Tax Working Group Public Submissions Information Release

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Submission

To

Tax Working Group

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1. BACKGROUND

This submission is made by the Employers and Manufacturers Association (Northern) Inc. [EMA].

EMA's membership of over 4000 companies, including 1700 manufacturers, is based in the top half of the North Island. Those companies are represented by 7500 operating or business units, which in total employ over 250,000 staff.

Our highly diverse membership includes companies and organisations involved in the manufacture, importation, supply, distribution and retail of most product types and the provision of services in a wide range of service sectors including governmental, contractual, tourism, IT, banking, insurance and business advisors.

EMA seeks to have the principles of international best practice, and recognition of compliance costs, fully addressed in any legislation.

As the leading voice of business in the upper North Island we actively participate in both the submission process and any development of regulatory proposals that may impact on our membership.

The EMA is considered the leading employers' organisation by most business and on issues that affect employment relations. It also takes an active role in cross industry initiatives and cooperates with government activities that will assist or improve the growth and development of business within New Zealand.

2. CONTACT

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3. Submission

The EMA submits the following points to the questions raised by the Tax Working Group in its background paper.

We have chosen to address each point raised in the background paper in order to give full weight to our recommendation points under each heading.

The Future Environment

While some trade protection is evident outside of New Zealand, we are a commodities and trading nation that relies heavily on the external trade to ensure the tax incomes we generate continue to occur.

New Zealand is also heavily reliant on international capital investment within the country and tax policies can harm future investment in New Zealand if not carefully applied.

New Zealand is increasingly dependent on tourism and the spend by tourists within the country to generate GST however in general terms this sector is not a high wage sector. In the medium term some of this sector can transform to higher wages. We believe it is unlikely that the service parts of the sector will see this occur due to the pressures for tourist operators, accommodation and food and beverage providers to be competitive.

In the near to medium future we do not see that these three key aspects of the country's economy will change.

This said, there are changes occurring with growth in sectors such as technology and innovation and even some non-traditional export focused sectors of manufacturing showing significant growth.

It is important that tax policy does not stifle the growth sectors and if government truly wishes to see a change to a high wage economy then continued promotion of these sectors is necessary.

This may include tax incentives to promote new investment and innovation, however the EMA does believe that tax incentives on their own will not achieve this outcome. Other vehicles are also necessary to generate transformation over time away from a commodities based economy.

Tax will not generate the desire for reinvestment in New Zealand business by New Zealanders but it may play a part and reduce New Zealand's high level of dependence on foreign direct investment. We do not support any form of trade barriers in the form of tax penalties however in order to achieve such outcomes.

New Zealand businesses use the internet to reach global markets but this also has the reverse challenge in that the internet already reaches deep into the New Zealand market and will continue to grow in the near future. This globalisation has the potential to both benefit and harm the New Zealand tax base. Tax law around this needs to be robust but flexible as changes will continue to occur and the ways products and services are sold will evolve.

To achieve this, a constant review may be necessary in order to address trends that evolve outside of those already known.

As a country we should not be focused on company tax providing the substantial part of the tax base it currently does. This is in part due to the need for New Zealand's company tax to be competitive with the global economy.

Key points for the future

- Tax must not penalise the existing economy in order to drive a transformation to a high wage economy
- Tax may be used to incentivise growth in the sectors that will provide higher wage
- Inequality is a fact of life in a freely operating market however some targeted tax reduction and redirection of taxes such as working for families can reduce this inequality and is more appropriate than wealth taxes.
- Transactional taxes such as GST must be applied evenly but in a way that does not provide either a burden to business or cost more than is recovered for government agencies.
- Transaction and income taxes remain the best long term method for retaining the tax base against the growing globalisation created through online sales.
- Company tax must be internationally competitive if we are to retain and grown business within New Zealand

The purpose and principles of a good tax system

Purpose

A tax system has the purpose of providing to the government the funds necessary to provide the functions of government for agreed services and facilities, protection and wellbeing of its citizens.

A tax system must not over burden its citizens with taxation and must be fair in the application of the taxes on all citizens while providing the funding necessary for government for functions.

A tax system should ensure that compliance with the system is maintained but the methods of compliance not be burdensome to the citizens and businesses required to comply.

Where ever possible the tax system should tax at source unless the compliance cost in doing so is unfair and for the likes of independent contractors would harm their ability to contract their services.

Enforcement is key to a good tax system being maintained

Principles

The government must identify the budgets it needs to achieve the functions of government and match that expectation to the achievable levels of tax from the tax system.

Income tax must be fair and equitable across all citizens regardless of income or accumulated wealth. We believe excessively high tax thresholds has causational effects when in fact high incomes by their very nature will pay significantly more tax even if a flat tax rate were applied.

Company tax should match the countries we compete with, in order to retain business investment and continuity within New Zealand.

Company tax should be low rather than differing income thresholds as this may provide an incentive of splitting of companies and other adverse outcomes. We support a low tax rate with the natural effect of reducing the imputation credits for New Zealand shareholders as the best way to assist smaller businesses to grow and retain earnings for reinvestment.
We recognise that any change in the company tax rate does have a short term effect before the decreased imputation tax credits take effect but the long term effect is more beneficial.

Tax should significantly come from transactional taxes.

Transaction tax should not have exemptions unless the practical application of the tax to an area would create undue complexity and compliance costs. By example, GST should not have food or other exemptions applied, but may continue to exempt financial transactions or domestic rentals.

Key points

- Retain a fair and equitable thresholds for personal income that are do not excessively target high incomes
- Retain a single tax rate for companies but look to lower that rate to make it highly competitive globally and accepting that the reduced imputation credits would see shareholders paying more tax where personal income tax rates are higher than the company tax rate
- Retain transactional taxes such as GST without unnecessary exemptions and aim to have more of the total tax take coming from this form of tax

The Current New Zealand Tax System

The current tax system is robust but does need to review where the majority of tax comes from.
The income tax thresholds are generally accepted as fair for personal income with this providing a significant part of the tax base necessary to retain.

The company tax system needs to be reviewed in order to ensure it is competitive and therefore attractive to investors.

GST has been established well in New Zealand and the distorting effects that are seen in other jurisdictions around particular socially targeted exemptions have been seen those jurisdictions and businesses operating in them with unduly complex obligations to comply.

Some jurisdictions have subsequently removed some of those exemptions due to that complexity. For example the UK removed its heating oil exemption from VAT and ultimately even the differing rate for this reason.
In Australia we see supermarkets having to take extra time to price the exempt foods from the non-exempt and the difficulties when product crosses over from one category to the other.

The existing working for families is effectively a redirection of taxes to those needing support due to low incomes and with families. We recognise this is a social policy and not necessarily something that should be part of the tax system but is applied here due to the efficiency it offers for the employee against the payroll taxes they may pay.

Key Points

- Retain income tax thresholds at the current levels
- Retain GST without exemptions
- Whether social policy redirection of taxes under the working for families' scheme should remain within the tax system should be reviewed with consideration of how it might be more appropriately resourced outside of the tax system.

The Results of the Current Tax System

The current balance between the productive system and the speculative system is about right.
The current bright line test at 5 years does provide an appropriate level of speculative reduction however we believe that the intent of selling for profit has been long standing around speculation for capital gain. The previous lack of visibility of the IRD on these types of transaction has been overcome by both this test and the need for IRD numbers to be recorded.
As a result capital gain can be effectively taxed under the existing income tax law.

The current system has be adapted over time to reduce the compliance costs to business and this includes the pay as you go system that allows business to pay their tax at the time they file a GST return. We feel this could have been more widely available even for larger companies who have steady year round cash flow in order to reduce the end of year and provisional tax burdens.

It is however, the modern accounting systems, which have provided the best compliance cost reductions with their integration to file directly with IRD and direct debits of tax. Removing the manual processes improves significant time costs and we encourage any additional improvements at the operational levels. Such work does not require regulatory change just a willingness to engage with business by IRD in order to develop ongoing improvements.

The current cross border situation for purchased goods and services does provide some disparity for local businesses when particularly goods are able to be purchased without GST or any border taxes included due to the value being below the threshold.
This is a complex issue where the cost of recovery can outweigh the amount recovered and there is a reliance on the company shipping the goods to correctly declare the value.

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We are aware that while the GST on services provided to New Zealand, such as Netflix, is now being paid, there are other services who do not deliberately target New Zealand and therefore do not pay GST, but are providing services to New Zealand citizens and companies. This is particularly noted in areas such as conference calling and software able to be purchased only in a foreign currency such as Euro or US currencies and in the latter area only able to be downloaded.

The payment for services on bitcoin or other similar crypto currencies is also an area for concern as it can be both tax avoidance and in relation to criminal activities, however action on this would need to be applied internationally by all nations in order to be effective.

Key points

- The current methods for addressing the speculative versus the productive sector is adequate.
- The pay as you go system for company tax should be extended to a wider and higher threshold for those companies that wish to opt in
- The issues around cross border transactions and GST need to be resolved to remove the disparities
- New Zealand needs to work internationally to address the use of bitcoin or crypto currencies to move transactional money in or out of the country whether legal or illegal.

Thinking outside of the system

A major issue for the New Zealand tax system is profit shifting and where multinational companies opt where to take most of their profits using licensing fees, management fees or similar fees to reduce the profit within New Zealand. While some may be legitimate it can be difficult to assess whether they are fairly representative of what should be applied to the New Zealand business. Any significant change downward to the company tax rate would discourage such activities and make it more attractive to take the profits within New Zealand.

The EMA is strongly opposed to the introduction of any new taxes. The suggestion of including capital gains tax to punish speculation is unnecessary due to the bright line test and the existing tools that have now been established to allow IRD to identify and target those speculators.
We believe the existing law is adequate and the application of a new tax adds cost without any real benefit. Other jurisdictions that have applied a capital gains tax still have issues with high housing prices and speculation and therefore there is no quantifiable evidence that such a tax will be effective in New Zealand outside of the current rules.

The hypothecation of taxes does have some merit when we look at fuel and road taxes being applied to the areas they were intended. Such Hypothecation does not stop a government applying greater funding for specific projects in order to get them in place earlier.

If the taxes on tobacco and alcohol were allocated to health this may be a benefit but given the greater spend required in this area and that in the case of alcohol there are also costs around policing, we believe hypothecation of these is not justified and the consolidated fund can be used.

ACC may be considered a tax that is hypothecated however as this goes directly into the funding of that agency it may be considered more of an insurance for the average citizen.

Key points

- No new taxes should be applied
- A capital gains tax is unnecessary due to previous changes
- Hypothecation of taxes should only be for fuel and road user charges

Specific Challenges

Most of the points raised in the background paper are suggestions of possible action or focus rather than challenges and only become a challenge if they are seriously being considered for introduction.

We have addressed many of the points raised under this heading earlier in this document and explained them at those points. However for the sake of clarity the following points are made to address the suggestions.

- Housing affordability is a social issue and tax is not where this needs to be addressed other than to ensure that speculation on housing prices is fairly taxed. The need for IRD to have visibility of house sale transactions by IRD numbers being recorded and the application of the bright line test achieves this
- There is no need for a capital gains tax and should it be applied to rental properties it will have the effect of reducing the rental properties available from the private sector.
- A land tax has no justification and arguably this is already in place through local council rates. Such an addition to other than the family home will impact on businesses, farmers and rental properties from the private sector. Such a tax will be onerous to apply and will be open to interpretation about when it should be applied meaning the onus will be on the home owner to prove they are actually living at the property. For those with more than one property such as the beach Bach/Crib it is effectively a penalty for having the wealth to own that property. The cost of application of the tax may exceed the tax value collected due to such difficulties.
- Environmental taxes are not part of the purpose or principles for a good tax system. The current Carbon tax applied is intended to achieve an outcome of reduced carbon emissions however with the ability to buy credits there is considerable doubt it will achieve such an outcome in the longer term. Companies will seek to be carbon neutral for commercial benefit around their products and services. We believe the carrot versus the stick will provide a better outcome in this area.
- We believe having a progressive tax rate for companies will make tax more complex and may drive perverse outcome. We favour a lower tax rate for all business as this will assist greater investment and reinvestment within companies.
- We believe that the application of GST should remain across as wide as possible goods and services to keep it simple. There is no evidence that removal of it from produce will drive more to eat healthier. The lost to the tax base will also mean that either income tax must rise or the rate of GST on other goods must rise to compensate. We do not support either of these options.

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