CORPORATE TAXPAYERS GROUP

C/- Deloitte
Attn: Mike Shaw
P O Box 1990
WELLINGTON
Telephone 04 495-3932
Facsimile 04 472-8023

19 November 2009

2025 Taskforce
C/ - PO Box 3724
WELLINGTON 6140

Dear Dr Brash

2025 TASKFORCE INVITATION TO COMMENT

The Corporate Taxpayers Group ("the Group") appreciates the opportunity to contribute to the deliberations of the 2025 Taskforce ("the Taskforce"), recognising the importance of bridging the income gap with Australia and the important role the Taskforce will play in achieving this.

By way of background, the Group is an organisation of major New Zealand companies that works with key Inland Revenue and Treasury officials to achieve positive changes to tax policy in New Zealand. At present there are 32 members of the Group; a list of the Group's membership is included in this letter.

Described by the Inland Revenue as one of the three most active tax special interest groups in New Zealand, the Group regularly makes submissions on tax policy documents, tax bills and Inland Revenue interpretations. The focus of the Group is on achieving the right corporate tax policy outcomes for New Zealand, not to push individual or industry specific agendas.

We note that a number of submissions received by the Taskforce have stated that tax reform could improve productivity and help close the income gap with Australia. This submission is devoted to examining, albeit at a relatively high level, a number of tax policy initiatives that could help to achieve these goals.

Tax policy can have an impact on productivity, through its influence on the performance of New Zealand corporates, domestic investment decisions, and the attractiveness of New Zealand as a destination for foreign direct investment. The Group firmly believes that tax can be used as a lever to help stimulate corporate activity, capital markets and the wider economy, and as such impact on productivity growth.

To facilitate your continued deliberations we have provided comment in Appendix One in relation to a number of tax settings where the Group believes change could help directly or indirectly improve productivity and close the income gap with Australia. Reform in these areas would send a bold statement that New Zealand is serious about competing with Australia. The specific matters that we have provided comment on are:

- The corporate tax rate
- Non-resident withholding tax on foreign sourced income
- Foreign investments of between 10% and 50%
- Approved issuer levy
- Non-resident withholding tax rates

- Integration of tax bases
- Streaming of imputation credits
- Mutual recognition of imputation credits
- Alignment of tax rates
- The taxation of profit distribution plans
- The taxation of stapled securities
- Tax administration
- Compliance costs

A key concern of the Group is that a number of tax policy initiatives, including those outlined above, are not being progressed because of the absence of a longer term view of how the tax system can help facilitate investment into New Zealand.

We believe that a clear destination of tax reform is important to ensure tax policy decisions are made consistent with an overall tax strategy while also signalling to businesses greater long-term tax certainty.

In terms of that destination of tax reform the Group is supportive of a tax policy framework that is designed to prioritise and ensure the following types of economic activities are attracted to and retained in New Zealand:

- New Zealand owned businesses that operate domestically
- New Zealand owned businesses that operate globally (as well as domestically)
- Foreign owned businesses that operate domestically in New Zealand
- Foreign owned businesses that operate globally as well as domestically
- Hybrids of all of the above
- High net wealth individuals particularly those that have global investments / businesses

We consider that it is important for the long term benefit of the New Zealand economy that tax policy decisions are **consistent** with attracting and retaining the above activities in New Zealand. Clearly, there activities will have an impact on economic growth and productivity. Inconsistent decisions have the potential to make New Zealand an unattractive place for business to operate from and through.

The Group would be pleased to meet with members of the Taskforce if they would like to discuss our comments in further detail or would like us to otherwise elaborate on our comments. We note that this submission can be made public on the Taskforce's website along with other submissions.

For your information, the members of the Corporate Taxpayers Group are:

1. Air New Zealand Limited
2. Airways Corporation of New Zealand
3. AMP Life Limited
4. ANZ National Bank Limited
5. ASB Bank Limited
6. AXA New Zealand
7. Bank of New Zealand
8. Contact Energy Limited
9. Fisher & Paykel Healthcare Limited
10. Fletcher Building Limited
11. Fonterra Cooperative Group Limited
12. General Electric
13. The Hongkong and Shanghai Banking Corporation Limited (New Zealand branch)
14. IAG New Zealand Limited
15. Infratil Limited
16. KiwiRail Limited

17. Lion Nathan Limited
18. Mitsui E&P New Zealand Limited
19. New Zealand Post Limited
20. Opus International Consultants Limited
21. Rio Tinto Alcan (New Zealand) Limited
22. Shell New Zealand Limited
23. SKYCITY Entertainment Group Limited
24. Sky Network Television Limited
25. Solid Energy New Zealand Limited
26. Telecom New Zealand Limited
27. Telstra Clear Limited
28. TOWER Limited
29. Turners and Growers Limited
30. Vodafone New Zealand Limited
31. Westpac New Zealand Limited
32. ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

John Payne
For the Corporate Taxpayers Group

APPENDIX ONE

Corporate tax rate reduction

Headline company tax rates are globally recognised as an important feature in attracting and retaining mobile capital and (therefore) labour in New Zealand.

Directly relevant in the New Zealand context is recognising and potentially having to address any policy settings Australia will make in this area as a consequence of the Henry review.

The current New Zealand corporate tax rate of 30% is still materially above the un-weighted OECD average of 26.6% which is a concern and will need to be addressed, particularly given New Zealand's issue with mobile capital. We refer to the meeting summary of session four of the Tax Working Group in this regard, where it is stated by officials that; "*the company tax rate is relatively high. This undermines international competitiveness and inbound investment...*"

A further relevant consideration is the extent to which tax settings for corporate earnings effectively encourage the retention and reinvestment of those earnings by those corporates. This is generally currently the case, to the extent that the corporate rate is lower than the effective tax rate on distributions.

The Group believes that mobile capital is a material issue that needs to be addressed recognising the challenge of targeting such an initiative. Addressing this issue will play an important part in boosting New Zealand's economic performance.

Incentivising the retention and reinvestment of corporate earnings is a related but separate topic that the Group believes also needs to be explored.

Non-resident withholding tax on foreign-sourced income

The Group has previously submitted that non-resident withhold tax ("NRWT") should not apply on foreign-sourced income derived through New Zealand corporates by non-resident shareholders.

This issue is particularly relevant to organisations like Fletcher Building that has a material number of foreign portfolio investors and material foreign operations.

The Group believes that foreign taxed and untaxed income in such a context should be able to flow through to foreign shareholders without a further New Zealand tax cost (that is the New Zealand NRWT cost should be reduced to zero percent) given that the current 15% "NRWT charge" actively discourages such multinational companies from using New Zealand as the base of their operations. If we want to catch Australia, we need to compete with them for regional business operations. The Group's proposed treatment already accords with what is the case in both Australia and the United Kingdom.

The Group anticipates that this issue will be explored by officials as part of phase II of the international tax reforms and that the relevant discussion document should be released shortly.

Foreign investments of between 10% and 50%

The current uncertainty as to the future tax treatment of non-portfolio foreign investment funds which generally refers to an investment in a foreign corporate of between 10% and 50% is a material concern and an impediment to such foreign investment.

Currently materially different regimes apply to investments generally above and below the 10% and 50% thresholds. This raises considerable uncertainty (which impacts on investment decisions) as to which of

those regimes (either the fair dividend rate regime or the active income exemption) will be adopted for foreign investments between 10% and 50% as part of an upcoming review of this area.

Clarity in this area is of upmost importance.

Approved issuer levy

The extent and application of the approved issuer levy ("AIL") impacts upon the ability of New Zealand corporates to access foreign debt markets.

Consistent with this, officials have recently released an issues paper proposing to apply AIL at a rate of zero for interest paid on "qualifying" corporate bonds.

The Group is supportive of this proposal but is concerned that the proposals are unlikely to provide any additional net capital for New Zealand. At a minimum the reduction of AIL to nil should be extended to syndicated debt structures used by New Zealand corporates.

Non-resident withholding tax rates

It is important to progress New Zealand's Double Tax Agreement ("DTA") negotiations with our key trading partners, with a particular focus on reducing non-resident withholding tax rates to the levels negotiated in the recently updated DTA's with Australia and the United States so as mirror what Australia is progressing with its DTA network.

Like the corporate tax rate, withholding rates are materially important in terms of mobile capital.

Recognising that New Zealand has largely given away withholding taxes on dividends (to the extent of imputation credits and using the FITC regime), reduced withholding rates on dividends also enable New Zealand based corporates to more tax effectively repatriate funds from foreign subsidiaries for potential reinvestment in New Zealand. Again, such investment is positive for New Zealand's capital markets and the wider economy.

Integration of tax bases

The current bias of the tax system for non-resident investors to acquire 100% of New Zealand corporates is suboptimal from a capital markets perspective.

The tax system should be neutral as to whether such investors acquire (say) a direct investment of 50% with the remaining investment held by portfolio interests or a direct investment of (say) 100%.

The current bias is that generally only through a 100% holding can a cornerstone investor appropriately fund their investment through debt and equity.

This occurs at the expense of the New Zealand tax base as often greater levels of debt are introduced in a 100% acquisition by a foreign cornerstone shareholder. There are also wider economic implications in a 100% acquisition given the greater propensity in that instance for previously undertaken head office activities to be removed from New Zealand.

An implication of the above bias is that tax incentivises listed companies being taken over and delisted, or New Zealand privately owned businesses sold in their entirety to foreign buyers with no local portfolio participation. Often with the surviving group being undercapitalised, having minimal public reporting pressures, and the head office activities being reduced, the group can effectively turn into a "branch operation" of the non-resident. There are downstream implications of this, including:

- Non-resident parent company removes core decision making out of New Zealand,
- Talented individuals are transferred out of New Zealand; and
- New Zealand tax payments materially reduce.

There are various ways to reduce the bias for 100% foreign ownership including:

1. Mutual recognition of imputation credits/franking credit between New Zealand and Australia to the extent of direct investment from Australia.

2. Allow controlling shareholders to appropriately debt fund holding companies and obtain a partial refund of imputation credits distributed to them (i.e. ensure they only pay tax to the extent they have net income after the interest costs are deducted, excess imputation credits would then be refunded).

3. Allow such controlling shareholders to offset tax losses in their holding companies with the target company, and a mechanism to extract profits from the target company without an additional tax cost.

We believe the above, particularly the third option, is easily achievable within the current policy framework and will go a large way to dealing with the pressures faced by controlling shareholders. The net effect is that these changes will remove the tax pressures forcing controlling shareholders to take 100% ownership of the target company.

The direct benefit to New Zealand would be the retention and perhaps reintroduction of significant New Zealand corporates to the NZX.

Streaming of imputation credits

In October 2008 the Government released a discussion document on "streaming and refundability of imputation credits". The discussion document noted that the government was particularly interested to hear of any features of the imputation system that might be inefficiently restricting the development of New Zealand's capital markets.

The discussion document recognised that the anti-streaming rules may be hindering companies, including standing in the way of legitimate business transactions, and sought comment on whether streaming should be allowed in certain circumstances.

The Group believes that limited streaming should be allowed. Particularly:

- In the non-resident withholding tax on foreign-sourced income context referred to above, that imputation credits be able to be streamed to New Zealand shareholders.

- In terms of Australian direct investment, allowing Australian owned companies which are listed on the New Zealand stock exchange to stream New Zealand sourced income to their New Zealand shareholders, with imputation credits attached.

These are targeted policy initiatives that will maintain or enhance New Zealand's capital markets and thereby the attractiveness of New Zealand as an investment destination.

We note that our understanding is that officials are currently not progressing work on the imputation regime, preferring to wait for the outcome of the Henry Review in Australia.

Mutual recognition of imputation credits

The Group has previously submitted to officials, and to the Australia's Future Tax System review, in favour of mutual recognition of imputation credits between New Zealand and Australia.

As elaborated on above, mutual recognition will go some way to reducing the existing tax impediments to Trans-Tasman investment. Whilst there are a considerable amount of issues to be resolved before mutual recognition could be implemented, the Group believes that there is a net benefit to mutual recognition and that all efforts to enact this regime should be pursued.

The future of mutual recognition is now essentially in the hands of the Australia's Future Tax System review panel, given the New Zealand Government has also submitted to the review in favour of mutual recognition.

Alignment of tax rates

The Group is strongly in support of the low rate broad base system; ideally the tax rates for corporates, savings vehicles and individuals should all be aligned. We are therefore supportive of the Government's medium term objective to align tax rates.

Aligning tax rates would resolve the current arbitrage that exists, particularly between the top personal income tax rate and the company tax rate. The removal of this arbitrage will result in a more efficient tax system that will have material benefits for the wider economy, including for capital markets.

Any alignment of tax rates may only be temporary given the downward pressure on the corporate tax rate. A key objective should be to keep any differentials in tax rates as minimal as possible to discourage arbitrage opportunities (i.e. any gains from structuring into lower rates will likely be equalled or exceeded by compliance costs).

Profit distribution plans

A recent example as to how tax can influence investment decisions and capital markets is the current debate as to how profit distribution plans ("PDPs") should be taxed and whether their treatment should be aligned with the tax treatment of dividend reinvestment plans ("DRPs").

The Group strongly opposes the proposed official's response and has suggested more targeted measures that still address officials concerns noting that if what is proposed is implemented, PDPs will likely no longer be available as an active capital management tool by appropriate publicly listed companies. This is in a context where PDPs are the only mechanism that allows company's to "signal" their ability to pay a dividend while also enabling very high equity participation rates, being 3-4 times greater than those achieved by DRPs.

The Group welcomes the decision that the taxation of PDPs be considered in the context of the Taskforce and the Tax Working Group's considerations.

Stapled stock

In February 2008 the government announced, via press release, that it would amend the Income Tax Act to ensure that when a debt instrument that would normally give rise to tax deductions is stapled to a share, it will be treated as equity for tax purposes – meaning that no deductions for interest payments will be available.

The Group strongly submitted against this proposal however it has now been legislated for in the Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009.

Part of the Group's concern with the stapled stock changes is that they provide a further tax incentive for non-residents to acquire 100% ownership of New Zealand companies, as this would eliminate any need for legally stapled shareholder debt.

At the heart of our concern is that stapled stock is no more than shareholder debt in a widely held company context. There is no policy rationale for treating shareholder debt differently whether it is legally stapled, as required in a widely held company context, or economically stapled as exists in a non-widely held company context.

The Group's view is that all debt should be treated as debt regardless of whether the debt comes from shareholders or third parties and whether it is stapled to equity or not.

Improving tax administration and providing tax certainty

The Group believes that the efficiency and fairness of tax administration in New Zealand should be operated in such a way to help make New Zealand known as an attractive and easy place to conduct business with a welcoming and pragmatic tax administration department.

The success or failure of any tax reform, including the initiatives specified in this letter, depends to a large extent on the administrative framework underlying the tax system.

The Group specifically wishes to draw the Taskforce's attention to the following matters:

Binding rulings

The Group sees binding rulings as an integral aspect of the relationship taxpayers have with Inland Revenue, and as such it is very important that the regime functions as effectively and efficiently as possible.

The Group is supportive of any changes to the binding rulings regime, legislative or otherwise, which will help improve the certainty of the regime, including by improving the timeliness of binding rulings. Inland Revenue has recently released two papers contained proposals designed to achieve these changes, both from an operational and legislative perspective. The Group has submitted on both of these papers.

Finalisation of Interpretation Statements

The finalisation of Inland Revenue interpretation statements on the application of the anti-avoidance provisions and the care and management rules will provide improved certainty for taxpayers and improve the efficiency/remove some of the deadweight costs of the tax administration system.

In particular, the interpretation statement on the interpretation of the anti-avoidance provisions has been outstanding since it was released for consultation in September 2004, and its re-release for consultation has been continually deferred since that time.

Remedial Unit

Corporate taxpayers require the ability to deal with legislative anomalies and difficulties on a timely basis. The Group suggests that the Policy Advice Division have a designated "remedial unit" to effectively undertake maintenance on the Tax Acts. Such a unit should be formally established with the key output to address remedial issues. Alternatively, the current Rewrite Advisory Panel could be given this role, essentially as an extension of its current duties.

Compliance costs

The Group is concerned that Inland Revenue does not adequately consider the imposition of taxpayer compliance costs when making tax policy decisions. Unnecessary compliance costs are a burden on taxpayers and ultimately a further impediment to corporate growth.

A recent example can be found in the Taxation (Consequential Rate Alignment and Remedial Matters) Bill. One of the proposals in the Bill was to increase the default resident withholding tax rate (where no election is made) to 38%. After receiving negative feedback on this proposal before the Finance and Expenditure Select Committee, officials are now proposing to increase the default rate to 21%, but to give Inland Revenue the power to require certain financial intermediaries to increase a taxpayers RWT rate if they are on a lower rate than their marginal tax rate.

The above proposal could impact up to 100,000 taxpayers – but it is the financial intermediaries, not Inland Revenue, that have to make the change and deal with upset individual taxpayers. Essentially, Inland Revenue is forcing a compliance cost on corporates that they do not want to bear themselves.

A further example of compliance costs being borne by taxpayers is that companies are required to withhold RWT at 3% on dividends if they are fully imputing dividends at 30/70. We note all companies will only be able to impute at a maximum of 30/70 from 1 April 2010.

The requirement to withhold 3% RWT for dividends paid to many resident shareholders leads to substantial and unwarranted compliance costs. Many companies have to deduct RWT on dividends at 3% and shareholders are still required to file tax returns to make up any additional tax liability.

The Group is of the view that this situation should be remedied as a priority and we have historically proposed two options for a policy response to this issue being in preferential order:

- All fully imputed dividends paid by widely held companies to resident shareholders should be subject to a final maximum rate of 30%; or

- The RWT rate for dividends should be reduced to 30%.