Fisher&Paykel
HEALTHCARE

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Tax Working Group Secretariat
PO Box 3724
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Dear Secretariat

Tax Working Group Future of Tax: Submissions Background Paper

We are writing to submit on the Tax Working Group's *Future of Tax: Submissions Background Paper* ("the submissions paper"). We are members of the Corporate Taxpayers Group, who is also making a submission; however, given the importance of the topics included in the submissions paper we are also making a separate submission.

We would be happy to be contacted by the Tax Working Group and the Secretariat to discuss any of the points raised in our submission.

About Fisher & Paykel Healthcare

Fisher & Paykel Healthcare Corporation Limited (and its branches and subsidiaries) (the "F&P Group") is a leading designer, manufacturer and marketer of products and systems for use in respiratory care, acute care, surgery and the treatment of obstructive sleep apnea.

Our headquarters, R&D facilities and New Zealand manufacturing operations are located in East Tamaki, Auckland. We also operate a manufacturing facility in Tijuana, Mexico. We have over 4,100 of our people located in over 30 countries worldwide, with the majority located in New Zealand. Our products are sold in over 120 countries worldwide. Principal sales and distribution sites are located in the United States, the United Kingdom, Europe, Asia and Australia. Our competitors are predominantly headquartered in the United States or Europe with operations in multiple jurisdictions.

Our aspiration is to double our constant currency revenue every five to six years through investing for long term growth in research, technology and the development of our employees.

Summary

We have responded to the question for submitters: *What do you see as the main risks, challenges, and opportunities for the tax system over the medium-to long term? Which of these are most important?* as this question and our responses encapsulate the topics of particular relevance and importance to the F&P Group.

Our main submission points are:

- The fundamental challenge to the New Zealand tax system is to remain competitive and to continue to attract and retain investment in New Zealand.
- In order to maintain its competitiveness New Zealand requires a lower headline corporate income tax rate.
- A lower effective corporate income tax rate achieved by incentivising good behaviour (such as R&D) and allowing tax deductions for black hole expenditure (such as tax depreciation on buildings) should be considered.
- Reducing compliance costs for business should also be considered.

What do you see as the main risks, challenges, and opportunities for the tax system over the medium-to long term? Which of these are most important?

While the F&P Group is headquartered in New Zealand 99% of our revenue is generated offshore. We also have people located in over 30 countries worldwide, including at our manufacturing facility in Tijuana, Mexico and at our sales and distribution sites in countries such as the United States, the United Kingdom, Europe, Asia and Australia. We are currently expanding our facilities in New Zealand and in Mexico with the construction of a new building in New Zealand and a new facility in Mexico to accommodate our growth. Our competitors are predominantly headquartered in the United States and Europe.

We have been closely monitoring the tax developments in a number of key countries in which we operate, many of which have introduced or are proposing tax changes specifically targeted at encouraging or retaining investment in their country. Some of these changes are to reduce the headline corporate income tax rate (relevant countries for the F&P Group are the United Kingdom, the United States, France and Australia), while other changes are targeted at specific incentives (such as the changes for exporters from the United States). Given our global operations, these changes are likely to be beneficial for the F&P Group and its shareholders but they do lessen some of the benefits of being located in New Zealand.

The F&P Group's decisions on where to undertake its operations are based on sound business and commercial factors, of which tax is one consideration. Given our global operations we believe that the fundamental challenge to the New Zealand tax system is to remain competitive and to continue to attract and retain investment in New Zealand. We believe that the Tax Working Group should have New Zealand's tax competitiveness as its primary objective. We support the following considerations:

Competitive headline corporate income tax rate

Lowering the headline corporate income tax rate to a rate more in line with New Zealand's major trading partners (see also the above countries relevant for the F&P Group) and the OECD average (24.9% for 2017) should be actively considered. Sound investment decisions consider all factors, of which tax is generally a part. Having a corporate income tax rate above the OECD average is not sustainable in the long term for New Zealand given its relative small size and distance to major trading nations or for multinationals with a choice of where to locate and carry on business. A more competitive corporate income tax rate is one lever available to continue to encourage and maintain investment in New Zealand.

We are aware of the desire to align company and individual tax rates as a reason for not reducing the New Zealand corporate income tax rate. However, a number of countries appear

to have overcome this "issue" in their own countries and do not believe that this should be a primary determinant in maintaining the close alignment. We also believe that there are sufficient controls available in this area to prevent any abuse.

We continue to support the imputation regime and believe that this should be maintained. However, we believe that improvements could be made to the system to ensure that it remains competitive in the international context. We would encourage the consideration of trans-Tasman recognition of imputation / franking credits and/or limited streaming of imputation credits to ensure that maximum value can be provided to domestic and foreign shareholders.

Competitive effective corporate income tax rate

Lowering the effective corporate income tax rate by incentivising good behaviour/activities (such as R&D tax incentives) or re-introducing tax deductions for certain black hole expenditure (such as depreciation on buildings) should also be actively considered.

We generally support the broad-base low rate approach of the New Zealand tax system. In the paragraphs above we question whether the "low rate" label can still be applied given the actions that other countries have taken to lower their own corporate income tax rates. If there is little appetite to reduce the headline corporate income tax rate in New Zealand, then other tax changes should be considered which have the same desired outcome of encouraging or maintaining investment in New Zealand.

R&D

We welcome the theme of the proposals set out in the R&D Tax Incentive Discussion Document: *Fuelling Innovation to Transform our Economy* as a measure to encourage positive investment and spending in New Zealand. Some of our largest competitors already benefit from R&D Tax credit/incentive regimes in the countries in which they operate and we support the consideration of an equivalent regime for New Zealand. We intend to make a detailed submission on this topic.

Building depreciation

In recent years there have been some positive changes to address specific types of black hole expenditure. However, there are still some areas of legitimate (and potentially significant) business expenditure for which there is no tax deduction available; tax depreciation on buildings is particularly relevant to the F&P Group.

Our headquarters in East Tamaki, Auckland are located on 42 hectares of land and the F&P Group currently occupies 85,000m^2 of purpose designed facilities housing R&D, sales and marketing, manufacturing, operations and administration teams across three buildings. Approximately 32% of the area is allocated to manufacturing related activities and the remainder to office and support areas for R&D, sales and marketing, and administration. Earthworks is well progressed on a new 36,000m^2 building at our East Tamaki site which will principally accommodate a blend of R&D and pilot manufacturing, and will accommodate anticipated growth from 2020 until around 2023. The East Tamaki site has capacity for another building of a similar size, beyond which a further site (in New Zealand or elsewhere) will need to be considered.

In addition to leased land in Tijuana, Mexico we also own 15 hectares of land in Tijuana and are constructing a new 17,000m^2 manufacturing facility on the site, as the first of a potential four building manufacturing campus. It is anticipated that the first facility will be completed later in calendar year 2018. Once the construction of this facility is complete we intend to commence exploring the possibility of manufacturing at a further location outside of New Zealand.

The value of the buildings in the F&P Group's balance sheet is not insignificant and when the two additional buildings are completed will be substantially more. In New Zealand we receive no tax relief on the significant investment we have made and are continuing to make to our

structural assets. In comparison, in Mexico there is tax depreciation available for the investment we are making (and intend to make) by constructing a manufacturing campus in Tijuana. The tax treatment of the specialised buildings in which we design and manufacture our products is one of the inputs included in our facility location decision making. We consider that re-instating tax depreciation on buildings will support New Zealand growth, complement other initiatives such as the R&D tax incentive and level the playing field for New Zealand based companies compared to our offshore competitors.

We are aware that the Tax Working Group is considering a capital gains tax and believe that this analysis should not be undertaken in isolation, and should also address tax depreciation on buildings.

Compliance costs

With an increasing reliance on technology in the workplace, the ability to provide and share large amounts of data and the consequential changes in the way that business takes place across borders we consider that the Tax Working Group should also have an objective to reduce tax compliance costs for businesses. We support the following considerations of relevance to the F&P Group:

Active income branch exemption

For genuine commercial reasons we conduct a proportion of our offshore operations through branches of New Zealand and foreign companies. We are supportive of the active income exemption for Controlled Foreign Companies ("CFCs") and for Foreign Investment Funds. We are also supportive of extending the active income exemption for foreign branches of New Zealand companies. We believe the treatment of branches should, where possible, mirror the treatment of CFCs. In our mind businesses that operate as subsidiaries or branches are no different from an operational view point and should be treated as such. We consider that this is also critical in order to reduce the current compliance costs that arise when operating offshore from New Zealand through a foreign branch. We consider this to be consistent with the current Business Tax Simplification policy work programme.

We are aware that the active income exemption for foreign branches was considered during New Zealand's response to hybrid mismatches. We understand the introduction of an active income exemption for foreign branches would restrict the flow through of foreign losses against the New Zealand tax base and there are concerns about the impact on taxpayers of removing this flow through of losses from foreign branches (especially for small start-up type businesses). While this is generally only a timing benefit as future income arising from the foreign branch should also be recognised in New Zealand, it is possible for taxpayers to structure their arrangements such that this is not necessarily the case.

Employee mobility

Domestic and international tax rules and, importantly, how these rules are applied and enforced by tax authorities can act as a significant barrier to the mobility of labour and employers being able to source the skills they need. Various tax barriers exist to both trans-Tasman labour mobility and to attracting highly skilled personnel from further afield. Addressing these issues will help New Zealand businesses, such as the F&P Group, deploy and attract talent. Some of the compliance costs / issues we have encountered are connected with the application of the treaty exemption based on the time spent in country and who is the economic employer, superannuation (including Kiwisaver) complications particularly for short secondments and the time and cost of operating shadow payrolls and applying for special tax codes.

Concluding comments

We continue to be a large New Zealand headquartered business employing a growing number of people both in New Zealand and offshore. We want to continue to be based in New Zealand and pay the majority of our taxes here. However, being an international business with

substantially all of our customers and revenue base and a growing proportion of our manufacturing outside of New Zealand, we therefore have a choice in where we locate growth and value creating activities and assets and employees to support them. We therefore encourage the Tax Working Group to ensure we and other New Zealand headquartered businesses have access to an internationally competitive tax regime to assist (or at the least not inhibit) this intention and our competitive position against our international competitors.

Please let us know if you have any queries in relation to our submission, or would like to discuss any of the points further.

Yours faithfully

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Rachael Bull

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