Tax Working Group
Te Awheawhe Tāke

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This paper has been prepared by the independent advisor to the Tax Working Group for consideration by the whole Group.

The advice represents the views of the independent advisor and does not necessarily represent the views of the Group or the Government.

Business tax – companion note

At the time of writing officials hadn't finalised their papers so apologies for any cross over between these points and officials papers. This paper was also written quickly on Thursday afternoon so I apologise if anything is not clear. Happy to discuss.

The points I would like to add or emphasise are as follows:

Dividend avoidance

This issue can arise when the value received by shareholders from a company in the form of drawings exceeds the amount they formally allocate to themselves. According to officials documents this amount is at least **$25 billion** of untaxed value received by shareholders.[1]

For example. Shareholders will take drawings from their company in advance of money that the company will formally pay to them in the form of interest, dividend or shareholder salaries.

With the progressive tax scale being higher than the company rate there is an incentive to keep these payments below the rate where 33% or even 30% kicks in but instead pay tax at the lower company rate. This is all the more stark when for whatever reason the taxable income of the company is low in the first place.

When this difference becomes structural there then becomes an incentive to find ways to eliminate this net advance and preferably give a buffer for future net advances.

A number of the schemes seek to unlock the embedded goodwill in the company and have it passed out as effectively a untaxed capital gain. In substance these arrangements boil down to ways of creating the accounting entry of Dr Goodwill Cr shareholders advances although I doubt they are this blatant.

Regardless they violate horizontal equity in that dividends/ value from company are not taxed at the same rate as all dividends. Arguably it also violates vertical equity as the progressive tax scale is not applied to that income.

Collection

Channelling my inner Nick Malarao, these papers are all framed in terms of assessment and show the disconnect between the framework for taxing – companies are vehicles for shareholders and collection – corporate veil.

This disconnect may be something the Group wishes to seek more information from Nick on.

Imputation balances

Since the recent Australian treaty came into force it is possible for a NZ company to pay a dividend to a wholly owned Australian listed parent without paying non-resident withholding tax if the

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[1] There will be interest paid of approximately 6% on these balances by shareholders or FBT paid on the value of the lack of interest. There is also the risk following the *Krukziener* case of Inland Revenue assessing this value as taxable income.

dividend is not imputed. Ie dividends can leave NZ in these circumstances without any tax being paid.

While this is an intentional policy decision what it does mean is that such companies will be building up imputation credits which have no use to them. As shown in past prospectuses from companies such as Fairfax and CBA unused credits can be used to subsidise preference share arrangements.

This all came to a head in Australia in the Mills case where it was found to be not avoidance or *streaming.* My understanding is that for various reasons we no longer have these schemes in NZ. However this can always change and I would suggest we get a briefing from officials on the total of such credits in existence, the risks and how they are currently mitigating the situation.

Productivity paper

Loss restrictions and Depreciation

In a world with incomplete inclusion of capital income I am less concerned about these issues than officials.

This is because I see both as second order mechanisms of limiting the benefit of capital gains not being fully taxed. This is particularly the case for building depreciation. But for losses as a loss is inherently a loss of capital; the fact that they could be lost on shareholder change which could also involve an untaxed capital gain on sale – while far from optimal is some way of mitigating the imbalance of taxation.

General comments

I agree with Robin it would be good to get advice from the Productivity Commission as well as look at this issue from the point of other taxes – environmental? which may or may not assist. Perhaps this could be included in the blue skies paper I need to do with the young Treasury official.

Effective tax rates paper

While I have yet to see this I would envisage the differences will include:

Realised and unrealised capital gains

Looking at the accounts of retirement villages this is a key line item in their accounts[2]. We may need to think about how or if we should do anything about the unrealised component.

Interest deductions

As mentioned in my interest paper tax allows immediate deductibility while accounting requires interest to be capitalised into assets or assigned to projects. In both cases tax gives a timing advantage over accounting. Whether or not this is right could be a topic of conversation.

Andrea Black

[2] This is different from the trading of their 'occupancy advances'. This is the value of their underlying ownership.