



Submission of the Government of New Zealand

28 May 2015

Introduction

- 1 The New Zealand Government welcomes the opportunity to provide a submission in response to the *Re:Think* tax review discussion paper. This submission focuses on the benefits of retaining a system of imputation credits and the benefits of introducing mutual recognition across the Tasman. This submission also discusses the application of the Australia New Zealand Closer Economic Relations Trade Agreement to the Wine Equalisation Tax and the Brewery Refund Scheme.

Australia and New Zealand's economic relationship: towards a Single Economic Market

- 2 Australia and New Zealand have the most open and integrated economic and trade relationship in the world, characterised by substantial flows of merchandise trade, services, capital, labour and people. In a trans-Tasman single market, New Zealand adds another Victoria to the Australian economy. New Zealand considers the introduction of mutual recognition of imputation credits to be the single biggest positive step we could take in developing this relationship further.
- 3 The Australia New Zealand Closer Economic Relations Trade Agreement (known as CER) underpins our close trade and economic relationship. Signed in 1983, it delivered free trade in goods five years ahead of schedule in 1990, with nearly all services also covered. Today, we have a two-way trading relationship worth AU\$24 billion per year
- 4 The economic relationship took a further leap forward in 2004 with the joint development of a Single Economic Market (SEM) agenda. The goal in mind is a seamless market in which people and businesses can have domestic-like experiences in one another's countries. Showing how successful the SEM model has been for both countries, roughly half of the foreign direct investment (FDI) in New Zealand comes from Australia, with half of our FDI going to Australia. Australia's stock of FDI in New Zealand is nearly three times that of New Zealand investors in Australia.

Unfinished business for the Single Economic Market agenda

- 5 The lack of mutual recognition of franking and imputation credits is now the most significant barrier to a seamless trans-Tasman market. The way Australia's franking and New Zealand's

imputation credits systems currently operate are an effective tariff on foreign investment by taxing our investors twice: at a rate of 60% for Australian investors, and 53% for New Zealanders. Mutual recognition of imputation credits has been estimated to deliver a NZ\$5.3 billion increase in trans-Tasman GDP by 2030.¹ And that amount does not include the dynamic productivity gains delivered by improved competition and innovation, as well as reducing the diversion of effort towards tax avoidance.

- 6 The next leap forward in trans-Tasman integration will require the type of visionary political leadership shown by the architects of CER. The New Zealand Government is conscious that mutual recognition would have a fiscal cost. In a period where fiscal consolidation may trump wider economy-wide benefits from tax reform, we understand the tax revenue loss may influence decision-making about the *timing* for implementation of mutual recognition. If Australia is not able to move now to mutual recognition, we seek at least an in principle decision to implement mutual recognition when fiscal circumstances permit, with CER Ministers reviewing the situation at their annual meeting.

Benefits of Mutual Recognition

Mutual recognition will benefit individual investors

- 7 Currently, dividends from Australian companies in New Zealand that are repatriated to shareholders in Australia are taxed twice: once via company tax in New Zealand and once via the personal tax system in Australia. The same double-tax applies to dividends from New Zealand companies in Australia repatriated to shareholders in New Zealand.
- 8 As a result of this double-taxation Australian equity investors in New Zealand face an effective tax rate of some 60%, and New Zealand investors in Australia face an effective tax rate of 53%.
- 9 Table 1, below, illustrates the extent to which Australian shareholders in a New Zealand company would be better off if mutual recognition was implemented. In this table it is assumed that all profits are passed out to final shareholders each year.

Table 1

Australian shareholder in a New Zealand company	Status quo	With mutual recognition
Company income	100	100
Tax paid	28	28
Australian shareholder		
Taxable dividend	72	100
Personal tax @ 45%	32.4	45
Franking credit	0	28
Net personal tax	32.4	17
Net income	39.6	55
Effective tax rate	60.4%	45%
Increase in post-tax dividends		38.9%

¹ *The costs & benefits of mutual recognition of imputation & franking credits*, NZIER and CIE final report (August 2012) at page 21, <https://nzier.org.nz/publication/the-costs-amp-benefits-of-mutual-recognition-of-imputation-amp-franking-credits>

Mutual recognition will promote free movement of capital across the Tasman and lead to economic growth

- 10 Australia and New Zealand are two of the most integrated economies in the world. Both countries are relatively small economies, and benefit from the greater competition that comes from a larger trans-Tasman market.
- 11 Australia and New Zealand have recently implemented an ambitious investment agreement, the CER Investment Protocol, which maintains CER's status as one of the world's most comprehensive free trade agreements. It allows larger investments in each other markets without screening and increases certainty for investors. However the free flow of capital is the most economically significant outstanding issue for New Zealand's and Australia's shared vision for a seamless trans-Tasman business environment. Mutual recognition would remove tax barriers to investment flows in much the same way as CER removed tariffs on flows of goods.
- 12 Mutual recognition would provide economic benefits through greater trans-Tasman investment efficiency and increased product market competition in our two economies.
- 13 We appreciate that while modelling of MRIC has shown it would increase trans-Tasman welfare, the modelling has been inconclusive about whether it would increase Australian welfare. Modelling by independent economic think tanks suggested gains for Australia, but modelling by the Australian Productivity Commission suggested a likely loss. However, many of the most important benefits of MRIC were necessarily left out of the modelling. For example, it would reduce incentives for artificial structuring in trans-Tasman business dealing (particularly relevant given the recent global focus on profit shifting), would make it less costly of businesses to expand into their trans-Tasman neighbour, and would result in increased competition and innovation.
- 14 We also consider that Australian Productivity Commission model is likely to have concluded that mutual recognition would have a smaller effect on investment than is realistic. We understand that the underlying assumption in that model was that if a company has any foreign shareholders, imputation has no effect on investment because foreigners are assumed to be "marginal shareholders". We consider that there is important anecdotal evidence that imputation has significant incentive effects on firms with large proportions of both resident and non-resident shareholders.
- 15 Additionally, we believe there is scope for Australian and New Zealand officials to consider practical design issues that seek to minimise Australian losses and maximise Australian gains. These could include options such as phasing-in mutual recognition. We would welcome the further opportunity to discuss these options with Australia.

The Wine Equalisation Tax and the Brewery Refund Scheme

- 16 The discussion paper refers to indirect taxes on wine - the Wine Equalisation Tax (WET) and other types of alcohol. There is also mention of two tax concession schemes for producers of alcoholic beverages: "brewery refund scheme provides eligible independent breweries

with a refund up to a maximum of \$30,000 per financial year, while the WET producer rebate provides eligible wine producers with a rebate up to a maximum of \$500,000 per financial year, regardless of whether they are independent or not”.

- 17 The focus of the discussion is on whether the taxes applying to alcohol could be made simpler and whether there should be consistent taxation for different types of alcohol. We note that a further discussion paper on the Wine Equalisation Tax (WET) rebate is scheduled to be released in July.
- 18 The Australian Government decided to extend the WET to New Zealand producers in July 2005 in accordance with obligations set out under Article 7(2) of CER.
- 19 New Zealand expects that CER obligations will be included in the examination of the WET rebate, and that the core obligation of equal treatment for New Zealand producers will be preserved in any changes to the WET rebate.
- 20 The brewery refund scheme is analogous to the WET rebate. Therefore, CER obligations should also be taken into account in the examination of excise taxes on beer and the brewery refund scheme. New Zealand seeks the extension of the brewery refund scheme to New Zealand independent breweries, in accordance with the CER obligation of national treatment.