BusinessNZ
GROWING PROSPERITY AND POTENTIAL

JacksonStone House
3-11 Hunter Street
PO Box 1925
Wellington 6140
New Zealand

Tel: 04 496-6555
Fax: 04 496-6550
www.businessnz.org.nz

21 February 2022

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

Dear Sir/Madam

Re: Tax, investment and productivity: consultation on the scope of Inland Revenue's long-term insights briefing

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

The Document outlines IRD's proposal to focus its 2022 Long Term Insights Briefing (LTIB) on tax and its impact on investment and productivity. Overall, BusinessNZ agrees on this focus given investment and productivity are important factors affecting long-term living standards in New Zealand.

We also believe it is useful to get a better understanding of how taxes are likely to be affecting costs of capital and the likely implications for inbound investment, productivity, and economic performance. Such assessment will be critical if evidence shows New Zealand may not be maximising its tax policy settings compared with other countries that also seek to improve their economic performance and well-being.

1. Background

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

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

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

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

The main aim 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.

2. Trends and scope of the LTIB

The Document outlines some sobering statistics in terms of New Zealand's current investment and economic path. This highlights to us the need for a deeper examination of the country's investment and productivity challenge.

Figure 3 in the Document that shows Foreign Direct Investment (FDI) as a percentage of GDP underlines the increasing importance New Zealand needs to place on policies that look to increase FDI in this country. At worst, it shows New Zealand's flat to declining pattern is in stark contrast to other OECD countries, including Australia and the United Kingdom. Figure 4 that outlines Outbound Direct Investment (ODI) is equally damning, with no increase whatsoever going back to 2009. Last, the Document rightly points out that our relative levels of GDP per capita examined in figure 5 look better than they would otherwise look because of hours of work increasing in New Zealand relative to the United States.

Considering the relatively poor trends New Zealand is showing with key international metrics, to that end paragraph 33 of the Document states that *the aim of the briefing is to open up the question of whether or not New Zealand's business tax settings have been part of the reason for New Zealand's relatively poor productivity performance*. Therefore, in terms of the proposed scope of the LTIB, BusinessNZ

wishes to pick up on a few points that we believe are relevant to what the LTIB should examine.

The Company Tax Rate

Paragraph 36 of the Document points out that the briefing will be seeking feedback on the pros and cons of various approaches which might lower costs of capital and whether these are likely to be improvements on the status quo. Among the seven likely areas outlined, the first seeks to examine lowering of the company tax rate (CTR).

Within that context, paragraph 23 of the Document notes that there may be some movement back towards higher CTRs internationally, as countries consider how best to repair their fiscal positions after having responded to COVID-19. At the very least, this may reduce the downward pressure on the CTR.

There will undoubtedly be pressure in some countries to increase taxes, including their CTR. 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. Analysis could determine if the loss in revenue from the decrease would be outweighed by the overall increase in new business investment.

Paragraph 24 of the Document also points out that the CTR is only one of a much broader set of tax considerations that can influence incentives to invest, with the six other possible measures which might lower costs of capital mentioned in paragraph 36. Overall, BusinessNZ agrees. Other measures such as tax depreciation provisions, other tax incentives such as New Zealand's R&D Tax Incentive and thin capitalisation rules can all impact on hurdle rates of return and affect investment.

However, the only additional point we would make here is that 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.

The document also points out that that IRD is *also interested in the impacts on other New Zealand firms including companies listed on the NZX and small and medium enterprises (SMEs) which may have little or no foreign shareholding*. BusinessNZ supports a wider examination of such areas, especially since for many SMEs it is not the CTR, but the top personal tax rate that has the greatest relevance.

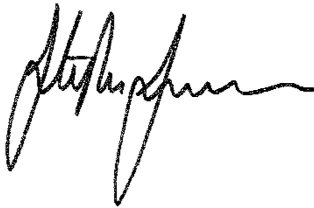
Connection with Personal Taxes

We believe any further examination through the LTIB also requires personal tax rates to be taken into consideration. Until 2000, the CTR was aligned to the top personal tax rate (PTR), but an increase of the top PTR in 2000 to 39% brought a 6-percentage point gap between the two rates. While this gap was closed to 5-percentage points by 2010 with a revised PTR set at 33% and CTR at 28%, the current Government's decision to again increase the top personal tax rate to 39% now means New Zealand 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.

The above point is recognised in paragraph 35 of the Document which states *there are many ways of lowering costs of capital which can have different distributional effects. For example, lowering the company tax rate by itself could make it harder for the Government to levy as progressive an income tax on individuals (because high income earners may be able to shelter their income in companies and have this taxed at the company rate rather than at higher personal tax rates).* With the top personal tax rate at 39%, and the current company tax rate at 28%, we would argue that some of this may already be occurring given the significant differential. Therefore, we believe it is important that the LTIB also considers New Zealand's recently increased top PTR, especially since New Zealand's tax policy settings have centred around a broad-based low-rate structure.

Overall, we believe that tax and its impact on investment and productivity is a worthwhile subject to investigate further through an LTIB, and we look forward to further developments.

Kind regards,



Steve Summers
Economist
BusinessNZ