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GROWING PROSPERITY AND POTENTIAL

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DRAFT SUBMISSION

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LTIB First Draft
c/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
Wellington 6140

Dear Sir/Madam

Re: Tax, Foreign Investment and Productivity draft long-term insights briefing

I am writing to you regarding the consultation document entitled '*Tax, foreign investment and productivity*' (referred to as "the Document").

BusinessNZ took the opportunity to submit on IRD's previous Document that consulted on its proposal to focus its 2022 Long Term Insights Briefing (LTIB) on tax and its impact on investment and productivity. We agreed on this focus given investment and productivity are important factors affecting long-term living standards in New Zealand. Therefore, we are pleased to see the release of the current Document, and broadly support the LTIB process whereby key future issues are examined by Government Departments every three years.

The Document examines a number of potential measures to initiate a process of discussion. We welcome the decision to look at a number of different options, rather than concentrate on only a few that may not provide the broadest spectrum of choices to consider. We agree with the point raised in the Document that there is unlikely to be a single best option, so it is important to consider and rank the best options going forward given it may involve a number of difficult questions and conversations to be had.

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

We believe the main aim of tax policy is for New Zealand to continue its journey towards achieving a broad-based, low-rate tax system, collecting taxes in the most optimal way possible, and creating minimal disruption for the general population. In terms of this specific Document, we agree with the point made in paragraph 12 that *"the aim of this draft LTIB is to start a conversation"*. BusinessNZ sees it as the start of a journey towards meaningful change in lowering the costs of capital and improving inbound investment in New Zealand.

1. Setting the Scene

Benchmarking and the case for change
In our submission on the initial LTIB in September 2021, we noted that Document's sobering statistics about New Zealand's current investment and economic path, which highlight the need for a deeper examination of our investment and productivity challenge. The current Document provides further evidence for the case for change.

Figures 1.2 and 1.3 of the current Document that outline foreign direct investment (FDI) and outbound direct investment (ODI) illustrate how far New Zealand lags behind the countries we typically compare ourselves with. We agree that there is unlikely to be a silver bullet to properly address our weak productivity and poor economic performance over a number of years, and believe that a mix of policy changes is required to lift our performance. We believe a fundamental question that IRD needs to ask itself both now and ahead is, *'What would be the tax policy mix that would make a foreign investor look to New Zealand to invest?'*. If this question is kept top of mind when assessing future policy options, we believe there will be a greater chance of ensuring new tax policies integrate with existing ones to create the best platform for raising investment.

A cross-government effort
The Document rightly acknowledges the fact that while tax policy is an important element in addressing productivity issues, tax policy alone is not always sufficient in ensuring the best solution. Instead, broader policy settings often need to be examined to ensure policy changes that have the best opportunity for success.

BusinessNZ strongly agrees that regulatory and policy settings will also play a significant role in addressing our productivity and investment concerns. Therefore, we support the publication of LTIBs across key Government departments to promote wider discussion around future policy options.

We note that chapter 5 of the Document mentions the 2021 Treasury LTIB that BusinessNZ also submitted on. Given the Treasury LTIB was very much focused on long-term fiscal pressures from the aging population and rising healthcare demand, the link between future options that both Treasury and IRD outline are obvious.

Ideally, we would want the collective works of briefings across Government departments to be examined to ascertain what broad policy frameworks should be changed and/or introduced. This means Government policy needs to take a coordinated and considered approach, rather than the ad hoc, silo-bound, and often reactionary approach currently evident.

Recommendation: That the Government takes a coordinated approach across government to the various LTIBs being produced.

Estimated cost of capital
In our submission to the Tax Working Group in 2019, we noted that there is significant scope for the Government to conduct some updated research on the dynamic effects of reducing the CTR. While modeling work can only be as good as the structure and information fed into the model, there continued to be a serious hole in terms of research in this area where the Government tends to view changes in a static sense only. We noted that there is every chance that research into the dynamic implications of further reductions in the CTR may provide the greatest broad economic benefits, compared with changes in other direct taxes. We even supported private sector involvement via an economic agency becoming involved to help in the research.

Therefore, BusinessNZ is pleased to see that the current Document provides some in-depth modelling (based on OECD work) so as to provide a better understanding of the policy implications of various options.

Chapter 3 of the Document provides a useful outline of how New Zealand's company tax rate and tax depreciation rules likely compare to those in other OECD countries. In an attempt to analyse potential options, we support the modelling work IRD has undertaken on how tax rules can affect the cost of capital. While we acknowledge the caveats placed on the model IRD produced, it nevertheless provides a useful gauge of the likely outcomes of various tax rate changes.

We agree with the statement made in paragraph 3.20 of the Document, "…*that any economic model is no more than a partial insight. In particular, the OECD model treats the tax rules as certain and assumed to continue forever."* As a number of submitters including BusinessNZ have previously outlined, certainty has been in short supply. Haphazard decision-making that seems to be more political than policy-orientated has left the business community experiencing extreme uncertainty about the direction of Government policy. A clear and consistent policy pathway needs to be shown to entice investors to New Zealand, as opposed to the constant chopping and changing currently being experienced.

While we acknowledge the limitations and key assumptions of the OECD model used, table 3.1 summarising the data by country paints a fairly stark picture of where New Zealand currently sits with regard to estimated costs of capital over the four asset classes.

A ranking of 1st, 2nd, 3rd and 18th of 38 OECD countries tells us that if the table was ranked by overall ranking instead of alphabetically by country, New Zealand would rank first overall for cost of capital. Unlike paragraph 3.25 which states *"The OECD data suggest that New Zealand has relatively high costs of capital,"* we would go a step further and say without question New Zealand has the overall highest costs of capital in the OECD.

Furthermore, Paragraph 3.30 points out that, *"Little difference exists between New Zealand's costs of capital for the three main types of business investment included in the data … thus New Zealand's tax settings appear to be reasonably neutral across these three different aggregate assets."* While this is technically true, it misses the broader point above, that our overall ranking is significantly out of line with most other countries. In short, the neutrality of our tax settings across these assets does nothing to improve our chances of being seen as a viable country for investment.

Last, it does not surprise us that the restoration of building depreciation for commercial and industrial property in 2020 reduced the cost of capital for buildings from 4.9% to 4.1%. BusinessNZ strongly objected to the removal of depreciation on these buildings when it was initially discussed in 2010, given it placed New Zealand as a policy outlier with the rest of the world in terms of standard global tax practice. However, it should be pointed out that its reintroduction simply returned New Zealand to what is typically considered normal tax policy settings and cannot really be viewed as a recent proactive policy change to improve our investment competitiveness.

2. Options for the Future

The Document considers seven possible tax changes to initiate a process of discussion. For each option, we have included the specific questions asked in the Document, along with our overall thoughts and recommendations regarding their ability to see firms increase their investment in New Zealand.

The only overarching point we would like to make regarding the various options is that we have to be careful to avoid 'paralysis by analysis.' There are always costs and benefits associated with every policy option. However, the fact that some options would lead to certain costs should not automatically preclude them from consideration. Instead, we would expect that the policy journey to improve firms' inbound investment would eventually outline concrete options that the public and private sectors broadly view as the best way forward.

A. Reducing the Company Tax Rate

If New Zealand wished to reduce EMTRs, should reducing the company tax rate be an option to be considered?
If governments wanted to reduce costs of capital and EMTRs without reducing the progressivity of the tax system, what accompanying tax changes would you suggest?
Would the case for or against company tax rate cuts depend materially on what happens to company tax rates in other countries?
If there were a cut in the company tax rate, should there be changes to other tax rates at the same time?

Figure 3.1 in the Document highlights how high New Zealand's company tax rate (CTR) and Effective Marginal Tax Rates (EMTR) are, compared to not only other small, advanced economies, but also larger advanced economies. Whereas New Zealand once had a very competitive CTR and EMTR, this advantage has eroded over time. BusinessNZ has consistently argued for many years that our broad tax rate settings need to remain competitive to ensure we remain a viable and attractive country to invest and reside in. Unfortunately, we are now at the point where significant decisions need to be made to reverse our failing economic fortunes.

Some view the CTR as only one part of the overall assessment when deciding upon investing in a country. However, we believe the CTR is still considered a 'headline' rate when initial comparisons across countries are made. Obviously, we would expect any company that is looking to run operations in another country to do their due diligence, which would include examining the wider tax system of a country. Nevertheless, the setting of the CTR can often provide the first 'look in the room' regarding competition for foreign investment, with a favourable rate warranting further examination by the company.

To undertake a deeper look at costs of capital and EMTRs in New Zealand, we support IRD's examination into the key set of assets involving commercial and industrial buildings, plant, machinery and equipment, as well as a zero-depreciation asset. Further modelling work that culminates in table 6.1 in the Document shows reductions in the CTR would narrow the range of EMTRs, thus lowering costs of capital for investments that are heavily taxed and reducing tax subsidies for investments that are subsidised.

With regard to consistency, paragraphs 6.21 to 6.29 examine the issues of consistency, fairness and efficiency of personal income tax. While BusinessNZ understands the implications around fairness of a tax system that has significantly differing company and personal tax rates, the discussion seems to miss an obvious point that we believe should be addressed.

Prior to 1 April 2021, the top personal tax rate was 33%, which represented a 5-percentage point difference between the company tax rate, and a match for the trust rate. The increase in the top personal tax rate to 39% since 1 April 2021 has already led to a significant difference of 11 percentage points between that and the company tax rate. New Zealand now has the largest percentage point differential for some decades. Historically, a gap between the company and the top personal rate can cause distortions and encourage avoidance. We note that paragraph 6.23 does mention that *'…reducing the company tax rate would exacerbate these gaps unless personal rates were cut at the same time. Cutting personal tax rates may be supported by some future governments but not by others.'*

Table 1 below outlines the percentage point difference scenarios for the top personal tax rate at 33% and 39%, along with the three company tax rate options as outlined in chapter 6.

Table 1: Top Personal Tax and Company Tax Rate Differentials

Top Personal Tax Rate	Company Tax Rate	Percentage Point Difference
33%	28%	5%
33%	24%	9%
33%	20%	13%
39%	28%	9%
39%	24%	15%
39%	20%	19%

This table tells us that a 33% top personal tax rate means more options are available if seeking to lower the company tax rate, and that a cut in one rate should also see a cut in the other.

The full tax picture of global comparisons

Paragraph 6.25 notes that even with a relatively new top marginal tax rate of 39%, the 11-percentage point difference between that and the company tax rate is not large compared with other OECD countries. The Document also notes that only six other OECD countries had a smaller gap than this in 2020. However, the Document does not elaborate on the dollar thresholds at which the top personal tax rate kicks in, across the various OECD countries.

While Australia has a top personal tax rate of 45% and begins at the same dollar amount as New Zealand's (AUS$180,000), there are a number of other countries that New Zealand typically compares itself with that have a top personal tax rate that begins at a much higher dollar amount. Therefore, it would be useful for any future consultation work to include analysis of where New Zealand sits regarding the top rate and the threshold where it begins.

Paragraph 6.32 outlines the current state of play in Australia, noting a reduction in the company tax rate there would increase incentives for profits to be streamed to Australia. It also points out the two-tiered company tax rate system in Australia, which has a lower 26% rate for small-medium sized companies. While Australia has decided to go down this policy route, in no way would BusinessNZ support New Zealand doing the same, in an attempt to alleviate the issue around gaps in personal versus company tax rates. As we outlined to the Tax Working Group in 2018, a progressive CTR would move New Zealand away from the broad-based low-rate system we support, and in our view would create the unintended consequences outlined by the Tax Working Group. This would most probably lead to gaming via changes in the structures of the larger companies, and move us further away from a flat tax structure. Therefore, any change in the CTR should be a decrease that benefits all businesses.

Global trends

Paragraph 6.33 notes recent indications that there may be some movement back towards higher CTRs internationally, especially since the COVID-19 response has led to a weakening fiscal position for many countries. In addition, new international tax frameworks that would result in a global minimum CTR of 15% targeted at income from intangibles may indeed reverse the long downward trend in CTRs that have been ongoing for decades.

However, we believe New Zealand needs to be nimble in its tax policy decisions to ensure it covers every competitive position possible. Alignment is an important factor to consider, but this does not automatically mean increases and decreases in the CTR should be viewed equally. Therefore, if some countries that New Zealand typically compares itself with raise their CTR, there is an argument to be had that we could look to lower ours for competitive purposes. Further analysis could determine if the loss in revenue from the decrease would be outweighed by the overall increase in new business investment.

The key point from BusinessNZ's perspective is that this should be viewed as an opportunity and not a potential threat. As the Document mentions a number of times, New Zealand is a relatively small advanced remote economy that has to regularly compete with much larger countries that are able to influence global settings. Simply put, what New Zealand does or does not do has a much lesser impact than what other countries do that might affect us. For instance, a drop in the CTR to 15% in the USA is, on balance, likely to have a larger effect on New Zealand than what would happen in the USA if we decided to do the same thing.

As a small open economy, we should always seek opportunities that present themselves to remain competitive, while ensuring we hold true to the integrity of the tax system. If the future trend is indeed towards higher CTRs, it makes little sense for New Zealand to simply follow that trend.

Recommendation: That a decrease in the company tax rate is given the highest priority when examining how to improve New Zealand's inbound investment.

Implications for unincorporated enterprises and domestic SMEs operating as companies

Building on the discussion above, BusinessNZ is pleased to see that the document asks an important question regarding whether personal tax rates should be cut at the same time as the company tax rate. The Document takes the view that a reduction in the company tax rate, because of cost of capital concerns, should not provide a case for lower personal taxes. Instead, it should, *"…ensure that company income is adequately taxed at the personal level to ensure that company income ends up being taxed at appropriate personal rates"*.

BusinessNZ understands the point being raised in the Document. However, as we have pointed out, the practical implications of a company tax rate at say 20 or 24% and the continuation of a top personal tax rate of 39% does open a significant differential between the two rates. There is no doubt that this would move New Zealand further away from its traditional broad-based low-rate tax system. From our perspective, any serious consideration involving a reduction in the CTR should also take into account a reduction in the top personal tax rate to ensure ongoing integrity of the tax system.

Recommendation: That a decrease in the company tax rate is accompanied by a decrease in the top personal tax rate to ensure New Zealand retains its broad-based low-rate tax system.

Should future company tax rate cuts be signalled in advance?

In principle, BusinessNZ supports steps that provide improved settings for business, and certainly around the policy path ahead. If the Government decided to cut the company tax rate, we would broadly support the move.

Unfortunately, we note that, especially in recent times, politics have played too great a part in tax rate changes. Examples include announcements of tax cuts that have ended up not occurring. We have no problem with political parties announcing what changes they will make as part of their taxation policy heading into a General Election. However, we have seen in recent years the practice of an incumbent Government passing legislation to reduce personal tax rates etc, but for these not to be enacted till after the election. This strikes us as purely distractive electioneering, rather than a genuine attempt towards best tax policy practice. Often, there is very little reason for such changes to have to wait till after an election to be enacted.

Recommendation: That future tax rate cuts are both signalled and enacted within a Government's political term.

B. <u>Accelerated Depreciation</u>

If New Zealand wished to reduce EMTRs, should accelerated depreciation be considered as an option?
If accelerated depreciation measures are considered, should these be restricted to new investments or available for both new and existing investments?
If accelerated depreciation measures, or other measures that increase the present value of depreciation deductions, are considered, are there reasons to prefer depreciation loading, partial expensing or some other scheme?

While the Document points out that Australia introduced a partial expensing scheme as part of its response to COVID-19, we believe any re-introduction on this side of the Tasman should be based on long-term tax policy planning, rather than one-off economic shocks such as COVID-19. Given the on again/off again history of accelerated depreciation in New Zealand, we believe there needs to be a willingness across the policy and political spectrum to see its return. This would help minimise the incidence of chopping and changing as noted above.

BusinessNZ submitted to the Government as part of the 2009/2010 Tax Working Group review, saying we were not convinced that the options of reducing the loading figure or removing it, were the best steps forward for raising productivity levels, given the 20% addition to depreciation claims was introduced to encourage investment in income-producing assets. In addition, the savings for the Government by way of changing the policy was estimated to be around $0.3B, which in the scale of the Review seemed a punitive policy change for little gain. Therefore, we placed the options of removing or reducing loading as one of the 'least supported' as part of the review.

We were disappointed the Government at that time decided to remove accelerated depreciation. We have continued to hold the view that some sort of return to the pre-2010 policy of a 20% loading for purchases of new machinery and equipment should be allowed.

One option outlined in the Document sees accelerated depreciation being restricted to new assets only, which would mean that firms owning depreciable assets on the day a new scheme came into force would not benefit from a higher deprecation rate on these assets. While BusinessNZ sympathises with those businesses who would be caught in the time period where no accelerated depreciation on new assets were allowed, we generally agree with the point made in the Document that if the policy was implemented to incentivise investment, there would seem little reason to allow it on investments that have already taken place.

Recommendation: That some form of accelerated depreciation is reintroduced in New Zealand.

The analysis undertaken in the Document shows that both forms of accelerated depreciation (depreciation loading and partial expensing) reduce some of the higher costs of capital and EMTRs. In terms of which specific measure should be considered in the future, the Document believes depreciation loading would be better targeted at reducing costs of capital and EMTRs on the most heavily taxed depreciable assets. However, it should also be pointed out that partial expensing provides a significant benefit to all depreciating assets.

While BusinessNZ does not have any strong views regarding deprecation loading vs partial expensing, our interest is more geared towards having an overall accelerated depreciation scheme that best facilitates increased inbound investment, while still ensuring the general elements of good tax policy are maintained. Therefore, we are open to not only the two options outlined, but also the possibility of other options that may be suggested through the submission process.

Recommendation: That the scheme for the reintroduction of accelerated depreciation is predicated on the best options to improve inbound investment, while maintaining good tax policy practice.

C. Indexation

Might comprehensive indexation of the tax base, including indexation of interest, depreciation and trading stock, be worth considering further and does the answer depend on future inflation and interest rates?
Might partial indexation of the tax base, including indexation of depreciation deductions or indexation of both depreciation deductions and trading stock, be worth considering further and does the answer depend on future inflation and interest rates?

The two questions above examine the issue from either a comprehensive or partial indexation of the tax base. In principle, BusinessNZ is not against the idea of further consideration of indexation. If we were to look at personal taxes, we believe there is every justification to regularly index the personal tax rate thresholds. Although the Document clearly states that what it is examining here is different from the idea of inflation-indexing personal income tax thresholds, in many ways the same logic applies. Therefore, we see no reason why such measures should not be considered for other areas of tax policy.

However, as the Document rightly points out, complexity and practicality need to be taken into account when considering indexation. The fact that no other OECD country has comprehensively indexed their own tax system illustrates the potentially fraught compliance path ahead. Any steps taken in this space need to be well thought-through.

In relation to the current IRD Discussion Paper entitled *The Future of Tax Administration in New Zealand*, the way in which New Zealand administers its tax administration in a digital setting is very much open for change, with the private sector most likely becoming a key partner. Therefore, over time, there is every possibility that advances in technology and the increased use of private-sector software may present indexation as a viable option for a number of areas. However, that is a conversation still in its infancy, begging the question of whether indexation is an option for the near-term, or more appropriately the medium- or longer-term.

Comprehensive or partial indexation?
The Document asks for views on whether a comprehensive or partial index is the best way forward. Given our expectation of further policy work on digital tax administration in the foreseeable future, we are conscious of not putting the cart before the horse in terms of which option would best work for improving the neutrality of the tax system. This is perhaps a question better asked at a later date.

How do these measures compare with other ways of reducing higher EMTRs and reducing current tax distortions?
In comparison with other measures, we believe some of the other options outlined in the Document would be more appropriate to pursue at this time. However, this does not mean we should simply discard indexation as a viable option in the near future. As mentioned above, the speed at which the private and public sectors can collaborate to create products serving the specific needs of taxpayers will determine whether indexation can be introduced efficiently and effectively in the short-, medium-, or long-term.

Recommendation: That indexation is given further consideration at a future date when the relevant digital technology is at a sufficient level for this to occur.

D. Incentives for Specific Businesses or Industries

Are there specific businesses or industries where spillovers are large enough to justify lower tax rates?
Are there specific businesses or industries where economic rents are large enough to justify higher tax rates to fund lower general business tax rates?
Are there any other arguments for specific incentives?

As mentioned in the Document, *"The main objective of this policy option is to favour specific industries or activities where it is believed there will be too little of these industries or activities without an incentive."*

Overall, BusinessNZ **does not** support incentives for specific businesses or industries. We have strongly supported New Zealand's broad-based low-rate system, which has served the country well over many decades. The use of incentives is effectively 'picking winners,' which historically no Government has ever been able to do properly.

We believe that once tax incentives are considered, this opens a Pandora's Box of concerns about what incentives should be introduced. We concur with the view expressed in the McLeod review and mentioned in the Document, that arguments for favourable tax treatment due to positive externalities or other benefits can become a platform for practically any lobbyist's reform agenda. As overseas evidence has shown over many years, there is no doubt the introduction of incentives distorts the market and creates its own set of problems requiring attention.

BusinessNZ would strongly object to any further consideration being given to the option of incentives for specific businesses or industries.

Recommendation: That the LTIB does not consider the future use of incentives for specific businesses or industries.

E. Dual Income Tax System

Is a dual income tax worth considering further as a way of allowing costs of capital and EMTRs to be reduced?
Would a dual income tax be worth considering as a way of reducing distortions in the way that different forms of savings are taxed?
Would a dual income tax be an attractive or unattractive measure on progressivity grounds?
Is a dual income tax only worth considering in the future if it becomes harder to tax capital income at high marginal tax rates?

BusinessNZ is not against the idea of examining other countries' tax systems to ascertain whether part or all of them could be introduced in New Zealand. It is important that the fundamental structures of New Zealand's tax base are examined from time to time to ensure they are the best fit for the competitiveness of the country.

Specifically, the dual income tax systems adopted by Nordic countries have been discussed for some time now, including as far back as 2009 when examining New Zealand tax reform. As the Document rightly points out, the introduction of a dual income tax system would represent a complex tax change and would present many detailed issues to work through. Therefore, if this was given serious consideration, there would have to be clear and unequivocal net benefits for New Zealand given our overall need for increased investment and reduced cost of capital.

Investigating a dual income tax system would require addressing a number of fundamental issues, such as New Zealand's use of transfer payments (including Working for Families), along with how high we would need to increase personal tax rates (and other taxes such as GST) to compensate for a low tax rate on capital income.

While a dual income tax system may directly address some of the concerns we share around how to improve inbound investment in New Zealand, we believe that this option is not one that should be given first priority. From our perspective, this option represents the most radical solution, which should only be considered once other policy mechanisms have received consideration.

Recommendation: That a dual income tax system is only considered further when other tax setting options have been investigated for the improvement of inbound investment into New Zealand.

F. Thin Capitalisation and Allowance for Corporate Equity

Would it be sensible for the tax rules to be as neutral as possible between foreign direct investment and foreign portfolio investment or are there good grounds to promote one form of investment over another? If so, what should be promoted and why?
Is the current 60% thin capitalisation safe harbour broadly reasonable? If not, should it be increased or decreased?

If problems of integration with personal taxes could be resolved, would an ACE be a viable tax reform option if governments wish to reduce EMTRs and make investment decisions more neutral?
Are there viable ways of integrating an ACE with personal taxes and, if so, what are they?
If an ACE system were to be introduced, would it be viable to levy a tax on firms with negative equity? If not, would the neutrality properties of the tax be sufficiently compromised for this to be an unattractive option?

The two remaining areas for change involve thin capitalisation and an allowance for corporate equity. Regarding the former, BusinessNZ believes further investigation into the option of increasing the safe harbour threshold is warranted, given we believe there is potential for the benefits to outweigh the drawbacks if comprehensive future research is undertaken.

Interestingly, the last time the Government made a change to the safe harbour threshold for inbound investment was following the Tax Working Group review of 2009/10. At that time, IRD considered the 75% safe harbour was too generous and encouraged multinationals to over-allocate debt, rather than equity, to New Zealand. Therefore, from the 2011-12 income tax year it was reduced to 60%. The decrease in the safe harbour was also one way of making a fiscal gain given other tax changes at that time created a fiscal cost.

In our submission at that time to the 2009/10 Tax Working Group, we noted that lowering the safe harbour threshold from 75% to 60% could lead to more questions than answers and urged caution. The IRD paper recommending the drop did not specify the net benefit from reducing the threshold. The figure of 75% was essentially arbitrary, based on judgment and compromise, and so the reduction was one of the least supported options by BusinessNZ at that time.

Now in 2022, the discussion has returned to the possibility of returning tax settings to previous levels. While we have no strong view as to what a revised safe harbour threshold should be, the fact that we did not support the decrease in 2010 indicates that on balance, we favour it increasing. Also, if this is considered a viable option in the future, we encourage IRD undertake greater sensitivity analysis around a revised safe harbour threshold, including how it would sit with other possible future changes to improve inbound investment.

Recommendation: That the option of increasing the thin capitalisation safe harbour for inbound investment includes further sensitivity analysis regarding what an optimal threshold level should be.

Regarding the option of allowance for corporate equity, the Document states that this, *"…would be an option that would reduce the cost of capital on inbound investment without inducing firms to take on additional debt finance and apply to a much broader set of inbound investment."* While the Document does a good job of laying out the theoretical model, it also highlights some significant practical obstacles to overcome, including how it would properly integrate with personal taxes.

While BusinessNZ is not against this as a future option, we believe greater weight should be placed on other potential changes first, to ascertain whether they would provide a better pathway towards improving firms' inbound investment in New Zealand.

Recommendation: That the option of allowance for corporate equity is not considered at this time.

3. In Summary: Ranking of Options

Table 2 below ranks the most preferred options through to those that should not be considered. BusinessNZ believes a reduction in the company tax rate and accelerated depreciation are two options of immediate benefit, while most of the remaining options will require further in-depth investigation and consultation. Of the seven options, we place incentives for specific businesses or industries last and prefer no further work be carried out in this space.

Table 2: Prioritisation of Options

Future Options	Ranking
Reducing the company tax rate	Most preferred
Accelerated depreciation	Worth further investigation
Thin capitalisation	Worth further investigation
Indexation	To be considered in the future
Allowance for corporate equity	Possible consideration for the future
Dual income tax system	Possible consideration for the future
Incentives for specific businesses or industries	Should not be considered

Thank you for the opportunity to comment, and we look forward to further developments in this space.

Kind regards,

Steve Summers
Economist
BusinessNZ