Tax Working Group
Te Awheawhe Tāke

Tax Working Group Information Release

Release Document

September 2018

taxworkingroup.govt.nz/key-documents

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: **Effective company tax rates in New Zealand**

Background Paper for Session 7 of the Tax Working Group
April 2018

Purpose of discussion

This paper provides preliminary information on:

- effective company tax rates for significant enterprises in New Zealand split by industry;
- analysis of the tax adjustments of significant enterprises in New Zealand; and
- analysis of the untaxed realised gains of small and medium companies in New Zealand.

The paper is intended to help inform the Group about the industries in which some companies may be paying low levels of tax relative to their accounting profit and the reasons why some firms may be over or under-taxed relative to their accounting profit.

Key points for discussion

- The tax adjustment analysis indicates several tax adjustments that potentially cause under-taxation and over-taxation of companies in New Zealand.

- The primary cause of under-taxation is untaxed capital gains, both realised and unrealised. Does this information affect the Group's views on business and company tax?

- Are there any areas that the Group wishes to focus additional attention on?

Recommended actions

We recommend that you:

a **note** the Secretariat's preliminary effective company tax rate analysis may change as the Secretariat refines its analysis and undertakes further quality assurance.

b **indicate** if there are any areas the Group wishes to focus additional attention on as part of future work streams. For example does the Group wish to consider:
   i. areas of potential under-taxation such as depreciation settings?
   ii. areas of potential over-taxation as part of productivity and efficiency enhancing reforms?
   iii. are there any other areas of concern the Group wish to consider further?

Effective company tax rates in New Zealand

Background Paper for Session 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.

April 2018

Prepared by the Inland Revenue Department and the New Zealand Treasury

TABLE OF CONTENTS

Executive Summary

This paper provides analysis on the effective tax rate of significant enterprises[1] and analysis on the untaxed realised gains of small and medium companies in New Zealand. This analysis is intended to help inform the Group about the industries in which some companies may be paying low levels of tax relative to their accounting profit.

Role of effective company tax rate analysis

While effective tax rates can be useful for indicating potential under-taxation, they face several limitations. In particular, the analysis can only indicate where there is potential under-taxation due to differences between accounting profit and taxable income. There are other factors that can affect the overall taxation of businesses in New Zealand that this analysis does not capture such as profit shifting or income splitting. There are also data limitations that means that these results will not be precise or comprehensive.

The analysis in this report is based on income tax return data and IRD compliance data for 2013-2016. Approximately 20% of significant enterprises are in tax or accounting loss and do not have effective tax rates calculated for the purposes of this report.

Results

The analysis indicates that the (four-year) *unweighted* effective company tax rate for significant enterprises in New Zealand is 28%. The *weighted* average effective company tax rate for significant enterprises is 20%.

The difference between the weighted and the unweighted average arises because the weighted average takes into account the relative size of firms while the unweighted average does not. The remaining results in this paper are unweighted averages unless otherwise stated.

There is a significant variation in effective company tax rates among industries and some industries appear to pay a low amount of tax when compared with their accounting profit. For example the unweighted average effective company tax rate for the insurance and superannuation fund, residential care services, and motion picture and sound recording activities industries is 16%.

Analysis of small and medium companies indicates that untaxed capital gains make up 20% of the total accounting profit for small and medium companies.

Causes of variation

Analysis of the tax adjustments made by firms is the best means for understanding why some firms pay low amounts of tax relative to their accounting profit and indicating potential areas of over or under-taxation.

[1] Approximately 500 corporate groups with each group having consolidated turnover greater than $80 million.

Preliminary analysis of tax adjustments of significant enterprises indicates that untaxed capital gains, both realised and unrealised, play a significant part in lower effective tax rates in 2016. However, the results raise other areas that may create lower taxable income relative to accounting income such as overseas income adjustments, non-assessable receipts and depreciation settings. The preliminary analysis also indicates areas of potential over-taxation including accounting impairments, non-deductible expenditure, and depreciation settings.

Cautions in the use of the analysis

As there are limitations in this analysis, we would recommend taking these results as indicative only.

In particular, Inland Revenue systems do not always enable us to accurately reconcile consolidated accounting group profits to the taxable income reported by individual group members. We have tested the impact of this limitation for the largest consolidated groups and concluded that it results in a weighted average effective tax rate that is lower than would otherwise be the case. We have attempted to mitigate this limitation by focusing primarily on unweighted average effective tax rates.

In addition, we note that the analysis has only recently been completed by the Secretariat. The Secretariat will undertake further quality assurance which may change the results.

1. Introduction

1.1 Purpose

1. The Tax Working Group asked the Secretariat to provide analysis on effective company tax rates in New Zealand.

2. Effective company tax rates can be useful to indicate where there may be potential under-taxation or over-taxation of companies. This paper focuses on potential under-taxation in particular, as our analysis indicates that the weighted average effective company tax rate for New Zealand's significant enterprise corporate groups are below the statutory rate for the four-year period 2013-2016.

1.2 Content and scope

3. This paper provides effective company tax rates for significant enterprises in New Zealand split by industry. Significant enterprises are groups of entities which have consolidated turnover greater than $80 million. There are approximately 500 significant enterprises and they pay approximately 51% of the total income tax paid by companies.

4. Effective tax rate information on small and medium companies has not been analysed as there are significant constraints for analysing this group which mean that the insights gained from looking at these enterprises is limited. This is mainly due to the absence of consolidated accounting and tax data for small and medium companies.

5. As a result, we believe the effective tax rate analysis for small and medium companies is less reliable. However, we consider looking at the tax adjustments for untaxed capital gains by small and medium companies is more robust and have provided this information in part 4.

6. To assist in understanding the reason why some companies may have lower effective tax rates, this paper also provides analysis on the tax adjustments made by significant enterprises.

7. While effective tax rates can be useful for indicating potential under-taxation, they face several limitations. In particular, the analysis will only indicate where there is potential under-taxation due to differences between accounting profit and taxable income. There are other factors that can affect the overall taxation of businesses in New Zealand which this will not capture such as methods used to shift accounting profits. There are also data limitations so these results are neither precise nor comprehensive.

8. As a result, we would recommend taking this analysis as indicative only.

2. Background

2.1 What are effective company tax rates?

9. New Zealand's statutory company tax rate is 28%. However, due to differences in how tax rules apply to companies, they may pay a rate of tax on their accounting profit that is different to the statutory tax rate.

10. The effective tax rate compares the amount of income tax paid by a company with their accounting profit before tax. For the purposes of this report, the effective company tax rate is calculated as follows using a four-year average (2013-2016).

$$Effective\ tax\ rate = \frac{28\%\ x\ Total\ group\ taxable\ income\ (before\ losses\ brought\ forward)}{Accounting\ profit\ before\ tax}$$

Example scenario – capital gains and effective tax rates

A boat building company earns $500,000 profit from the taxable sale of boats.

The company also makes a $500,000 untaxed gain from the sale of excess land it owns (the land was acquired for $500,000, sold for $1m and was recorded on their balance sheet at its cost).

The accounting profit of the boat building company before tax is $1m. The taxable income for the boat building company is $500,000.

$$Effective\ tax\ rate = \frac{28\%\ x\ 500{,}000}{1{,}000{,}000}$$

The boat building company's effective tax rate is 14%.

2.2 What are effective tax rates useful for?

11. Effective tax rates can provide a high level indication of where there may be under-taxation of companies, in particular where companies are paying a low level of tax relative to their accounting profits.

2.3 What are effective tax rates not useful for?

12. Effective tax rates are imprecise and non-comprehensive. There are a number of limitations to an effective tax rate analysis which mean they can be imprecise as to the true degree of under or over-taxation (some of these issues are outlined below).

13. Effective tax rates will also not provide information on the reason why there may be over or under-taxation. To help overcome this difficulty, part 4 of this paper provides information on the tax adjustments recorded by companies.

Limitations of effective company tax rate analysis

There are a number of limitations in effective tax rate analysis. The degree of impact each of these limitations have on the results is not able to be quantified however, they are potentially significant and mean that effective company tax rates can only be used to provide high-level indications of under or over-taxation These limitations include:

- ***Effective tax rates look at the tax paid by companies, not by their shareholders or tax paid by other entities:*** The analysis provided will not show how much of any under taxation will be "corrected" by our dividend or imputation rules. The analysis will also not show the effects of other issues such as income splitting or the effective tax rates of other structures.

- ***The analysis only looks at differences between accounting profit and taxable income and does not take into account any reduction in tax paid due to reduced accounting profits:*** For example, foreign owned firms could possibly use strategies to shift profits overseas through decreasing both their accounting profit and taxable income. One example of this is interest payments to parent companies that would reduce both their accounting profit and taxable income.

- ***Effective tax rates are sensitive to what years are being looked at:*** Firms effective tax rates fluctuate over time, in particular as temporary tax adjustments can fluctuate the rate from year to year. Some timing advantages (or disadvantages) will also only be visible in particular years. The analysis in this report is based on effective tax rates covering a four-year period 2013-2016 which smooths out some temporary timing differences. There can be some significant timing tax preferences that this analysis will not show.

- ***New Zealand has relatively thin markets:*** In particular for significant enterprises, a small number of firms can distort the data for sector-based analysis.

- ***Effective company tax rates exclude companies that are in a tax loss position:*** 20% of NZ significant enterprises were in a tax loss position that excludes them from the analysis. To help give an indication of which companies are making a tax loss, we have provided a split of tax losses by industry alongside effective company tax rates. The impact of excluding these companies could increase or decrease the effective rate depending on the degree of taxable or accounting loss of the group.

- ***Data quality and technical issues mean there are margins of error:*** For example, Inland Revenue data does not always enable matching of consolidated accounting profits across tax groups. If an entity's entire consolidated accounting income is included in the calculation, but not all of its taxable profit, it can distort the rate provided. Effective tax rates are also net figures and a positive adjustment can balance out a negative one.

- ***Effective tax rates only look at income tax:*** The analysis does not include other taxes or charges such as royalties that can affect the overall tax paid by businesses.

Appendix B contains the tax expenditure statement for 2017 that outlines policy-motivated expenditures made through the tax system. This can help outline tax concessions that will not be apparent in effective tax rate analysis due to these limitations. These include accelerated deductions for bloodstock, forestry, farming, and mining; employee allowance and fringe benefit concessions; and charitable concessions.

3. Effective company tax rates

14. Our analysis on the effective tax rates for significant enterprise groups is provided below.

Significant enterprises

15. Significant enterprises faced the following average effective tax rates over 2013-2016:

	Unweighted average effective tax rate	**Weighted average effective tax rate**
All significant enterprises analysed[2]	28%	20%

16. The weighted average effective tax rate takes into account the relative size of the firms through aggregating all significant enterprises accounting profit and taxable income. The unweighted average effective tax rate instead calculates the effective rate for each group and then averages these results, not taking into account the respective sizes of the firms.

17. This result indicates that there are some larger significant enterprises with low effective company tax rates that reduce the average when the results are weighted for their respective size.

18. However, some of the lower effective rate for larger significant enterprises is due to an issue with matching consolidated accounting income and the taxable income reported by individual group members. This issue primarily affects larger significant enterprises and results in a lower weighted average effective tax rate than would otherwise be the case. As a result, without this consolidation issue the weighted average effective tax rate would be higher than 20%, although we expect the rate would still be lower than 28%. We cannot quantify the degree to which this issue affects the results and therefore we cannot estimate what the weighted average rate would be without this issue.

Industry results

19. There is significant variation in effective company tax rates among industries. There are 21 industries[3] with effective company tax rates less than 25% (using an unweighted average). The average effective company tax rates for the insurance and superannuation funds, residential care services, and motion picture and sound recording industries are 16% and for these three industries 38% of the groups are making a tax loss, while only 11% are making an accounting loss.

[2] Rounded to the nearest percentage point. Groups which are in a tax or accounting loss have not been included in the analysis.

[3] Using industry groupings in Level 2 ANZSIC2006

20. The effective company tax rates outlined exclude consolidated groups of companies that are in an accounting or tax loss. Approximately 20% of significant enterprises are in tax or accounting loss and do not have effective tax rates calculated for the purposes of this report. To provide an indication of how many of these consolidated groups have been excluded, information on the proportion of companies making an accounting or tax loss is provided alongside the effective tax rates.

21. Many industries have only a small number of significant enterprises operating in them. This raises confidentiality concerns with providing information on effective tax rates for individual industries[4]. To overcome this issue, the results have been aggregated into 6 groups.

22. The Groups have been made by ranking industries by lowest to highest effective company tax rates. Group 1 includes the three industries with the lowest effective company tax rates while Group 6 contains the industries with effective tax rates close to the statutory company rate of 28%.

[4] The information provided is calculated using tax information and is therefore subject to Inland Revenue's secrecy obligations.

Industries with effective company tax rates less than 28% (2013-16)	Average effective tax rate (unweighted[5])	Proportion of groups with tax loss	Proportion of groups with accounting loss
Group 1 Insurance and Superannuation Funds Residential Care Services Motion Picture and Sound Recording Activities	16%	38%	11%
Group 2 Primary Metal and Metal Product Manufacturing Rental and Hiring Services (except Real Estate) Fishing, Hunting and Trapping	19%	21%	25%
Group 3 Forestry and Logging Transport Support Services Pulp, Paper and Converted Paper Product	21%	21%	20%
Group 4 Furniture and Other Manufacturing Postal and Courier Pick-up and Delivery Services Finance	23%	12%	20%
Group 5 Electricity Supply Fuel Retailing Agriculture Computer Systems Design and Related Services Fabricated Metal Product Manufacturing Beverage and Tobacco Product Manufacturing Property Operators and Real Estate Services Polymer Product and Rubber Product Manufacturing	24%	16%	12%

[5] The results are the unweighted average effective company tax rate. An unweighted average has been provided because the weighted results are heavily affected by large businesses within each industry, which can skew the results and raise confidentiality concerns. In addition an unweighted average has been used due to the issue regarding consolidating accounting and taxable income outlined earlier. Some industries have been removed due to confidentiality concerns.

Group 6 Repair and Maintenance Personal and Other Services Sport and Recreation Activities Machinery and Equipment Wholesaling Public Order, Safety and Regulatory Services Basic Chemical and Chemical Product Manufacturing Publishing (except Internet and Music Publishing) Construction Services Defence Broadcasting (except Internet) Basic Material Wholesaling Telecommunications Services	27%	18%	12%

4. Tax adjustments

Tax adjustments for significant enterprises

23. This section provides a preliminary analysis of the major tax adjustments of significant enterprises for the 2015/16 year. Analysis of tax adjustments can help explain why some firms have lower (or higher) effective tax rates. This under or over-taxation potentially has negative impacts on the fairness and efficiency of the tax system and may have negative impacts on social and financial capital. As a result it may indicate areas the Group wish to consider further or recommend further review.

24. The information is provided from a sample of significant enterprises tax adjustments and this sample is not randomised. As a result the information should be taken as indicative.

What is a tax adjustment?

25. Businesses determine their accounting income and profit for their financial statements based on accounting practice.

26. For the purposes of calculating their tax obligations, businesses typically take their accounting income and profit and make changes to these figures to account for where tax law is different to accounting principles. These changes are called tax adjustments.

Types of tax adjustments by significant enterprises

27. The most significant adjustments which decrease taxable income relative to accounting profit recorded are[6]:

Untaxed realised gains *Mainly sales of subsidiaries, shares, businesses or brands. Also includes realised gains from the sale of land, however, these were less significant for significant enterprises.*	At least $2.2 billion
Unrealised gains *Unrealised gains for shares, land and intellectual property. Unrealised gains for both land and shares were significant for significant enterprises.*	At least $1.3 billion
Overseas income adjustments *Mainly untaxed foreign dividends.*	At least $1 billion
Non-assessable receipts *Includes government grants, settlement payments, and limited partnership distributions.*	At least $400 million
Tax depreciation greater than accounting depreciation *Note this is a temporary adjustment. A temporary adjustment means it will be reversed out over time; however it is unclear over what time period this will occur.*	At least $800 million
Lease and financial arrangement adjustments *This is where the treatment of leases and financial instruments is different for accounting and tax. These are generally temporary adjustments.*	At least $150 million
Capitalised interest *This is interest that is capitalised into the value of an asset for accounting purposes but is deductible for tax.*	At least $50 million

28. The firms in the sample had approximately $13 billion in net taxable income for the year.

6 Some modifications have been made to address confidentiality concerns. All of these figures are provided as "at least $X" as they are from a sample of significant enterprises. The results for all significant enterprises are expected to be larger.

29. The most significant adjustments which increase taxable income relative to accounting profit recorded are:

Reversal of accounting impairments *An accounting impairment is where the assets of a company are reduced in value on their balance sheets. This reduction in value reduces accounting profit but is not deductible for tax.*	At least $1.1 billion
Non-deductible capital losses *Mainly from sales of fixed assets.*	At least $600 million
Non-deductible expenditure *Mainly impairments and write-offs of goodwill, expenditure incurred for a listing of a company or a company amalgamation, and non-deductible expenditure from using a government grant.*	At least $280 million
Interest adjustments *Includes adjustments such interest allocations and thin capitalisation adjustments.*	At least $100 million
Tax depreciation greater than accounting depreciation *Note this is a temporary adjustment.* *This adjustment will also include instances where tax depreciation is less than accounting due to the value of the asset including capitalised interest.*	At least $500 million
Lease and financial arrangement adjustments *This is where the treatment of leases and financial instruments is different for accounting and tax. Note, that these are generally temporary adjustments.*	At least $500 million

30. These results indicate that untaxed capital gains play a significant part in the effective tax rate results. Realised and unrealised capital gains make up the largest recorded adjustments that reduce taxable income relative to accounting profits and appear in a number of industries that appear to have lower effective company tax rates. The Group will consider the taxation of capital gains in future sessions.

31. The next most significant adjustments that decrease taxable income relative to accounting profit are overseas income adjustments. Overseas income adjustments reflect deliberate policy decisions regarding what overseas income New Zealand chooses to tax. This issue was considered further in the discussion paper *International Issues in Taxing Business Income.*

32. Other adjustments that decrease taxable income relative to accounting profit are non-assessable receipts, depreciation, lease and financial arrangement adjustments.

33. The tax adjustments also indicate areas that increase taxable income relative to accounting profit and therefore indicate potential over-taxation. The main areas are reversals of accounting impairment, non-deductible capital losses and expenditure, and tax depreciation being less than accounting.

34. These results may highlight areas the Group wish to consider further to address potential over or under-taxation. For example:

    - Does the Group wish to consider other areas of potential under-taxation such as depreciation?
    - Does the Group want to look at areas the results indicate potential over-taxation as part of productivity and efficiency enhancing reforms?
    - Are there any other areas of concern the group wish to consider further?

Tax adjustments for significant enterprises with low effective tax rates

35. Below is an outline of the main tax adjustments for the industries which our analysis indicates have low effective company tax rates.

Insurance and superannuation funds

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Unrealised gains *Increase in value of shares*
	PIE adjustments *Including untaxed gains by PIEs as well as other PIE adjustments.*
	Interest adjustments *Mainly differences in accounting and tax treatment of derivatives (for example interest rate swaps).*
	Life insurance and superannuation fund adjustments *Life insurance companies and superannuation funds have specific tax rules applicable to them to address their unique circumstances. These lead to a number of tax adjustments for these industries.*

Significant tax adjustments that <u>increase</u> the effective company tax rate:	Life insurance and superannuation fund adjustments *Life insurance companies and superannuation funds have specific tax rules applicable to them to address their unique circumstances. These lead to a number of tax adjustments for these industries.*

Residential care services

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Unrealised gains and occupation rights adjustments *In addition to revaluations of properties owned by residential care services this includes adjustments made for sales of occupation rights.* *Occupation rights are effectively interest free loans that a resident provides to a retirement village that roughly matches the value of the property a resident is moving into. When a resident leaves, the village repays the loan (minus a fee) and enters into a loan with a new resident based on an increased value of the property.* *Some villages appear to treat the increase in the value of the loan as income for accounting; however the difference is not taxable.*
	Deferred management fees *Some firms have management fees that are payable when a resident of a retirement village leaves the village. There can be differences in when they are recognised as income for tax and*

	accounting purposes.
	Interest adjustments *This is mainly interest that is deducted for tax purposes but has been capitalised into the cost of the asset for accounting purposes*
	Tax depreciation being greater than accounting depreciation

Motion picture and sound recording activities

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Non-assessable receipts *From Large Budget Screen Production Grant (government grants are excluded from taxable income but are included in determining a company's accounting profits)*

Significant tax adjustments that <u>increase</u> the effective company tax rate:	Non-deductible expenditure *Production costs incurred using a government grant (expenditure incurred using a government grant a not deductible for tax but is included in determining a company's accounting profits)*

Primary metal and metal product manufacturing

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Unrealised gains *Fair value adjustments of assets*
	Untaxed realised capital gains *Including sales of intangibles*

Significant tax adjustments that <u>increase</u> the effective company tax rate:	Non-deductible capital losses *Sale of fixed assets*
	Tax depreciation being less than accounting depreciation

Rental and Hiring Services (except Real Estate)

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Tax depreciation being greater than accounting depreciation
	Non-assessable receipts *Trust distributions*[7]
	Overseas income adjustments *Non-taxable foreign dividends*

[7] The adjustments have been listed as they were stated in the group's tax adjustment schedules.

Fishing hunting and trapping

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Untaxed capital gains
	Overseas income adjustments *Non-taxable foreign dividends*

For the fishing hunting and trapping industry, many investments are included in the accounting profit but are not included in the taxable income as the shareholdings are too small to be consolidated for the tax analysis. This may skew the results towards a lower rate than would otherwise be the case.

Forestry and logging

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Unrealised gains *Forestry revaluations*
	Accounting treatment of the depletions of timber different from tax deductibility of timber *This increases the effective rate for some firms and decreases it for others*
	Amortisation adjustment *Expenditure that has been immediately expensed for accounting (in a previous year) but has been amortised (spread over several years) for tax.*

Significant tax adjustments that <u>increase</u> the effective company tax rate:	Accounting treatment of the depletions of timber different from tax deductibility of timber *This increases the effective rate for some firms and decreases it for others*
	Taxable gain on timber sales *The taxable sale of timber can increase the effective tax rate when the increase in value of the timber has previously been recognised for accounting through an accounting revaluation. When this happens, the eventual sale of the timber will reduce the effective tax rate result for that year as it will increase taxable income with no increase in accounting profit.*

Transport Support services

Significant tax adjustments that <u>decrease</u> the effective company tax rate:	Unrealised gains *From property revaluations*
	Accounting impairment valuation changes *This increases the effective rate for some firms and decreases it for others*
	Non-assessable receipts *Non-assessable insurance receipts*

Significant tax adjustments that <u>increase</u> the effective company tax rate:	Accounting impairment valuation changes *This increases the effective rate for some firms and decreases it for others*
	Non-assessable receipts

Capital gains for small and medium companies

36. Our analysis on the untaxed capital gains for small and medium companies is provided below.

37. The average yearly value of untaxed realised gains by all small and medium companies was $2.2 billion for 2013-16[8]. The average annual accounting profit for all small and medium companies was $11 billion for 2013-16[9].

38. The industries with the greatest value of untaxed realised gains were:
    - Rental, hiring and real estate services ($763m)
    - Agriculture ($412m)
    - Financial and insurance services ($217m)
    - Professional, scientific and technical services ($92m)
    - Manufacturing ($79m)

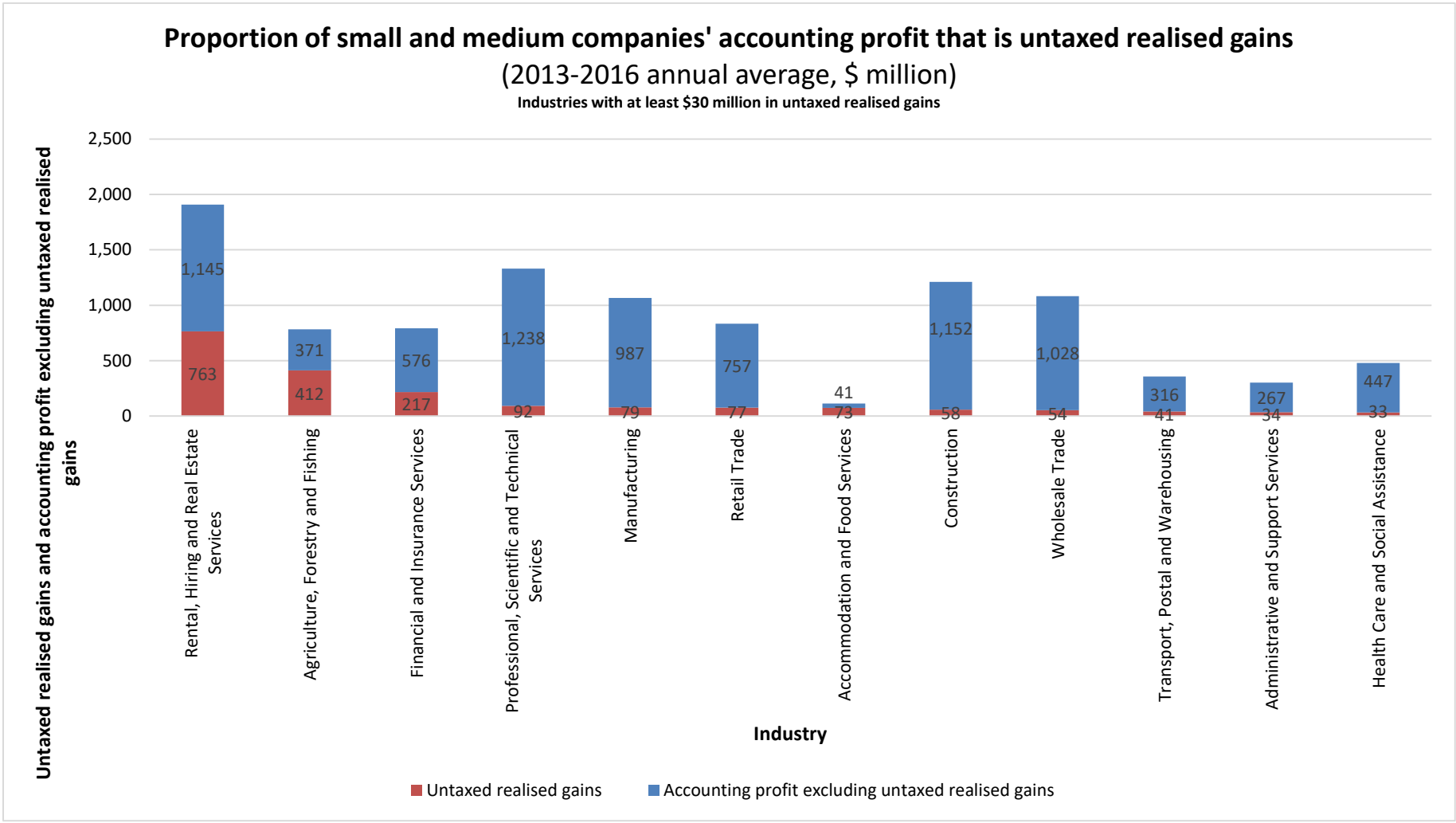
39. Four industries stand out as having high proportions of untaxed realised gains when compared with the accounting profits of the industry. These four industries are:
    - Accomodation and food services (64%)
    - Agriculture (53%)
    - Rental, hiring and real estate services (40%)
    - Financial and insurance services (27%)

40. The remaining small and medium enterprise industries have untaxed realised gains as a proportion of accounting profit ranging from 6-14%.

41. These results indicate that the non-taxation of some capital gains has a significant impact on the taxable income of small and medium firms and that the benefit of this non-taxation is concentrated within a few industries.

[8] Information on other tax adjustments for small and medium companies is not able to be provided as this is not recorded in the IR 10 Financial Accounts Summary.

[9] This is a net figure. As the majority of small and medium enterprises are in a loss position this may look relatively small compared with the value of untaxed realised gains.


Proportion of small and medium companies' accounting profit that is untaxed realised gains
(2013-2016 annual average, $ million)
Industries with at least $30 million in untaxed realised gains
Untaxed realised gains and accounting profit excluding untaxed realised gains
2,500
2,000
1,500
1,000
500
0
1,145
763
371
412
576
217
1,238
92
987
79
757
77
41
73
1,152
58
1,028
54
316
41
267
34
447
33
Rental, Hiring and Real Estate Services
Agriculture, Forestry and Fishing
Financial and Insurance Services
Professional, Scientific and Technical Services
Manufacturing
Retail Trade
Accommodation and Food Services
Construction
Wholesale Trade
Transport, Postal and Warehousing
Administrative and Support Services
Health Care and Social Assistance
Industry
Untaxed realised gains
Accounting profit excluding untaxed realised gains

Appendix A: Academic research on effective tax rates

42. A number of academics have also analysed New Zealand's effective company tax rates.

43. The results from these researchers will differ from the information provided in this paper. This is because the researchers are only able to look at companies with publically available financial statements while the information in this paper includes a larger sample of significant enterprises. The research results also use a different methodology for calculating effective company tax rates than the one used in this paper[10].

44. Results from a 2017 study from Jilnaught Wong and Norman Wong looked at the effective tax rates for the largest 50 New Zealand companies[11]. The rates are broadly similar to those presented in this paper.

	2015	***2016***	***2017***	***3 year average***
Top 50 companies	25.9%	23.1%	22.0%	21.9%
Property, retirement and aged care companies	7.0%	7.1%	6.8%	6.5%
Top 50 companies excluding property, retirement and aged care companies	31.9%	28.2%	27.3%	26.7%

(Wong & Wong, 2017)

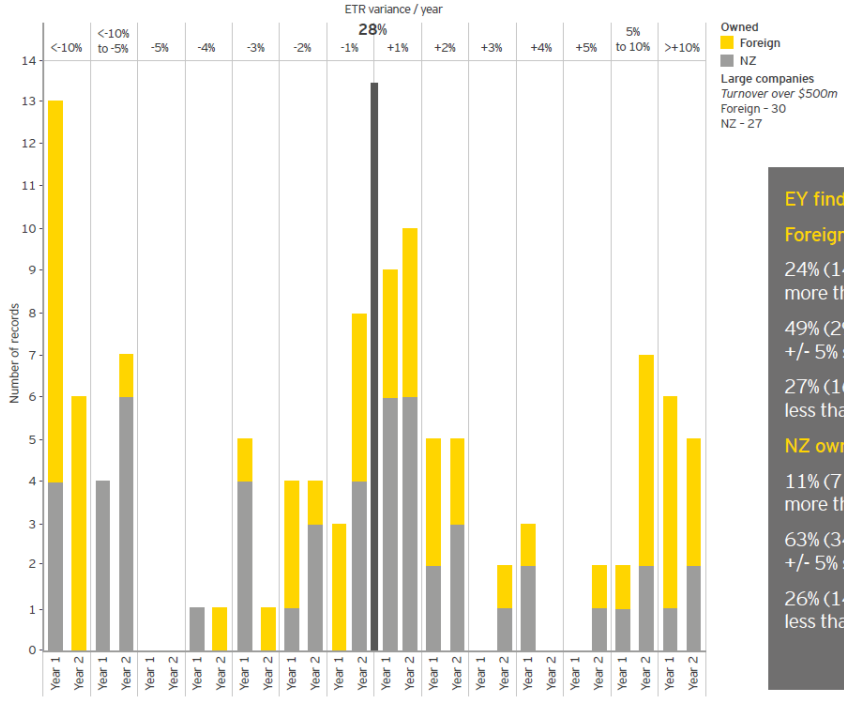
45. A report by EY in 2017 looked at the distribution of effective tax rates for New Zealand companies split by company size. The EY research indicated that the majority of large and medium sized companies in New Zealand had effective tax rates close to the statutory rate while smaller companies had more variation.

46. The report by EY calculated the effective tax rate utilising the income tax expense as recorded in the financial reports of the companies in the sample. This is different to the information provided in this paper which calculates the effective tax rate utilising the taxable income for the relevant year. In particular, this can lead to differences where the income tax expense recorded in the financial reports includes provisions for deferred taxes, which are taxes expected to be paid in the future and relate to transactions or assets which impact the current balance sheet.

[10] The research results typically compare income tax expense as recorded in financial statements with accounting profits.

[11] This excludes Fonterra Shareholders' Fund and two Australian banks. The Australian banks are excluded because they are domiciled in Australia and subject to Australian company tax. Fonterra Shareholders' Fund is excluded because it is an investment scheme and therefore not similar to the other companies in the top 50.

Figure 2: ETR Variance - Large companies



EY finding highlights:

Foreign owned

24% (14 out of 59 points)
more than 33% effective tax rate

49% (29 out of 59 data points)
+/- 5% standard 28% effective tax r

27% (16 out of 59 data points)
less than 23% effective tax rate

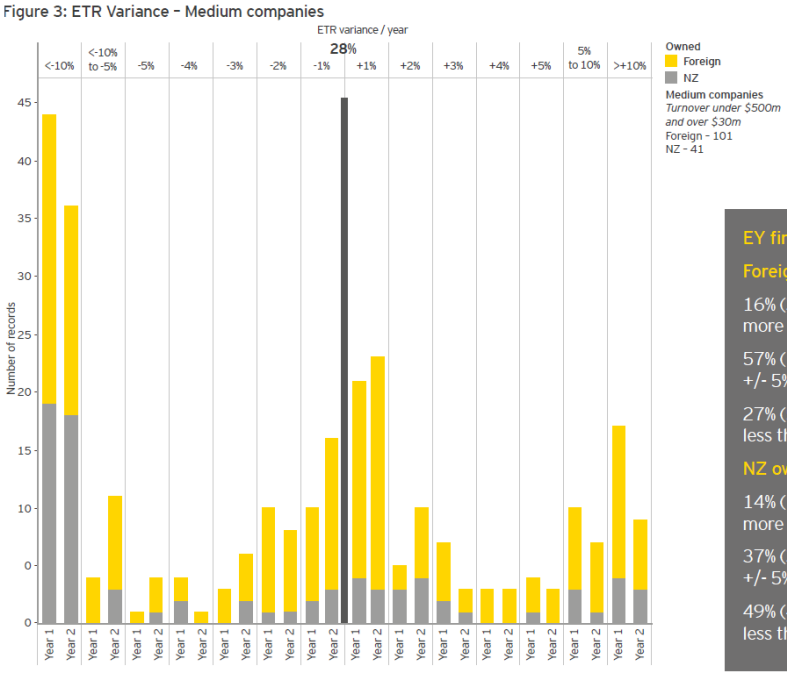
NZ owned

11% (7 out of 54 data points)
more than 33% effective tax rate

63% (34 out of 54 data points)
+/- 5% standard 28% effective tax r

26% (14 out of 54 data points)
less than 23% effective tax rate

Figure 3: ETR Variance - Medium companies



EY finding highlights:

Foreign owned

16% (32 out of 202 points)
more than 33% effective tax rate

57% (115 out of 202 data points)
+/- 5% standard 28% effective tax rate

27% (55 out of 202 data points)
less than 23% effective tax rate

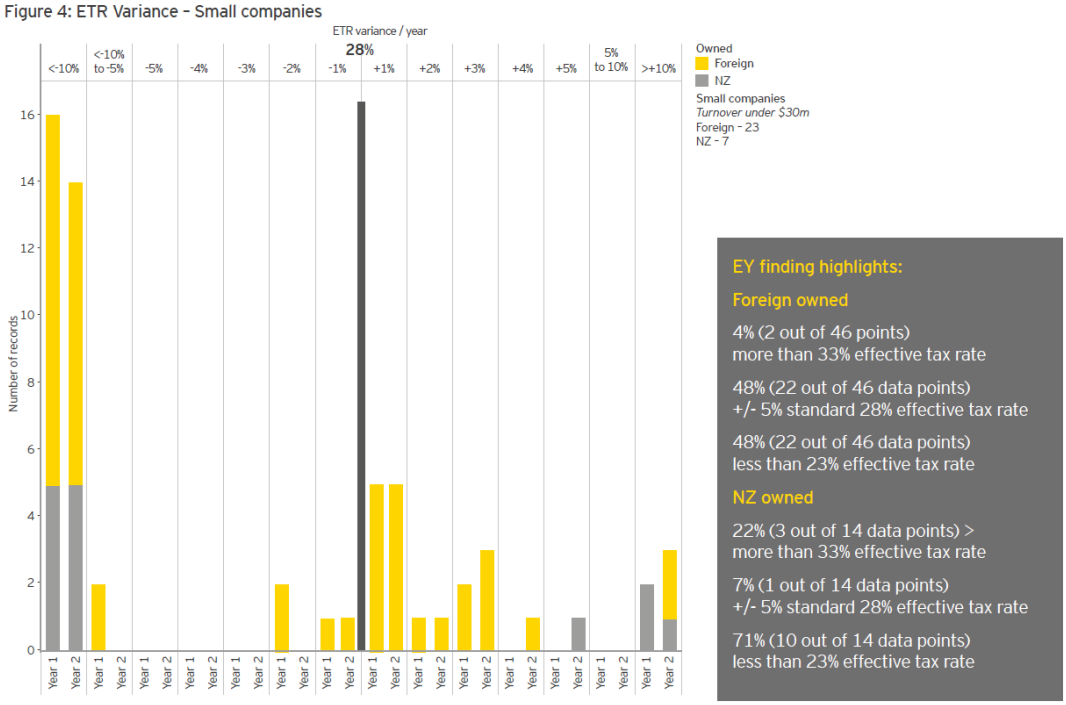
NZ owned

14% (11 out of 81 data points)
more than 33% effective tax rate

37% (30 out of 81 data points)
+/- 5% standard 28% effective tax rate

49% (40 out of 81 data points)
less than 23% effective tax rate

Figure 4: ETR Variance – Small companies



(EY, 2017)

International research

47. Research in 2013 by Markle and Shackelford analysed effective tax rates for multinationals across a number of countries[12]. This research indicates that differences between statutory company tax rates and effective company tax rates are common internationally. For the full sample of companies analysed the difference between the statutory and effective rate was 31%.

[12] New Zealand is not included separately in the results due to not having significant numbers of multinationals in the database used by the researcher. It is unclear if New Zealand is included in the aggregated results.

Country	Effective tax rate	Statutory rate	Percentage difference between effective rate and statutory
Full sample	25%	36%	31%
Middle East	14%	27%	48%
India	22%	34%	35%
United Kingdom	20%	29%	31%
Canada	23%	32%	28%
United States	28%	39%	28%
Australia	22%	30%	27%
Asia	24%	31%	23%
China	21%	27%	22%
Sweden	21%	27%	22%
Germany	26%	33%	21%
South Africa	28%	35%	20%
Africa	25%	30%	17%
Latin America	24%	29%	17%
France	28%	33%	15%
Taiwan	19%	22%	14%
Europe	24%	27%	11%
Switzerland	19%	21%	10%
Japan	38%	41%	7%
Singapore	17%	18%	6%
South Korea	24%	25%	4%
Tax Havens	16%	10%	-60%

(Markle & Shackelford, 2013)

New Zealand (weighted average based on research in this paper)	20%	28%	19%

48. New Zealand's effective tax rate based on the research in this paper is provided for comparison. However, given methodological differences, they will not be directly comparable.

Appendix B: Tax Expenditure Statement

Attached

Appendix C: Glossary

Accounting impairment. Where the assets of a company are reduced in value on their balance sheets.

Capital gains tax: A tax on the increase in the capital value of an asset

Consolidated group: Where multiple entities owned by the same shareholders are treated as a single economic entity.

Dividend: A sum of money paid by a company to its shareholders.

Financial arrangement: An arrangement where a person receives money or moneys worth now in exchange for money or moneys worth later. There are specific tax rules allocating income and deductions over time for these arrangements.

Imputation rules: Rules that integrates company tax with personal income tax for residents, ensuring that residents are not double-taxed on their income from companies.

Income splitting: Methods to reduce tax paid by moving income so it is received by associates (usually family members) who are on lower marginal tax rates.

Non-assessable receipt: A specific receipt of income that is included in a firms accounting profit but is not included in taxable income

Non-deductible capital loss: The sale of a capital asset that has decreased in value which is not deductible for tax.

Overseas income adjustment: Adjustments to reflect that some income earnt from overseas is not taxable in New Zealand.

Portfolio investment entity (PIE): A PIE is a form of collective investment vehicle where investors combine resources to make investments. PIEs pay tax on investment income based on the *prescribed investor rates* of their individual investors, rather than at the entity's tax rate. The prescribed investor rate is a final rate and is capped at the company tax rate (28%). There is no additional layer of tax when a PIE distributes money to investors, so saving in a PIE can provide a small tax break compared to saving directly by an individual.

Realised gain: A gain from the sale of an asset that has increased in value.

Tax depreciation: The rate of depreciation of an asset that is allowed as a deduction for tax. This may differ from the depreciation rate of an asset used for accounting purposes.

Thin capitalisation rules: Rules determining how much of a deduction a company is allowed for interest payments made to a related party.

Unrealised gain: A gain from the increase in the value of an asset that has not been sold.

References

EY. (2017). *Do corporates pay their "fair share" of tax in New Zealand? Effective tax rates in corporate New Zealand - domestic corporates versus foreign multinationals.* EY.

Markle, K. S., & Shackelford, D. A. (2013). *The Impact of Headquarter and Subsidiary Locations on Multinationals' Effective Tax Rates.* National Bureau of Economic Research.

Wong, J., & Wong, N. (2017). *Corporate tax avoidance or corporate responsibility? AN examination of the NZX 50 companies.* Auckland: University of Auckland.