Tax Working Group Public Submissions Information Release

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30 April 2018

Tax Working Group Secretariat
PO Box 3724
WELLINGTON

Dear Secretariat

TAX WORKING GROUP FUTURE OF TAX: SUBMISSIONS BACKGROUND PAPER

The Corporate Taxpayers Group ("the Group") is writing to submit on the Tax Working Group's *Future of Tax: Submissions Background Paper* ("the submissions paper"). The Group's submission addresses the questions asked throughout the Paper, in particular commenting on the areas that affect our membership, as well as providing broader comments on various aspects of the tax system.

The Group would welcome the opportunity to make an oral submission to the Tax Working Group ("TWG") on the contents of this submission.

ABOUT THE GROUP – INFORMED, PRINCIPLED, PRACTICAL

About the Group

The Corporate Taxpayers Group is an organisation of major New Zealand companies that works with key Inland Revenue and Treasury officials to achieve positive changes to tax policy in New Zealand.

The focus of the Group is achieving the right corporate tax policy settings for New Zealand's tax system, not to push individual or industry specific agendas. The Group has traditionally not only devoted resources to responding to issues being progressed by Inland Revenue, but has also been forward-looking and proactively raises policy and operational issues to ensure that the tax system is working efficiently and effectively.

The most significant stakeholders of Group members are New Zealanders, and therefore a New Zealand economy and society that is functioning well is in the interests of the Group.

The Group's Principles for a Good Tax System

Underpinning the Group's submissions and engagement on tax policy matters are three main principles that the Group believes a good tax system should be built around:

- High certainty, predictability and low business risk;
- Low compliance costs; and
- International competitiveness.

These principles are central to the way the Group judges tax policy issues and we discuss these further below in our submission.

INTRODUCTORY COMMENTS

In preparing this submission, members were surveyed for their opinions on the various questions asked in the submissions paper and this submission incorporates some of the themes arising from this survey. The submissions paper and issues arising from this have also been discussed at Group meetings and via other forms of correspondence. Given the Group's varied constituency, there are areas in this submission where we discuss the potential impact of an issue but do not as a Group express a preference / opinion either way. In these situations the Group does not intend to imply that we support or do not support particular issues and silence as to an issue (or no clear view) merely reflects the short consultation period, the broad potential breadth of the TWG's review, the lack of detailed information about options and trade-offs, our broad membership base and the differing impact different taxes will have on their diverse businesses.

With this in mind, we would like to emphasise that any changes arising from recommendations made by the TWG (and accepted by the Government) should be consulted on in full, in accordance with the Generic Tax Policy Process ("GTPP"). It is vital that detailed policy decisions are not made by the TWG without the proposals being considered by the wider public in the usual way. New Zealand has an effective and robust tax system and some of this success is attributable to the transparent and meaningful consultation between Officials and stakeholders. It is important that this continues in the future.

EXECUTIVE SUMMARY OF SUBMISSION POINTS

Competitiveness and the future

It is vital that the New Zealand tax system helps create a business environment which is better than that which exists in competing countries. The tax system needs to support and incentivise, rather than hinder, economic growth. Other countries actively seek to compete on taxes in order to attract investment and the submissions paper does not place enough emphasis on the importance of New Zealand's need for financial capital.

As New Zealand and "New Zealand Inc" look towards the future, we must ensure that we have the flexibility and capability to capitalise on opportunities as they arise. It is in New Zealand's best interests to continue attracting and retaining not only business investment but also individuals who, like many businesses, have the choice of whether to base themselves in New Zealand or not. This needs to be considered in a business tax context, particularly when the corporate tax rate is considered.

Given the TWG's unique opportunity to broadly consider New Zealand's tax system, it is important to consider the "overall equation". What is the overall package of initiatives that New Zealand has in place, should have in place, and would like to have in place for the benefit and growth of New Zealand.

A strong corporate sector

A strong corporate sector is important for any country's economy, and New Zealand is no different. It is important that New Zealand's corporate sector is maintained and continues to grow. New Zealand ranks first overall in the latest World Bank survey on ease of doing business, but only 9th when it comes to paying taxes. In recent years we have seen micro reforms, increasing compliance costs for New Zealand businesses. This burden should not be increased with the introduction of complex new tax rules and we should focus on improving the current tax settings for New Zealand.

The Group refers you to the ATO's computable general equilibrium ("CGE") modelling of the major Australian taxes, which concludes that company income tax has a high marginal excess burden and that, in the long run, much of the economic burden of company tax falls on workers; i.e. the taxes on the corporate sector have the highest long-term costs for living standards and are more 'harmful' than other taxes.

The corporate tax rate needs to be competitive

The OECD 2017 Economic Survey of New Zealand noted "It is hard to see how [New Zealand] can resist the global trend to lower corporate tax rates without losing out on foreign investment." Lowering the corporate tax rate is therefore something New Zealand must also consider.

As it stands, New Zealand has one of the highest corporate tax rates in the OECD. Further, four of the five OECD countries with higher tax rates than New Zealand (Greece, Belgium, Australia and France) have proposals to reduce their corporate tax rates to lower than New Zealand's current rate of 28%.

Despite other jurisdictions (in particular the UK) being at the forefront of targeting BEPS, they have also recognised the need for balance and are vocal about their goal of having a competitive corporate tax system, with the UK committed to a 17% corporate tax rate.

In the past there have been concerns with the 'wedge' (difference between the corporate and individual tax rates) being too large, and avoidance opportunities arising due to the non-alignment of tax rates. In the Group's view, the level of concern around an increased wedge is not necessarily justified, particularly given the measures now in place to address avoidance opportunities (such as the personal services income attribution rule). It would also be possible to adopt some form of an integrated company tax regime where the profits of the company are either attributed to the shareholder or taxed at the shareholder's tax rate (or some proxy thereof).

Alternatively we need a competitive effective tax rate

If the corporate tax rate cannot be lowered to a competitive tax rate, then the tax base on which that higher rate is levied needs to be reconsidered. Possible examples of measures that could reduce the effective tax rate include a comprehensive tax deduction regime (e.g. for black hole expenditure), changes to the depreciation base, rate and low value threshold, or relaxation of rules that spread or defer deductions for expenditure as well as incentivised deductions (e.g. R&D), relaxation of thin capitalisation rules is also an option. Such measures may have the added advantage of reducing unnecessary compliance costs.

The Group notes that it can see a place for tax incentives, with tax rewarding positive actions; for example accelerated depreciation on electric vehicles or sustainably innovative technology, reduced fringe benefit tax for electric vehicles to recognise the lower running costs.

Corporate tax base

There are specific aspects of the corporate tax base that need to be addressed, including:

- Widely-held look-through companies
- Black hole expenditure
- Loss continuity
- Non-resident employee issues
- Tax pooling
- Fringe benefit tax

- Entertainment expenditure
- Provisional tax – tax income method (TIM) for large taxpayers

The Group considers that there is further scope to reduce compliance costs for businesses and we refer you to our "Business Tax Wish List" attached as an Appendix to this submission. Over the past few years the Group has seen the need for flexibility in the tax system emerge as one of the most important considerations. Aspects of the tax rules are currently too prescriptive and can be hard to get right. Rigidity and strictness add compliance costs without adding any significant benefit.

Purposes and principles of a good tax system

Underpinning all of the Group's submissions on tax policy matters are three main principles that the Group believes a good tax system should be built around. These are:

- High certainty, predictability and low business risk
- Low compliance costs
- International competitiveness

The Group is also of the firm belief that a properly functioning GTPP is an appropriate measure for all parties to apply and adhere to, allowing for transparent and meaningful consultation between officials and stakeholders.

However sitting above all of this is the first and foremost consideration of national interest – what is in the best interests of New Zealand as a whole?

Fairness

The submissions paper focuses a lot on the idea of fairness. Fairness is a subjective concept. In the Group's view, to the extent fairness is intended to encompass progressivity, this objective is best addressed through the transfer system and targeted measures that address problems at source. The role of the tax system should be as a mechanism for revenue collection in the most efficient (and least distortive) way possible.

One area in which fairness can, however, be a guiding principle in tax system design concerns the need for maintaining the tax legislation to ensure it applies as intended. Given the complexity of the tax system, there will inevitably be a need for the correction of drafting errors and other amendments to address unforeseen issues from time to time. Fairness requires that an appropriate balance be struck between Inland Revenue led base maintenance initiatives (to address the risk of under-taxation) and taxpayer favourable initiatives to address unintended overreach that would result in over taxation, relative to the policy intent. Broader macro initiatives to remove impediments to investment that would grow tax revenues should also be part of the mix.

Broad-base low-rate (BBLR)

The Group has been a longstanding supporter of New Zealand's BBLR system and continues to support BBLR as an appropriate approach for our tax system. BBLR minimises distortions in the tax system and allows for tax to be a relatively neutral factor in decision making.

However, the Group considers that in recent years there has been a trend towards detail and complexity this is driving inefficiency. Detailed rules to address every conceivable compliance risk or possible gap are resulting in increased compliance costs to the vast majority of taxpayers who are seeking to comply with their obligations. Taxpayers should be afforded more freedom in which to run their businesses rather than spend time and resources trying to comply with complex and uncertain tax law – as noted earlier, compliance costs are part of the deadweight loss associated with tax.

The focus has been on micro reform, when in reality it is macro reform that is needed. Compliant taxpayers are made to weave their way through an increasingly complex labyrinth of rules, designed to combat the behaviour or risks associated with a minority of non-compliant taxpayers. A better approach is for Inland Revenue to identify those non-compliant taxpayers and enforce existing laws including (in cases of aggressive tax avoidance) by applying section BG 1 and other anti-avoidance provisions.

If the tax base is to be broadened significantly, such as if a capital gains tax is introduced, it is important that changes in other areas of tax are considered so that the overall effective tax rate is not driven up as a result.

Capital gains tax

Given the Group's diverse membership, we do not have a view on whether a capital gains tax (CGT) should be introduced or not. However some of our members have strong views that a CGT is harmful and unnecessary and are planning to lodge their own submissions setting out these views. We do note, however, that in a world of falling corporate tax rates, the lack of a general capital gains tax is one of the few competitive advantages the New Zealand tax system offers to businesses looking to locate themselves in New Zealand.

If a capital gains tax is introduced, care must be taken to minimise complexity and compliance costs. For this reason the Group considers that a targeted CGT would be preferred.

For more detailed comments on a CGT (and answers to the CGT design questions posed in the submissions paper), please see our submission below.

Please let us know if you have any queries in relation to this letter, or would like to discuss any of these points further.

For your information, the members of the Corporate Taxpayers Group are:

1. Air New Zealand Limited
2. Airways Corporation of New Zealand
3. AMP Life Limited
4. ANZ Bank New Zealand Limited
5. ASB Bank Limited
6. Auckland International Airport Limited
7. Bank of New Zealand
8. Chorus Limited
9. Contact Energy Limited
10. Downer New Zealand Limited
11. First Gas Limited
12. Fisher & Paykel Healthcare Limited
13. Fletcher Building Limited
14. Fonterra Cooperative Group Limited
15. Genesis Energy Limited
16. IAG New Zealand Limited
17. Infratil Limited
18. Kiwibank Limited
19. Lion Pty Limited
20. Meridian Energy Limited
21. Methanex New Zealand Limited
22. New Zealand Racing Board
23. New Zealand Steel Limited
24. New Zealand Superannuation Fund
25. NZME Limited
26. Pacific Aluminium (New Zealand) Limited
27. Powerco Limited
28. Shell New Zealand (2011) Limited
29. SKYCITY Entertainment Group Limited
30. Sky Network Television Limited
31. Spark New Zealand Limited
32. Summerset Group Holdings Limited
33. Suncorp New Zealand
34. T & G Global Limited
35. The Todd Corporation Limited
36. Vodafone New Zealand Limited
37. Watercare Services Limited
38. Westpac New Zealand Limited
39. WSP Opus
40. Z Energy Limited
41. ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely,
[1]

John Payne
For the Corporate Taxpayers Group

Corporate Taxpayers Group: Tax Working Group Submission

CTG

Judging the tax system – the Corporate Taxpayers Group Approach: The 3 C's

Competitiveness: The tax system plays a critical role in our competitive position with our major trading partners and competitors

Compliance Costs: Tax compliance costs of both taxpayers and Inland Revenue should be kept as low as possible

Certainty: Tax rules must be designed to provide certainty, predictability and low business risk

Tax reform equation

The CTG supports BBLR. If there is broadening of the base there needs to be a lowering of the rate. Tax changes can only be evaluated in the context of the wider package of reform.

Growing NZ Inc

New Zealand has a need for capital, from both within NZ and offshore. The tax regime needs to be competitive to bring in foreign capital.

Let's be aspirational and get out there and compete.

Incentivising saving into the right things

Tax rules need to incentivise New Zealanders to save and invest in productive assets. A capital gains tax on savings products would not create the right incentives.

Preferences for housing

The statistics show a tax preference for housing (including owner occupied housing) but is this driving New Zealand's housing problems? The CTG suggests reforms directly targeting housing are preferable when weighing up the potential revenue vs compliance costs of a capital gains tax.

Looking through to shareholders

Large projects often require multiple investors. New Zealand needs tax rules that allow investors with different tax profiles to co-exist. This could be tax integration, a form of widely-held look-through company, or something else.

The headline tax rate

The corporate rate involves a trade off in how to tax mobile and immobile capital. It is important, however, that the resulting tax rate is competitive so as to attract mobile capital.

Company taxes are more harmful than other taxes and consideration should be given to shifting to more efficient taxes.

The effective tax rate

If the headline rate can't move then what can be done to enhance deductions to reduce the effective tax rate on mobile capital? BEPS changes and black hole expenditure have been increasing the ETR.

Business costs should be deductible

Tax rules are overtaxing businesses looking to grow and innovate. Business costs should be deductible, industrial buildings should be depreciable, debt and equity raising costs should be treated the same; the list goes on.

Letting businesses grow without tax consequences

Innovative start up businesses will typically be in a loss position and the tax rules penalise businesses that need to bring in new shareholders. Loss continuity rules are hampering the ability of businesses to grow.

Businesses need to get on with business

Tax rules are becoming unnecessarily complex and are increasing compliance costs on businesses. Business is already the unpaid tax collector. Any tax reform needs to be conscious of the cost to comply.

APPENDIX ONE – THE GROUP'S SUBMISSION

The Group has set out (in green boxes) the "Questions for submitters" in the submissions paper, in the order that these questions are asked by the TWG and below each question the Group sets out its response.

1. The future environment

> **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?**

Competitiveness and the future

1.1. The Group believes that New Zealand's tax system plays a critical role in our competitive position with our major trading partners and competitors – tax is a significant cost of doing business. The New Zealand tax system should help create a business environment which is better than that which exists in competing countries. The tax system needs to support and incentivise rather than hinder economic growth.

1.2. This need to be tax competitive with other jurisdictions is very important, in order to attract and retain foreign investment. Taxes are distortionary and if taxes are excessive, they will ultimately be passed onto New Zealanders. New Zealand is a small economy reliant on exports, right next to a very large Australian economy. New Zealand is in a constant struggle against Australia for capital / foreign direct investment ("FDI"), particularly given we are geographically separated from the world. Other countries actively seek to compete on taxes in order to attract investment and the submissions paper does not place enough emphasis on the importance of New Zealand's need for financial capital.

1.3. It is worth noting that the Australian Treasurer has requested that the House of Representatives Standing Committee on Economics conduct an inquiry into the impediments to business investment in Australia.[1] In the media release, the Treasurer noted that:

> "*Business investment is critical to economic growth. When firms are empowered to invest in new productive capacity and technology, it supports innovation and helps create new opportunities and employment for Australians*."

The inquiry also specifically includes consideration of:

> "*The role that taxation policy, at the Commonwealth and State government levels, can have on the encouragement of new business investment.*"

[1] http://sjm.ministers.treasury.gov.au/media-release/030-2018/

The results of this report should be considered carefully by New Zealand. In New Zealand the coalition Government[2]:

> *"is committed to […] sustainable economic development increased exports and decent jobs paying higher wages, a healthy environment, a fair society and good government."*

1.4. This economic perspective is missing from the submissions paper. We cannot look at the New Zealand tax system in isolation and in relation only to itself, we must also look at tax systems of competing jurisdictions and the wider economic context. Increased financial capital is important for an economy like New Zealand and greater FDI not only brings in more capital, but also new ideas and innovation. Yet all New Zealand has done recently is increase complexity in the tax system (take the BEPS reforms as an example), actions that will only act to reduce the level of investment in New Zealand. However we do understand that the TWG has had a full briefing on the New Zealand economic environment and therefore should be well briefed on the impact that tax changes can have on the economy. We also note that the April 2018 Government discussion document in respect of research & development *Fuelling innovation to transform our economy* which is an example of tax assisting with improving the competitiveness of the economy.

1.5. An appropriate starting point is to ask the 'simple' question, where does New Zealand see itself in twenty years? This requires not only consideration of where we would like to be, but consideration of the reality of the international landscape, changing demographics and attitudes, and the evolution of technology and digital economies. If there is to be meaningful reform, we must look further ahead than merely 5-10 years into the future. Considering the time it will take to get any meaningful change enacted (in following the TWG and proper consultation processes), New Zealand's position in the world (and indeed the world itself) will have already moved on. We need to consider where we see ourselves in the future (e.g. will we still be heavily reliant on dairy and agricultural exports and tourism or will we be a land of digital entrepreneurs?), and then future proof our tax system so that we can adapt and react to the changes to come.

1.6. Part of this is to consider where in the value chain New Zealand will lie. We are currently an industry based country, with a solid foundation based on our natural capital and labour capital. However, in the future we would expect to see a more mobile workforce, less reliance on natural resources and a more digitalised industry where it doesn't matter where you are based. It is important that New Zealand adapts to meet this challenge.

1.7. We must also specifically consider who we think New Zealand's major trading partners will be and identify the businesses and people we think will be coming to New Zealand in the future (or that we would want to attract to New Zealand). These trading partners, businesses and people may not be those that we have traditionally favoured / worked with, but we must have the flexibility to capitalise on opportunities as they arise.

1.8. New Zealand will want to continue attracting and retaining not only business investment but also individuals who, like many businesses, have the choice of whether to base themselves in New Zealand or not. One way of attracting these

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[2] Coalition Agreement New Zealand Labour Party & New Zealand First refer > http://www.scoop.co.nz/stories/PA1710/S00058/coalition-agreement-nz-first-and-labour.htm

taxpayers could be to reduce headline tax rates. However, if some of the tax base is lost, there would need to be more reliance placed on sourcing tax revenue from other sources. This needs to be considered in a business tax context, particularly when the corporate tax rate is considered.

1.9. With the above in mind, the Group sets out below some of the key areas of opportunities, risk and challenges it sees for the tax system.

Company taxes

A strong corporate sector

1.10. A strong corporate sector is important for any country's economy, and New Zealand is no different. Corporates employ a significant section of New Zealand's working population and there is a direct correlation between a successful corporate sector and growth and innovation. The previous Government's Business Growth Agenda noted the importance of New Zealand being internationally connected, as internationally connected firms can access large markets and bigger opportunities. In particular:

> *"With access to bigger pools of capital, skills and ideas, most internationally connected firms are more innovative and productive. They are therefore critical to creating jobs and lifting incomes in a sustainable way."*[3]

These "internationally connected" firms are those such as the corporates that make up the Group's membership base. They are also the corporates we want to invest in New Zealand and those that we want to trade with New Zealand[4]. For these corporates, their potential tax impost and the perceived complexity and compliance costs within the tax system are hugely significant factors for them in deciding whether to do business in and/or with New Zealand. It is important that the tax system does not act as a deterrent.

1.11. New Zealand prides itself on the ease of doing business in New Zealand, particularly in relation to setting up companies and other company administration. However the same cannot be said for our tax system (at least overall). In recent years we have seen micro reforms, increasing the burden of paying tax (from a compliance costs perspective) on businesses in New Zealand. This burden should not be increased with the introduction of complex new tax rules and we should focus on improving the current tax settings for New Zealand. In this regard we note that the latest World Bank survey on ease of doing business ranked New Zealand as first overall, but only 9th when it comes to paying taxes.[5]

The corporate tax rate needs to be competitive

1.12. The Group understands that a reduction in the corporate tax rate is not as simple as it sounds, and that many factors must be taken into account. However the Group notes that recently there has been a trend within the OECD member countries of recognising the need for a competitive tax system and reducing their corporate tax rate. The OECD 2017 Economic Survey of New Zealand noted "it is hard to see how [New Zealand] can resist the global trend to lower corporate tax rates without losing

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[3] https://enz.govt.nz/assets/Uploads/BGA-2017-refresh-report.pdf
[4] The OECD in the 2017 Economic Survey of New Zealand recognised the importance of international connections for improving productivity. See OECD, *OECD Economic Surveys: New Zealand* (2017) at 16.
[5] http://www.doingbusiness.org/rankings

out on foreign investment"[6]. Lowering the corporate tax rate is therefore something New Zealand must also consider.

1.13. For example Australia intends to lower its corporate tax rate to 25%, the UK is dropping its corporate tax rate to 17% from April 2020 and the US has lowered its corporate tax rate to 21%. We have attached as an Appendix the OECD corporate tax rates and rates of parties to the Trans-Pacific Partnership, including any proposed changes. As it stands, New Zealand has one of the highest corporate tax rates in the OECD. Further, four of the five OECD countries with higher tax rates than New Zealand (Greece, Belgium, Australia and France) all have proposals to reduce their corporate tax rates to lower than New Zealand's 28%.

1.14. This difference is even more pronounced given our broad-base low-rate tax system and the general lack of tax incentives (unlike most other jurisdictions) which means our effective cash tax rate is close to or exceeds the corporate tax rate. Other jurisdictions (in particular the UK) have been at the forefront of targeting BEPS, but they have also recognised the need for balance and are vocal about their goal of having a competitive corporate tax system. While the Group agrees that lowering the corporate tax rate is not a silver bullet, New Zealand needs to keep an eye on the corporate tax rates and tax systems of other countries and not let itself fall behind. Where the gap between New Zealand and other countries widens, New Zealand is at a real risk of becoming a less attractive investment destination.

1.15. The impact of the corporate tax rate on the cost of capital and investment attractiveness is an important issue for the wellbeing of New Zealanders. New Zealand relies heavily on inbound investment to fund its capital stock and a range of studies have suggested that New Zealand has under-developed financial markets and low capital intensity. As a consequence, productivity is negatively affected. *New Zealand's taxation framework for inbound investment* notes there "[t]here is a reasonable degree of consensus in the literature that FDI is normally highly sensitive to the company tax rate." [7]

1.16. The Group understands that Inland Revenue may be concerned with avoidance opportunities due to the nonalignment of tax rates (i.e. if the 'wedge' is perceived as being too large). However the Group would like to see an analysis / study of whether this is in fact the case (which could include a study of how other countries have addressed this issue, such as with Australia's current 30% company tax rate and the top personal tax rate of 45%). In the Group's view, the level of concern around an increased wedge is not necessarily justified, particularly given the increased controls and settings that have been put in place to address avoidance. The Group notes that within this debate imputation plays an important role as a back stop to the corporate tax rate. Without having undertaken a full assessment of the regime, the Group considers that, on-balance, the imputation system is working well and should be retained.

1.17. Leaving the above aside, educated investors will look beyond the corporate tax rate and look more broadly at New Zealand's tax settings when determining whether they will invest in New Zealand. Our international tax settings in particular play a part in this. Around the world, jurisdictions moving towards or with low corporate tax rates have implemented, amongst other things, interest limitation and thin capitalisation changes to balance the low corporate tax rate. However in New Zealand, we have implemented these changes to the international settings *and* left our corporate tax rate where it is. There has been no overall rebalancing of the tax system. The

[6] OECD Economic Surveys: New Zealand (2017) at 40.
[7] Inland Revenue *New Zealand's taxation framework for inbound investment* (June 2016) at 8.

consequence of this is that both our headline and effective corporate tax rate risk falling out of step with the global trend, with the result that capital becomes harder or more costly for New Zealand to attract.

1.18. If the 'non-alignment' concerns over the personal and corporate tax rate are considered to be persuasive, then consideration could be given to adopting some form of an integrated company regime where the profits of the company are either attributed to the shareholder or otherwise taxed at the shareholder's tax rate (or some proxy thereto). This would ensure that domestic shareholders are not able to shelter income from tax through the use of a corporate structure whilst ensuring that the company tax rate remains competitive to attract capital to New Zealand. Such a regime would involve some complexity. However, a similar regime has in effect successfully been in place within the savings industry via the Portfolio Investment Entity ("PIE") regime.

1.19. An integrated company regime would allow for a more deliberate targeting of the corporate tax rate to allow it to be competitive without concern for domestic avoidance opportunities that the non-alignment of the corporate and personal tax rates may be perceived to provide. We note that there are a variety of valid commercial reasons for companies retaining earnings at the expense of dividends, e.g. for planned investment.

1.20. The complexity of such a regime would in part be driven by the desire for accuracy. Full integration would be the most complex, but some sort of calculation similar to the PIE regime where income is taxed based on the shareholder's tax rate (or proxy) may allow for a less complex system. However, regardless of whether an integrated regime is adopted to address the non-alignment issue, we consider the ability for taxpayers to utilise a tax pass-through corporate entity is important as it reduces complexity. This is particularly true in comparison with New Zealand's unwieldy limited partnership regime. This will improve our competitiveness and puts New Zealand on the same footing as Australia which is implementing a tax pass-through company regime.

Alternatively we need a competitive effective tax rate

1.21. If the corporate tax rate cannot be lowered to a competitive rate, then the tax base on which that higher rate is levied needs to be re-considered. Possible examples of measures that could reduce the effective tax rate include a comprehensive tax deduction regime (e.g. black hole expenditure, wind back of thin capitalisation rules), changes to the depreciation base and rates, enhanced timing of deductions as well as incentivised deductions (e.g. R&D). Such measures may have the added advantage of reducing unnecessary compliance costs.

1.22. In June 2016 Inland Revenue released a draft paper *New Zealand's taxation framework for inbound investment (*"inbound investment framework paper"). The inbound investment framework paper was an overview of New Zealand's framework for taxing income earned on inbound investment and noted that a priority for the Government (at that time) was "*…to ensure that New Zealand continues to be a good place to invest and for businesses to be based, grow and flourish. Excessive taxes on inbound investment can get in the way of this happening."*

1.23. While the paper did not conclude on whether a reduction in corporate tax is necessary, it did note that the non-deductibility of certain expenditure for non-residents drives up their effective tax rate. For example:

> *"…if the foreign country had a lower company tax rate than New Zealand, the foreign parent would prefer to debt-finance its New Zealand subsidiary and tighter thin capitalisation rules would lead to an increase in the effective tax rate on inbound investment and an increase in the pre-tax cost of capital for that investor."*

1.24. As the inbound investment framework paper[8] notes, there is a difference between the effective tax rate and the full corporate tax rate for non-residents investing in New Zealand. It is a common feature of tax systems internationally that non-residents are not subject to the full corporate tax rate on all their returns, since part of those returns will usually be in the form of interest. This is the case in New Zealand also. Provided certain thresholds are met and non-resident withholding tax ("NRWT") is paid, non-residents can debt fund a portion of their investment, and the New Zealand tax on the interest component of the non-resident's return will be the relevant NRWT rate. For example, non-resident owned corporates are taxed at 28% on the equity component of their investment, but (typically) at 10% on the debt component (note that if NRWT applies on dividends, then the tax burden on equity could potentially be higher than 28%).

1.25. However, if there is a reluctance to reduce the 28% corporate rate, the Group queries what the TWG consider is the ideal effective rate for non-residents? If a non-resident has money to invest, they have a choice of where they want to invest this money and will look at all their options. New Zealand needs to remain competitive.

1.26. One potential solution is to evaluate the boundary between debt and equity to allow non-residents to take out earnings as interest subject to NRWT – which will lower their effective tax rate (depending on the mix of debt / equity). As it stands, if the tax rate does not change and there is increased tightening on debt funding, this will have an overall negative effect. While it might be politically expedient to look to clamp down on non-residents putting debt into New Zealand we have to acknowledge the flipside, which is that this will reduce investment in New Zealand.

CGE modelling on company taxes

1.27. In March 2015 the Australian Taxation Office released a tax discussion paper, *Re:think Better tax system, better Australia* (the "Re:think discussion paper").[9] A section of this report covered the CGE (computable general equilibrium) modelling of the major Australian taxes, concluding that stamp duties and company income tax have the greatest "marginal excess burden" (i.e. they are the taxes with the highest long-term costs for living standards and are more 'harmful' than other taxes). The following graph sets out the results of CGE modelling on the various taxes in Australia. While obviously specific to the Australian context, the Group expects a similar study run in New Zealand would generate broadly the same results.

[8] http://taxpolicy.ird.govt.nz/sites/default/files/2016-other-nz-framework-inbound-investment.pdf
[9] http://bettertax.gov.au/files/2015/03/TWP_combined-online.pdf

Chart 2.9 Long-run modelling estimates of the marginal excess burden of some of Australia's taxes

Note: Marginal excess burdens were estimated using a long-run CGE model of the Australian economy and tax system. Australian households are captured as a single economic unit in this model. The labour income tax is modelled as a stylised flat tax on labour income only. An out-of-model calculation for a marginal tax rate (MTR) of 25 per cent is presented as an illustration of an average taxpayer in 2011-12. Transfer payments are not captured in this model. For more information on this modelling, as well as analysis of a stylised capital component of individuals taxation, see the Australian Treasury working paper forthcoming, *Understanding the economy-wide efficiency and incidence of major Australian taxes*.
Source: Treasury estimates.

1.28. Some key points to draw out from this report include:

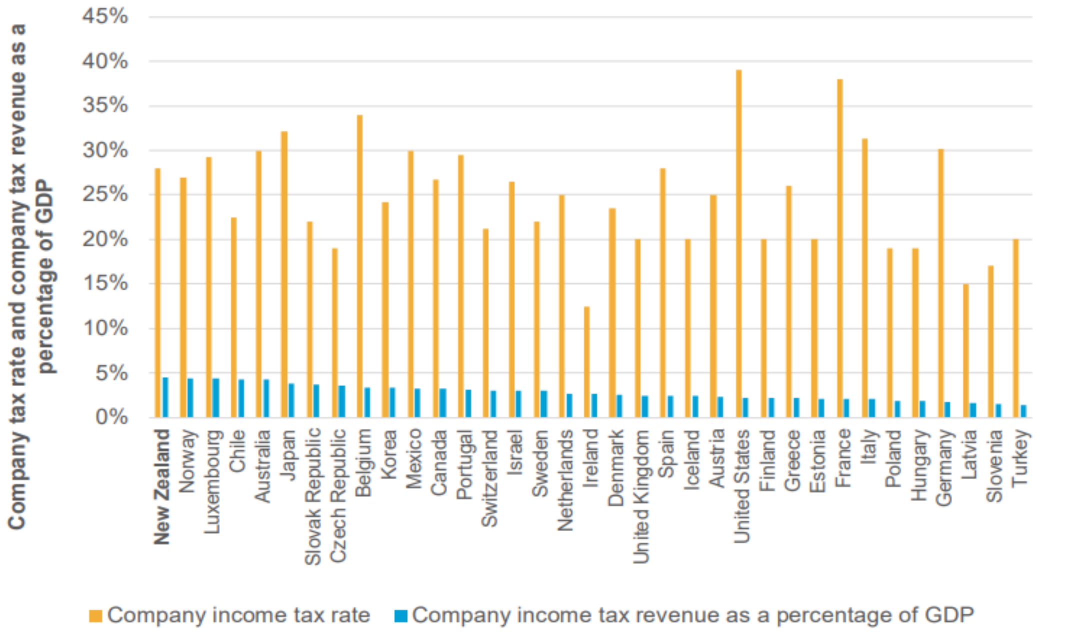
> *"Company income tax has a high marginal excess burden because of the relatively high company tax rate of 30% in Australia, combined with the high level of mobility of the underlying tax base."*
>
> *"Recent research by the Treasury indicates that, in the long run, much of the burden or incidence of company tax falls on Australian workers. This is because, over time, the amount of capital investment in Australia (for example, the construction of buildings and purchase of equipment for production) is affected by the company tax rate. Lower amounts of capital investment in the Australian economy will reduce the output or productivity of labour and, in turn, reduce the real wages of workers."*
>
> *"The high economic cost of some taxes, combined with the distribution of those costs through the economy, has prompted a policy response internationally. Many countries, including the United Kingdom and Canada, have reduced their company tax rate in recent years and strengthened their integrity rules to counter multinational planning. Consequently, while Australia's integrity rules are strong, our company tax rate of 30 per cent is now significantly above the average rate of other countries, particularly our Asian neighbours, with whom we compete for foreign investment."*

The above suggests that New Zealand would be better off reducing corporate income tax (or seeking to reduce the effective tax rate) and should instead seek to maintain the tax base through other, less harmful taxes, such as GST. The impact of the corporate tax rate on FDI cannot be underestimated and it is important that this is considered carefully as part of the wider consideration of corporate / business taxes.

GST

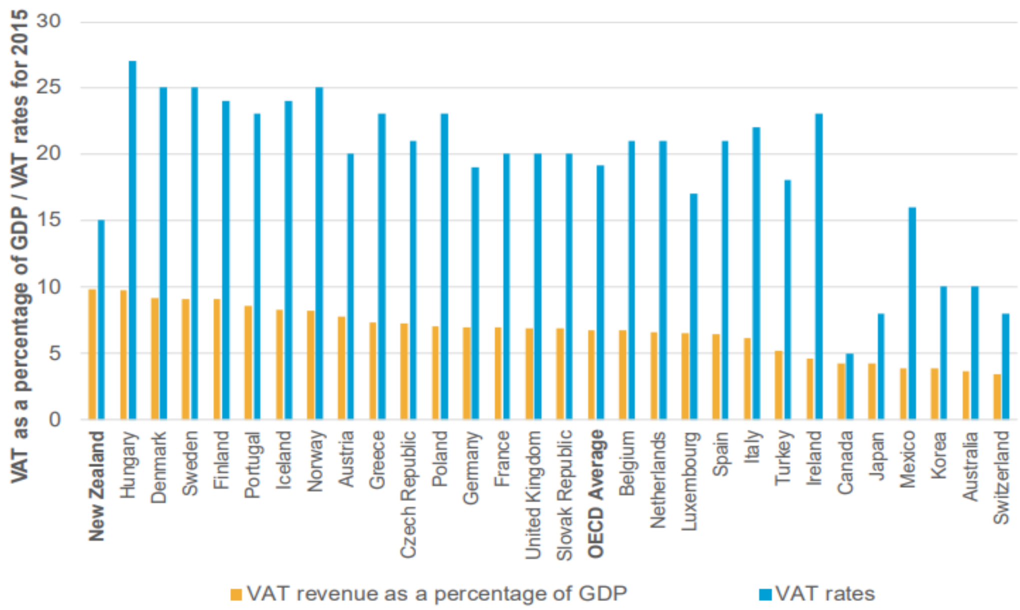
1.29. The Group acknowledges that the TWG has been precluded from looking at raising the overall GST rate. However an increase in the GST rate would be the simplest and most efficient method of raising more revenue if that is considered necessary. The government could amend the benefits regime to "compensate" low earners for the increased GST (or make corresponding tax rate changes to lessen the impact). The figures below (taken from the TWG report but based on OECD statistics) show New Zealand has a relatively high corporate tax rate, but one of the lowest GST rates in the OECD.

Figure 8: Company income tax rates and revenues (2015)



Source: OECD

Figure 9: Value-added taxes as a percentage of GDP (2015)



Source: OECD

Corporate tax base

1.30. In the Group's view, there are also some specific aspects of the corporate tax base that need to be addressed. We set out below some specific examples of issues of importance to the business community. We also refer you to our "Business Tax Wish List" attached as an Appendix to this submission.

Widely held look-through companies

1.31. The closely-held look-through company regime recognise the distortions and added costs that the interposition of a corporate vehicle can have. The Group would like the benefits and treatment of closely held look-through companies to be extended to widely held companies, creating an entity that can be described as a widely held look-through company ("widely-held LTC"). Small companies can use LTCs and private equity can use limited partnerships. However widely-held corporates have fewer options (and can struggle to use limited partnerships as these are unwieldy and not well understood offshore).

1.32. Most businesses prefer to use companies as these are a relatively simple and well-known form of entity. However, companies have significant tax implications when there are different tax profiles in play (i.e. ordinary companies, non-resident investors, charities, Maori authorities etc) meaning income can be over-taxed relative to the tax profile of the shareholder. This can incentivise the use of more complicated structures, such as limited partnerships, which allow for income to be taxed at the level of the investor.

1.33. Introducing the concept of a widely held LTC would go a long way towards increasing New Zealand's competitiveness in the international market. It is notable that Australia has put forward proposals[10] in this space and it is likely that changes will be made in the near future.

[10] https://consult.treasury.gov.au/financial-system-division/asia-region-funds-passport/

Loss continuity

1.34. The Group, along with a number of interested business groups including BusinessNZ, have formally collaborated 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.

1.35. We also note the Government's recent discussion document on R&D tax credits suggests excess R&D tax credits will be carried forward on a similar basis to tax losses. The lack of an alternative carry forward test in this context means carried forward credits will potentially be forfeited where new equity is sought by these innovative and fast growing companies, defeating the purpose of the regime.

Black hole expenditure

1.36. Over the years there have been a number of ad hoc changes to address specific types of black hole expenditure, and Officials have recently been working with the Group on a solution to deal with "feasibility expenditure". Substantial work has been performed and possible solutions have been explored which the Group would like to see completed as soon as possible.

1.37. However, in addition to feasibility expenditure there are still a number of other categories of black hole expenditure in the New Zealand tax system, where tax deductions are not available for legitimate business costs. The Group believes that the following examples of black hole expenditure require consideration:

- Costs incurred by a business seeking to raise debt funding (either by way of a traditional loan or by issuing bonds), where ultimately the taxpayer does not successfully raise that debt.

- Costs incurred in raising equity (i.e. through the issue of shares). This creates a tax preference (i.e. a distortion) to raise debt over equity.

- Certain resource consent costs and certain improvements made to land.

- Losses on disposal of buildings (i.e. where the building is sold below its tax book value). A tax deduction is available for a loss made on the disposal of any asset aside from a building. When a taxpayer disposes of a building below its original cost, there is unquestionably a reduction in the value of the building. The Group believes this should be allowed as a deduction when the building is ultimately sold.

- Capital expenditure to earthquake strengthen buildings. Many taxpayers have suffered a reduction in the value of their buildings due to a reassessment of the seismic risks. When they incur expenditure to strengthen the building, they obtain no tax relief for these costs given the removal of tax depreciation on buildings. In many cases the expenditure is simply a result of changing building regulations. Taxpayers should be allowed to claim a tax deduction for that expenditure either upfront or amortised over time. We believe this should be considered in detail by the Government.

- Costs incurred in acquiring a business asset, for example due diligence costs, especially when the acquisition does not proceed.

1.38. Previous governments have sought to resolve instances of black hole expenditure one at a time. However the Group notes that there is a case for a broader "catch all" category, to provide a tax deduction for black hole expenditure that is not otherwise covered by specific legislation. This would minimise the resource demands on Inland Revenue and the private sector alike. In this respect the Group notes that Australia adopts this "catch all" approach to black hole expenditure by providing an effective deduction for black hole expenditure which is not otherwise deductible spread over a period of 5 years. While such an approach has an obvious cost, this is significantly outweighed by the benefit of simplifying the position and eliminating the additional deadweight loss of a more complicated regime; a more holistic solution will also significantly reduce compliance costs judging the capital / revenue boundary and could be fiscally positive[11]. The Group has previously endorsed this approach and would like to work with Officials on this issue.

1.39. Some, but not all, of the issues raised above have a connection with capital (that is, if capital gains are to be taxed, capital expenditure should be deductible). As part of the consideration of the introduction of a CGT, some of the above issues should be analysed at the same time given the overlap and interconnectivity of the issues. However, the Group notes that even outside of the introduction of a CGT there remains a need to resolve the issue of black hole expenditure.

Research & development expenditure – wider reform

1.40. The Group sees loss continuity, R&D tax credits and black hole expenditure as part of a wider package of attracting business to New Zealand and fuelling positive expenditure and growth within New Zealand as a whole. These are issues that should be considered together and given the release of the recent R&D discussion paper (which mentions tax losses), there should be more thought given to a broader approach for New Zealand Inc. In particular, the Group considers that a solution to black hole expenditure is just as important and relevant as R&D in the context of attracting the large firms to New Zealand.

1.41. The R&D discussion paper notes that there is a lack of R&D being carried out by large companies (and that New Zealand lacks the large multinational companies driving R&D expenditure overseas). It also notes that large firms bring resources to the economy that small firms struggle to provide, such as high quality managers and entrepreneurs, knowledge of international markets, large capital budgets, corporate finance and a customer base for smaller high-growth firms. If multinationals are so important to New Zealand, then more should be done to attract them, and addressing the issue of black hole expenditure should be high on this list.

Tax remedials

1.42. The Group supports a more flexible process for dealing with remedial tax matters. The tax system is complex. There will inevitably be aspects of the legislation that do not apply as intended. In addition, there can sometimes be areas where minor technical changes would improve the way the tax system operates.

1.43. A more flexible approach to administration (such as is called for below) does not remove the need for adequate resourcing for progressing remedial amendments. The

[11] As taxpayers may conservatively amortise expenditure over 5 years rather than taking an immediate deduction

pace and scale of tax reform inevitably leads to drafting errors and other instances of the law not operating as it should and hence an increased demand for resources to remedy these deficiencies. At the same time, the demands that the general tax law reform programme places on Inland Revenue constrains the resources available to address remedial tax matters.

1.44. The problem will likely be exacerbated in the future as many of the current reforms are complex and will likely involve post implementation issues that need remedying. Addressing remedial matters when they arise ensures that tax law operates as intended. If these tax remedials are not addressed on a timely basis this will create significant uncertainty for taxpayers. Therefore, dedicating sufficient Inland Revenue policy resource to addressing remedial tax matters regardless of other priorities is essential for maintaining perceptions of fairness and public support for the tax system.

Non-resident employees: source and the traditional work environment

1.45. The residency and source rules are an area that will need to be considered further as we move into a world of advanced technology and increased mobility. The make-up of the future workforce is expected to look very different to what it is now, with the existence of some jobs under threat and new jobs expected to be created. It is also expected that many roles will become automated and the future workforce will be more mobile (if not already so). The traditional work environment and workforce as we see it now is changing.

1.46. This change represents both an opportunity and a threat for New Zealand. In the future, the tax base we are taxing now will not exist in the same form and it is important that the New Zealand tax system is flexible enough to adapt for these changes. New Zealand operates on a broad-base low-rate system so it is important to remain agile to retain the benefits of this system and not just in relation to residency.

1.47. In particular, the Group has long supported changes to the tax system to take into account non-resident employee issues. The key issue that arises is where an employer/employee relies on a day count exemption (either 92 day domestic rule or 183 day treaty rule) to not withhold PAYE in New Zealand and then the individual inadvertently breaches the relevant limit. Penalties and interest then apply from day one. The Group would like to see to some leniency applied in this area and a wider review of this issue to consider the way the PAYE rules apply to non-residents working in New Zealand.

1.48. It is arguable that in the future the taxation of non-residents should become a matter of administration for the government (as opposed to employers). For example, immigration could identify non-residents entering New Zealand on working visas and pass their information on to Inland Revenue (including their contact details). These people would be given information about their tax obligations and would need to fill out some sort of disclosure form (could be part of the visa application process). Inland Revenue could then contact the non-resident person(s) and deal with them directly on the collection of appropriate deductions (i.e. taxes, withholdings, levies etc from the income or revenue they earn whilst in New Zealand). On leaving New Zealand the non-resident person(s) would be required to make a declaration or obtain clearance about the payment of taxes. Such a process (acknowledging that this would need to be refined) would remove some of the current issues and risks faced by employers and other payers of non-resident contractors.

Tax pooling

1.49. The tax pooling regime exists to try and overcome the fact that interest rates that the Inland Revenue charges and pays on under and overpaid tax are the same across all sectors of the economy regardless of their credit risk. The reality for much of corporate New Zealand is that the rate of interest charged by Inland Revenue exceeds the corporate's cost of funds. Consequently, such taxpayers typically overpay their tax instalments to mitigate the risk of the higher Inland Revenue interest rate applying. This results in an inefficiency in that money is in effect deposited with Inland Revenue at less than market rates.

1.50. Assuming that a single interest rate dynamic remains, it is imperative that the pooling regime is effective to mitigate the additional deadweight loss that such an interest regime imposes. The numerous amendments to the pooling regime that have been required to overcome restrictive applications of this regime by Inland Revenue evidence that it has not been fully successful in this regard and issues still remain. With this as background, the Group would support a broad review of the tax pooling regime, in particular consideration of whether the regime is working as intended, and whether any changes are necessary following amendments to the provisional tax regime and other Business Transformation changes.

Fringe Benefit Tax

1.51. The Group supports a review of the FBT regime. The FBT rules currently operate in a punitive manner, leading to significant over taxation of benefits. In particular, the Group believes that the FBT rules in relation to motor vehicles do not reflect the commercial and practical reality of the benefit being provided to employees. Other FBT issues could also be considered such as removing FBT from certain "positive" benefits, including the provision of electric / hybrid cars to employees (at a minimum there should be a reduction in how FBT is calculated given these vehicles have lower running costs).

1.52. Another example of the need for review of the FBT rules arises from the increased use of flexible working arrangements including the ability to work remotely. Tax law has not kept pace with developments in technology, for example with communication benefits / allowances, where more people are working out of the office (and are often required to be contactable outside of work hours, and/or to be able to work from home if necessary as part of the employer's business continuity planning). The Group would support a pragmatic and flexible solution to this issue that provides greater certainty and does not treat equivalent benefits differently.

Entertainment expenditure

1.53. The Group would like to see a review of the entertainment expenditure regime. This is an extremely complex area of tax, particularly as it has income tax, FBT and GST implications, as well as numerous exceptions and qualifications that must be considered. The amount of tax at stake (and the amounts of expenditure involved) are relatively small and the precision required is unjustified, especially when the regime is an arbitrary one. It is currently extremely difficult to identify, code and capture entertainment expenditure properly and this has become a real pain point for businesses.

1.54. One example of this is the tax treatment of gifts of food and drink provided to clients, noting that the current interpretation of the rules is beyond what a layperson would consider entertainment. Another is the differing tax outcomes when a cup of coffee is drunk on or off premises (and the list goes on). The entertainment expenditure regime is too compliance cost heavy, especially when considering the amount of tax that is at stake.

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

1.55. The tax system is entering a new world of real-time engagement and greater flexibility and, as the tax system evolves, the rules governing it also need to adapt and improve. We set out below some general comments on how the tax system should change in response to various issues raised.

1.56. Over the past few years, the Group has seen the need for flexibility in the tax system emerge as one of the more important considerations. Linked closely to this concept of flexibility is the desire for certainty and the Group considers that these two concepts could be applied to better effect (both being of vital importance to the New Zealand tax system). Aspects of the tax rules are currently too prescriptive and can be hard to get right. Rigidity and strictness add compliance costs without adding any significant benefit. Taxpayers should not have to jump through multiple hoops to achieve the end result and there should be more leniency in allowing taxpayers to arrive at that final output.

1.57. There should be more consideration given to practical, real-world outcomes, especially where there is law change or operational change. Taxpayers should be afforded the freedom to run their businesses how they wish to do so and some examples of potential principle based outcomes from the Commissioner of Inland Revenue include:

- Black letter law should be drafted as simply as possible, consider the extra compliance costs of absolute precision, use 'safe harbours' and be supplemented by Inland Revenue determinations / regulations.
- Where possible Inland Revenue should make use of existing law (rather than instigating new laws) and use its existing tools such as section BG 1.
- Taxpayers should be given answers that are practical and not overly restrictive, and should be given real-world solutions that fit in with their business.
- There should be flexibility in the way in which the Commissioner exercises her power to allow for the myriad ways in which businesses operate.
- This could be achieved through greater use of determinations.
- The focus should be on what the right outcome is, not what the specific inputs are.
- In this new technological world, where we have provisional tax paid through accounting software (for some) and more direct links through reporting of information, Inland Revenue shouldn't have to expend resources to turn over every stone.
- There should be more alignment of the tax rules with the IFRS accounting standards.
- Adherence to GTTP consultation with realistic timeframes for discussion.

1.58. The Group considers this is an area where the Commissioner's discretion and care and management role under section 6A (of the Tax Administration Act 1994) should come to the fore. Under these provisions (and using any of the examples above), there needs to be flexibility in the rules and in the administration of the rules to provide taxpayers with certainty *in real time*. The Group has had a number of interactions with Tax Policy Officials in relation to this and we understand that a considerable amount of work has been done.

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

1.59. A number of the Group's members have business relationships with the Maori economy and co-invest in a number of projects and assets. The Group sees the Maori economy as an important part of the New Zealand business environment.

1.60. Reflecting the comments above on the complexity that the traditional company model has for accommodating different tax profiles (such as Maori authorities or charities) the Group believes that investment alongside the Maori economy would be enhanced and simplified if a corporate flow through vehicle, such as a widely held look through company, was available. This would allow other investors to easily co-invest with Maori businesses operating under the Maori Authority tax regime (which we understand is working well and should be retained).

2. Purposes and principles of a good tax system

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

2.1 Underpinning all of the Group's submissions and engagement on tax policy matters are three main principles that the Group believes a good tax system should be built around. These are certainty, compliance costs and competitiveness (collectively known as "The 3 C's"). We set out what these mean to the Group below:

- *High certainty, predictability and low business risk:* For the corporate sector, tax is not just a cost of doing business but is also a very significant risk. If the tax rules increase business risk by creating uncertain or unexpected tax outcomes, this has a negative effect on all businesses who must spend significant resources considering the tax implications of their decisions. Tax should not distort decision making and low certainty and predictability detrimentally impacts growth and innovation.

- *Low compliance costs*: Compliance costs imposed by the tax system contribute to the deadweight loss of tax. Tax compliance costs of both taxpayers and Inland Revenue should be kept as low as possible. Those resources used to meet compliance costs would be better employed creating jobs and raising the wealth of New Zealand.

- *International competitiveness*: Taxes are a significant cost of doing business. The higher those costs are in New Zealand relative to other countries, the higher the relative costs of doing business in New Zealand. That flows through to less investment, fewer jobs and lower wealth. New Zealand's tax system plays a critical role in our competitive position with our major trading partners and competitors.

2.2 The 3 C's have significant overlap with the common principles, as described in the Paper, that are used for considering costs and benefits of various reforms. These are efficiency, equity and fairness, revenue integrity, fiscal adequacy, compliance and administration costs and coherence. The Group believes that these are all important considerations but notes that trade-offs may need to be made between various principles when changes are made to the tax system. In this situation, the most important consideration is that of national interest – what is in the best interests of New Zealand as a whole?

2.3 The Group is supportive of tax policies also being analysed against the Living Standards Framework as this recognises the trade-offs that need to be analysed when considering tax policy changes. For example, a tax policy change in pursuit of perceived fairness could improve social capital but at significant cost to financial capital which could have flow-on impacts to natural capital. In this submission, the importance of a competitive tax system has been emphasised by the Group, and when analysed from a Living Standards Framework perspective, the Group considers a competitive tax system is still important.

2.4 Sitting alongside all of the above considerations and principles is the importance and continued relevance of the GTPP. This framework allows for transparent and meaningful consultation between Officials and stakeholders and is a pillar of New Zealand's robust and effective tax system. The Group is of the firm belief that the GTPP is an appropriate measure for all parties to apply and adhere to.

2.5 However, in the past couple of years, the Group has seen a deterioration in the quality of application of the GTPP. This has been a significant concern for the Group and the GTPP should only continue if the application is improved. One particular example of a breakdown in the GTPP process has been with the BEPS consultation process.

2.6 The Group is aware of the considerable time pressure Officials were under to get the *Taxation (Neutralising Base Erosion and Profit Shifting) Bill* ("the Bill") introduced into Parliament before the end of 2017. However, where the subject matter is as significant and technical as the issue of BEPS, exposure drafts of legislation should be meaningfully consulted upon, to ensure that quality legislation is making its way to Parliament. While there was some limited consultation on aspects of the Bill, this was undertaken under extreme time pressure and in most instances there was no opportunity to consider revisions. The Group believes there should have been more detailed consultation on the draft legislation before it was introduced into the House. There needs to be more emphasis on getting it right from the start.

2.7 In addition, there is currently a worrying trend developing whereby, in our view, Inland Revenue Tax Policy has become unduly influenced by Inland Revenue investigators, resulting in a number of reforms that are contrary to the overall tax policy framework and create significant collateral damage (e.g. employee share schemes, aspects of BEPS reforms). In particular, Inland Revenue's KPIs are in part based on adjustments to positions taken by taxpayers – this is an inappropriate measure and drives distortionary behaviour.

2.8 The Group would support a regulatory / determination making power that could be used to ensure that legislation is applied consistent with the original policy intent. This would allow for more flexibility in amending any errors in legislation. If this option is pursued, Officials or the Finance and Expenditure Select Committee should consult with stakeholders on the appropriate scope of such a power. However, while the Group accepts that there will at times be mistakes in legislation and unintended consequences, continued commitment to a full and effective GTPP should be the first line of defence in seeking to minimise mistakes and complexity in tax legislation.

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

2.9 Fairness is a subjective concept that can be difficult to measure. In the Group's view, the concept of fairness is best addressed through the transfer system and targeted measures that address problems at source. If overall the broad-base of New Zealand's BBLR system is maintained, then the transfer system should then apply to ensure that the revenue collected is distributed appropriately, allowing for targeted measures for those most in need.

2.10 Recently multinationals and big business have received bad press about the amount of tax they pay. In a large number of cases this press has been misinformed as the recent Tax Heroes articles featured on the Spinoff have illustrated.[12] Further, tax aside, these businesses are also making significant contributions to New Zealand in their capacity as employers, and through their broader contributions to the community. As the Group has noted earlier in this submission, there are wider benefits to encouraging large corporates to do business in New Zealand such as increased innovation and productivity. While most New Zealand businesses are small enterprises, organisations with more than 100 employees employ 47% of the workforce (and make up less than 1% of all enterprises).[13]

2.11 Fairness can also be addressed by considering issues as they arise and by raising and resolving issues proactively as required. It is important that New Zealand's tax settings are set appropriately, taking into account the views of all stakeholders, including those of Officials, individuals, large businesses, small business, tikanga Māori and any other interested parties, including non-residents (capital providers or investors). This means that when points of ineffectiveness in the tax settings are raised, they should be addressed by the tax system (and through the GTPP where appropriate). It is also important that the broader New Zealand economic position is considered by Inland Revenue as part of the introduction of any wide reaching proposals (for example the interest cap suggestion under the BEPS proposals would have benefitted from consideration from this perspective).

2.12 The Group has, in its experience found that revenue positive initiatives are often raised and addressed by Officials. However other, just as relevant issues raised by other stakeholders are not given the same resources. It is important that all issues are addressed for an effective and fair tax system. While revenue take is an important part of the tax system, there are other benefits to be considered. For example the recent feasibility expenditure and loss continuity discussions have highlighted the potential positive impact these proposals could have on innovation and business certainty. The Group and other stakeholders do not raise issues lightly – when problems are identified and raised with Officials, they are generally significant enough to warrant attention.

[12] https://thespinoff.co.nz/tag/tax-heroes/
[13] https://www.stats.govt.nz/information-releases/new-zealand-business-demography-statistics-at-february-2017

3. The current New Zealand tax system

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 to the future, is it still the best approach for New Zealand? If not, what approach should replace it?

3.1 The Group has been a longstanding supporter of New Zealand's BBLR system and continues to support BBLR as an appropriate approach for New Zealand's tax system. BBLR minimises distortions in the tax system and allows for tax to be a relatively neutral factor in decision making.

3.2 New Zealand has a robust and effective tax system, driven in part by its (relative) simplicity, which leads to business certainty. New Zealand's GST system in particular is a good example of this, its effectiveness driven by the fact that the rules are broad and encompassing, with few exceptions. New Zealand's BBLR approach is part of the reason New Zealand's tax system is held in such high regard.

3.3 However, the Group considers that in recent years there has been a trend towards a level of detail and complexity that is driving inefficiency. Detailed rules to address every conceivable compliance risk or possible gap are resulting in increased compliance costs to the vast majority of taxpayers, who are seeking to comply with their obligations. Taxpayers should be afforded more freedom in which to run their businesses – as noted earlier, compliance costs are part of the deadweight loss associated with tax.

3.4 The focus has been on micro reform, when in reality it is macro reform that is needed. One example of this is the resources that have been directed towards hybrid mismatch arrangements, of which there are only about a dozen in the country. While other countries have taken action in this area, New Zealand is a small country that has its own unique issues (and is not as impacted in the same manner as larger countries).

3.5 Another example of this is the recent introduction of the Kilometre Rate method in the *Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017* (with the Kilometre Rate operationalised in the draft operational statement *ED0203: Commissioner's statement on using a kilometre rate for business running of a motor vehicle*). The use of this rate, while in theory being a more accurate reflection of actual costs, drives inefficiency with its two tiered rate system based on the type of motor vehicle and engine. While not perfect, a flat rate would be preferred as a more simplistic approach that minimises compliance costs.

3.6 A number of surveys released in the last year have reinforced this point. Deloitte's Asia-Pacific Tax Survey[14] notes that taxpayers are increasingly concerned with certainty and predictability, particularly in relation to future developments of tax law. The Business NZ - Deloitte Major Companies Tax Survey[15] noted that tax certainty is of upmost importance to businesses, emphasising the importance of tax system integrity and Inland Revenue's role in its administration. Further to this, it is highlighted that there should be greater flexibility from Inland Revenue when it

[14] https://www2.deloitte.com/nz/asia-pac-tax-survey
[15] https://www2.deloitte.com/content/dam/Deloitte/nz/Documents/tax/nz-en-major-companies-tax-survey-2017.pdf

comes to immaterial tax adjustments and that such an approach would maintain the integrity of the tax system, while reducing the strain on Inland Revenue's resources.

3.7 The 80-20 rule has been discussed widely over the last couple of years and while this rule has its flaws, it remains relevant to tax policy and the New Zealand tax system. From a customer point of view, it is important that this is applied in an operative manner, to achieve efficient yet effective solutions. Compliant taxpayers are being punished by being made to weave their way through a labyrinth of rules. Often this complexity is driven because the rules are designed to combat the behaviour or risks associated with a minority of non-compliant taxpayers. The Group considers that a better option is to target the non-compliant taxpayers with more direct rules, still capturing them in the tax base. This is opposed to the current position of setting the standard wide and then forcing everyone to determine whether they are caught in the rules as has been done with the proposed restrictive transfer pricing rules.

3.8 The Group considers it important that New Zealand remain committed to a BBLR system. Base maintenance reduces upwards pressure on tax rates, however this must be balanced with situations where the base is broadened significantly or consistently. If the tax base is to be broadened significantly, such as if a capital gains tax is introduced, it is important that changes in other areas of tax (GST, withholding taxes, income tax etc) are considered so that the effective overall tax rate is not driven up as a result. The Group also refers the TWG to our earlier comments on black hole expenditure.

Should there be a greater role in the tax system for taxes that intentionally modify behaviour? If so, which behaviours and / or what type of taxes?

3.9 The Group is not generally supportive of using taxes to modify behaviour. In the Group's view, behavioural taxes are ineffective in actually amending people's actions and merely penalise the intended consumer. Such taxes will change the behaviours of some, but unless the tax is comprehensive and covers all alternatives, it will only have a limited effect.

3.10 Even if a behavioural tax is cast broadly it may not achieve the intended outcome. Take a 'sugar tax' for example. The underlying issue here is the (physical) health of New Zealanders and the impact sugary products have on this. To put an excise tax on 'sugar', it first needs to be considered what products are covered by this tax and where the line is drawn. Unless the tax applies broadly enough, consumers may move to cheaper alternatives that aren't covered by the tax, or consume other products that are just as, or more detrimental to their health. There is evidence that such taxes do not achieve the desired outcomes.[16] A Treasury Working Paper notes about a sugar tax "[t]he health status of those responding to a price increase is generally not known, and higher responses may come from healthy consumers rather than the target population.[17]

3.11 The Group considers it is more effective to address this behaviour at its source, via targeted education, rather than through taxation. This would be a more effective way to achieve the intended purpose.

[16] NZIER Report to Ministry of Health *Sugar taxes: A review of the evidence.*
[17] John Creedy Sugar Taxes and Changes in Total Calorie Consumption: A Simple Framework (The Treasury, WP 16/06, February 2016).

3.12 In some situations behavioural tax costs are just passed on to the consumer, without effecting a change in behaviour where it really counts. For example with the Emissions Trading Scheme, some costs are merely passed on to the consumer, without any new investment in technologies for reducing emissions by industry.

3.13 The Group notes that it can see a place for tax incentives, with tax rewarding positive actions; for example electric vehicle fleets, environmental initiatives etc. In this regard, the Group points to Japan's proposals for tax credits of 15% for companies who raise wages and capital investment. The tax credit may be increased to 20% where a company increases the amount spent on employee education and training by 20% or more.[18] This is an example of the tax system taking proactive action to achieve a wider goal. That said, we consider there is a high hurdle to move away from the BBLR status quo.

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?

3.14 As the submissions paper notes, New Zealand is unusual in that it operates a Taxed-Taxed-Exempt ("TTE") approach to retirement savings (consistent with our broad-base, low-rate system). This can have distortionary consequences, particularly when the current system is applied to housing (in a simplified world where surplus income is either invested in housing or put towards retirement savings). To reduce these distortionary consequences (and to incentivise savings), there is an argument for moving to an Exempt-Exempt-Taxed (EET) model for retirement savings.

3.15 Changing the taxation of retirement savings to an EET model may in theory reduce demand for houses (and decrease house prices), especially if it is too difficult to address the issue directly on the housing side. However overall, savings should first be looked at as a standalone issue. That is because changing the tax treatment of retirement savings alone will simply shift the distortionary differential tax treatment from a distortion between housing and other types of savings to being between housing/retirement savings and other types of savings. The Mirrlees Tax Review in the United Kingdom in 2010 acknowledged this and recommended continuing the EET tax treatment of pensions, but with additional reforms to tax other assets on an expenditure basis.[19]

4. The results of the current tax system

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?

4.1 If it is a simplified choice between the speculative economy and the productive economy, Inland Revenue should err on the side of taxing the non-productive asset as it provides fewer overall benefits to the economy. However this is an arbitrary decision and in the Group's view, the focus of the TWG should be elsewhere. A farmer and their farm could be considered to be part of the productive economy as they are actively earning income. However the productive economy could also include a rental

[18] https://www2.deloitte.com/jp/en/pages/tax/articles/bt/japan-inbound-tax-alert-dec-2017-no26.html
[19] See Chapter 14 of James Mirrlees and others *Tax by design* (Oxford University Press, 2011).

property, as in a low-interest environment, it is possible investors may hold rental properties for long-term rental yield (with a possible prospect of capital gain in the future).

4.2 It should be noted that in terms of taxing the speculative economy, there are current provisions to tax speculative gains. It is arguable that the issue is one of enforcement rather than a deficiency in existing tax legislation.

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

4.3 As the Group has previously noted, compliance costs are a deadweight loss to the economy. The *Organisational Review of the Inland Revenue Department* (colloquially and hereafter referred to as the "Richardson Review") noted that "Excessive compliance costs, may in their effect, amount to a hidden tax on commercial activity."[20] The Richardson Review also noted that:

> *"First and most importantly, the tax policy development process must ensure that compliance cost impacts of new policy initiatives are fully costed and considered, to allow the Government to make appropriate trade-offs between these and administrative and economic costs. Equally, compliance costs must be a matter for explicit focus in the post-implementation review of legislation and in the identification of remedial issues requiring legislative amendment in existing legislation."*

4.4 In the Group's view, these comments are as relevant today as they were in 1994. Whenever changes to the tax system are contemplated, part of the analysis should include a consideration of compliance costs and whether these costs outweigh the benefit of the proposal. While compliance costs are a consideration and Officials have listened to the Group's concerns during consultation, the Group considers that there is further scope to reduce compliance costs for businesses.

4.5 One example of this is the recent Business Transformation process, particularly the investment and employment income changes. A large number of these proposals imposed additional compliance costs to businesses, which in the Group's view, were over and above what was necessary to achieve the intended outcome of the proposals. Large amounts of information are being provided to Inland Revenue but it is not clear if this information is necessary and is being used by Inland Revenue. The Business Transformation process has also often merely moved costs from Inland Revenue to businesses. Further, as noted earlier in our submission, there has been a trend towards precision in the tax system and the Group considers that such precision is unnecessary – these resources are best spent elsewhere.

4.6 Other examples of rules that unnecessarily contribute to deadweight losses include PAYE and NRCT issues associated with non-residents working in New Zealand, that businesses are required to deal with (including shadow payrolls, getting employees to file income tax returns in the appropriate jurisdictions etc). Many taxpayers also have to fill out questionnaires (i.e. annual international questionnaire for Inland Revenue with information that can mostly be obtained from an entity's annual financial reports).

4.7 Compliance costs could also be reduced in respect of simple compliance matters, such as completing returns and other tax administrative functions that businesses

[20] Page 134, *Organisational Review of the Inland Revenue Department 1994*

often have to face (i.e. businesses should not act as tax collectors for Inland Revenue except in so far as is practically necessary like with PAYE or there is an appropriate reduction in their own overall compliance costs). It is important that the only costs in the tax system are necessary for the efficient functioning of the tax system.

4.8 The Group considers there is more scope for Inland Revenue and other government departments to share information and/or data amongst themselves. The Group understands that this is a wider government issue, but the government as a whole needs to understand what information / data they have and allow for sharing of it as appropriate. Taxpayers should only have to provide the same information to government once (and it should only be asked for once). This would remove the requirement for businesses to provide similar data or information to different parts of government. This would assist in reducing costs as the provision of information and/or data is expensive.

4.9 It is also important that compliance costs are reviewed after changes have been integrated into the tax system. There are often hidden compliance costs or additional considerations that only become clear once proposals are put into practice. This is an issue for both Officials and stakeholders to consider and changes can be made where necessary. These changes do not have to be legislative, and other more flexible methods of implementing remedial change should be considered.

Does the tax system do enough to maintain natural capital?

4.10 The Living Standards Framework describes natural capital as the aspects of the natural environment needed to support life and human activity, including land, soil, water, plants and animals, as well as minerals and energy resources. Noting the Group's comments on behavioural taxes earlier in this submission, the Group does consider that there is further scope for the tax system to maintain natural capital. One way in which this can be done is by amending the tax system in areas that reward taxpayers who are maintaining our natural capital, for example by providing tax concessions to businesses who use electric / hybrid vehicles.

4.11 While the Group does see some areas where tax can help maintain natural capital, environmental taxes are blunt tools and the Group considers that regulation is a more effective and efficient method for achieving the intended goals. It is better that the government use other tools in its arsenal, specifically targeted at the behaviours it wishes to change. However, where there are specific regimes (or there are proposed regimes) within the Income Tax Act 2007 targeted at pollution mitigation measures, Inland Revenue should err on the side of deductibility so that tax is not a barrier to doing the right thing for the environment. Often this expenditure ends up in the black hole expenditure bucket, with no immediate deduction available and no depreciation deduction.

4.12 To take this point further, the issue of the deductibility of feasibility (and other black hole) expenditure should be considered. Feasibility expenditure is the expenditure spent on determining the practicability of a project and currently is only deductible to the extent it does not materially advance / tangibly progress a capital project. This is an issue for many businesses, as it increases the costs and uncertainty in exploring new projects. Many examples of feasibility expenditure arise in the energy generation sector, where new and more environmentally friendly alternatives are explored by businesses, or, to consider a different industry, this feasibility expenditure could be towards researching less detrimental ways of farming. The non-tax deductibility of feasibility expenditure impacts on the willingness of taxpayers to undertake innovative or new projects. The resolution of this issue (if also coupled with an R&D tax credit regime as signalled by the Government) would go some way to promoting protection and maintenance of natural capital.

4.13 A recently released draft report from the New Zealand Productivity Commission (on how a transition to a lower carbon economy might be achieved) highlights the importance of developing environmental sustainability technology.[21] The draft report also noted that the Government should be cautious about setting stringent targets for electricity-sector emissions before technology becomes available to further reduce emissions at reasonable cost. Further, the report notes that the government should be wary of intervening in a complex sector and of the unintended and expensive consequences that could result.

4.14 The TWG should also consider tax incentives for sustainable products, for example accelerated depreciation on electric vehicles or sustainably innovative technology. As a general rule, the Group believes that the tax depreciation regime is too complex and should be more aligned with the accounting rules. However allowing greater initial deductions to taxpayers through accelerated depreciation (which at the end of the day is only an issue of timing) is one way that the government can encourage businesses to undertake more environmentally sustainable initiatives.

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?

4.15 Any question of reductions in effective tax rate because of "excessive deductions" needs to consider that question in the context of why such regimes exist. In the Group's view, one of the main considerations in relation to such deductions is that of (international) competitiveness. For particular New Zealand businesses and industries to remain competitive with their competitors, the Government has made a measured decision to allow deductions for particular expenses. This requires a consideration of the global tax frameworks and whether certain clawbacks are appropriate to ensure that New Zealand companies can compete on the global stage.

5. Thinking outside the current system

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

Taxpayer positive versus Revenue positive

5.1 The Group sees the biggest inconsistency arising where changes are being proposed to the tax system. Inland Revenue, by way of focus on revenue, is incentivised to bring more into the tax net (and to increase the 'broad-base' aspect of BBLR). Not unexpectedly, there is a natural tendency to raise proposals that are not in favour of the taxpayer and the majority of changes only seek to increase revenue (for example the recent bright-line test and BEPS changes). It is inappropriate for Inland Revenue

[21] New Zealand Productivity Commission *Low-emissions economy: Draft report.* April 2018

to measure performance by adjustments and then allow for this to affect the setting of the tax system.

5.2 An appropriate balance must be struck between Inland Revenue initiatives and taxpayer favourable initiatives (such as black hole expenditure), as well as broader macro focused projects which are designed to encourage investment and grow tax revenues. This has been highlighted by the Group's concerns with the current tax policy programme that appears to be driven by Inland Revenue Officials, with little time / resource for private sector friendly measures. The work programme includes reforms necessary for the ongoing maintenance of our tax system, however these have tended to be base maintenance concerns and changes that shift compliance costs from Inland Revenue to taxpayers. If new items and issues are raised by taxpayers, these should be added to the work programme and progressed. If not there is a real danger that New Zealand's tax system will stagnate and our tax settings will endanger (as opposed to maintain) New Zealand's BBLR system. We also need a degree of consistency with other jurisdictions – if not we risk being out of step and becoming uncompetitive.

5.3 In particular there has been insufficient effort in introducing policy changes that would simplify tax for businesses. These are not issues taxpayers raise lightly and resources must be allocated to progressing these other proposals as well. We attach as an Appendix to this submission the Group's "Business Tax Wish List" which contains a list of the business tax initiatives that would improve compliance costs for businesses. The wish list was prepared in November 2016 in response to the tax policy work programme for 2016-17, but is just as relevant today as only one or two of the wish list items have actually been progressed.

Accounting versus Tax

5.4 In the Group's view, more should be done to align the corporate tax code with accounting standards. This does not have to be a comprehensive alignment, but there are certain areas that would significantly benefit from more overlap (with no real detriment / risk). Some examples include:

- Tax depreciation
- Provisions and accruals
- Unexpired expenditure / prepayments

These are areas where it is possible to have a sensible interface between accounting and tax. However, currently there are specific arbitrary principles that must be applied that generate compliance risk for taxpayers in their relative complexity. For example the unexpired expenditure rules are hard to understand as they have no solid, principled basis. This makes their application compliance cost heavy as relatively more resources must be expended to comply with the rules.

5.5 The IFRS accounting standards are acceptable standards that are independently audited and usually merely represent short timing differences. There is little justification for having a complex tax overlay to accounting treatment. The depreciation rules in particular should be simplified, given the sheer number of rates and determinations for different depreciable assets. This is an area where a 'close enough is good enough' attitude can be applied and tax depreciation is a good example of looking for precision where none exists. This is an arbitrary timing difference and closer alignment with accounting should be considered.

5.6 There should also be greater acceptance of materiality for tax purposes (and this could perhaps be statutorily defined), coupled with raising the permissible limit for writing capital expenditure off immediately to the profit and loss account (up from the current threshold of $500). These initiatives would give taxpayers more certainty and lower compliance costs, which are especially relevant in a self-assessment world.

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?

5.7 The Group does not comment on the introduction of any specific new taxes and is not opposed to the introduction of new taxes if required on the proviso that new taxes are accompanied by a lowering of taxes elsewhere. The Group notes that if the tax base is to be increased by the introduction of new taxes, serious consideration should be given to other initiatives such as reducing the corporate tax rate or the effective tax rate. It is inappropriate for the tax base to get larger and larger with no corresponding decrease in other areas (as we have noted earlier in this submission).

5.8 Any new taxes (and the reduction of existing taxes) should be considered in the context of added / reduced compliance costs and we refer you to our submission points on compliance costs above.

5.9 The Australian Re:think discussion paper noted that Australian tax revenue is drawn from more than 100 different taxes, however most of this revenue is collected from just a few taxes.[22] At its heart, tax is about revenue collection for the government. To do this, it is important to maintain the broad base and small additional taxes are often neither effective nor efficient in raising the revenue required.

6. Specific challenges

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?

6.1 In the Group's view, the first consideration is whether housing issues are driven by supply or demand. If it is demand driving the issue, then it must be asked whether these demand issues are driven by tax. If the answer is in the affirmative, then tax should act to deal with the issue. However, if tax is not the cause of the issue, then the Group considers that the issue should be addressed at source, as this is a more effective approach.

6.2 Further, the existing comprehensive tax code for taxing land transactions needs to be adequately policed by Inland Revenue and the extended five year bright line test (and ring-fencing of rental losses if introduced) should be given time to be put into action and their impact considered, before any additional changes are introduced.

[22] Re:think, page 15

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

6.3 Given the Group's diverse membership, we do not have a view on whether a capital gains tax (CGT) should be introduced or not and our following comments are not intended to be read as support for or support against a CGT. We do note, however, that in a world of falling corporate tax rates, the lack of a capital gains tax in a business environment is one of the few competitive advantages the New Zealand tax system offers businesses looking to locate themselves in New Zealand. Any potential CGT must be looked at as part of the wider 'equation' and there are a large number of significant considerations that must be analysed in full if a CGT regime is to be introduced. These include design considerations, exemptions / coverage, who it would affect, implementation and other various other miscellaneous issues. Amongst these design issues there will be trade-offs and New Zealand must decide where in the equation these trade-offs lie. We detail our response to the design issues below.

6.4 In addition, the TWG needs to be very aware that its recommendations need to take into account the New Zealand political landscape and the implications for any Government at the "ballot box" of changing the tax settings on retirement savings, farms and small businesses. Recommendations should be practical and politically achievable. For example there needs to be consideration of the costs for Inland Revenue for administering a capital gains regime and the costs for all taxpayers, from 'mums and dads' to larger corporates.

Design issues

6.5 If a CGT is introduced, there are a number of design issues to be considered. These include (but are not limited to), rollover relief, inflation, integration with existing capital boundaries, CFC integration and preferences for certain industries (e.g. savings), as well as broader consideration of the wider equation and how a capital gains regime fits into New Zealand's economy. The complexity of a capital gains regime cannot be underestimated and our Australian members' experiences with their regime has been mixed.

6.6 The introduction of a CGT will have far-reaching consequences, many of which have not even been considered, and many of which will not be realised until the capital gains regime is actually in place. However, some current tax rules or regimes will need to be removed or redesigned to ensure that double taxation does not occur (i.e. the interface of the FIF rules, in particular FDR, and CGT. It is important that if a CGT is introduced, the capital gains regime is designed effectively so that there is consistency in application and the intended policy outcomes are met. New Zealand has a competitive advantage of sorts in not having a capital gains tax and so any potential introduction of a CGT must minimise any negative consequences as much as possible.

6.7 We set out below the Group's view on the specific design issue questions from Appendix 2 of the submissions paper. We would like to again emphasise the need for full consultation on all aspects of any future CGT proposal. This following section proceeds on the basis that a CGT is to be implemented and <u>is not intended to be read as support for a CGT</u> (or disagreement with the introduction of a CGT)

Should the CGT be a separate tax or part of the income tax? Most countries tax capital gains as part of the income tax.

6.8 In the Group's view, if a CGT is introduced it would be best introduced as part of the Income Tax Act rather than a separate Act. This is a simpler and a more efficient approach given the flow on effect changes that will need to be made to income taxes. The Group acknowledges there is a clarity perspective in keeping a CGT in a separate code (like with GST), however the close link with income tax means that it is best kept in the Income Tax Act.

Should capital gains be taxed on an accrual basis or only when realised (i.e. only when the asset is sold)? Most countries tax on a realisation basis. How should matrimonial property settlements and disposal of assets on death be treated?

6.9 In the Group's view a CGT applied on an accrual basis would provide a reasonably accurate reflection of the position. However this will introduce greater compliance costs, will impact cash flows (particularly where unrealised gains are taxed, with no immediate cash relief for losses in subsequent years) and will add another level of complexity into the tax system. It is for these reasons that most other jurisdictions which have adopted a CGT have done so on a realisation basis. If a CGT is to be taxed on a realisation basis there will be considerations around timing of disposal, creating its own distortions. A realisation based CGT will also be a less effective form of a CGT. However, as noted most countries with a CGT have implemented this on a realisation basis and their approach should be taken into account.

6.10 If the policy intention is base broadening then a comprehensive capital gains tax would be preferred. However, if the issues are perceived inefficiencies or 'unfairness' in the tax system, these issues should be fixed by a more targeted method. An example of this occurring is international portfolio shares – the FDR regime (cost method) is more appropriate than a CGT, particularly as many international equity investments do not have market values available (and so an unrealised CGT is also not available).

6.11 The main concern appears to be the under-taxation of residential rental homes, being a concern that commercial returns reflect a capital gain element and that rental income does not cover the costs without that capital gain. However, as noted above, if the supply and demand issue is driven by tax, then and only then should tax step in to fix the issue?

6.12 In the Group's view a CGT, if introduced, should be limited to residential rental properties. The same tensions do not apply to commercial property and commercial property should not be included in any capital gains regime. A targeted approach is best as a more comprehensive regime (but with exemptions) will introduce significant complexities and any tax revenue to be collected would be offset by the costs of the system. This will involve trade-offs, between various positives and negatives, that must be considered carefully when designing a potential capital gains regime.

Should assets held by KiwiSaver and other savings schemes be taxed?

6.13 In the Group's view, there should be as few distortions and inconsistencies in any potential capital gains regime as possible. If the way in which retirement savings schemes are to be taxed is to change, any change should be consistent (unless Government has a specific policy reason for incentivising one scheme over the other). The Group notes, however, that imposing a CGT on savings but not the family home risks further incentivising capital to flow away from rather than towards productive assets.

Should assets held offshore be subject to tax?

6.14 New Zealand's residency rules deem New Zealand residents to be subject to income tax on their worldwide income. This is an agreed and accepted principle, with foreign tax credits, double tax agreements and other exceptions in place to avoid any double taxation. Any capital gains on assets held offshore should be treated with the same principles for consistency (i.e. prima facie taxable, but with a foreign tax credit or other mechanism acting to provide relief from double taxation where necessary). Careful thought should be given to how these rules should interact with the active income exemption for Controlled Foreign Companies ("CFCs"). Many other countries exempt capital gains made by active CFCs.

How would a capital gains tax integrate with current tax laws, such as when land sales are already taxable, our company imputation system and our CFC/FDR rules?

6.15 The answer to this will depend significantly on the extent of any proposed capital gains regime. In the Group's view, if it is only a targeted capital gains regime, where assets are already held to tax under the current regime, this should not change (i.e. taxation on properties in the land sales rules). However there could be a case for full integration if a comprehensive capital gains regime is introduced as this will reduce complexity. Any existing regimes will need to be considered and if they are a more effective, efficient and accurate method for collecting capital gains, then these should be left unchanged.

When should non-residents be subject to tax?

6.16 Consistent with our current residency / source principles, non-residents should only be subject to CGT on certain New Zealand sourced assets (regard should be had to what other countries do, such as only taxing land assets / land rich companies). The impact of New Zealand's double tax agreements will need to be considered carefully, particularly in relation to issues arising from specific asset types, source and silence as to taxing right.

Should capital losses be ring-fenced to be offset only against capital gains income or should they be offset against any income? If capital gains are taxed on a realisation basis tax base maintenance considerations suggest that capital losses should be ring-fenced.

6.17 This is an issue that depends on the extent to which any potential capital gains regime extends. If it is a comprehensive regime then any capital losses should be able to be offset against all income of a taxpayer. However it is unlikely that the capital gains regime will be comprehensive in which case it may then create more justification for capital losses to be ring-fenced. Ring-fencing would bring in significant complexity into the tax system so should be implemented with caution, weighing up compliance costs versus perceived issue.

Should there be roll-over relief allowing capital gains reinvested in similar assets to be treated as unrealised? If so, when should roll-over relief apply? For example, should a farmer selling a farm and buying a new farm be taxed on the increase in value of the old farm?

6.18 Any roll-over relief will need to be considered carefully from a policy perspective. There are sound reasons for providing such relief in ensuring that tax does not result in tax locking in investments in lower performing assets to avoid triggering a CGT. By providing roll over relief, the regime allows capital to flow to the best performing asset unimpeded by the loss of value that a CGT would impose if it were to apply when assets are essentially swapped. However, it needs to be recognised that deferring any capital gain may reduce the effectiveness of the regime due to the deferral of the tax event. The counter being, however, that a roll over relief allows for more efficient investment decision making which can increase the amount of capital gain which is ultimately taxed.

6.19 On balance, the Group would favour roll-over relief, particularly to allow normal business to continue without tax being a barrier (such as allowing corporate restructures and M&A activity to take place with no tax cost).

How should death, emigration and immigration be handled?

6.20 If a CGT is imposed, the regime must work so that individuals / organisations with a CGT liability are not able to escape the regime in any way – i.e. if they leave the country they should be held accountable for their tax liability. Immigration is a trickier issue that will require some balance, especially as we will want to ensure we are attracting people and organisations to New Zealand. The main issues will be around timing (i.e. when do they fall into the regime) and whether any exclusions (such as transitional residency) will cover a capital gains regime. It must also be considered whether these companies / individuals have a right to tax former residents for a period of time following their emigration.

6.21 We comment on emigration / immigration in relation to competitiveness and attracting and retaining capital investment in New Zealand further below.

How should gifts and gambling winnings be taxed?

6.22 Gifts and windfall gains should remain outside the tax base (as should gambling losses).

What should the rate of tax on capital gains be – the normal income tax rates, or some other rate(s)?

6.23 A CGT at the normal income tax rates would be the least distortionary method of taxing capital gains, as it would apply tax at the appropriate marginal tax rate for individuals and would not incentivise particular investments over others (i.e. if capital gains were taxed at a lower rate, then there would be a tendency to put money towards these sorts of investments as opposed to others). While slightly more complex than a flat rate CGT, it would make for a more coherent tax system.

6.24 The other option is a flat rate tax (similar to GST) where all capital gains are taxed at one rate. On the face of it, this may be simple and may be appropriate for certain types of investments; however it may also drive further compliance costs having to distinguish between capital and other income due to the different tax rates. Some Nordic countries attempt to tax all forms of capital income at a lower rate than labour income. However, distinguishing capital from labour income has proven difficult in practice. For example, Norway initially treated widely held and closely held companies differently with all income in widely held companies treated as capital income while income from closely held companies was split into labour and capital components. This created additional distortions as it became more advantageous to be treated as "widely held".

6.25 The Group considers that further research and study must be done before the method and rate of taxation are chosen, with a focus on what other countries are doing and the success of their regimes.

Should any allowance be given for inflation in calculating capital gains?

6.26 The Group believes that if a capital gains tax is introduced, some allowance should be given for inflation in calculating capital gains (particularly for assets held long-term). In the absence of any specific measures, gains from inflation will be brought to tax which would be inappropriate, especially where this amount is significant (which is likely where assets are held for many years). A capital gains tax should not be looking to tax nominal gains but the 'true' capital gain.

6.27 Inflation is dealt with in various different ways throughout the economy and indexation is one such method. However indexation of the tax rate will not offer 'real-time' benefits to taxpayers given the time it takes to implement. It will also introduce greater administrative costs and complexity.

6.28 There is a case for a more progressive rate to deal with inflation concerns, based on the length of time an asset is held (or some other measure as appropriate). This will add additional complexity into the tax system but it is important that taxpayers are not taxed on inflationary gains. Another option is to amend the quantum of the capital gain that is taxed to reduce the impact of inflation, depending on the length of time the asset is held (i.e. only 50% of the gain is taxed if held for more than 5 years). Again this would need to be a progressive scale.

6.29 The problems here is if the distinction / progression is not set correctly, the tax system will distort and influence investor decisions. For example if the capital gains rate (or the portion of the capital gain that is subject to tax) were to change significantly for assets held for (say) 5 years or more, then investors would be incentivised to hold onto these assets for a longer period of time. In the case of residential housing, this would mean that rental properties would be held for a longer period of time (which the government may or may not want). If this is the intention then this must be explicitly publicised.

Should there be a de minimis rule?

6.30 In the Group's view, a de minimis will be appropriate if a CGT is introduced to reduce compliance costs and reduce complexity. At a certain level the taxation of capital gains may be a net loss to economy, as any revenue from taxation will be far outweighed by the compliance costs to administer and adhere to the regime. A de minimis may also negate concerns around inflation, but this will only be true for short-term investments where inflation has less impact.

6.31 The question is whether the de minimis is applied on an investment by investment basis, or whether it takes a more portfolio basis (i.e. an annual brightline exclusion for the total capital gain arising from disposal of all assets in a year). An annual brightline exclusion will remove taxpayers who have only small capital investments and are not the target of a CGT, noting there will be compliance costs around valuation for those close to the threshold and added complexity for taxpayers who have never previously had to consider these issues.

6.32 Any potential de minimis must be set at an appropriate rate in order for it to be effective and not influence behaviour. It will need to be a percentage measure of the asset as opposed to a single monetary figure (i.e. if the capital gain is more than 5% of the original cost then it should be brought to tax). It would be inappropriate to use a monetary figure as this will be insignificant depending on the size of the investment.

6.33 An issue is that an appropriate de minimis level will also differ depending on the type of investment. All assets are not equal and have differing expected gains / losses. Further to this, take the sale and purchase of a rental house. At the margin there is greater control here to decide on a price and prices could be amended so that the de minimis is met and no tax is collected – this is particularly true for short-term sales (assuming property is not held or deemed to be held on revenue account) where any capital gain may be minimal.

What administrative implications would there be from a capital gains tax?

6.34 A potential capital gains regime will obviously add greater administrative costs and compliance costs into the tax system, particularly where there are exemptions and particularly when any gain / revenue is modest. We refer you to the extracts at para 6.49-6.55 on the Victoria University Tax Working Group Tax Review and McLeod Report, both of which noted a CGT would introduce significant complexity and compliance costs (whether a full or partial regime). This also forms part of the consideration of the wider 'equation' – where does a capital gains regime fit in, in New Zealand's economy?

What rules should govern the transition into a capital gains tax? The options seem to be cost of the assets (retrospective taxation of past accrued gains), valuation at date of introduction or only assets acquired post introduction (the Australian rule).

6.35 In most circumstances it would be inappropriate to require the original cost of assets to be used as a measure for the retrospective taxation of accrued gains; there is an argument to have cost as an option where there has been a temporary reduction in market value between the purchase of the asset and the CGT being implemented. The Group would be strongly against mandatory use of original cost.

6.36 From a policy perspective it would be appropriate if the capital gains regime were to only include assets acquired post introduction. This would mean that investment decisions made prior to the introduction of the regime and any presumptions made at that time are preserved. However this will add in additional complexity and will distort investment decisions going forward, as well as rewarding those who have already invested and disadvantaging those who have not.

6.37 Having the option to obtain a valuation at date of introduction would be the fairest approach as from that point in time. However this will obviously introduce a cost and put pressure on valuers in respect of time and volume – regulation of this process will be necessary to ensure that no manipulation occurs.

How should family trusts be integrated into the system?

6.38 This is not an issue for the Group.

A targeted capital gains tax

6.39 If a capital gains regime is to be implemented and if it is to be workable, a significant number of exemptions will be required which will reduce the amount of revenue a CGT will actually collect. This is the same for whether a comprehensive regime is considered or a slightly less comprehensive regime is considered. In the Group's view, if a CGT is to be introduced, it would be more worthwhile introducing a targeted CGT on the specific areas that the government considers should be addressed. This would avoid some of the costs that would be introduced by a broader capital gains regime.

6.40 It will also be important to undertake research and analysis into how much tax could be collected by a CGT, charged on a realisation basis, by asset type. This will enable an informed decision to be made by weighing up the tax to be collected when certain assets are excluded against the compliance costs imposed on the economy by the CGT.

Impact of a CGT on competitiveness / investment in New Zealand

6.41 The traditionally strong agricultural / primary sectors of New Zealand have been relatively easy to tax, given their clear source / base. However, the technology sector and other more moveable industries have a real choice as to where they base themselves. These industries are not as restrained by natural capital and labour capital restraints and their clients are usually based outside of New Zealand (i.e. it is not vital for them to set up shop here). These entities do base themselves in New Zealand however, for one reason or another, whether it be ease of setting up their business here and a simple tax system, or the mere fact that New Zealand is a great place to live.

6.42 Currently, if these entities are successful and decide to sell their business, then there is no capital gain element to be considered. However, if a CGT is implemented, these entities will have less incentive to set up shop in New Zealand. In this situation businesses will start to consider other countries, even ones like the US who also have a CGT, because there they would at least be closer to their target market and capital, with the increased savings and opportunities that come with that; and of course the benefit of a lower corporate tax rate.

6.43 New Zealand's geographical location and economy size are very relevant considerations and we must be aware of these sorts of unintended consequences that a capital gains tax regime may bring. Part of the consideration of a CGT must map where we think New Zealand will be in the future, and what trade-offs New Zealand is willing to make (including potentially losing a competitive advantage). If the entities described above are ones that New Zealand wants to be enticing to New Zealand, then this needs to be considered. Further, for many companies already based in New Zealand it is currently very complex for them to move to Australia or the United States, as there are capital gains to consider. However the introduction of a CGT will reduce the relative complexity of this and the barrier to leaving will appear lower.

Further deductions must be considered

6.44 If a capital gains tax is introduced this would significantly broaden the tax base. This would give an opportunity for other taxes to be reduced (or for further deductions to be allowed to reduce the effective tax rate). This is particularly relevant for capital intensive businesses, as a capital gains tax will place a significant burden on these businesses that did not previously exist. These businesses (and others) do not exist to make a capital gain, this is not part of their business model and this must be considered if a capital gains regime proceeds.

6.45 Under a potential capital gains regime, the Group submits that a deduction for goodwill must be allowed. Organisations are taxed on the income that they receive to earn their goodwill balance, however no corresponding deduction is allowed. In New Zealand an annual impairment test must be performed for goodwill under NZ IAS 36. The Group argues that if there is any impairment, a tax deduction should be allowed.

6.46 If a capital gains tax is introduced, it should be clear that certain other costs are fully deductible. For example, there are a number of instances where businesses can incur costs for which a tax deduction is not available. This is known as 'black hole' expenditure and we refer you to our comments on this earlier in our submission.

6.47 The Group considers that there is also scope for a deduction to be allowed for tax depreciation on commercial/industrial buildings. In reality these buildings depreciate over time, given the particular requirements of the building can change rapidly due to new technology or a shift in focus involving the operations of the business. There also must be care taken in defining and differentiating residential and commercial buildings if any ring fencing is to take place.

Complexity

6.48 Members of the Group with experience in the Australian capital gains regime have not been complimentary of the complexity of Australia's regime. In particular members have noted that there are significant compliance costs in the regime in understanding what is captured, what isn't, quantum affected and so on, so that any benefit of the regime is essentially netted off by its complexity. This is not a future New Zealand should be chasing. If a capital gains regime is introduced, care must be taken to minimise complexity and compliance costs and it is for this reason that a targeted CGT would be preferred. However, the Group reiterates again that this is not intended to be taken as support for (or against) the introduction of a capital gains tax.

Reviews of New Zealand's tax system / A capital gains tax

6.49 There have been a number of reviews of New Zealand's tax system in the past and these also included consideration of the introduction of a CGT. While undertaken in a different time / context, many of the same considerations apply today and so we briefly consider these below.

Victoria University of Wellington Tax Working Group's report: A Tax System for New Zealand's Future

6.50 The 2010 Victoria University of Wellington Tax Working Group's report *A Tax System for New Zealand's Future* concluded that the most comprehensive option for <u>base broadening</u> with respect to the taxation of capital would be to introduce a comprehensive capital gains tax. However, most members of the Victoria University Working Group had significant concerns over the practical challenges from a comprehensive CGT and the potential distortions and other efficiency implications that may arise from a partial CGT.[23]

6.51 It is worth noting that the Victoria University Tax Working Group report noted that if owner-occupied property was excluded from the tax (as will be under the TWG's terms of reference), then there would then be a bias towards investing in primary residences.

6.52 It was also noted that some members of the Victoria University Working Group would support applying a deemed notional calculation using a risk-free rate of return ("RFRM") method to tax returns from capital invested in residential rental properties. However, the Working Group noted that there would be a number of complex design issues that would need to be addressed with this option. There would also need to be consideration regarding the extent to which the benefits of a RFRM tax would be reduced by excluding owner-occupied housing from the tax base.

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[23] Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future*, January 2010.

McLeod Report

6.53 The 2001 Tax Review ("McLeod Report")[24] concluded that New Zealand should not adopt a general realisations-based capital gains tax, in particular noting:

> "*We do not believe that such a tax would make our tax system fairer and more efficient, nor do we believe that it would lower tax avoidance or raise substantial revenue that could be used to reduce rates. Instead, such a tax would increase the complexity and costs of our system.*"

However the McLeod Report did note that the RFRM could be used to address the specific problem of disparate tax treatment of different savings entities, continuing the past approach of dealing with specific capital gains issues as they arise.

6.54 The McLeod Report also considered the tax treatment of housing, noting the concern that New Zealand's tax system creates a bias in favour of investing equity in a home, with renters and those with mortgages paying from after-tax income. In contrast, those without mortgages earn what amounts to a tax free return on the equity invested in their owner-occupied dwellings, encouraging people to apply savings to owner-occupied housing in circumstances where higher overall (fully-taxed) yields can be obtained from alternative investments.

6.55 In response to the above, the McLeod Report rejected the OECD view that housing should be taxed on imputed rental income and capital gains (with deductions for mortgage interest, depreciation and repairs and maintenance). In particular, noting that the RFRM to tax the net equity-component of owner-occupied and rental houses would be unlikely to be supported. Given this, the McLeod Report concluded that there would be no more viable way to making this aspect of the tax system fairer and less distortionary and did not recommend that the government proceed.

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

6.56 If any such tax is introduced in relation to land, this should be limited to land in relation to residential rental properties. As noted earlier, a rental property can be considered to be a 'non-productive' asset, whereas a farmer and their farm would be considered a 'productive' asset on New Zealand's balance sheet. Inland Revenue should err on the side of taxing the non-productive asset (in a choice between the two). However this is an arbitrary decision and tax is not the appropriate mechanism for addressing any inequities in housing – these issues should be addressed by other mechanisms of government.

6.57 New Zealand already has a comprehensive capital gains regime on land sales (with an exclusion for the family home except where a regular pattern of trading has occurred). Instead of adding further complexity into the regime by adding new taxes, the focus should be on the enforcement and use of the existing regime. Further, the extended five year bright line test (and ring-fencing of rental losses if introduced) should be given time to be put into action and their impact considered, before any additional changes are introduced.

[24] 2001 Tax Review, McLeod et al.

What are the main opportunities for effective environmental taxation?

6.58 One area in which the tax system can incentivise and reward environmentally friendly behaviour is through concessions in areas that are considered to be environmentally positive. One example that the Group has previously raised is the tax treatment of employers providing both electric cars and hybrid cars to employees, and any concessions that could be provided to promote sustainability-related initiatives. We note also our comments earlier on feasibility expenditure / R&D tax credits / loss continuity changes promoting innovation and potentially sustainability.

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

6.59 A progressive company tax is not really an issue for the Group to comment upon, but if such a system is introduced, it is important that this is a final tax. If it is not, this will result in significant uncertainty for businesses. Certainty over tax is important for all businesses, but for small businesses even more so, given many of them have relatively slim margins in which they operate. A progressive company tax rate will increase the complexity of the tax system and will raise a number of flow-on issues that will also need to be addressed. In particular the 'line in the sand' thresholds between small, medium and large businesses will need to be carefully considered. The Group does see value in a progressive company tax to the extent the capital is retained by the business to reinvest. However, overall the Group considers that the complexity such a system would introduce would outweigh any benefits.

Should the tax system exclude some goods and services from GST? If so, what should be excluded? What else should be taxed to make up for the lost revenue?

6.60 As noted earlier in our submission, New Zealand's GST system is successful due to its simplicity (in both administration and application). GST is an effective and efficient tax, driven by the fact that the rules are broad and encompassing, with few exceptions. In the Group's view, this simplicity should not be undermined by exclusions (and in particular exclusions that would add additional compliance costs). The underlying issues regarding the exclusion of some goods and services from GST are an issue for the transfer system and should not be addressed by tax. Both the McLeod Report and Victoria University Working Group Review concluded that there should be no exemptions from GST.

7. Other comments

7.1 The Group sets out below a non-exhaustive list of recent live issues / issues that the Group would like to see continue to be addressed. These are:

- FBT remedial issues
- Tax pooling review
- Feasibility and black hole expenditure
- Business continuity
- Entertainment expenditure

- Non-resident employee issues
- Provisional tax reform – TIM

The Group has discussed with and written to Officials / Ministers on most of the above issues and would be happy to provide any copies of these letters as required.

APPENDIX ONE: BUSINESS TAX SUGGESTIONS PROVIDED TO OFFICIALS

Policy changes

- Tax loss shareholder continuity rules - Consider appropriateness of the current 49% shareholder continuity requirement. Current threshold significantly restricts the ability to introduce new capital into a business. Consider reducing the threshold and / or introducing a same business test concept (similar to Australia). A 10% threshold should be sufficient to ensure there was not loss trading.

- Imputation credit continuity rules - Consider appropriateness of current 66% shareholder continuity requirements. Is there still a policy justification for a distinction between ICs and losses.

- Consider shortening time bar periods.

- Accruals for expenditure incurred booked in financial statements - If financial statements are audited, then accruals booked should be accepted as expenditure incurred for tax without any review of possible under or over accruals.

- Similarly, unexpired expenditure / prepayment rules should follow IFRS accounting if financial statements are audited. The compliance costs associated with unexpired expenditure are not justified when it is simply a matter of timing.

- Entertainment expenditure regime - Review and simplify regime e.g. expenditure on meals where business contact present should be fully deductible, off premises morning and afternoon teas deductible, etc. The entertainment regime is very compliance intensive and the outcomes are not always logical.

- Write-off low value residual asset balances in tax asset register - If DV depreciation rates are adopted, then can end up with minor asset balances that never reduces to zero. Create the ability to write-off residual asset balances of say $50 or $100.

- Allow taxpayers to align their ICA with their balance date (rather than having an ICA to 31 March for a taxpayer with an early or late balance date).

- A comprehensive solution to black-hole expenditure that allows taxpayers to group expenditure otherwise not deductible and spread the tax deduction over a number of years (e.g. five years).

- Simplification of the depreciation framework / deprecation rate table – The sheer number of rates and constant need to update the table and produce new determinations makes depreciation unnecessarily complex. Suggestion would be to simplify the asset categories so that there are a few broad categories for rates to be allocated against.

Legislative thresholds

Many legislative thresholds were set a number of years ago and should be reviewed for their appropriateness in the current business climate. Suggestions include:

- Higher thresholds for immediately deducting the cost of "low-value" assets (e.g. increase the threshold from $500 to $1,000).

- Increase in the DC 13 share scheme threshold of $2,340 (we expect this will be considered as part of the share scheme work but this is included for completeness).

- Determination E12 (unexpired portion of accrual expenditure) - Consider increasing maximum threshold amounts, noting that for large corporates the Group's view is that tax should follow accounting where audited IFRS accounts are prepared.

- DB 62 Legal fees - Currently where legal fees are $10,000 or less, a taxpayer can claim a deduction without the need to review for capital items. Consider raising this threshold.

- Consider setting an additional de-minimis threshold for the application of the thin cap rules based on the total interest deduction claimed (i.e. if the taxpayer's interest for the year is less than X they wouldn't need to undertake any thin capitalisation calculations).

Approvals and certificates

- Remove the requirement for taxpayers to have to seek the Commissioner's approval to issue Buyer Created Tax Invoices.

- Allow special rate certificates and certificates of exemption to be granted retrospectively (often commercial arrangements mean that payment needs to be made before a certificate has been granted. This would also be helpful, where a taxpayer has inadvertently neglected to withhold amounts, but ultimately no tax is payable in New Zealand).

- Remove the requirement to withhold NRCT on contract payments made to the New Zealand branch of a non-resident entity (noting that the income is returned in New Zealand).

- Increase the period of validity for a certificate of exemption.

Employer obligations and payroll taxes

- Refer to separate document previously provided to Inland Revenue for a number of non-resident employee issues which cause compliance difficulties for New Zealand businesses.

Other employee / employer tax issues include:

- Clarifying the source of directors' fees paid to non-residents. There is widespread differences in treatment between organisations. Some will treat only a portion of the fees as sourced in New Zealand based on the number days spent in New Zealand (which creates apportionment issues). Whereas others treat the full amount as taxable on the basis that they were paid by a New Zealand company. Deeming the full amount to be sourced in New Zealand would reduce compliance costs.

- Business Travellers – (i.e. highly mobile employees who travel to one or more countries on short term assignments). Where employees come to New Zealand to work short term but remain on a foreign payroll it can be difficult to ensure PAYE obligations are met at the time the individual is in New Zealand. Often it is uncertain how long they will be here for. Consider a mechanism that allow for the obligation to be assessed at year end and a wash up undertaken. The UK are currently considering a similar system.

Filing obligations

- Remove the requirement to file change of imputation ratio notices with the Commissioner. If a blanket removal will not be contemplated, we suggest that a concessional threshold should be introduced for small changes in imputation ratio. If the change in imputation ratio is below the threshold (we suggest less than 10%), the company would not be required to file a change of imputation ratio notice with the Commissioner. This would remove a compliance burden on companies paying dividends in foreign currency from filing a change in imputation ratio where the change in imputation ratio is due to foreign exchange movements.

- Remove the requirement to file company dividend statements with the annual income tax return.

- Extend the ability to file group returns for other tax types (i.e. beyond GST and income tax). This could include, group FBT, PAYE and other withholding tax returns.

- Simplification of non-resident insurer return process.

Inland Revenue systems

- Greater pre-population of return forms. For example Inland Revenue could prepopulate the NRWT annual reconciliations with the data already held.

- Ability to file a wider range of returns online for example RWT and NRWT returns.

- Allow online access to the status of the filing of tax agent's returns and agency list.

- An agents online log on where you can file an online income tax return for your clients (like MYIR but for agents where they are able to file several Income Tax Returns) [This may already exist but the functionality does not appear to be working].

- Tax reclaim forms (to obtain refunds of overpaid NRWT):

    - Update to electronic forms,
    - Inland Revenue should provide automatic residency certification to overseas authorities. Currently we have to complete duplicate hard copy forms and send the forms to the IRD for stamping,
    - Agree the treaty rate when the security is obtained rather than deducting at the full rate and obtain a refund

- Online FBT return form should have a box to manually enter the GST amount

- When registering a PIE online with Inland Revenue having the option to select a certificate of exemption from RWT instead of having to writing in to request one.

APPENDIX TWO: CORPORATE TAX RATES

OECD corporate tax rates*

	OECD Country	Corporate Tax Rate	Notes
1	Switzerland	8.5%	No future rate changes proposed.
2	Hungary	9.0%	Changed from 19% to 9% in 2017.
3	Ireland	12.5%	No changes planned per Budget 2018.
4	Canada	15%	No corporate tax rate changes planned.
5	Germany	15.83%	No corporate tax rate changes planned.
6	Luxembourg	18%	Reduced from 19% from January 2018.
7	Poland	19%	No corporate tax rate changes planned.
8	Czech Republic	19%	No corporate tax rate changes planned.
9	Slovenia	19%	Reduced from 20% in January 2017.
10	United Kingdom	19%	Reduced from 20% to 19% in April 2017.
11	Latvia	20%	Increased from 15% in January 2018.
12	Estonia	20%	Expected to decrease to 14% from January 2019.
13	Finland	20%	Reduced from 27% to 20% in 2017.
14	Iceland	20%	No changes planned.
15	Slovak Republic	21%	Reduced from 22%.
16	Portugal	21%	No changes planned.
17	United States	21%	Reduced from 35% from January 2018.
18	Turkey	22%	Increased from 20% in January 2018
19	Denmark	22%	No changes.
20	Sweden	22%	Potential reduction to 20% in July 2018.
21	Israel	23%	Reduced from 24% in 2018.
22	Norway	23%	Reduced from 24% in 2017.
23	Japan	23.2%	Reduced from 23.4% in April 2018 for ordinary corporations with share capital exceeding JPY 100 million.
24	Italy	24%	Reduced from 27% in January 2017.
25	South Korea	25%	Increased from 22% from January 2018.
26	Austria	25%	No changes planned.
27	Chile	25%	No changes planned.
28	Netherlands	25%	No rate changes planned. Proposed extension of corporate tax bracket for income subject to tax at 20% rather than 25%.
29	Spain	25%	Reduced from 28% in 2015. No further rate changes proposed.
30	New Zealand	28%	
31	Greece	29%	Potential for reduction to 26% in 2020.
32	Belgium	29%	Reduction from 33% from January 2018. Proposed reduction to 25% in 2020.
33	Australia	30%	Proposal for reduction over time to 25%.
34	Mexico	30%	No changes proposed.
35	France	34.33%	Will be progressively reduced to 25% in 2022.

Trans-Pacific Partnership corporate tax rates*

	OECD Country	Corporate Tax Rate	Notes
1	Canada	15%	No changes proposed.
2	Singapore	17%	No changes proposed.
3	Brunei	18.5%	No changes proposed.
4	Vietnam	20%	No changes proposed.
5	United States	21%	Reduced from 35% from January 2018.
6	Japan	23.2%	Reduced from 23.4% in April 2018 for ordinary corporations with share capital exceeding JPY 100 million.
7	Malaysia	24%	No changes proposed.
8	Chile	25%	No changes proposed.
9	New Zealand	28%	
10	Peru	29.5%	No changes proposed.
11	Australia	30%	Proposal for reduction over time to 25%.
12	Mexico	30%	No changes proposed.

* Note, these are the headline tax rates, in some instances there may be additional surcharges and levies which may increase the effective tax rate.