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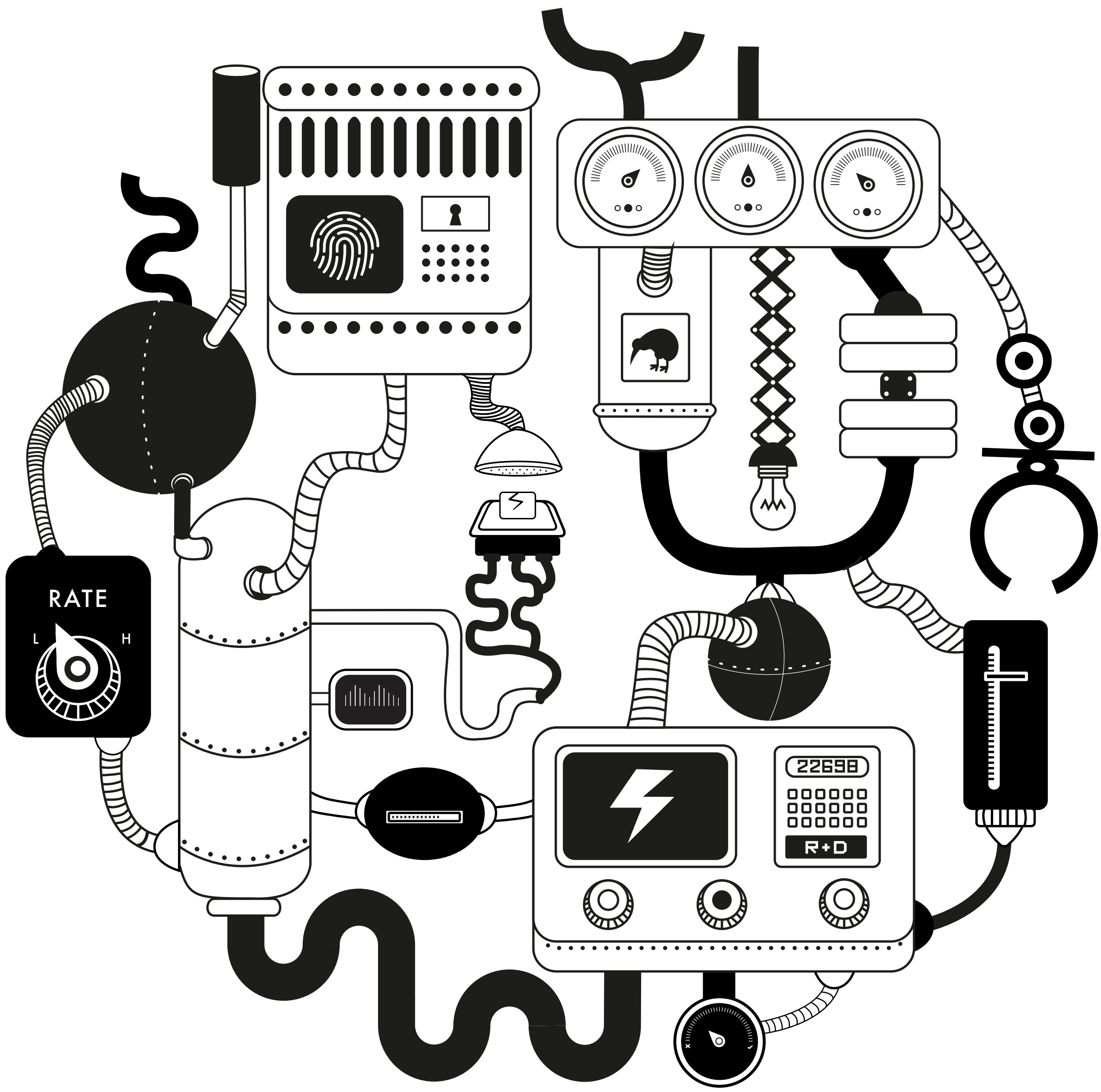
GROWING PROSPERITY AND POTENTIAL



Fine-tuning for optimal performance

Major companies tax survey

August 2017

Foreword

Welcome to the first BusinessNZ-Deloitte Major Companies Tax Survey report

Tax policy plays an important role in achieving a successful economy and society. Since the "tax switch" reforms in 2010, any changes to company tax have largely been tweaks to the existing settings. Instead, government's focus more recently has been on personal tax.

But businesses, and large companies in particular, make a meaningful contribution to government's ability to achieve its goals. Tax revenues from these companies and their employees help pay for the public services and infrastructure enjoyed by all Kiwis.

It is in this context that we decided it was timely to test what our largest companies would like to see from the tax system. The resulting survey report is aimed at informing public policy with regard to the taxation of large companies.

The survey and its results are not focused on reducing tax on large companies – it is acknowledged that taxpayers both large and small need to pay their fair share. Rather, the focus is on adjusting certain specific tax settings to drive appropriate policy and administrative outcomes that are also relevant to a much wider group of taxpayers.

Important also are the themes of retaining global competiveness and putting New Zealand first in decision making on tax policy issues. We surveyed both CEOs from the BusinessNZ Major Companies Group and tax professionals from the Corporate Taxpayers Group on a range of tax issues including corporate tax rates, deductibility, depreciation and incentives to invest.

The results are articulated in this report through ten themes that came through loud and clear from the respondents. Those themes cover a range of issues that relate to the competitiveness of our tax system and to its administration.

Some of New Zealand's most senior business leaders and tax professionals generously gave their time to complete the survey and both BusinessNZ and Deloitte greatly appreciate the engagement shown by all our survey respondents.

We hope our report provides you with valuable insights into how we can fine tune the tax system.

Thomas Pippos
Chief Executive
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Recalibrating our tax system

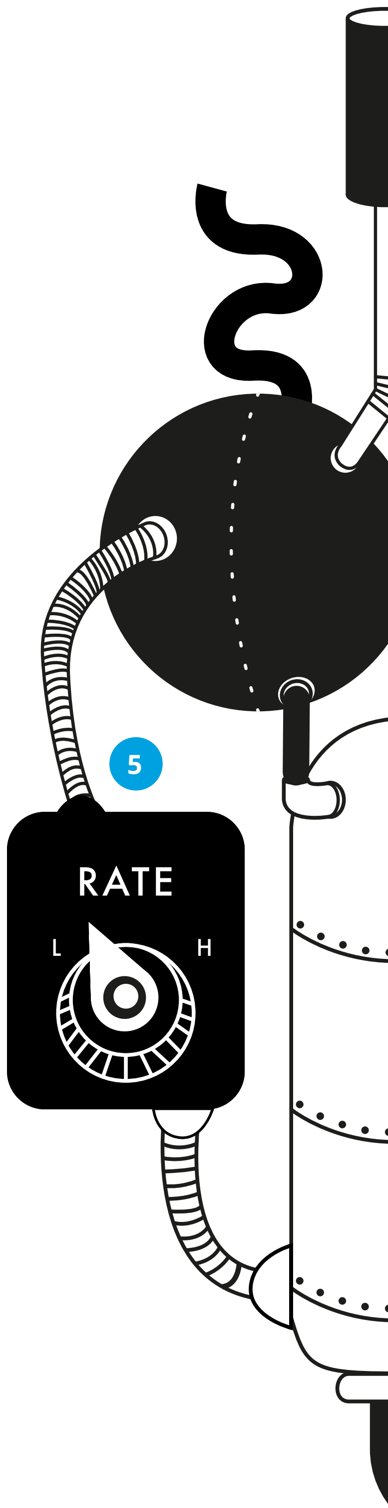
Ten key themes have emerged from the BusinessNZ-Deloitte tax survey of New Zealand's largest companies.

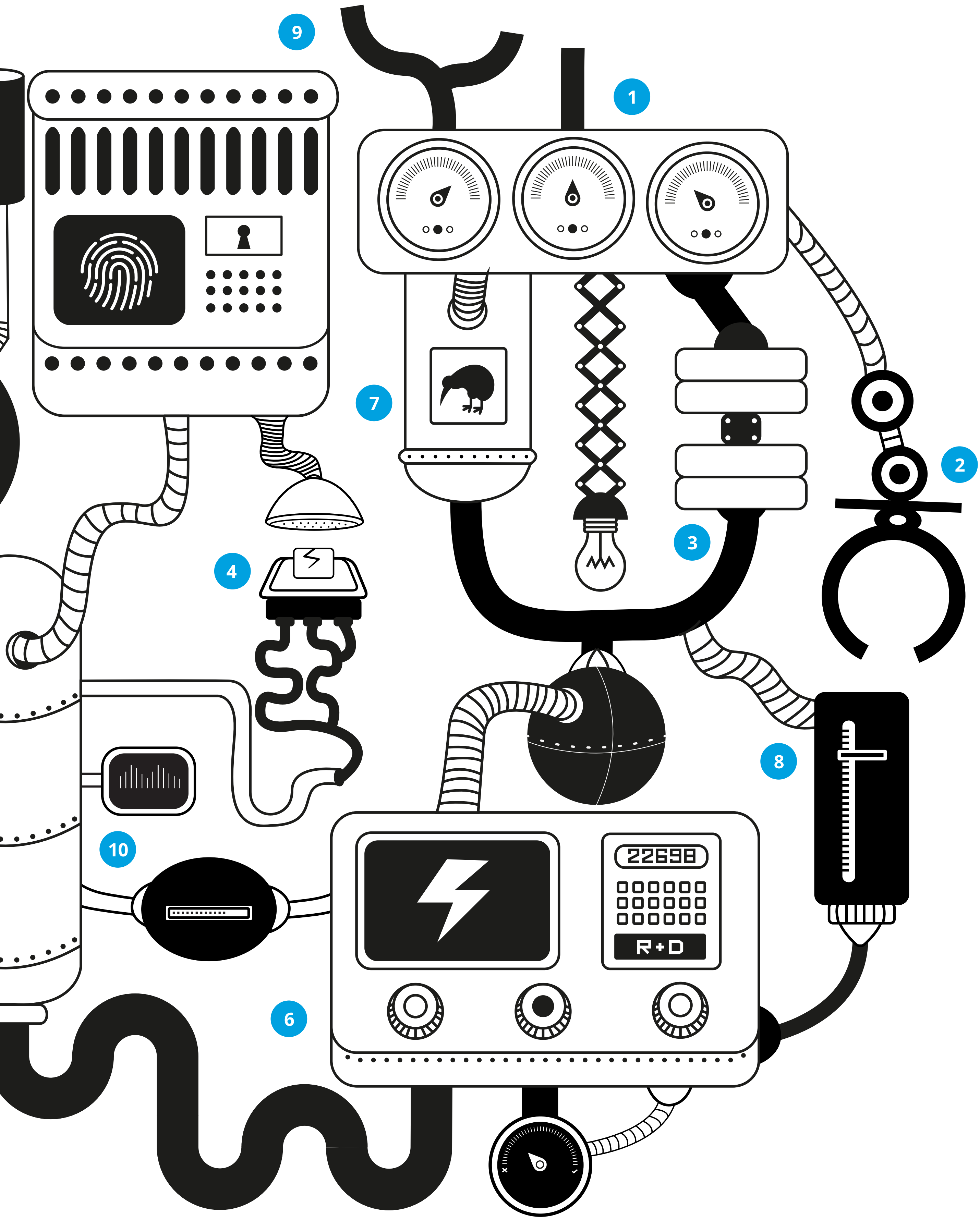
It is well accepted, and acknowledged by business, that generally-speaking New Zealand has a pretty good tax system.

But like all machines, some fine-turning is regularly required to make sure that we are performing optimally – both in our global competitiveness and the administration of the tax system. The survey has identified some of the levers that major business would like to see pulled by the government to help make our tax system competitive, efficient to run, and of the highest integrity. Those are the measures that make a tax system world class.

The ten themes identified through the survey are:

1. Provide certainty
2. Eliminate black hole expenditure
3. Help to strengthen buildings
4. Restore depreciation for industrial buildings
5. Maintain an internationally competitive rate
6. Encourage research and development
7. Put New Zealand's interests first
8. Allow taxpayers some flexibility
9. Treat commercial information like personal information
10. Determine policy based on realities

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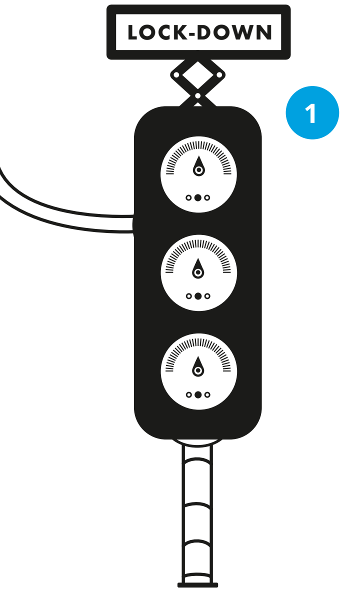
Top ten themes

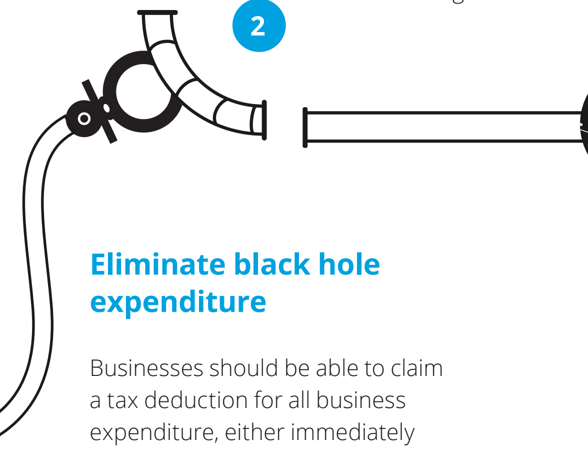


Provide certainty

The ability to make business decisions with certain knowledge of the tax implications is important for business.

In recent years, there has been tinkering with some areas of tax law. This includes Inland Revenue changing positions on long understood interpretations and areas of law (eg. thin capitalisation rules) changing multiple times. The effect is to undermine business confidence and certainty.

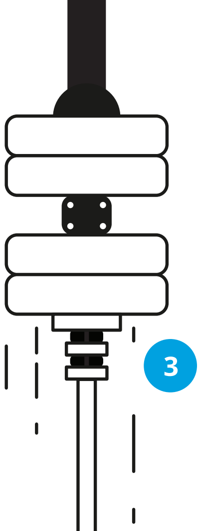
We urge government to consider tax changes with a commercial lens, balancing the integrity of the tax system with long term certainty for business.



Eliminate black hole expenditure

Businesses should be able to claim a tax deduction for all business expenditure, either immediately or over time. Currently there are a number of gaps in the law where legitimate business expenditure is not deductible at all – this is known as “black hole” expenditure. The costs of raising capital is a common example.

The government should support business by developing a comprehensive solution to allow tax deductions for existing areas of black hole expenditure – just as the Australian government has done. Two areas that require targeted relief are seismic strengthening and industrial buildings, as elaborated in principles 3 and 4.

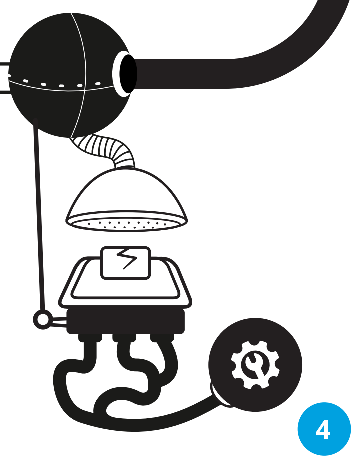


Help to strengthen buildings

Introduce relief to assist with earthquake strengthening buildings.

In most situations building owners are unable to claim relief for the costs associated with seismic strengthening of their buildings – whether by way of compensation from government or a deduction through the tax system.

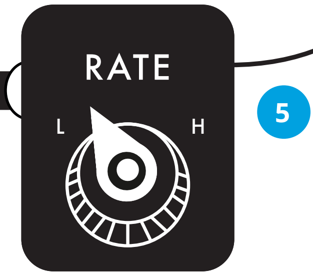
If government does not compensate for the regulatory taking imposed on building-owners, then the tax system should not add a further barrier.



Restore depreciation for industrial buildings

By their very nature, and due to their intensive use, industrial buildings wear out and can become obsolete over time. The government should restore depreciation deductions for this building class, reversing the 2010 decision to treat them in the same category as commercial and residential properties – when there are clear differences in their use and long-term utility.

A large part of New Zealand's economic activity is driven by businesses across the spectrum operating from industrial premises in industrial zones all over the country.

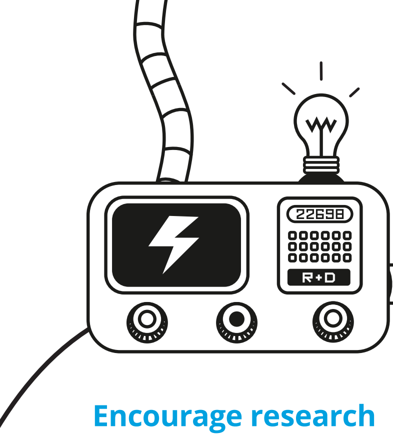


Maintain an internationally competitive rate

Corporate tax rates around the globe are on a downward trend, with the OECD average now just over 22 percent. While it is important that companies pay their fair of share of tax, in a world where capital is mobile it is also critical that our headline corporate rate doesn’t become uncompetitive – at least compared to our closest competitors such as Australia.

While some broader policy considerations would need to be addressed, major companies support dropping the corporate tax rate over time. Based on the OECD average, and direction signalled by Australia, this may require a reduction to between 20% and 25% in the next decade.

As part of this New Zealand should continue to maintain an imputation system to ensure that New Zealand investors are not subject to double taxation on company earnings.



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Encourage research & development

The majority of major companies would support tax policies to further encourage research & development ("R&D"). A lack of investment in R&D by New Zealand business risks our Intellectual Property being developed offshore and skilled labour transferring overseas.

While government has recently introduced R&D loss tax credits, these are only available in limited situations. We encourage government to revisit the framework around R&D and consider what levers can be pulled to optimise and support investment in this crucial area, both through the tax system and more generally.

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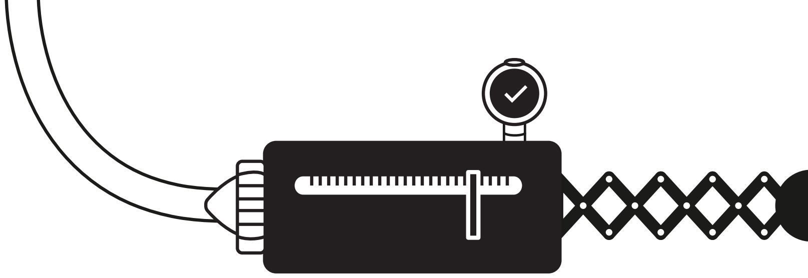
Put New Zealand's interests first

The government should develop tax policy based on what is in the best interests of New Zealand, based on our principles, not what is the best interests of other countries.

While major companies support working with other countries through the OECD, New Zealand's involvement should recognise that we are a uniquely small open economy, and we need to be globally competitive in order to attract international investment. Our tax policy should reflect what works for us, not large European economies.



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Allow taxpayers some flexibility

In a world where technology will play a greater role in assessing taxpayers, the government should allow Inland Revenue to accept some flexibility, rather than require absolute precision from taxpayers by introducing more safe harbour and de minimis discretions.

The cost of complying with tax obligations should not be higher than the amount collectable. We need to move towards a more pragmatic approach to tax assessments that recognises there is a cost to both the government and business in perfecting tax positions to the last dollar.

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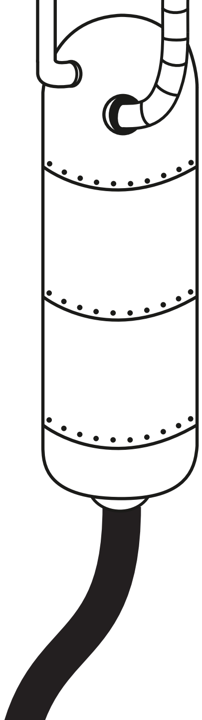
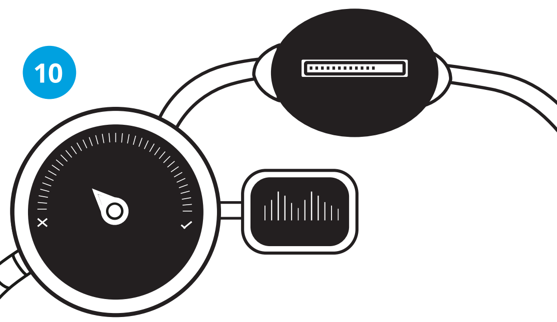
Treat commercial information like personal information

Major companies regularly supply Inland Revenue with commercially sensitive information – the obligation to keep this confidential is fundamental to the integrity of the New Zealand tax system.

The government should continue to treat information supplied by major companies with the same confidence as individual personal information. This obligation of secrecy should not be compromised by Inland Revenue's "Business Transformation" project and information-sharing between government agencies.





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Determine policy based on realities

There is a general perception across society that multinational companies are not paying their "fair share" when compared to regular taxpayers – but this is not always based on an informed view.

The government should take a careful approach to the taxation of multinational companies to ensure that any reforms are measured and justified, in the same way as other matters of policy are approached. Inland Revenue should assist by providing high quality policy advice that is evidenced by commercial realities. The attention on some multinationals should not tar all large companies, and it is important that the government plays its part to clarify the reality of the policy issue – not fuel any inaccurate perceptions.

Turning the dial on tax

A globally competitive regime

In recent years, much commentary on corporate tax matters has invariably focused on multinational tax avoidance and the OECD project on Base Erosion and Profiting Shifting (BEPS) to ensure that multinational companies pay their "fair share" of tax on earnings.

Governments around the world, including here in New Zealand, have acted in support of the BEPS project over the past four years. With this global work moving closer to completion, it has been interesting to observe how some jurisdictions are now more overtly moving to increase the competitiveness of their tax systems relative to their peers so as to encourage, rather than address, BEPS activities.

That is, having been through the BEPS project in order to ensure that companies pay tax somewhere, countries are still actively competing for tax to be paid on their shores relative to others, such that tax competition between jurisdictions remains alive and well regardless of the status of various BEPS measures.

While at one level it's incongruous to have jurisdictions introduce BEPS initiatives to curb that activity while at the same time introducing other initiatives to compete for global tax revenues, the fine line is that competition as between jurisdictions is accepted – it just needs to be fair and transparent.

The results of the BusinessNZ-Deloitte major companies' tax survey suggest that it's time for New Zealand to be more active on this rather than taking a back seat. That is, in a fair and transparent way to also compete for global tax revenues by ensuring that New Zealand businesses remain globally competitive having regard to all costs (including tax) associated with operating in New Zealand. In some respects this is as much about protecting the current tax base as opposed to growing it.

Research and development (R&D) was singled out in the survey as an area where the government could do more, with two-thirds of respondents suggesting that some form of assistance is needed to encourage R&D, noting that existing assistance is very limited. While there was no clear policy favoured, the sentiment is that other jurisdictions offer more, with one respondent noting that the lack of R&D in New Zealand can result in intellectual property being developed offshore, and skilled labour following that development.

Unsurprisingly therefore, the 2014 Deloitte BusinessNZ Election Survey found that business was in favour of the government helping to develop better connections between science and business, and investing in practical measures to assist with development; a theme that continues with the soon-to-be released 2017 survey.

A further area of concern is businesses' continued frustrations with black hole expenditure – an issue that has been exacerbated in New Zealand due to the government's policy on building depreciation.

Eighty percent of respondents believe that all forms of business expenditure should be deductible, either immediately or over time, and 96 percent supported the introduction of a rule to allow a tax deduction to be spread over five years if the expenditure is not otherwise deductible – which is what exists in Australia. Two specific examples of black hole expenditure shone through:

- 71 percent of respondents were in favour of restoring tax depreciation on industrial buildings. From a tax policy perspective, a line can sensibly be drawn between industrial buildings which tend to suffer wear and tear and obsolescence over time, and commercial buildings that by their nature tend to be more recyclable and located on land with greater utility. It is worth highlighting that tax depreciation, if allowed, would not result in a permanent deduction if the building did not actually depreciate – if an industrial building were sold for more than its tax-depreciated value, the tax depreciation claimed is clawed back and taxed as income.
- Nearly two-thirds of respondents were also in favour of government support to assist with the seismic strengthening of buildings. BusinessNZ has consistently advocated for compensation for building owners for the regulatory-taking imposed through code changes. Alternatively, if building-owners are required to incur the costs of seismic strengthening, a tax deduction for this expenditure should be considered in some form – for example as an amortised deduction that is spread over time – as it is a legitimate business cost of owning those buildings.

	OECD Country	Corporate Tax Rate
1	Switzerland	8.50
2	Hungary	9.00
3	Ireland	12.50
4	Canada	15.00
5	Latvia	15.00
6	Germany	15.83
7	Poland	19.00
8	Czech Republic	19.00
9	Slovenia	19.00
10	United Kingdom	19.00
11	Estonia	20.00
12	Finland	20.00
13	Iceland	20.00
14	Turkey	20.00
15	Luxembourg	20.33
16	Slovak Republic	21.00
17	Denmark	22.00
18	Korea	22.00
19	Sweden	22.00
20	Japan	23.40
21	Israel	24.00
22	Italy	24.00
23	Norway	24.00
24	Austria	25.00
25	Chile	25.00
26	Netherlands	25.00
27	Spain	25.00
28	**New Zealand**	**28.00**
29	Portugal	28.00
30	Greece	29.00
31	Australia	30.00
32	Mexico	30.00
33	Belgium	33.00
34	France	34.43
35	United States	35.00
OECD average		**22.34**

The corporate tax rate also featured strongly in the survey responses. The average corporate tax rate in the OECD has now fallen to just over 22 percent, well below our 28 percent rate.

Nearly 70 percent of respondents stated that New Zealand should seek to keep its corporate tax rate below that of Australia, who are aiming for a 25 percent rate by 2027. More specifically, when asked what New Zealand's corporate rate destination should be in a decade, 30 percent of respondents were in favour of a 25 percent rate, but 63 percent indicated we should go lower, aiming for between 20 and 24 percent.

Linking back to global tax competition, 63 percent of respondents thought that the timing of corporate tax rate reductions should be responsive to moves from other jurisdictions, particularly Australia. The message in this regard is clear – let's not risk our companies being less competitive, or losing out on our share of global capital, simply because our closest neighbour has a more attractive headline rate.

Of course it was accepted that reducing the corporate tax rate involves complex policy issues – including around the alignment between the various rates. From a policy perspective a reduction in the corporate rate is more straightforward if it follows a general downward trend in tax rates given that substitutability, mobility, regional and global competitiveness are more easily addressed with a lower overall tax burden.

The Tax Working Group covered these issues in detail in its 2010 report, noting that company tax is one of the most damaging for growth and that it can reduce capital invested in the economy and adversely impact on labour productivity and real wages. The Tax Working Group also noted that a relatively high company tax rate can encourage firms to relocate business functions outside of New Zealand.

Balancing all the competing objectives addressed by the Tax Working Group report, the government reduced the corporate tax rate from 30 to 28 percent in 2012, increased the GST rate to 15% and left the remaining highest rates at 33%.

While this might seem like "recent" to many, especially since we have been through a period of stable government, that change was made over seven years ago in Budget 2010.

Since then, the global tax landscape has materially developed further – putting this issue back into the spotlight.

Administration and integrity

Business has also emphasised the importance of tax system integrity and Inland Revenue's role in its administration.

Front and centre is the ability for business to be able to make decisions with certainty around the tax implications. When asked how important tax certainty is on a scale of one to ten (with ten being "extremely important") the median from respondents was nine. No surprises here; uncertainty in any form is problematic for business, no matter the shape and size. Putting into context the level of the corporate tax rate, a recent Deloitte survey showed that predictability of tax regimes (followed closely by consistency) is the most important factor for businesses when deciding to enter or exit a market in the Asia Pacific region (as of course tax rates can change over time).

[1] 2017 Asia Pacific Tax Complexity Survey. Shifting sands: risk and reform in uncertain times. See www.deloitte.com/nz/asia-pac-tax-survey.

So while New Zealand enjoys a comparatively stable political environment and our legislative process is robust, uncertainty can creep into our tax system through unpredictable or time-consuming administration, regular shifting of the boundaries, changing interpretations and increasingly complex legislation. Three sets of changes to the thin capitalisation rules in the space of five years (assuming current proposed changes proceed) and a view issued by Inland Revenue advising that debt capitalisation (a well-trodden path) is tax avoidance are good examples of this.

In a similar vein, major companies are looking for some flexibility from Inland Revenue when it comes to immaterial tax adjustments. Being able to close off a tax year with no adjustments required goes to the heart of tax certainty. It allows a business to get on with being in business. The cost of fixing those immaterial errors through a formal process with Inland Revenue can exceed the tax shortfall in some situations and deflects attention from all involved from more material issues at hand. So why require absolute year-on-year precision from taxpayers – particularly as we move towards a more real time tax system – when such precision is not required elsewhere in business.

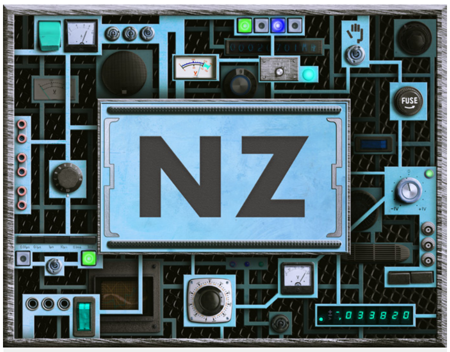
The current self-correction threshold of $1,000 is trivial for our largest companies – too low to be of practical benefit. The threshold must be higher given the compliance costs incurred by larger businesses in making adjustments to a previous period. Inland Revenue are currently considering this issue as part of proposed changes to the Tax Administration Act. Sensibly, the self-correction of errors should to some extent be based on an approach that is linked to the significance of the error to the taxpayer – for example up to the greater of 1% of taxable income for that period, or $10,000. This approach would provide a threshold that is high enough to provide some benefit to taxpayers, without being significant enough to cause concern.

Such an approach would maintain the integrity of the tax system, reduce the strain on Inland Revenue's resources and allow the Commissioner to collect the highest net revenue over time. It is also entirely consistent with New Zealand's self-assessment system. If we trust taxpayers to self-assess their income, we should also trust them to self-correct at levels that are low relative to their total taxable income.

Related to the issue of global competitiveness, when developing policy, major companies are also calling on the government to put New Zealand's interests first. When presented with the example of another country under-taxing a particular corporate activity, 86 percent of respondents thought that New Zealand's response should be to levy taxation based on our domestic tax policy principles, rather than deliberately seeking to overtax New Zealand activity as a means to compensate for under-taxation elsewhere.

This is directly relevant to some of the BEPS measures currently being considered, where New Zealand's treatment of certain cross-border financing instruments could hinge on the treatment offshore. The survey response suggests that how another country chooses to tax such an instrument should not be our concern.

Finally, the importance of keeping tax affairs confidential came through very strongly in the survey results. Respondents were universally of the view that when dealing with Inland Revenue and government, it is extremely important that tax affairs are confidential. That is, commercial information should be treated no differently from personal information. In a world where technology is changing and government departments are starting to share information with each other more and more, the importance of taxpayer confidentiality to the wider integrity of the tax system should not be underestimated.



What next?

In general, respondents are comfortable with the state of the tax system. The results drew out overwhelming support for the broad-base low-rate approach to tax system design (97 percent in support). And our system is certainly not viewed as particularly uncompetitive as it currently stands.

But tax systems by their very nature require constant refinement, whether to meet the demands of taxpayers, technology or other external factors including global competition. The purpose of the BusinessNZ-Deloitte survey was to identify some of these areas of refinement, where major companies believe a lever should be pulled to keep our system operating at the highest levels. The results of the survey provide just that.

In this light, it is important that the sentiment presented in this document does not represent the end of a process, but rather the beginning of an ongoing discussion between business and policy makers.

About the BusinessNZ-Deloitte Major Companies Survey

During May 2017 we surveyed members of BusinessNZ's Major Companies Group (MCG) and the Corporate Taxpayers Group (CTG) on a range of tax issues. Together these two groups include many of New Zealand's most senior business leaders and tax professionals working for some of our largest companies.

BusinessNZ's MCG helps ensure that New Zealand's largest companies are heard in policy, business and economic debate. It includes over 80 of this country's largest companies. Together, MCG members account for a dominant share of New Zealand's GDP, and bring a collective weight of influence that enables it to provide strong counsel to government and other key decision makers.

The CTG is an organisation of over 40 major New Zealand companies. It works to achieve positive changes to tax policy in New Zealand. The Group regularly makes submissions on tax policy documents, tax bills and Inland Revenue interpretations. The Group's members come from a diverse range of industries. Its focus is on achieving the right corporate tax policy outcomes for New Zealand as a whole, rather than for any individual industry or company.

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About BusinessNZ

BusinessNZ is committed to New Zealand's success – sustainable growth through free enterprise. Advocating for enterprise and promoting the voice of thousands of businesses across New Zealand, we work for positive change through new thinking, productivity and innovation.

Our unique strength lies in our capability to engage with government officials, community groups, MPs and Ministers on a daily basis, ensuring business interests are represented throughout the policy making process. What we do affects all New Zealanders, because when business is going well, it affects the wellbeing of our economy, our environment, our jobs, our communities, our families and our futures.

The BusinessNZ family has its roots in four large regional organisations of member businesses that together cover the entire country: EMA, Business Central, Canterbury Employers' Chamber of Commerce and Otago-Southland Employers' Association.

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