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30 August 2012

New Zealand Productivity Commission

Email to: transtasmanreview@productivity.govt.nz

Dear Sir/Madam

Re: Productivity Commission Trans-Tasman Review: Strengthening economic relations between Australia and New Zealand

Background

BusinessNZ's submission on the Trans-Tasman Review dated 28 May 2012 outlined four main issues that we believe are important for the closer integration of the Australia and New Zealand economies. As a follow-up, BusinessNZ wishes to elaborate on one of the issues discussed, namely the removal of tariffs/barriers to the free flow of capital by way of the mutual recognition of imputation and franking credits.

Mutual recognition of imputation and franking credits

As we have previously mentioned, the number one issue that New Zealand business would like to see progressed with urgency is mutual recognition of imputation and franking credits. This would help in unblocking investment and ensure better returns to shareholders in both countries. To assist in better understanding the value of this policy change, the Australia-New Zealand Leadership Forum, through its Project Steering Group of which BusinessNZ was a representative, commissioned a report aimed at examining the costs and benefits of mutual recognition[1]. The report is attached to this submission, but we would like to mention some of its key points.

The problem as it stands

At current estimates, approximately NZ$7.4 billion of trans-Tasman equity investment dividends could be potentially taxed twice, through the company tax in the destination country, as well as via personal tax regimes in the investor's economy. Therefore, New Zealand equity investors in Australia face an effective tax rate of around 53%, while for Australian investors in New Zealand the effective rate would be around 60%.

[1] The costs & benefits of mutual recognition of imputation & franking credits, NZIER and CIE Final Report (2012)

The existing situation is essentially a form of tariff on trans-Tasman flows, which means resources are not allocated efficiently. Investment decisions are often partly made to minimise investment payments, rather than on a proper economic basis, with implications for both countries. Firms may not be able to grow their trans-Tasman activities since they may need to use their resources to minimise tax.

The way forward
One of the most optimal ways forward to remove such inefficiency, as outlined in the report, would be for New Zealand and Australia to adopt mutual recognition of franking credits (in Australia) and imputation credits (in New Zealand). Both provide a credit against the tax on dividends received by domestic shareholders for tax paid at the company level.

The costs and benefits
Previous attempts to introduce mutual recognition have been resisted, primarily due to concerns about the tax that would be forgone. However, little work has been undertaken to examine potential economic benefits.

By using an internationally recognised CIEG-Cubed model of the global economy, the report indicates that previous concerns about forgone tax (especially within current tight fiscal environments) do not appear to valid. The model shows the changes to be revenue neutral for both countries since the tax forgone is regained by small increases in other household taxes.

The report outlines the gains possible, with an estimated NZ$5.3 billion by 2030 from mutual recognition based on the central modelling scenario. Even though New Zealand's gains are proportionally far larger than Australia's, the study finds that for Australia they are still net gains, rather than losses.

Overlaying all of this is the conservative approach to the modelling, examining only the allocative efficiency gains from mutual recognition. But dynamic productivity gains from increased competition and innovation, along with reduced time spent on tax avoidance would in all likelihood add to what has already been measured in terms of net gain.

Last, even when sensitivity testing on the modelling is undertaken, there is very little in the way of negative impacts on the results.

Overall, the report finds the changes would stimulate business and deliver a significant net benefit to the trans-Tasman economy.

Thank you again for the opportunity to comment, and we look forward to further developments.

Kind regards,

Phil O’Reilly
Chief Executive
BusinessNZ