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LTIB topics
c/- David Carrigan
Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
New Zealand

By email: **policy.webmaster@ird.gov.nz**

Dear David,

Inland Revenue's long-term insights briefing - tax, investment and productivity – consultation paper

CPA Australia represents the diverse interests of more than 168,000 members, including over 2,700 members in New Zealand, working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

We support the Inland Revenue's (**IRD**) proposed focus on tax, investment and productivity in its Long-term insights briefing (**LTIB**) **Consultation Paper** (**the Consultation Paper**). As acknowledged in the consultation paper, the causes of lower productivity and poor economic performance are complex, and the IRD's focus on the cost of capital and effective marginal tax rates is a practical approach to an issue that goes far beyond the tax system. Consideration could also be given to the composition of the overall tax base with New Zealand being more reliant on income and profit taxes rather than more efficient consumption-based taxes, and the question of whether the imputation system remains appropriate.

We also note that, in addition to the tax system settings (i.e., tax base and rate), the cost of complying with, and the administrative burden imposed by, the tax system can also give rise to reduced productivity. The overall regulatory burden on businesses is high and diverts resources away from high value-add activities. Potential opportunities exist in relation to designing tax laws to align with accounting systems and to reducing the cost of complying with tax obligations through business digitalisation.

Our responses to the key questions in the Consultation Paper are contained in the Attachment.

If you have any queries about this submission, contact Rick Jones, Country Head, New Zealand on +64 21 190 1039 or **rick.jones@cpaaustralia.com.au** or Elinor Kasapidis, Senior Manager Tax Policy on +61 3 9606 9666 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

Dr Gary Pflugrath	Mr Rick Jones
Executive General Manager,	Country Head,
Policy and Advocacy	New Zealand

Proposed scope of the LTIB

Is tax and its impact on investment and productivity a worthwhile subject to investigate further through an LTIB?

Yes. Tax settings should be reviewed regularly to evaluate whether they are achieving the desired outcomes and to identify unintended consequences.

The impact of taxes on investment and productivity is a worthwhile topic because settings need to support the Government's broader policy goals with sufficient revenue to fund public goods and services, while maintaining a competitive and efficient economy.

Earlier OECD research[1] identified a number of areas for productivity improvement in New Zealand, including:

- Lowering the corporate income tax rate
- Reducing the reliance on income and profit-based taxes
- Better aligning tax rates between entity types to reduce arbitrage and tax planning.

We expect the findings of the LTIB will help inform the public debate on such potential reforms and identify areas for further policy discussions.

Key trends and issues

Are there other global tax trends that are critical to this study which should be considered?

The OECD's work on base erosion and profit shifting (BEPS), including the progression of Pillars One and Two, should have an impact on reducing the effect of tax differences between jurisdictions on investment decisions. This could result in a level of tax rate harmonisation across jurisdictions and a shift away from the use of tax policies to gain a competitive advantage.

The increasingly global nature of business and employment also brings international tax issues to the fore, such as non-resident withholding tax (**NRWT**), tax agreements and tax residency.

For example, inbound investors see the corporate tax payable in New Zealand as an expense. Only if the double-tax agreement (**DTA**) imposes an NRWT obligation will the investor benefit via the foreign investor tax credit (**FITIC**) regime. Overall, this might reduce the tax cost to 15 per cent as the remaining tax is allowable as a tax credit for the New Zealand company. If there is no tax imposed on dividends paid offshore under the DTA, then the cost of capital will increase, as the non-resident investor will lose all imputation credits.

The LTIB could also consider the impact of tax on labour productivity in a global market for labour. As technology enables businesses to easily employ people across the globe, higher personal income tax rates can reduce the price competitiveness of New Zealand labour. Insights into the extent to which personal income tax rates may influence the price of labour and domestic employment would assist in determining whether there is a likely impact on tax revenues, thus enabling potential responses to be considered.

Suggested outline

Are these sensible policy options to consider?

We support the exploration of the policy options proposed for the LITB, noting that changes to the rate and structure of income taxes are far more significant than policies such as inflation adjustments or targeted tax incentives.

Our preliminary observations, informed by feedback from our members, are:

- Company tax should align with other countries, particularly Australia, which is New Zealand's nearest trading partner and largest source of foreign direct investment (**FDI**). The analysis could explore the productivity and investment benefits across a range of reduced tax rate settings down to 15 per cent
- Depreciation rates need to be revised and simplified as the time over which laws require an asset to be depreciated in New Zealand is too long
- Consideration should be given to raising the GST, as necessary, to reduce the reliance on personal income tax and marginal income tax rates. GST is by far the most efficient tax and with its minimal carve outs is contributing over 30% of all tax revenue in New Zealand

[1] OECD, 2009. Guillemette, Y., 2009. Structural policies to overcome geographic barries and create prosperity in New Zealand, PECD Economics Department Working Papers No. 696 ECO/WKP(2009)37, OECD https://dx.doi.org/10.1787/224223031816

- Potential changes to thin-capitalisation rules should be evaluated to lower the cost of capital. This could include allowing interest deductions in New Zealand, a reduction in the complexity of the rules and permitting a deemed interest deduction for equity as a mechanism to attract inbound investments.
- The adoption of a dual income tax structure for capital income and labour income may not necessarily impact the cost of capital for New Zealand resident shareholders. Countries that have adopted this dual income structure abolished their imputation credit systems, tax domestic dividends and capital gains under the dual system. The introduction of a dual tax system would likely require additional reforms such as the adoption of a capital gains tax for onshore equity investments and the removal of the imputation credit system
- Tax incentives may assist in supporting innovation and start-ups and may be more efficient than transfer payments. For example, in Australia, the proposed introduction of a targeted patent box regime and digital games tax offset complements the existing research and development tax incentive (RDTI). Consideration should be given to the design and effectiveness of such programs in other jurisdictions and their suitability for New Zealand
- Remaining internationally competitive is important for New Zealand, both in its tax settings as well as ease of administration and alignment with other jurisdictions' rules.

Are there other reforms which should also be considered?

The Consultation Paper acknowledges potentially different distributional effects and the need to consider tax neutrality. It is likely that potential reforms identified in the LTIB may lead to the need or opportunity to consider other changes in order to compensate for distributional impacts, or to raise tax revenue from alternative sources. These should also be identified in the LTIB to reflect the trade-offs that may be required.