NEW ZEALAND CHAMBERS OF COMMERCE

Business Vitality

New Zealand Chambers of Commerce (Inc)

Submission to the Finance and Expenditure Committee

Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill

July 2007

Introduction

The New Zealand Chambers of Commerce (Inc), NZCCI, is an umbrella organisation serving the interests of 34 Chambers of Commerce nationwide. These, in turn, represent over 24,000 businesses around the country. While many of our members are in the SME category our membership includes most of the largest corporations in New Zealand.

NZCCI is pleased to be able to make this submission on the proposed Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill.

Company Tax Rate Reduction

NZCCI welcomes the reduction in the company rate from 33% to 30%. However a reduction of 3 cents in the dollar is not enough if we are to fully transform New Zealand's economy.

Rather than simply matching Australia's rate we need a lower company tax rate than Australia's to maintain international competitiveness.

The decision comes as a result of the business taxation review but as approximately 40 per cent of New Zealand's businesses are unincorporated – for example as sole traders or partnerships, many businesses will not directly benefit from the reduction in the company rate. Notwithstanding this, however, the increased gap between the top personal and company tax rate will provide an incentive for tax planning to avoid the top personal rate.

In our view, Government must take steps to reduce personal income tax as well as company tax. An announcement to this effect is needed before next year's budget.

We are disappointed that the 2005 decision to inflation-adjust income thresholds has been abandoned. This would have been a start. The fiscal drag that has occurred since the thresholds were last adjusted has been a major drain on tax payers. A major overhaul is now necessary.

In the context of the current debate about the inflationary nature of expansionary fiscal policy, we would like to make the point that tax cuts are not inflationary if they are accompanied by a reduction in government expenditure. Unfortunately, under the 2007 budget the ratio of Government spending to GDP continues to grow.

Tax Credits for Research and Development (R&D)

NZCCI has a preference for a low-rate, broad based tax system rather than tax credits for certain activities and we agree with the government's conclusion from the business tax review that tax credits for most activities considered would be less cost effective than reductions in the tax rate and other existing mechanisms.

Notwithstanding this preference, we are prepared to support the proposed tax credits for R&D. We hope that these prove to be a cost effective way to increase legitimate R&D innovation as this outcome would have strong benefits for the economy. We note that private sector research in New Zealand is only one third of the OECD average and needs to increase.

However, we also note the difficulties around the definition of R&D which are likely to increase administrative costs (and benefit tax accountants in particular).

The explanatory note and the pertinent clauses of the Bill regarding the criteria to be met in order to gain the tax credit for research and development are indicative of this. Therein, R&D activities are defined as "(a) systematic, investigative and experimental activities that seek to resolve scientific or technological uncertainty or that involve an appreciable element of novelty […]". Despite several definitions of the given criteria, it appears to be difficult to predict whether an activity is covered or not.

For instance, what is an appreciable element of novelty and what activity fails to meet such threshold? Producing uncertainty in important matters such as tax liability should be avoided wherever possible. Thus NZCCI advocates careful drafting of the legislation in order to reach maximum predictability.

We are pleased that the R&D tax credits are not restricted to companies so that all New Zealand businesses are eligible.

Tax Reduction for Savings Vehicles

NZCCI supports the reduction in the tax rates for savings vehicles like portfolio investment entities (PIEs). Keeping these rates in line with the company rate will reduce administration and compliance costs and reduce tax planning.

International Tax Rules

The changes to the international tax rules to facilitate exporters and offshore economic activity are supported.

KiwiSaver

We are supportive of KiwiSaver as a means of changing New Zealand's savings culture and providing an increased supply of capital which business and the economy can to tap into. However, we have some difficulties with the scheme around the generosity of the tax credits vis a vis tax cuts, the compulsory contributions and the compliance costs faced by employers.

Previously announced KiwiSaver initiatives were fully supported. For example, the automatic enrolment/opt out provisions are an innovative way of encouraging saving and the $1000 kick start and subsidised fees are appropriate incentives. However, the size of the tax credits announced in the budget go too far in terms of fiscal cost.

The main driver for most people who have or will join KiwiSaver is the size of the government subsidy. We would have preferred a smaller subsidy (tax credit) and some personal tax cuts so that people have more choice as to how much they put into KiwiSaver and how much they spend otherwise. While we acknowledge the importance of preparing for retirement and addressing New Zealanders' relatively low savings rate, the budget announcements have shifted the balance too far towards *future* as opposed to *current* spending.

The benefits to business and the economy of the company rate reduction will be partially offset by the compulsory employer contributions to the extent they exceed the offsetting tax credits.

Compulsory employer contributions combined with partially offsetting tax credits will have an impact on wage bargaining with wage growth effectively being replaced by government payments channelled through employers. Not only will this reduce wage growth, compliance costs will be increased in the process.

The increase in businesses' compliance costs is a significant concern. The scheme's introduction has been rushed and employers have not had enough time to prepare for it with many employers only receiving the KiwiSaver books the week before commencement.

Small businesses in particular will be disadvantaged as they lack the resources to deal adequately with the additional obligations. This is likely to result in adverse consequences for their productivity and efficiency.

Finally, we support the mortgage diversion but note that the Kiwisaver housing deposit subsidy is likely to increase house prices (i.e. benefit the seller) rather than benefit first time house buyers.