49% shareholder continuity. From a compliance cost perspective, the most attractive option would be a complete removal of shareholder continuity requirements for the carry forward of losses. However, this raises other policy concerns. There is a desire from a tax policy perspective to prevent the trading of loss making companies. That said, we believe the current regime has not struck an appropriate balance between preventing loss trading and not dampening productive, innovative activity.

One approach that other countries have adopted to navigate this issue is the introduction of a "same/similar business" test. Australia has a "same business test" which has, in recent years being relaxed to a "similar business test'. The similar business test compares the business carried on before the ownership change) with the business carried on in the income year that the company wishes to deduct a prior year loss . Canada, the United States and the United Kingdom all have same or similar business tests as an alternative to their shareholder continuity tests. Xero supports this type of alternative approach in New Zealand for the carry forward of tax losses. Our innovative companies should not be penalised simply because they need access to additional capital to continue to grow.

**Employee share schemes**

Employee shares schemes are a vital tool in remunerating employees, driving alignment between business and employee interests and boosting employee engagement and retention. They are a particularly valuable tool for start up businesses or businesses in losses which may have cash pressures.

Xero believes that recent reforms to the taxation of employee share scheme arrangements have significantly increased the complexity of the tax treatment of such arrangements which will discourage their use. Xero would like to see more pragmatic approach adopted for the taxation of employee share scheme income to minimise compliance costs for businesses and encourage the use of such remuneration tools. There are wider economic benefits to be gained by empowering a more productive and engaged workforce, noting that increased economic growth should be a key outcome.

Once again, thank you for the opportunity to make a submission to the the Working Group. We would be happy to discuss the matters raised in this submission further. If you have any questions regarding the submission please contact Rebecca Small (Director Tax & Payroll) at [1] or on [1] [1] in the first instance.

Yours sincerely,

[1]

Kirsty Godfrey Billy
Chief Accounting Officer
Xero Limited
[1]