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23 November 2010

Kerry McDonald
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Dear Kerry

SAVINGS IN NEW ZEALAND

The following submission has been prepared by the Corporate Taxpayers Group ("the Group") for the Savings Working Group. The Group is a collection of some of New Zealand's largest corporate entities. It actively participates in consulting on tax policy and administrative reforms in New Zealand.

As the Group is a tax special interest group this submission focuses on the relationship between tax issues and savings, including the issue of tax distortions canvassed in the Treasury paper, *"Savings in New Zealand – Issues and Options")*.

We would like to thank you in advance for your consideration of the Group's submission. The Group would be happy to present the key points of this submission to you, including elaborating on any of the tax technical matters raised, at a future time convenient to you. Please contact us if you would like to arrange such a presentation or discussion.

Executive summary

The Group supports the establishment of a group of private sector experts to consider the wider issues of savings in New Zealand with this submission principally focused on the ability to use the tax system to incentivise savings.

The Group is very supportive of any initiatives to lift the level and quality of New Zealand's national savings. A higher level of quality savings in New Zealand should lead to higher investment in New Zealand, and therefore an increase in economic growth.

The Group believes that tax is not the silver bullet to increase national savings, and that real increases in savings will only occur if consideration is also given to other substantive changes in the wider policy landscape. Such changes include:

- Government fiscal policies,
- New Zealand superannuation,
- Reforms to increase the depth, breadth and quality of the investment market,
- Improved investment infrastructure,
- Investment compulsion or incentives, and
- Improved investor education.

Again, the Group does not canvass any non-tax reforms in this submission, but notes the report of the Capital Markets Development Taskforce in this regard.

From a tax perspective the Group has previously submitted 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.

We believe that such certainty is also important to encourage investment and savings. In terms of the destination of tax reform, the Group is supportive and have previously submitted on 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

The Group considers 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. Inconsistent decisions have the potential to make New Zealand an unattractive place for business to operate from and through.

Consistent with this, it is important that reforms designed to provide incentives for savings face a similar high hurdle. Any policy reform should be consistent with this policy framework.

This submission recommends four key areas of tax reform that the Group believes will ultimately improve national savings. The tax measures recommended by the Group in this submission are consistent with the above criteria.

Key tax changes that will assist in increasing savings

In the Group's view there are four key micro tax reforms can be made that would collectively contribute toward an improved savings environment.

1. Moving to an EET model

1.1. The Group sees merit in considering as part of this process the existing "taxed, taxed exempt" (i.e. TTE) regime and whether the framework should be changed to an "exempt, exempt, taxed" ("EET") regime. The Group notes that New Zealand already has certain modifications to a pure TTE regime (e.g. the KiwiSaver exemption for employer contributions)

1.2. While the Group believes that an EET model would provide significant savings incentives, we recognise the EET model would have a fiscal cost, as well as the compliance costs of implementation. Therefore, while the Group believes the EET model has merit in the longer term, <u>we are not convinced that a fundamental change at this time is warranted</u>.

1.3. The Group recommends that the move to an EET model is considered as an aspirational medium-long term goal, with the move towards this model being taken applying the generic tax policy process, undertaken in incremental steps to mitigate the fiscal cost to the government and potential compliance costs to taxpayers.

2. Taxation of passive income

2.1. One of the key policy reforms that the Group recommends as part of increasing savings is to reform the taxation of passive income to cap the tax rate on interest and dividends. This would remove many current distortions, increase incentives to save and reduce compliance costs; we expand in the attached appendix.

2.2. The Group is of the view that capping the tax on this passive income should be remedied as a priority (we have historically submitted on this issue). With the changes to tax rates announced in the Budget, the Group considers the two options below would be an appropriate policy response to this issue:

- Dividends:
  - All fully imputed dividends paid by widely held companies to resident shareholders should be subject to a final maximum rate of 28%; or
  - The RWT rate for dividends paid by widely held companies should be reduced to 28% with the shareholder having the option to treat this as excluded income (i.e. the regime that applies to listed PIEs)
- Interest: The top RWT rate for interest paid between non associated parties should be reduced to 28% with the investor having the option to treat this as excluded income (i.e. the regime that applies to listed PIEs).

2.3. Further detail concerning the Group's submission in relation to RWT on dividends can be found in an extract of the Group submission on the Taxation (Consequential Rate Alignment and Miscellaneous Matters) Bill, replicated at extract A in Appendix Three.

2.4. There are also material compliance costs savings. For example, for dividends, under current tax rates, companies are required to withhold RWT at 3% on dividends if they are fully imputing dividends at 30/70 (at the existing 30% company tax rate).

2.5. 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 (until personal tax rates fully transition to a top rate of 33%).

3. Clarify tax treatment of annuities / tax settings for retirement savings

3.1. Underlying investment income on annuity products is currently taxed at the company tax rate. However many potential investors in annuities are retired individuals, who have marginal tax rates that are significantly lower. We note that an EET regime addresses the tax concerns with annuity products.

3.2. The Capital Markets Development Taskforce recommended that there be consideration of the options that would tax annuities in a similar manner to other substitutable investments to remove a tax distortion that may discourage the development of a domestic annuities market - the tax distortion being the relatively high tax rate.

3.3. The Group believes that consideration of the tax treatment of annuities is extremely important, and some incentive should be provided for the development of an annuities market. The settings for the taxation of retirement savings should also be considered, and as noted above this should include consideration of moving from the TTE model to an EET model in the longer-term. This could be achieved by reducing the settings over time e.g. T or E could become a little t (i.e. income taxed at a concessional rate / setting).

3.4. The Group also notes that the purpose of annuities is to assist retirees by providing them with an income stream of fixed regular payments over a period of time. It is worth noting that when KiwiSaver balances are accessible, the entire balance becomes immediately available to the individual to do with what they want. The Group considers that there is some risk with the current KiwiSaver setting in this regard, and whether it is appropriate for the large KiwiSaver balances that will begin to be accessible in a decade's time. It may be more appropriate for there to be an annuity-type payment scheme in place for a portion of

KiwiSaver balances to ensure that the economic benefit of this form of savings is maximised, i.e. that the savings are not immediately consumed. It will obviously be important that the tax treatment of any such payment scheme does not give rise to any disincentive to save via KiwiSaver.

4. Employee share schemes

4.1. The Group believes that employee share schemes are an important savings device for employees. These arrangements also provide a tool for employers to increase employee efficiency, productivity and engagement.

4.2. The current rules are outdated and should be reviewed and modernised to encourage employers and employees to enter into share scheme arrangements. The tax issues associated with this are currently viewed as over-taxing employees and not providing sufficient deductions to employers, this should be addressed.

4.3. A further tax issue exists for New Zealand employees of Australian parent companies. If an employee share scheme was to be introduced for New Zealand employees, the shares offered would typically be in the Australian parent company rather than the New Zealand business operation. In this situation the employee is disadvantaged because any Australian franking credits accompanying dividends cannot be utilised. The Group believes that limited streaming of imputation credits should be considered in this regard; and we have made further comment on this matter in Appendix One.

4.4. Importantly, employee share schemes also provide an alternative source of savings/investment for employees, and may provide them with opportunities to increase their financial literacy skills.

In addition to the Group's key submission points, we have briefly outlined other areas of tax reform that we believe could be addressed, commented on the options presented by Treasury to remove tax distortions, and included relevant extracts from historic submissions. These additional submission points can be found in the following appendices:

- Appendix One (other tax reforms that will assist in retaining corporate activity)
- Appendix Two (removing tax distortions)
- Appendix Three (extracts from historic 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. New Zealand Post Limited
19. Opus International Consultants Limited
20. Origin Energy New Zealand Limited
21. Rio Tinto Alcan (New Zealand) Limited
22. Shell (Petroleum Mining) Company 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

John Payne
For the Corporate Taxpayers Group

APPENDIX ONE

OTHER TAX CHANGES THAT WILL ASSIST IN RETAINING CORPORATE ACTIVITY

The Group believes that retaining corporate activity in New Zealand is essential for future economic growth, and is inextricably linked to increasing both the quality and quantity of our future savings.

We have briefly outlined below areas of tax reform that the Group believes are important for encouraging corporate activity in New Zealand, many of which of which we have submitted previously to officials.

1. Portfolio Investment Entities

- The Group remains supportive of the portfolio investment entity (PIE) regime, as a means of encouraging savings and investment.
- Officials have recently consulted on a proposal to introduce a zero-rate of tax for non-resident investment into PIEs. The Group is very supportive of this measure as a first step towards increasing New Zealand's profile as a financial centre, and believes the measure should be enacted as soon as possible
- Further detail can be found in an extract of the Group submission on the officials issue paper, *"Allowing a zero percent tax rate for non-residents investing in a PIE"*, at extract B in Appendix Three.

2. International tax reforms

- The active income exemption for CFCs should be extended to cover financial services (for example insurers or taxpayers operating a money lending business). Without this being addressed, New Zealand based corporates will have an additional tax cost if they remain resident in New Zealand.
- The Group is very supportive of the extension of the active income exemption to non-portfolio FIF investments.
- 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. Further detail can be found in the extract from the Group's submission to the Capital Markets Development Taskforce, as replicated at extract C in Appendix Three.

3. 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. Proposals exist to apply AIL at a rate of zero for interest paid on "qualifying" corporate bonds.
- The Group is supportive of the reforms but is concerned that the proposals are unlikely to provide any additional source of debt capital for New Zealand corporate market therefore the ambit of the proposals should be extended.
- The Group has previously submitted on this issue, and has attached an extract from this submission summarising the Group's views, at extract D in Appendix Three.

4. The imputation regime and integration of tax bases

- The Group believes that limited streaming of imputation credits should be considered. Particularly:

  - In the non-resident withholding tax on foreign-sourced income context, 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 (with imputation credits attached) to their New Zealand shareholders.

- The Group also supports the refundability of imputation credits for certain shareholders.

- The above changes would demonstrate a move toward greater integration of the New Zealand and foreign tax bases.

- The Group has previously submitted on the imputation issues and the integration of tax bases, and we have attached an extract from the Group's submission to the Capital Markets Development Taskforce covering both these issues, at extract E in Appendix Three, which covers this issue.

5. Reform the Fair Dividend Rate regime ("FDR")

- The FDR method for calculating FIF income for individual direct investors is generally working well, but a small number of specific issues continue to give rise to concerns.

- The Group submits that the following changes to FDR would improve the investment and therefore savings outcomes for investors:

  - Under FDR a non individual investor will be taxed even if they make an economic loss. This is not an appropriate outcome. Such investors should have the same opportunity as individuals and family trusts to use the CV method in the event that FDR is going to result in over-taxation in an income year.

  - Alternatively, to the extent that the above is viewed as not practical, the Group submits that the 5% deemed return should be reduced to 4% for all taxpayers that do not have access to the lower of CV or FDR.

  - Portfolio investors into Australia can fall in and out of the FIF rules (and therefore in and out of having to apply FDR) because the FIF exemption. The Group believes that all portfolio investments in Australia should prima facie fall outside of the FIF regime as long as the Australian entity holds a franking credit account.

  - Consideration should be given to how FDR applies where the New Zealand investor hedges exchange rate movements.

APPENDIX TWO

REMOVING TAX DISTORTIONS

The Treasury paper states that the current tax system distorts saving and investment decisions in two main ways:

- Different forms of saving and investment are taxed in different ways and at different rates; and
- Returns on savings that accumulate over a longer period are taxed at high effective tax rates.

To address these distortions, the following tax reforms are suggested as options. The Group has provided brief comment on each of these.

1. Lower personal tax rates

- The Group believes that any further personal income tax reductions should be considered as part of a next step toward greater tax rate alignment.
- The Group is supportive of lowering the 30% and 33% personal income rates to align with the corporate and PIE rate of 28%. The Group acknowledges that this would have a fiscal cost, and suggests that this would best be met by reducing government spending. If full alignment is not possible, the Group does support having lower corporate tax rates.

2. Inflation indexation / partial exclusion for interest income

- The Group has some concerns with these options, particularly the complexity they would bring to the tax system, especially when inflation is expected to be at low levels. There is concern the benefits of an indexation regime may not outweigh the compliance costs of such a regime.
- In terms of inflation indexation, the Group is supportive of the concept of taxing real, rather than nominal earnings, and therefore preventing "bracket creep". However the Group would prefer to see continued tax reduction policies, rather than the introduction of a potentially complex indexation regime.
- In terms of the proposed partial exclusion for interest income, the Group notes that this would most likely be accompanied by a partial exclusion for deductions of interest expense. A discount on interest expense would increase the tax on investment and the cost of debt financing, which would be an overall negative for New Zealand's economic growth.

3. Dual income tax system

- The Group does not support the introduction of a traditional dual income tax system (such as currently exists in some Nordic states). We support the capping of tax on passive income as noted in the covering letter.
- The Tax Working Group ("TWG") considered the benefits of a dual income tax system in the New Zealand context, and it did not find favour in the final TWG report:

> *The dual income tax system, as with a classical system, provides scope for greater discretion to set separate corporate and top personal income tax rates. However, incentives to re-characterise labour income as capital income can give rise to boundary issues not dissimilar to the type of integrity problems that exist under the present New Zealand tax system. Furthermore, at least for New Zealand where skilled labour is highly mobile, the scope that a dual income tax system provides to set higher personal tax rates may be more limited if governments are concerned with efficiency and the effects of high personal tax rates.*

- The Group would be concerned at the impact of relatively high personal tax rates on New Zealand's mobile labour force. As noted above, the Group is supportive of lower personal income tax rates to encourage productivity.

- Given the findings of the TWG, the Group does not believe it is worth while spending further resources considering whether a full dual income tax system is appropriate, although the Group does support further consideration of the items set out in paragraph 2.2.

APPENDIX THREE

EXTRACTS FROM PREVIOUS SUBMISSIONS

Extract A - Submission on RWT on dividends

[Submission to Finance and Expenditure Select Committee on the Taxation (Consequential Rate Alignment and Remedial Matters) Bill, dated 25 August 2009]

Resident withholding tax on dividends

1.1. We note that the RWT changes contained in the Bill will only apply to interest, and <u>not</u> dividends. As such, companies will continue to be required to withhold RWT at 3% on dividends if they are fully imputing dividends at 30/70.

1.2. The Group has previously submitted that 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.

1.3. The Group is of the view that this situation should be remedied as a priority. We propose two options for a policy response to this issue below (in preferential order). We would like to see officials investigate these options:

1.3.1. All fully imputed dividends paid by widely held companies to resident shareholders should be subject to a final maximum rate of 30%. That is there should be no need for the shareholder to return the income as taxable.

While this appears to be a major policy request, we note that shareholders in widely held companies can achieve this 30% tax rate by simply investing through PIEs and other widely held collective funds.

There is no policy rationale as to why shareholders in widely held companies should be forced to invest through such vehicles to obtain the 30% tax rate.

Implementing this would result in substantial compliance cost savings (including no withholding of RWT and a reduction in the number of taxpayers having to file personal income tax returns) as well as encouraging further investment in New Zealand companies at this critical turning point in the economic climate.

More importantly, it is consistent with the Government's stated medium term objective of aligning the tax rates to 30%.

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

This would remove the compliance costs on corporates that are currently forced to deduct RWT at 3% on fully imputed dividends. This will benefit collective investment vehicles, namely removing the need for them to obtain exemption certificates; otherwise they must seek the 3% refund or otherwise use the credit.

Individual shareholders with a high marginal tax rate who receive material dividends from companies will continue with the same compliance costs they currently have in that they must file tax returns and pay any additional tax.

To the extent a professional registrar is engaged to manage the payment of dividends to shareholders of widely-held corporates, reducing the RWT rate to 30% will reduce the compliance obligations of the registrar and therefore the compliance costs incurred by the corporate. This is particularly important in relation to sourcing and monitoring certificates of exemption from RWT and dealing with situations where shareholders believe they have been over taxed.

From the Groups understanding, such a change will also result in material compliance cost savings for privately owned groups. Currently, privately owned companies have to deduct 3% when paying fully imputed dividends even though the shareholders will be filing tax returns. Further, in many of these situations the tax returns for the company and the shareholders will be prepared by the same person. In such situations it seems totally logical that the tax obligations are met through the filing of income tax returns without any interim withholding tax liability.

1.4. Retaining the status quo will see corporates continue to incur compliance costs in deducting RWT on fully imputed dividends. This compliance cost could easily be removed as part of the government's ongoing rolling maul of initiatives to ease compliance costs on New Zealand businesses.

Extract B - Submission on zero-rate for non-resident PIE investments

[Submission on the officials issues paper, "Allowing a zero percent tax rate for non-residents investing in a PIE", dated 4 June 2010]

General comments

4) The Group is supportive of the Government's investigation of an initiative to make New Zealand an attractive place of domicile for managed funds and an exporter of middle and back office services in respect of those funds. In particular, the Group is supportive of opportunities that the initiative would create for the New Zealand funds management industry in the provision of the New Zealand-based services to foreign fund managers, and also through greater depth to the industry and related servicing functions generally.

5) We note that the reforms are designed to facilitate middle and back office services being provided from New Zealand. We understand front office services are not being targeted as these are traditionally performed close to where the majority of investors are located. In our view the reforms need to be flexible enough to allow the same treatment of non-residents for funds where the front office services are also performed in New Zealand. While the Issues Paper does appear to provide this flexibility, the Group would be concerned if there is any erosion of this as the proposal is developed. This will allow a complete investment package to be offered from New Zealand for foreign investors, and in particular Australian Superannuation Funds given our close proximity to that market. In addition, in our experience the fund manager / front office will be responsible for choosing the middle and back office service providers, so having the front office (or affiliate) located in New Zealand will enhance the prospect of further activity occurring in this Country.

6) The Group is also supportive of the initiative being used to make investment in existing New Zealand based funds more attractive to non-residents, increasing inbound capital flows. As the Issues Paper notes, the current 30% PIR for non-residents is a significant disincentive for non-residents (including New Zealand citizens who are living overseas) investing in a New Zealand fund. Further, the current treatment is an anomalous outcome when compared to the tax treatment of direct investment in New Zealand or foreign assets by non-residents. The proposal

would address that anomaly, and would be consistent with the well established principle that New Zealand should not tax non-residents on their foreign-sourced income (as the Issues Paper recognises at paragraphs 1.3, 2.2 and 2.3).

7) However, while the proposals in the Issues Paper would address this policy issue in respect of foreign sourced income derived by non-residents through a PIE, the Group is concerned that non-resident shareholders in New Zealand resident companies remain effectively subject to New Zealand tax on foreign sourced income derived through that company. Accordingly, the Group would also like to see the same policy issue addressed by officials in that scenario.

8) For the Government's New Zealand domicile initiative to be successful the Group considers that the tax changes must result in a system that, when marketed overseas, is easily understood by offshore fund managers and institutional investors and has a broad application. To this end the tax regime will need to accommodate internationally recognised fund vehicles (i.e. limited partnerships and unit trusts), including listed vehicles, and will need to work in conjunction with the relevant securities laws (as amended to give effect to the initiative).

9) Finally, the Group notes the recent Australian announcements in this area. On 11 May the Australian Government announced that it will be pursuing the recommendations from the Australian Financial Centre Forum Report (also known as the Johnson Report) to:

   a. develop an Investment Management Regime to ensure that non-residents investing in foreign assets will not be subject to Australian tax where using Australian fund managers (see the Consultation Paper Developing on Investment Manager Regime: Improving conduit income arrangements for managed funds);

   b. ask the Board of Taxation to review the tax treatment of collective investment vehicles, including whether a broader range of tax flow-through vehicles should be permitted.

10) The Group is concerned to ensure that New Zealand's reforms keep pace with, and are consistent with, those being developed in Australia. This is particularly important given the size of Australia's funds management industry, and the potential for Australian managed funds to consider using New Zealand as a place of domicile in future, in order to reduce administration costs. New Zealand should ensure that there are no disincentives from a tax perspective for an Australian managed fund to be domiciled in New Zealand.

Extract C – Submission on NRWT on foreign-sourced income

[Submission to the Capital Markets Development Taskforce, dated 3 November 2009]

Non-resident withholding tax rates

The Group notes and agrees with the Taskforce's support for the continued updating of New Zealand's Double Tax Agreements ("DTAs"). It is important to progress 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, this is positive for New Zealand's capital markets.

Extract D – Submission on NRWT and Approved Issuer Levy

[Submission to officials on the issues paper, "AIL, NRWT and the Bond Market", dated 9 December 2009]

The Group is generally supportive of the direction of the reforms outlined in the issues paper as an initial step. We agree with the comments in paragraph 2.6 of the issues paper.

The Group believes that AIL/NRWT is a factor that is not helpful in furthering the development of the corporate bond market as clearly the imposition of AIL/NRWT adds costs to corporates seeking debt funding. The Group is supportive of achieving the objective of developing the corporate bond market and considers that applying a zero rate of AIL would reduce costs and therefore allow more New Zealand corporates to issue bonds.

That said the Group believes that the proposed reforms are too narrow and should be expanded beyond the further development of New Zealand's corporate bond market.

The Group believes the review of this area should also look to improve the ability of New Zealand corporates to access international debt funding, especially in situations where such funding cannot be obtained from New Zealand financial institutions. This is a key issue which has positive ramifications for the wider economy as it should reduce the number of projects that cannot be progressed due to the inability for appropriate finance to be raised.

As such, the Group's primary concern is with the breadth of the proposed changes. Noting the concerns in the paper raised by officials about tax base protection and taking account of our above comments, we believe the starting point for reform in this area should be to consider the following:

1) To assist in the growth of the corporate bond market (as per the issues paper).

2) To recognise that the tax base will need to be protected. While we do not agree with the extent of fiscal risk to reforming AIL (as noted in our detailed comments), we accept that officials are concerned with this given the current financial position of the Government. We believe further reform can be undertaken while still providing tax base protection.

3) To reduce the costs on corporates that are forced to access debt capital outside of New Zealand from non-associated parties. As noted above, this is a key issue for the Group. While ideally the reforms should extend the zero rate of AIL to all offshore lending, we appreciate this may be "a bridge too far" given officials fiscal concerns. As such, we propose that the AIL reforms should at a minimum at least extend to debt obtained from banking syndicates and private placements, but do not propose an extension beyond this.

4) To at least match the regime in Australia, noting that the current proposals in the issues paper do not achieve this.

As set out in (3) above, the Group believes it is important that the proposals be expanded to include debt obtained through banking syndicates and private placements. Specifically in situations where there is no ability to obtain equivalent debt funding from New Zealand based financial institutions. In Appendix One we outline the Group's comments regarding the proposals outlined in the issues paper, particularly the proposed widely held test and safeguards which the Group believes are too restrictive

Extract E – Submission on streaming of imputation credits and integration of tax bases

[Submission to the Capital Markets Development Taskforce, dated 3 November 2009]

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.

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 able to be achieved 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.