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This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

Coversheet: **Business tax**

Discussion Paper for Sessions 6 and 7 of the Tax Working Group
April 2018

Purpose of paper

This paper discusses New Zealand's system of taxing business income, and seeks the Group's direction on:

- areas that it would want to address in the Interim Report;
- any conclusions for the Report arising from the information provided; and
- the focus of subsequent work on this subject.

This paper is a summary of the key issues that we suggest be considered by the Group. A number of detailed papers are provided as stand-alone appendices to this summary paper. These appendices are intended to provide a fuller discussion of the issues raised in this summary paper, and additional background.

Three further papers for the Group's meetings on business tax will also be provided separately to this paper. These relate to effective tax rates for industry, Maori authorities, and trust structures.

Key points for discussion

- Is the imputation system still sensible for New Zealand, or should full integration be considered?

- Is the company tax rate still appropriate in light of international trends?

- Does the non-alignment of entity tax rates with personal tax rates raise fairness and integrity concerns? If so, how should this non-alignment be addressed?

- Should there be a progressive company tax rate, with a lower rate for small companies?

- Should the efficiency-enhancing proposals raised in the paper be considered further? If so, which ones?

- Are there other business tax reforms does the Group wish to consider further? Which reforms can be taken off the table?

- What further analysis would be useful to assist the Group's deliberations on this subject?

Recommended actions

We recommend that the Group:

a) **indicate** whether the following should be included in the Interim Report (recommended by the Secretariat):
   i) there be no change to the company tax rate
   ii) the imputation system be retained
   iii) a progressive company rate not be introduced.

b) **indicate** which of the following issues it wishes to consider further for recommendations in the Interim Report:
   i) any changes to the imputation system
   ii) integrity measures for closely-held companies
   iii) measures to enhance efficiency in the business tax context, including:
      (1) indexing the tax base for inflation
      (2) building depreciation
      (3) loss continuity
      (4) black hole expenditure.

c) **indicate** what, if any, further information is required by the Group in relation to the topics above.

d) **indicate** whether any other business tax reforms should be considered by the Group.

Business tax - summary

Discussion Paper for Session 6 and 7
of the Tax Working Group

This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

The Tax Working Group will release its interim report containing its recommendations in September and the views of the Group will be informed by public submissions alongside Secretariat advice.

March 2018

Prepared by the Inland Revenue Department and the Treasury

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Executive summary

This paper discusses New Zealand's system of taxing business income, and seeks the Group's direction on:

- areas that it would want to address in the Interim Report;
- any conclusions for the Report arising from the information provided; and
- the focus of subsequent work on this subject.

This paper is a short summary of the key issues that we suggest be considered by the Group. A number of detailed papers are provided as stand-alone appendices to this summary paper. These appendices are intended to provide a fuller discussion of the issues raised in this summary paper, and additional background.

Three further papers for the Group's meeting on business tax will also be provided separately to this paper. These relate to effective tax rates for industry, Maori authorities, and trust structures.

The Group has been directed to report, among other things, on the fairness, balance and efficiency of the tax system, whether the tax system promotes the right balance between supporting the productive economy and the speculative economy, and on whether there are changes which would support the integrity of the income tax system, having regard to the interaction of the systems for taxing companies, trusts, and individuals. Further, the Group has been asked to consider whether a progressive company tax (with a lower rate for small companies) would improve the tax system and the business environment.

Company tax is an important part of our revenue base. But the business tax regime also has a broader impact on wellbeing – it directly affects the accumulation of physical and financial capital (by changing the incentives on firms to save and invest), and it has a particularly important impact on social capital.

This impact arises from its function as a withholding tax for domestic shareholders, which supports New Zealand's personal income tax system.

The progressive personal tax system contributes to social capital by attempting to tax those with different levels of income fairly regardless of whether the income is earned directly. Consistent and neutral taxation of income accruing in different entities would support this. Since the rate of company tax is not aligned with the top personal tax rate, there are opportunities for high-earning individuals to shelter their income through a closely-held company. In addition, some businesses appear to be avoiding the full impact of the imputation system on company distributions through various forms of dividend avoidance. These issues are discussed in detail in Appendices 4 (Taxation of closely-held companies) and 5 (Dividend avoidance). These situations can negatively affect fairness and integrity, and may lead to a loss in social capital. They also impact negatively on the efficiency of physical and financial capital because business structures may be driven by tax considerations and there is an economic cost to tax planning. We propose the Group recommend that the Government address these issues, and suggest a number of possible approaches in Appendix 4.

The second function of company tax is that it operates as a final tax for foreign shareholders. As a result of the two separate functions, there are potentially conflicting drivers in considering the appropriate rate of company tax.

A number of other countries have been cutting their company tax rate and an important question is whether these reductions in other countries provide reasons for New Zealand to do likewise. There are arguments for and against cutting New Zealand's company tax rate. We review these arguments, and conclude on the basis of the information currently available that a cut in New Zealand's company tax rate is unlikely to be in our best interest.

Australia has been considering whether to move away from the imputation system (whereby a credit is given at the shareholder level for tax that has been paid at the corporate level). The imputation system broadly ensures that income derived through a company is taxed at the shareholder's marginal tax rate. The paper examines alternatives to the imputation system such as full integration (where company income is taxed at shareholders' marginal tax rates) and a classical company tax system (where no relief is provided for company tax at the personal level and income earned through companies is double taxed). We consider that imputation remains a fair and efficient system for taxing shareholders' income earned through companies.

The Tax Working Group is considering other measures, which may broaden the taxation of capital income and in so doing raise additional tax revenue. At the same time the Terms of Reference requires a tax system that supports a sustainable revenue base to fund government operating expenditure around its historical level of 30% of GDP. In the event that the Group decides to implement tax changes that increase revenue, there is a question about whether and how this revenue could be "recycled" to improve the structure, balance and/or fairness of the overall system. We outline several potential revenue-negative policy changes that would improve the efficiency of the taxation of business income. These include indexing the tax base for inflation, allowing deductions for building depreciation, allowing losses to be carried forward to future years in a greater range of circumstances, and allowing deductions for black hole expenditure.

Australia has a progressive company tax (with a lower rate for small companies), and the Group has been asked to consider whether this would be appropriate for New Zealand. We consider that any benefits of a progressive company tax rate are likely to be outweighed by disadvantages including being poorly targeted, complex and likely to reduce productivity, and we do not recommend this direction of reform for New Zealand.

Recommendations

We recommend that the Group:

e) **indicate** whether the following should be included in the Interim Report (recommended by the Secretariat):
   i) There be no change to the company tax rate
   ii) The imputation system be retained
   iii) A progressive company rate not be introduced

f) **indicate** which of the following issues it wishes to consider further for recommendations in the Interim Report:
   i) any changes to the imputation system;
   ii) integrity measures for closely-held companies
   iii) measures to enhance efficiency in the business tax context, including:
      (1) indexing the tax base for inflation
      (2) building depreciation
      (3) loss continuity
      (4) black hole expenditure

g) **indicate** what, if any, further information is required by the Group in relation to the topics above.

h) **indicate** whether any other business tax reforms should be considered by the Group.

1. Introduction

1.1 Purpose

1. This paper discusses New Zealand's system of taxing business income, and seeks the Group's direction on:
   - areas that it would want to address in the Interim Report;
   - any conclusions for the Report arising from the information provided; and
   - the focus of subsequent work on this subject.

1.2 Content and scope

2. The Group has been directed to report on, among other things:
   - the fairness, balance and efficiency of the tax system,
   - whether the tax system promotes the right balance between supporting the productive economy and the speculative economy, and
   - whether there are changes which would support the integrity of the income tax system, having regard to the interaction of the systems for taxing companies, trusts and individuals.

3. Further, the Group has been asked to consider whether a progressive company tax (with a lower rate for small companies) would improve the tax system and the business environment.

4. This paper refers to a number of more detailed papers. These papers have been provided as stand-alone appendices to the main paper. The appendices are intended to provide a fuller discussion of the issues, and additional background. They are referenced below.

5. This paper is structured as follows:

   - Section 1 gives a brief overview of the significance of company tax and an outline of the different types of business entities in New Zealand.

     It also comments on the "dual roles" of company tax, as a withholding mechanism for domestic shareholders, and as a final tax for foreign shareholders.

     ▪ Appendix 1 provides further detail on business structures and explains how they are taxed.

   - Section 2 discusses international considerations, the company tax rate and imputation.

This section notes the global trend towards company tax rate reductions and discusses what New Zealand’s response to these developments should be.

It also discusses New Zealand’s imputation system, and whether it would be appropriate to change the system.

- Appendix 2 provides further detail on costs and benefits of reducing the company tax rate.
- Appendix 3 provides further detail on the imputation system, and potential alternatives to this system.

- Section 3 discusses issues with the non-alignment of personal tax rates and entities. Changes to these areas could have positive impacts on social and financial capitals.

- Appendix 4 provides further detail on closely-held companies.
- Appendix 5 provides further background on dividend stripping techniques (whereby accumulated income that has not been taxed at the company level is paid out without being taxed).

- Section 4 discusses potential measures to enhance efficiency. This includes discussion on some specific measures that would make the tax treatment more neutral, and whether there should be a lower tax rate for small companies.

- Appendix 6 suggests some potential measures to enhance efficiency, including indexing the tax base for inflation, building depreciation, loss continuity, and black hole expenditure
- Appendix 7 provides further analysis on whether there should be a lower tax rate for small companies, and concludes that there should not.

- Three further papers are not discussed in this summary paper, but will be provided for Session 6 and 7. These are:

  - **Effective company tax rates.** The statutory company tax rate is 28%. If some sectors of the economy habitually pay lower effective rates, perhaps because they can apply excessive deductions, or benefit from timing regimes or some of their income is not taxed, it may be appropriate to consider whether those tax treatments are still relevant and fair. An analysis of effective tax rates will be discussed in a paper to be provided to the Group for consideration.
  - Further **information on trusts.** This provides information in relation to the Group's questions on trust structures.**
  - **Maori authorities.** This paper comments on the tax treatment of Maori authorities, which are organisations that manage communally-owned assets that are subject to certain restrictions.

**NB: The trusts paper referred to in this document is currently being prepared and will be provided to the Tax Working Group at a future date.

2. Background

2.1 Significance of company tax

6. In the year ended 30 June 2017, the Government collected $12.6 billion in company tax.[1] This represents 4.6% of GDP in 2017.[2] In 2015, New Zealand's collection of company tax was the highest in the OECD as measured as a proportion of GDP if measured on an unconsolidated basis. This reflects a broad and robust tax base and a relatively high rate. As at 2017 New Zealand has the tenth highest company rate of the 35 OECD countries.[3]

7. Company tax is an important part of our revenue base. But the business tax regime also has a broader impact on the 'four capitals.' It directly affects the accumulation of physical and financial capital, because it changes the incentives on firms to save and invest. From a human capital perspective, business tax can affect the ability of and incentives on firms to invest in the skills of their workers. Given that economic activity tends to consume natural resources and generate environmental externalities, business tax also has broader impacts on natural capital – through its impact on overall levels of economic activity, or on particular sectors of the economy that may have greater or lesser environmental impacts.

8. There is also an important link between social capital and the business tax regime. An effective business tax regime is an important means to sustain public trust and confidence in the tax system. This is because the business tax regime buttresses the personal income tax by reducing opportunities for wealthier individuals to reduce their tax obligations (for example, through the use of closely-held businesses). An ineffective and unfair business tax regime, on the other hand, will erode public acceptance of prevailing levels of taxation, as well as the spirit of voluntary compliance by taxpayers that underpins efficient tax collection.

9. Because of New Zealand's imputation system, there is only limited additional tax at the shareholder level when dividends are paid out of income that has been taxed at the company level. This additional tax applies for taxpayers on the top marginal rates, and is the difference between the corporate rate and the taxpayer's marginal tax rate. Many other countries have higher tax imposts at the shareholder level.

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[1] Financial Statements of the Government of New Zealand for the year ended 30 June 2017: Notes to the Financial Statements: Note 3', *The Treasury* (Wellington: The Treasury, 2017) <http://www.treasury.govt.nz/government/financialstatements/yearend/jun17/27.htm> [accessed 2 March 2018]

[2] GDP data sourced from Statistics New Zealand.

[3] This does not include the reduction in the US corporate rate from 35% to 21%.

New Zealand’s tax rate on domestic shareholders (including the company tax) when profits are distributed as dividends is the sixth lowest in the OECD.

10. The company tax rates referred to here are statutory rates. Some sectors of the economy pay lower effective rates, because they can apply deductions which exceed economic costs, or benefit from timing regimes or some of their income is not taxed. It may be appropriate to consider whether the tax provisions leading to these results are still relevant and fair. An analysis of effective tax rates for companies will be discussed in a paper to be provided to the Group for consideration at Sessions 6 and 7.

2.2 Types of business structures in New Zealand

11. Business taxpayers can earn income either directly or through various entities, such as companies, partnerships, trusts, Maori authorities, and various tax hybrids including look-though companies and limited partnerships. A description of these is included in Appendix 1 (Types of business structures and how they are taxed).

12. There are over a million businesses in New Zealand, with around half being sole traders and a third being companies.

13. Entities or structures that are controlled by individuals (such as closely-held companies) provide opportunities for some high-income earners to reduce or defer taxation. This can have important effects on fairness and integrity. When considered in light of the Living Standards Framework, these settings can potentially lead to a loss of social capital.

14. Differences in treatment can lead to businesses to be structured in inefficient ways, resulting in economic costs. When considering the Living Standards Framework, this can lead to a loss of financial capital.

15. These issues are discussed in more depth later in this paper, and in Appendix 4 and the future paper on trusts.

2.3 Functions of company tax

16. The taxation of companies performs two key functions. For New Zealand shareholders, the company tax is a withholding tax on income derived through the company. For foreign shareholders, company tax is a final tax.

17. These two functions mean that there are different considerations in relation to the company tax rate.

18. Differences in tax treatment of entities and individuals can lead to differences in the amount and timing of tax, depending upon the arrangements made to hold the investments and distribute income.

19. When focusing on domestic considerations, there are strong arguments for aligning the company tax rate with the top personal rate for integrity and fairness reasons. Combined with New Zealand's imputation system, this would provide a way of ensuring that New Zealand's progressive personal tax rates "stick". If the company tax rate was aligned with the top personal rate there would not be any artificial advantage in retaining income in companies even if shareholders were on the top personal marginal tax rate. If shareholders were on lower marginal tax rates, there would be incentives for profits to be distributed so that income would end up being taxed at marginal rates wherever this was material to a firm.

20. However, there are different considerations in relation to foreign shareholders. A lower company tax rate would provide greater net returns on investment and therefore increase incentives to invest. It would reduce pressure on base erosion and profit shifting (multinational companies that are able to shift profits out of New Zealand would have less of an incentive to do so with a lower New Zealand company tax rate). It would also reduce distortions that arise from the fact that the company tax base is not completely neutral. On the other hand, it should be noted that New Zealand would lose tax on economic rents (income derived that is in excess of the costs needed to bring that factor into production) and existing investments.

21. New Zealand does, however, have an element of allowing a lower final tax rate for foreign-owned firms by allowing foreign-owned firms to partially debt finance their domestic subsidiaries[4].

[4] A company is said to be thinly capitalised if it obtains a lot of its funds as debt. New Zealand's thin capitalisation rules restrict the amount of debt that can be deducted. These rules allow for a 60% debt-to-asset safe harbour. This "safe harbour" allows foreign investors a lower effective tax rate on their New Zealand investments than otherwise (because debt is taxed at a lower rate than equity).

3. International considerations, the company tax rate and imputation

3.1 Company tax rate

22. At 28%, New Zealand's company tax rate is relatively high by international standards. As at 2017 New Zealand's company rate is the 10th highest in the OECD, with the unweighted OECD average being 24.9%[5].

23. New Zealand relies heavily on inbound investment to fund its capital stock, and as a result, if tax is an undue impediment, New Zealand will ultimately have lower capital stock. This can result in lower wages for New Zealanders. This is generally because workers are more productive when using more capital.

24. Conceptually, the effects of a company tax cut would be:
    - Greater capital investment in projects that are viable at the lower company rate (but would not have been viable at the higher previous rate), with corresponding benefits for labour productivity due to increased capital investment.
    - Reduced pressure on base erosion and profit shifting – multinational companies that are able to shift profits out of New Zealand would have less of an incentive to do so with a lower New Zealand company tax rate.
    - Windfall benefits to those who have invested in New Zealand in the past.
    - Windfall benefits to those who would have invested in the future at the prior rate in any event.
    - Loss of taxation on location-specific rents (rents arising from factors that are linked to a location - such factors could include resources, or access to particular markets that allow above-normal profits to be earned).
    - Increased integrity concerns from New Zealand investors sheltering income in companies, although this may be ameliorated through other policies, including a capital gains tax.

25. All of this leads us to conclude that, on balance, in the judgement of the Secretariat it would not be in New Zealand's best interests to lower the company tax rate. The key judgement in this assessment is the level of economic rents earned by foreign investors. If these economic rents were small, or were likely to be decreasing over time, a better case could be made that New Zealand should lower its company rate.

26. At the same time, this assessment is very much a judgement call. The Australian Treasury has modelled the effects of a company tax cut in Australia. The modelling finds modest gains in national welfare from reducing the corporate

[5] This statistic does not include the recent corporate tax rate cuts in the USA, from 35% to 21%.

rate (0.1% improvement when the loss of revenue from the 5% corporate tax rate cut is made up by increasing personal income tax).

A key question for the Group is whether it consider that the company tax rate still appropriate in light of international trends.

3.2 New Zealand's imputation system

27. An important feature of New Zealand's company tax system is its imputation system. The Group has asked for further information about the imputation system.

28. Imputation ensures that company profits are taxed once, at the shareholders' marginal tax rates. Under imputation, a credit is given at the shareholder level for tax paid at the corporate level. Under the previous classical tax system, company profits were taxed in the company and again when distributed as dividends to the shareholders, resulting in significantly higher effective tax rates than income earned directly.

29. Imputation is a 'belt and braces' approach to securing taxing rights on New Zealand-sourced income, and acts more generally as a buttress to company tax. If the company reduces the amount of tax it pays, the reduction may be offset by higher taxes on shareholders. Another important benefit of imputation is that it reduces undesirable biases that existed under the classical system.

30. Previous reviews of New Zealand's imputation system have lent it consistent support, finding that it works well.

31. Nevertheless, globally there appears to be a general trend away from imputation. European countries in particular have been removing imputation, although we note that this is in order to meet their non-discrimination obligations under European Union Single Market laws. Australia has also recently considered a return to a classical system. In particular, we understand that Australia considers that having an open economy undermines the rationale for imputation to the extent that foreign investors rather than domestic investors determine the cost of capital to firms.

32. Appendix 3 notes that imputation continues to play a constructive role for SMEs and other sectors of the economy that are not fully integrated into global capital markets.

33. Appendix 3 also considers the case for returning to a classical tax system, perhaps as a means of increasing the progressivity of the tax system. There are serious downsides to this approach that suggest there are better means to achieve that goal.

34. Another option examined would go a step further than imputation, and introduce a system where full integration of entities with their owners (where company income is taxed at shareholders' marginal tax rates) is achieved.

35. The Secretariat do not recommend this approach. There are a large number of practical issues that make full integration difficult to implement. This is illustrated by the fact that while some other jurisdictions have investigated a fully integrated corporate tax system, none have implemented it. The main "deal breaker" for full integration in larger more complex organisations is the practical difficulty in attributing income and expenses to owners.

Key questions for the Group are:

- Do they agree that imputation still a good tax system for New Zealand?
- Do they agree that neither a classical system or full integration should be examined further?
- Are there any areas of the imputation system that are not addressed in the paper that they think should be examined? (The following section discusses imputation in the context of closely-held companies)

4. Integrity concerns

4.1 Closely-held companies

36. Appendix 4 examines the taxation of closely-held companies and in particular of differences in taxation that arise from individuals holding investments in entities rather than directly.

37. Currently New Zealand has a small gap between its company tax rate and top personal marginal tax rate by international standards. Any increase to personal income tax rates is outside the Terms of Reference for the Tax Working Group. But future governments may wish to either increase the top personal marginal tax rate or to lower the company tax rate and the tax rules should allow this to happen in a way which does as little as possible damage to fairness or economic efficiency.

38. Inland Revenue audit staff have recently encountered a variety of arrangements that, in their opinion, allow taxpayers to avoid the intended taxation of dividends on the distribution of income or assets from companies to their shareholders. There has also been a rapid growth in shareholder current accounts since 2010. These balances arise when companies lend to their shareholders, often instead of paying dividends. Overdrawn shareholder current accounts may not necessarily be a problem if the tax rules are fully complied with and the loans are repaid, but the rapid build-up suggests that the accounts are not being used appropriately. Appendix 4 and Appendix 5 outline evidence of potential dividend avoidance. The effect of dividend avoidance is to undermine imputation, which seeks to apply personal taxation to distributions of value from companies. This can be a particular problem for closely-held companies.

39. The key policy questions for the group are:
    - Is the current model of taxing income earned in a closely-held company at the company tax rate with imputation still the best one or should some form of personal taxation be applied as the income is earned?
    - Can the current imputation-based model be made to work in a manner that is fair, efficient and reasonably simple and certain for taxpayers and the tax administration?

40. Appendix 4 explores the issues in this area and outlines a number of possible approaches. The potential approaches outlined are:
    - A number of technical and administrative measures intended to make imputation work as intended and prevent dividend avoidance;
    - Special taxes on closely-held companies in certain circumstances to prevent the deferral of tax arising from the lower tax rate offered to companies; and,
    - A reform of the tax rules applying to closely-held companies, so that they are taxed as if the income they earn was received directly by their shareholders and subject to personal taxation.

The paper notes that some (though not all) of the current integrity issues would be reduced if a capital gains tax were introduced

41. The choice among these approaches depends upon the desired policy outcomes of the Group, and so officials have not identified a recommended approach.

Questions for the Group are:

- Is the taxation of closely-held companies an area they would like to discuss in their Interim Report?
- Do they wish to pursue any of these approaches in the Report?
- Are there any other approaches they would like to examine?

5. Potential measures to enhance efficiency

5.1 Specific measures to enhance efficiency

42. A business income tax system is most neutral when it reflects the economic income or loss of the entity over the relevant period. This is done by taxing economic income, and providing deductions for economic losses. In the New Zealand income tax system we do not generally tax capital gains, and as a consequence do not generally provide deductions for capital losses. (The issue of capital gains is not addressed in this paper, and will be addressed in a later paper on capital gains.)

43. The Group is considering other measures, which may broaden the taxation of capital income and in so doing raise additional tax revenue. At the same time, the Group's Terms of Reference requires a tax system that supports a sustainable revenue base to fund government operating expenditure around its historical level of 30% of GDP.

44. In the event that the Group decides to implement tax changes that increase revenue, there is a question about whether and how this revenue could be "recycled" to improve the structure, balance and/or fairness of the overall system. We outline several potential revenue-negative policy changes that are likely to reduce distortions, and therefore increase efficiency. These are as follows:
    - Indexing the tax base for inflation.
    - Allowing a deduction for depreciation on buildings.
    - Allow businesses to carry forward losses to be used in future years in a broader set of circumstances.
    - Allow a deduction where expenditure results in an economic loss ("black hole" expenditure).

Questions for the Group are:

Noting time constraints, would the group like a fuller analysis of:

- Inflation indexing the tax base?
- Reinstating building depreciation deductions?
- Allowing greater loss continuity?

5.2 Progressive company tax rates

45. The Group has been asked to consider whether a progressive company tax rate (with a lower rate for small companies) would improve the tax system and the business environment.

46. A lower rate for small businesses could be applied in a number of ways – for example, it could apply to business income below a certain threshold, or for a set number of years after a company has commenced business. Australia has had a

lower company tax rate for small business since 2015, based on a turnover threshold, to support and encourage SMEs given that, like in New Zealand, SMEs form a significant part of the business sector and economy. It is also a first step to lowering the company tax rate more generally.

47. A split company rate would provide more funds for small businesses to grow, and might be seen as a way of compensating for the relatively higher costs of compliance faced by SMEs. On the other hand, unless there is a market impediment that cannot be addressed more effectively, a split rate can distort business decision-making, is unfair on other businesses just over the threshold, and adds considerably to tax system complexity. It can also be a disincentive to business expansion as it only helps businesses that are making profits, and would exacerbate system integrity concerns. Overall productivity is likely to be reduced.

48. If a purpose of a progressive company tax rate is to better reflect the progressive personal tax rates of the underlying investors in small businesses, we note that there are already a number of ways that investors can achieve this using the existing tax rules. Look-through companies and limited partnerships effectively enable individual or partnership tax treatment by attributing the income, losses and capital gains made by the entity directly to the individual owners in accordance with their ownership shares.

49. On balance, we would not recommend a lower company tax rate for small businesses. Instead, higher relative compliance costs for small businesses can and are being more directly addressed, particularly through Inland Revenue's Business Transformation programme.

The question for the Group is whether they agree with the Secretariat's recommendation.