Tax Working Group Information Release

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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: **Māori authorities**

Discussion Paper for Session 6 of the Tax Working Group
April 2018

Purpose of paper

This paper discusses the tax rules that apply to Māori authorities. Māori authorities are entities through which businesses can be operated, subject to certain criteria. As suggested by the Group's Māori advisory board, this will form part of the Group's discussion on business tax.

The paper 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.

Key points for discussion

- Is the 17.5% tax rate still appropriate for Māori authorities, or should this be reviewed?
- Are there changes to the Māori authority tax rules that the Group wishes to consider further?
- What further analysis would be useful to assist the Group's deliberations on this subject (noting that further analysis of the tax treatment of subsidiaries will be provided)?

Recommended actions

We recommend that the Group:

a) **note** that the Secretariat will provide further advice on the competitive neutrality implications of commercial entities being able to access a lower tax rate as part of the scheduled discussion on charities in July.

b) **indicate** whether the following should be included in the Interim Report (recommended by the Secretariat):
   i) that the factors that resulted in the 17.5% headline Māori authority rate remain relevant.

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

Māori authorities

Background Paper for Session 6
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 Treasury

Background

1. This paper covers the tax treatment of Māori authorities. Māori authorities are entities through which businesses can be operated, subject to certain criteria. As suggested by the Māori advisory group, this paper forms part of the Group's consideration of business tax. Part of the discussion, around competitive neutrality, will be covered more fully at a later Tax Working Group session.

2. "Māori authority" is a tax-specific term. In legal form, a Māori authority will be either a company or a trust that elects to be treated as a Māori authority for tax purposes. In order to be eligible for Māori authority status, a trust or company must meet certain criteria. These criteria include statutory or other restrictions on the ability to develop or trade the assets held in communal ownership. For example, an entity can elect Māori authority status if it owns Māori freehold land governed by the Te Ture Whenua Māori Act 1993.

3. Some Māori authorities, which manage Treaty settlement assets, may not have an explicit legislative restriction on their ability to alienate assets, but some other restriction on alienation could apply in the form of trust deeds or constituting documents. These entities are unique in that membership is restricted by whakapapa (genealogy), and therefore membership rights are not transferable on the open market.

4. The current Māori authority rules, which have been in effect from the 2004-05 income year, were designed to address these constraints, which are not faced by other trusts or companies with similar investments. Based on Inland Revenue data, there are currently over 5,000 entities recorded as being Māori authorities.

5. The Māori authority rules operate in a similar manner to the company imputation model. They replaced an older set of rules, which were seen to impose unnecessary compliance costs and resulted in double taxation of Māori authority income in some circumstances.

Tax rate for Māori authorities

6. Tax is paid by a Māori authority at 17.5%. The tax paid then forms a credit in its Māori Authority Credit Account. These credits can be attached to distributions made to its members (shareholders or beneficiaries, depending on the legal form of the authority). Members use the credits received to offset their individual tax liability. The 17.5% rate reflects the most common marginal tax rate of the economic owners of Māori authorities. The current rate is designed to reduce compliance costs for Māori authorities and their members. Tax paid at the entity level is essentially a withholding mechanism for the final tax paid by Māori authority members.

7. In 2010, when the current rate was set, approximately 80 percent of Māori authority members had a marginal tax rate of 17.5% or lower, meaning they would have no additional tax to pay (or they could claim a refund).

8. Inland Revenue does not hold good information on Māori authority distributions, and cannot accurately state how many Māori authority members are in a particular income tax bracket. However, according to the 2013 Census, 82 percent of Māori earn less than $50,000. It is still likely that a majority of Māori authority members are below the $48,000 threshold.

9. The Secretariat considers that factors that resulted in the 17.5% entity rate for Māori authorities continue to be relevant, both from a compliance and administrative cost perspective, and ensuring that the right amount of tax is paid by members.

10. Recently enacted changes to Inland Revenue systems will allow more frequent and detailed information to be collected for Māori authority distributions.[1] These changes, which will apply from 1 April 2020, will provide better data to evaluate how much income Māori authority members are earning. Proposals to introduce more real-time, automated tax administration processes (for example, when claiming refunds) may also help reduce compliance costs for Māori authority members. This could mean that the current reliance on Māori authorities to act as effectively a tax collecting intermediary for members may become less compelling in the future.

11. It would therefore be appropriate to wait until the new Business Transformation changes have been implemented and Inland Revenue has better data on Māori authorities and their members before any wholesale changes to the tax regime are considered.

Wholly-owned commercial subsidiaries of Māori authorities

12. Wholly-owned commercial subsidiaries of Māori authorities are not taxed at 17.5%, but are taxed at the full corporate rate of 28% (unless the entity could qualify as a Māori authority in its own right – including commercial entities). This was in response to concern that the lower entity rate would confer a competitive advantage and distort competitive neutrality.[2]

13. One implication of denying Māori authority status to wholly-owned subsidiaries is that a Māori authority will end up with excess credits upon receipt of a dividend from one of its subsidiaries. This is because the dividends are likely to have imputation credits attached at a 28% ‘ratio’, but the Māori authority is restricted to only attaching Māori authority credits at a 17.5% ratio. As a result, annual Māori Authority Credit Account closing balances have increased from $98 million in the 2010-11 income year, to $239 million in the 2016-17 income year.

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[1] Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018.

[2] Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill as reported from the Finance Expenditure Committee – Commentary.

14. Some large Māori authorities have responded by either conducting commercial activities directly, or using limited partnership structures. This allows them to apply the 17.5% tax rate instead of the full corporate rate due to the look-through treatment provided by limited partnerships. However, not all Māori authorities are able to structure themselves in this way, and it is inefficient for entities to be structuring themselves to try and achieve a tax outcome rather than according to commercial merit. The difference in rates may mean that Māori authorities lose the ability to quarantine commercial risk or access more efficient commercial structures.

15. It is arguable that subsidiaries of Māori authorities should also be able to access the same tax rate as its ultimate economic owners. By way of comparison, wholly-owned commercial subsidiaries of charities are able to access the same tax rate as their parent entity (i.e. both are exempt from income tax). We note that analysis of the competitive neutrality implications of commercial entities being able to access a lower tax rate will be considered in greater depth as part of the future paper that the Secretariat will provide to the Group when it considers the charities tax regime (currently scheduled for meeting 12 in July).

Conclusions

16. Overall, we do not consider that a wholesale review of the regime is necessary at this time. The economic constraints on assets owned and managed by Māori authorities still remain in place, justifying a specific regime to address the unique characteristics of Māori authorities.

17. On information currently held, the factors that resulted in the 17.5% headline Māori authority rate remains relevant. We consider that it would be appropriate to wait until the implementation of Inland Revenue’s Business Transformation programme before exploring alternative options for reducing compliance costs.

18. However, because the Māori authority rules are modelled closely after the imputation model of company taxation, any significant change to the overall framework for company taxation may justify reviewing whether the settings for taxing Māori authorities should also be changed to remain consistent. The Tax Working Group may also wish to consider making other changes to the existing regime to improve the overall efficiency of the current rules. This could include for example aligning the tax rate for commercial subsidiaries of Māori authorities with their parent entity, but we consider this is better discussed as part of a future conversation on competitive neutrality.