Budget 09

Deloitte Budget commentary – 28 May 2009

Signpost for the future

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CEO view

From Santa to Scrooge?

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Bill English must have felt he had drawn the short straw as he prepared to deliver his first budget. Having watched his predecessor preside over continually climbing surpluses and distribute largess like Santa Claus he seems positively scrooge-like by comparison.

The backdrop for the Budget is the recession spawned by the global financial crisis and the hole that is leaving in the Government's accounts. Not only is tax revenue slumping but investment losses are also contributing. So far the Government's response has been relatively orthodox. It acknowledged the stimulus already in the pipeline (Labour's tax cuts and expenditure), added some more tax cuts and some accelerated infrastructure spend, and moved to support those least able to manage as unemployment rises. It has avoided the massive packages offered by other governments, where there is mounting concern as to their effectiveness. One possible rationale for this is that as an exporting nation we will benefit from the stimulus others provide without needing much of our own. If this is so we will indeed be lucky.

Much is being made of the rising debt levels and potential for rating downgrades. While these are obvious concerns so too are the forecasts on which they are made – after all the continued large surpluses of the past decade were also not forecast.

This is not to say that the rising debt problem should be ignored – just that the measures required may not need to be so extreme. A combination of deferring tax cuts, eliminating the increased expenditure planned by Labour and possibly suspending contributions to the Cullen Fund for a few years may be enough. That then leaves plenty of room for adjustment of spending priorities to implement Government initiatives and avoiding a re-run of the "mother of all budgets" of 1991.

What is important for business is that the Budget focuses on the longer term issue of raising New Zealand's productivity as a means to raising incomes and wealth for all. In this context what the Budget has to say about regulation (less of it and higher quality), the long term tax path, education (back to content like the Australians?), science, infrastructure and innovation is important. Also important will be what is signalled for the future of health expenditure as this is clearly not currently on a long term sustainable path.

Sadly...critical for productivity and the rising debt problem is control over expenditure. Tax freedom day this year (measured by central and local government expenditure) is forecast to be June 13, worse than the OECD average and Australia's May 9. That is New Zealanders spend nearly half the year working just to pay for the expenditure of central and local government. This underscores the extent to which expenditure increases have become embedded over the past decade.

From Santa to Scrooge?

This budget sees an end to the large spending increases which were a hallmark of the previous Government. While the budget still provides an increase in overall spending, expenditure is not increasing by as much as in previous years. This is as to be expected in the current economic climate, and underlines the Government's commitment to taking control over the country's debt track. Further, line-by-line Departmental reviews have freed up $2 billion over the next four years for Government priorities. Progress undoubtedly, but there will be questions as to whether it goes far enough. Are there risks that harder decisions await us in 2010?

Overall the budget is "steady as she goes". Small foundations are laid for dealing with productivity but little hint is given around tackling thornier issues like privatisation, the welfare to work tax wedge, and health costs. Roll on 2010.

The backdrop for the Budget is the recession spawned by the global financial crisis and the hole that is leaving in the Government's accounts. Not only is tax revenue slumping but investment losses are also contributing. So far the Government's response has been relatively orthodox.

Infrastructure

A dearth of rabbits

It was always going to be difficult to pull a rabbit out of the infrastructure hat on Budget Day. The tight fiscal position means that rabbits are in short supply, and a lot of the Government's infrastructure plans have been announced or have already played out.

The seven "roads of national significance" have been around since Transport Minister Steven Joyce identified them back on 19 March, and the Waterview connection route has been announced. The electricity sector has been pressing on with investment in transmission capacity and we have fairly buoyant investment in oil and gas exploration.

All in all, there was not much to say that has not already been said, except the answer to the crucial question: "How is it all going to be paid for?" In this regard, Budget 2009 is something of a missed opportunity.

The key infrastructure announcement in the Budget was an increase in the capital spending allowance from $900 million to $1.45 billion, which includes the following funding:

- $245 million for new capital spending in Health
- $290 million for the first tranche of the Government's broadband plan
- $523 million to build new schools and upgrade existing ones
- $124.5 million for state houses, as already announced in February
- An extra $1 billion over three years for the state highway network, as announced in February

There is no time to reform like the middle of a crisis, and who knows if we wait long enough one might happen along. Government has enormous amounts of capital tied up in assets many of which it considers to be underperforming in commercial terms. Today's Budget was an opportunity to have a good long hard look at this portfolio and identify smart ways to free up some of that capital in order to pay for infrastructure improvements that have been announced, but which are not funded.

Partial sell-downs of State-owned enterprises would invigorate our capital markets, as well as provide ordinary New Zealanders with investment options other than domestic property. They could also be achieved without necessarily losing public control of the business. This would introduce greater accountability to shareholders for performance of the companies and make the results of investment decisions more transparent through an observable share price.

The SOE model was only ever really intended as a halfway house, rather than an end in itself, and having spent over a decade stuck halfway it is about time we completed the journey or at least moved things along.

A dearth of rabbits

Government has made some real progress in establishing a capability for infrastructure delivery with a new unit within Treasury. Although the mandate of this group is still evolving, the Budget could have been used to provide some signposts for where it was heading particularly with regard to how the private sector will contribute.

Public private partnerships (PPPs) have been experiencing some difficulties in developed markets where financing has dried up. This presents Governments with some problems in trying to progress their capital programmes for social and economic infrastructure. Overseas, governments have been swift to respond to this issue. The UK established effectively a financing operation to ensure that its key projects proceed.

The New Zealand Budget presented an opportunity to put some structure around how partnerships with the private sector would be structured. It also provided an opportunity for the Government to participate in these projects on sensible commercial terms, whilst setting the agenda for what it wants to get done. Some substantive steps toward establishing the "bond bank", which has so far only been talked about, or direction as to how the New Zealand superfund could participate in infrastructure would also have been useful steps in this direction.

As a country New Zealand is very late in coming to the PPP market, the size of our deals will be small by global standards, and our future pipeline relatively modest. Against this background, we need to do all we can to make ourselves more attractive than other competing investment destinations. There is much that could have been done in the Budget to achieve this with the issue still largely left outstanding.

7 Roads of National Significance
Puhoi to Wellsford - SH1
Completion of the Auckland Western Ring Route - SH20/16/18
Auckland Victoria Park bottleneck - SH1
Waikato Expressway - SH1
Tauranga Eastern Corridor - SH2
Wellington Northern Corridor (Levin to Wellington) - SH1
Christchurch motorway projects

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So what do we do now…

The cupboard is bare

What do you do when you stare into a fiscal abyss that was not of your making, while also having to deal with the insatiable appetite for Government revenue?

In Bill English's case it was stay calm and do nothing precipitous, including signalling any increase in taxes.

It was an unenviable predicament and small comfort that his international peers may be facing something that has morphed into a black hole.

While he will be pre-programmed to simply say "No", the defining moments will likely be when and to what extent he will say "Yes", with the current budget giving few clues in this regard.

Budget 2009 subliminally highlighted that there is no silver tax bullet, quick tax fix, or easy tax solution.

In fact, somewhat surprisingly, other than highlighting the indefinite deferral of the personal tax cuts, any comment on tax was largely limited to statements regarding Fiscal Risks.

In those statements there was no signalling at all that structural change to the existing tax rules was imminent, quite the opposite. The reference to Tax Working Group referred to facilitating the consideration of the direction of the tax system in the medium term, a term that the Minister did not want to define.

Consistent with this, there was no signalling that New Zealand's tax predicament is unique in the sense that it is more exposed than most to globalisation and the issues associated with the mobility of capital and labour; as we have a globally inquisitive population and a neighbour that has material gravitational pull when it comes to head office activity, including regional head office activity.

In terms of tax, there are a multitude of balls in the air...

Ultimately however, structural change of the tax system will be considered as part of the Tax Working Group process and depending on what that structural change actually comprises, there could be material changes to today's forecasts. Potentially, this could make Budget 2010 the budget to watch but again the Government is giving no clues in this regard.

In terms of some of the current tax challenges that remain unanswered:

1. There is just not enough revenue currently being collected
2. Tax rate alignment, which is an evasive nirvana, is not a total solution
3. Capital and labour has never been as mobile
4. A change in the tax mix (what's taxed and by how much) has to be a realistic possibility
5. Too few individuals pay too much of the current tax take

The cupboard is bare

6. Effective tax rates exacerbate the problem
7. "Broad base low rate" begs the question as to a capital gains tax
8. Australia is the dog that could wag the New Zealand tail
9. Structural change needs to be achieved politically

And in terms of the destination of any such tax reform, it can't just be about taxing what is here. It should be about attracting, retaining, and then taxing, the following types of economic activity in New Zealand:

• New Zealand owned businesses that operate domestically and or globally
• Foreign owned businesses that operate domestically and or globally through New Zealand
• High wealth individuals particularly those that have global investments / businesses

Attracting and retaining this activity is important because it is only this activity that creates and retains highly paid jobs that fuels the tax take. This is no better illustrated than through the stark contrast between the Australian and New Zealand average full-time wage, currently approximately A$61,000 playing NZ$51,000.

And whether the correct policy settings will ultimately be implemented will be materially influenced by whether officials can connect the dots to present an implementable tax strategy consistent these goals.

Time will tell, but it has taken us 20 years to introduce an active income exemption for international investments.

The ultimate tax answer could include some recognition of the mobile and immobile tax bases (by treating them differently) regardless of the anathema such differentiation may present to some.

And to the extent that we witness any structural tax changes, by definition, they will impact the masses. The rights or wrongs of which will be lost as everyone immediately reverts to the short term impact on themselves such that their true characterisation may only be properly recognised well after the architects are gone.

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The long-term view

Next steps: a reform of the tax system?

Budget 2009 was the anticipated fizzer in terms of current tax initiatives, and not simply because we had a confirmation of the deferral in the personal tax rate changes.

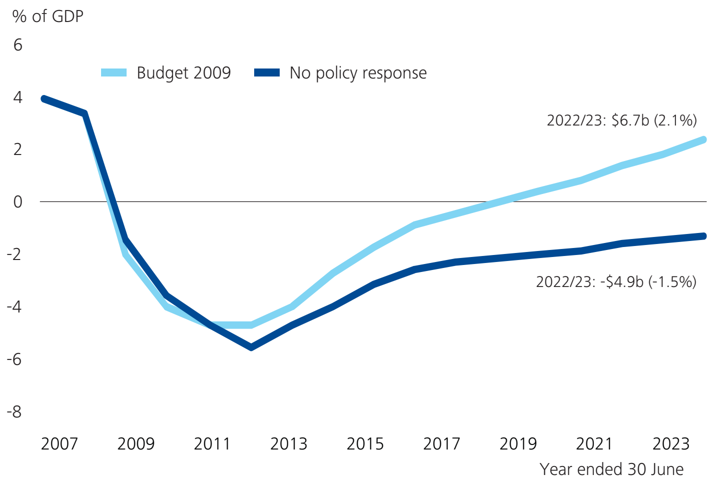
Structural changes to the tax system were not on this year's agenda with the Budget principally designed to keep New Zealand's credit rating from being downgraded... good.

But as continuing with the status quo isn't really an option, the lack of any material signalling in relation to the future from Budget 2009 was a surprise. Budget 2010 may be more inspiring but the Minister gave no clues in that regard.

In terms of why the status quo isn't an option and the balls that are in the air:

It's just not enough as Budget 2009 announced a deficit of $7.7 billion for 2009 and anticipated future deficits for the next 10 years.

Operating balance before gains and losses
2009/10: -$7.6b (-4.3% of GDP)



Source: Budget 2009 Key Facts for Taxpayers

The trend line is disturbing albeit that only time will ultimately tell what the actual magnitude and length of the deficits will be.

The Government's reaction will be twofold, to manage expenditure down and revenue up.

In terms of managing tax revenue up, structural changes to the current tax system will need to be considered having regard to the following:

Next steps: a reform of the tax system?

The flat tax nirvana is likely to be an elusive goal. The fiscal implications of levelling the tax rate across trusts, individuals (on the highest marginal tax rate) and companies will be prohibitive.

Also problematic is that international comparability will continue to put downward pressure on the Company tax rate, more so than the other rates.
Nonetheless this goal rightly continues, albeit it is unlikely to be able to be implemented in the near term, and possibly only with exceptions.

Mobility of capital and labour impacts New Zealand disproportionately more than other jurisdictions.

The New Zealand labour market is unusually internationalised by OECD standards, and faces increasing competition from Australia. And in terms of Australia, the risk is exacerbated by its capital base and the centralisation to Australia of more and more corporate activity that was traditionally undertaken in New Zealand.

An implication of this is that our tax system will likely have to recognise the mobile and immobile tax bases and treat them differently, as a "one-size fits all" approach is not affordable.

A change in tax mix has to be on the cards.

This doesn't necessarily mean introducing new taxes, but rather raising a greater proportion of taxes through indirect taxes, like GST, rather than direct taxes, like income tax.

At a philosophical level there are a number of advantages to moving to a greater reliance on indirect taxation (which is focussed on consumption in New Zealand), particularly around the efficiency of the tax system, removing investment disincentives and reducing some of the challenges to attracting and retaining mobile capital and labour.

A real world constraint however is that any increase in the level of indirect taxes operates regressively so as to negatively impact taxpayers at the lower end of the earning spectrum proportionately greater than those at the other end of the spectrum.

At the time GST was introduced in 1986 New Zealand was in a unique situation of being able to trade off material reductions in personal income tax rates to compensate for the broadening of the tax base that was GST. Specifically:

Tax thresholds and rates **before** introduction of GST		Tax threshold/rates **6 months after** introduction of GST		Tax thresholds/rates **2.5 years after** introduction of GST	
0 – 6,000	20.0%	0 – 9,500	15%	0 – 30,875	24%
6,001 – 25,000	33.0%	9,501 – 30,000	30%	> 30,876	33%
25,001 – 30,000	45.1%	>30,000	48%		
30,001 – 38,000	56.1%				
>38,000	66.0%				

Next steps: a reform of the tax system?

Our tax system will likely have to recognise the mobile and immobile tax bases and treat them differently

This is in stark contrast to what the current Government has to work with in terms of the current statutory rates, let alone effective marginal tax rates:

Current tax thresholds income range	
0 – 14,000	12.5%
14,001 – 48,000	21%
48,001 – 70,000	33%
70,001+	38%

The current situation is also made worse by New Zealand's :
- reliance on the personal tax take (see Table 1);
- shrinking tax take (see Table 2); and the
- disproportionately small number of taxpayers that pay the majority of that personal tax take (see Table 3).

Table 1

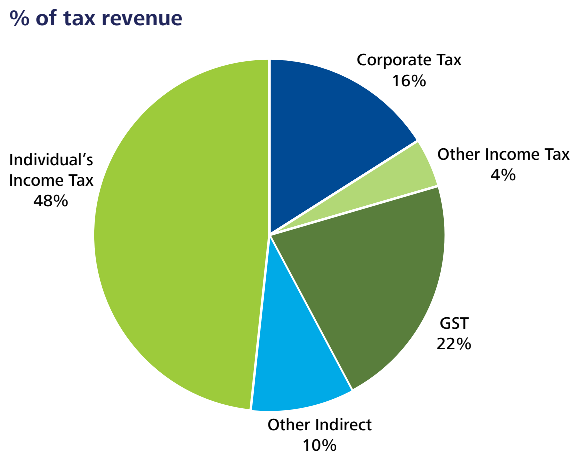
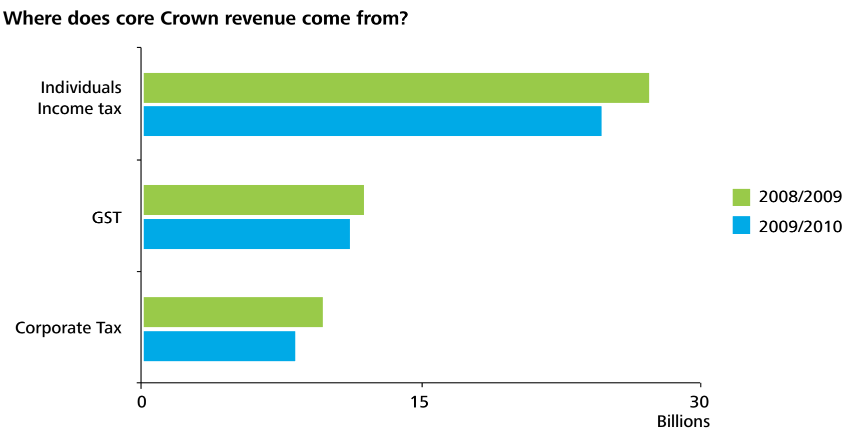


Table 2



Next steps: a reform of the tax system?

Too few pay too much, it's not sustainable and is a high risk model.

Currently a disproportionately small number of taxpayers pay a disproportionately large amount of personal tax.

The implication is that a disproportionately large number of taxpayers are unlikely to benefit in any material way from personal tax reductions as their personal tax burden isn't that great, particularly when the Working for Families tax credits are factored.

To conceptualise the problem, consider the aggregate percentage of personal tax paid by taxpayers earning over $60,000, being the highest marginal tax rate threshold up until October 2008:

Individual taxable income	Who pays tax… and how much?							
(NZ$)	2006		2007		2008		2009	
	People	Tax	People	Tax	People	Tax	People	Tax
Zero	6%	0%	7%	0%	7%	0%	7%	0%
1-10,000	16%	1%	14%	1%	14%	1%	14%	1%
10-20,000	32%	11%	26%	8%	26%	8%	25%	7%
20-30,000	11%	7%	12%	7%	11%	6%	12%	7%
30-40,000	10%	9%	11%	9%	10%	8%	11%	10%
40-50,000	8%	11%	10%	12%	10%	11%	10%	11%
50-60,000	5%	9%	6%	10%	7%	11%	7%	11%
60-70,000	4%	8%	9%	9%	4%	9%	5%	11%
70-100,000	5%	16%	6%	17%	6%	17%	6%	16%
100,000+	3%	27%	3%	27%	5%	29%	3%	26%
Above $60,000	**12%**	**51%**	**18%**	**53%**	**15%**	**55%**	**14%**	**53%**

In 2006 12% of individual taxpayers paid 51% of the Government's personal income tax revenue. This has remained relatively stable over the last few years, such that in 2009 14% of individual taxpayers paid 53% of the government's personal tax revenue, noting again that personal income tax comprises $24.9 billon or 48.3% of all tax revenues.

Compounding the problem is that the small amount of the population that pays a disproportionate amount of personal income tax is likely to also be, anecdotally, most likely to be mobile, as are their jobs.

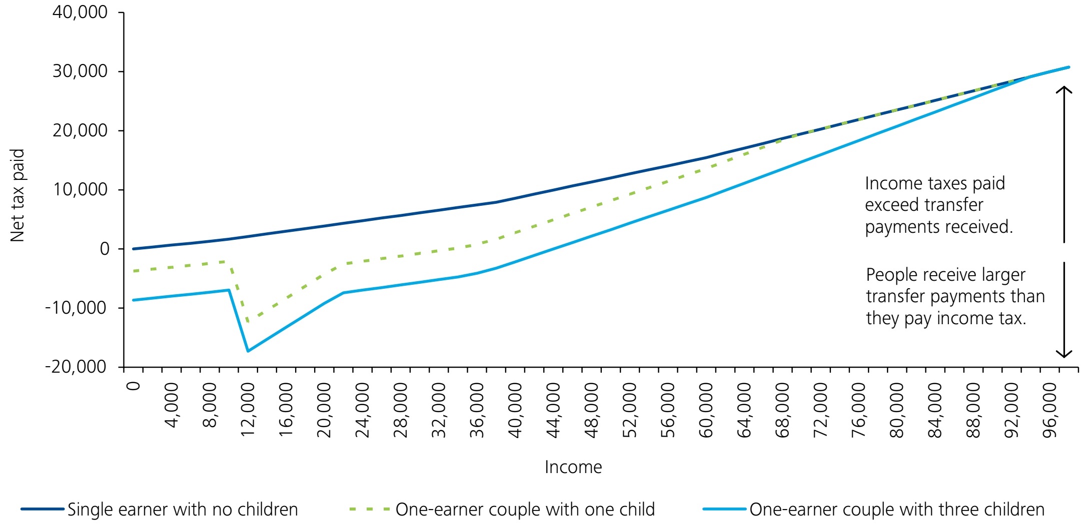
Effective marginal tax rates make everything a lot worse.

One of the reasons that there is a disproportionately small number of taxpayers paying a disproportionately large amount of personal tax is that many taxpayers have been able to benefit from the Working for Families (WFF) tax relief which, when combined with other social delivery mechanisms that abate through the tax system, result in material marginal tax rates that actively discourage taxpayers from looking to improve their current position.

Next steps: a reform of the tax system?

In terms of the level of tax paid, subject to the number of children, average families may commonly be in a net "no tax" position and are rather in a net position of receiving more family assistance than tax paid.

Net tax paid (year ended March 2007, non-beneficiaries, in dollars)

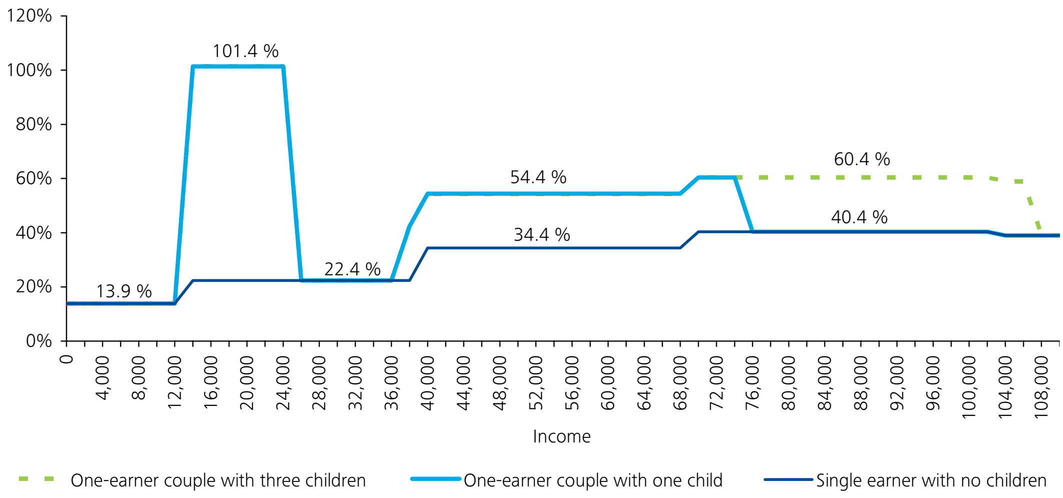


Source: Briefing for the Income Minister of Revenue – 2008 by Inland Revenue Department, page 29

The effective marginal tax rates, taking account of statutory tax rates, ACC and the abatement of WFF tax credits can particularly discourage low income earners from earning additional income as the effective tax rate is 100% (101.4% when ACC is added).

For many other earners the 20% WFF abatement rate puts the effective marginal tax rate at 20% above the ordinary statutory rate.

Effective marginal tax rates
(year ending March 2010, non-beneficiaries, in percent)



Source: Briefing for the Income Minister of Revenue – 2008 by Inland Revenue Department, page 32

Next steps: a reform of the tax system?

Officials see an intoxicatingly large gap in the tax system by New Zealand not having an explicit capital gains tax regime

Only recently has this issue achieved prominence. It is one of the major barriers to any structural tax reform.

Broad base low rate is still right but only a generalisation.

The cliché "broad base low rate" has been the accepted generalisation of how to achieve an efficient tax system since the mid 1980s and its merits are as sound now as they were then.

It is easy on first reflection to focus on the later part of the phrase which is most palatable, being "low rate", however in the coming months and years the Government will be searching for further revenue to keep its fiscal position stable. In such an environment it will be hard to ignore the "broad base" question with the inevitable next question being more widely taxing capital gains.

It is no secret that some officials have relentlessly sought to introduce capital gains taxes by stealth whenever possible. Examples include:

- The extension to the associated party definition that applies to tax certain land transactions,
- The introduction of the accrual rules that tax all economic gains whether on capital or revenue account on financial arrangements, and
- The Foreign Investment Fund (FIF) rules including the modifications applicable in the 2008 income year to introduce the Fair Dividend Rate (FDR) rules that similarly look to generally tax economic gains and losses in relation to overseas portfolio shareholdings.

Officials see an intoxicatingly large gap in the tax system by New Zealand not having an explicit capital gains tax regime. This gap is stated as fuelling the property boom which discouraged capital from being invested in more productive ways. Interestingly, the global property boom phenomenon was not limited to jurisdictions that did not have a capital gains tax.

Australia looms large and ominous.

It will materially influence what we do. New Zealand is the tail that will not wag the Australian dog. We are inexorably attached to that dog and will follow in its footsteps.

Only as an example, we await with interest the outcomes of the "Australia's Future Tax System" review, which looks to challenge the Australian tax status quo. Imputation is a classic example; if Australia looks to repeal its imputation regime as part of structurally changing its tax environment, New Zealand may be hard placed not to follow given the only other international precedent is Sri Lanka.

Politics will materially influence what we do irrespective of the economic rationale.

Structural tax changes by definition will impact the masses. The rights or wrongs of any proposed change will be lost on the masses that will immediately revert to its

Next steps: a reform of the tax system?

impact on their back pocket. Whether the right economic decisions can be separated from the right political decisions is yet to be seen.

A lost opportunity by the previous Government is how tax cuts should be seen.

Life is about choices. In the present case those historic choices have resulted in the current Government inheriting a tax structure that will be difficult to change and that was not of its own making.

Destination of tax reform:

It's not just about taxing what's already there. It should be about attracting, retaining, and then taxing, the following types of economic activities in New Zealand.

- New Zealand owned businesses that operate domestically and or globally
- Foreign owned businesses that operate domestically and or globally through New Zealand
- High wealth individuals particularly those that have global investments / businesses

The obvious goal is raising revenue. But the Government's objective should be to have a tax system that at a minimum does not discourage economic activity or better still encourages economic activity in New Zealand.

Of particular importance is economic activity which engages a highly skilled workforce (as is evidenced by the proportion of tax raised from that group), as this has a multiplier effect in terms of other activity that it generates.

Forgetting for a moment the more difficult concept of attracting mobile capital and labour that currently resides elsewhere, a good example of how to do this is to ensure that the tax system facilitates the retention of head office activity within New Zealand (as New Zealand corporates grow) when inevitably they need to introduce new direct or portfolio investors from outside of New Zealand.

In terms of **foreign direct investors** the tax system should allow for them to cohabitate with local portfolio or direct investors. This is not currently the case. The tax system currently actively encourages foreign direct investors to acquire the entirety of New Zealand businesses. The implication of this is that the New Zealand tax take ordinarily falls given the level of new debt that can be introduced by the foreign direct investor.

A further downside is the further dilution of New Zealand's capital markets.

In terms of **foreign portfolio investors**, particularly in the context of New Zealand businesses that have international operations, the current imputation rules act as a real impediment to those businesses staying in New Zealand.

Fortunately in relation to this, the issue has been accepted by Ministers as having some merit and is to be considered as part of the continuing review of our imputation and international tax regimes.

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Business taxation

Nothing new here

It's good news for business from a compliance cost perspective because Budget 2009 delivered no new initiatives to help (or hinder) business from a tax perspective.

That said, the fine print buried deep within the Budget documents provide an insight into some of the upcoming tax initiatives based on perceived fiscal risks (positive and negative). None of these should come as a surprise given the tax policy work programme was released earlier this year; however Budget 2009 highlighted the following areas:

- Alignment of the tax rates for Portfolio Investment Entities with personal tax rates.
- Alignment of Resident Withholding Tax rates with personal tax rates.
- Matters arising from the new Tax Working Group which is considering the medium-term direction of the tax system.
- More amendments around the tax rules for charitable giving, including the tax treatment of non-monetary gifts.
- Legislative options around GST on property transactions.
- Continued consideration of a range of compliance cost saving measures outlined in a discussion document from 2007.
- Other potential tax policy changes to various policies including:
  - o Use of money interest
  - o Provisional tax
  - o Deductions for certain capital expenditure
  - o Treatment of cross-border leases
  - o Treatment of hybrid financial arrangements

The devil's in the detail and the last two areas in particular will be interesting…

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Personal tax rates

Lies, damn lies, statistics and now personal tax rate comparisons

Such is the predictability of New Zealand budgets in the 21st century that it came as absolutely no surprise that National has backtracked on the tax cuts it electioneered on and legislated for shortly after entering office in December 2008.

As had been signalled, rather than cancel the tax cuts these have merely been deferred. The decision for a deferral rather than a cancellation should have been an easy one. Legislation to defer the tax cuts was tabled in the House today.

What was proposed?

The first phase of what was to be an ongoing series of tax cuts came into play on 1 April this year. The next two phases were to be come in on 1 April 2010 and 1 April 2011, as set out below.

New Zealand					
Current tax thresholds income range		New tax thresholds from **1 April 2010**		New tax thresholds from **1 April 2011**	
0 – 14,000	12.5%	0 – 14,000	12.5%	0 – 14,000	12.5%
14,001 – 48,000	21%	14,000 – 50,000	21%	14,000 – 50,000	20%
48,001 – 70,000	33%	50,001 – 70,000	33%	50,001 – 70,000	33%
70,001+	38%	70,000 +	37%	70,000 +	37%

What will happen instead?

The second and third tranches of tax cuts, which were due to take effect on 1 April 2010 and 1 April 2011 respectively have been deferred, however there is no indication of when they have been deferred to. The Government has only signalled that the affordability of future tax cuts will be considered as part of future budget processes.. It is worth highlighting that this deferral includes a deferral of the $5 increase in the independent earner rebate, which would originally have applied from 1 April 2010.

The domestic implication of the announcement is that potentially taxpayers will not see further tax relief for a number of years. While the Government has re-emphasised its commitment to lowering the top personal rate to 30% in the medium term, the timing of further cuts is inextricably linked to how fast and strong New Zealand emerges from the recession. In the context of what is happening around us, this doesn't seem that bad noting that the counterfactual under a different government could easily have been material tax increases.

Lies, damn lies, statistics and now personal tax rate comparisons

From an international perspective however, "competition" for labour with Australia continues, with Australia continuing the win the race in terms of tax albeit to some extent it is smoke and mirrors.

The Australian budget on 12 May included a continued commitment to the previously announced personal tax cuts and the original application dates. The rates may make Australia look like a highly taxed nation, but when you look beyond the maximum rate and consider the thresholds where different tax rates cut in, for the majority of New Zealanders the position is quite different.

Australia					
Current tax thresholds income range (AUD)		New tax thresholds from **1 July 2009** income range (AUD)		New tax thresholds from **1 July 2010** income range (AUD)	
0 – 6000	0%	0 – 6000	0%	0 – 6000	0%
6,001 – 34,000	15%	6,001 – 35,000	15%	6,001 – 37,000	15%
34,001 – 80,000	30%	35,001 – 80,000	30%	37,001 – 80,000	30%
80,001 – 180,000	40%	80,000 – 180,000	38%	80,001 – 180,000	37%
180,001+	45%	180,001+	45%	180,001 +	45%

If you wanted to sensationalise this, from 1 July 2009 an individual taxpayer would have to earn over $210,000 before they paid more tax in Australia than in New Zealand (not taking account of rebates, additional taxes and levies and making several simplistic assumptions).

But the tax wedge, being the difference between tax paid in Australia and New Zealand isn't generally the chasm that perceptions could lead you to believe. Focusing just of the statutory rates, ignoring foreign exchange differences, in English, generally it's between one and just over two thousand dollars each year, albeit it as the table below illustrates, the deferral of tax cuts in New Zealand increases the tax wedge to over $3000 for higher income earners.

Income	New Zealand Tax Current	Australia Tax From 1 July 2009	Australia Tax From 1 July 2010	Tax Wedge From 1 July 2009	Tax Wedge From 1 July 2010
20,000	3,010	2,100	2,100	910	910
40,000	7,210	5,850	5,550	1,360	1,660
60,000	12,849	11,850	11,550	999	1,300
80,000	19,948	17,850	17,550	2,098	2,399
100,000	27,549	25,449	24,949	2,100	2,600
140,000	42,749	40,649	39,749	2,100	2,800
180,000	57,949	55,849	54,549	2,100	3,400
200,000	65,549	64,849	63,549	700	600
240,000	80,749	82,849	81,549	(2,100)	(800)

Lies, damn lies, statistics and now personal tax rate comparisons

The real difference with Australia is the real wages upon which these rates are applied, and the opportunities to continue to grow that wage.

The key statistic, that is most concerning, is that on the latest Australian data available, an adult working full time would earns on average approximately A$61,000. The most recent New Zealand data available (June 2008) puts our average wage, significantly lower, at approximately NZ$51,000. These figures are based on average weekly earnings for full-time wage and salary earners:

Year	Average salary and wage (full time employees)		Wage Gap	
	New Zealand ($NZ)	Australia ($AU)	($)	(%)
2009	Not available	61,000		
2008	51,532	58,411	6,879	13.35%
2007	49,764	55,660	5,896	11.85%
2005	44,668	51,542	6,874	15.39%
2003	40,924	46,789	5,865	14.33%
2001	38,480	42,104	3,624	9.42%
1999	36,504	38,740	2,236	6.13%

There are clearly industry and geographic variances to these averages but the fact remains that even ignoring exchange rates, we are talking about a reasonable difference in the average wage.

If New Zealand wants to catch Australia it will need to step up to the mark in terms of competing for capital and talent, and more importantly, retain and if possible attract highly paid jobs to New Zealand. This will not be straightforward as highly paid jobs often follow head and regional office activity, which gravitationally is drawn to Australia in this part of the world.

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The recent Australian approach

Whatever it takes

It is inevitable that comparisons need to be drawn between how New Zealand is shaping up compared with our nearest neighbour. Australia continues to show that it will do what it takes to stimulate its economy and actively compete for the mobile dollar.

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	New Zealand	Australia
Prior stimulus	The Government indicated that it would undertake a "rolling maul" of stimulus initiatives which would include personal tax rate reductions and infrastructure spending. In February it also announced and enacted tax measures to help small businesses with cash flow.	The Government announced a number of stimulus packages, including the $10.4 billion economic security strategy in October 2008 and a $42 billion national building and jobs plan in February 2009 which included one-off bonus payments to eligible individuals.
R&D	The Government has repealed its R&D tax credit regime, which offered a 15% tax credit for eligible expenditure, with effect from the 2010 income year. The regime was only in place for one year. This has been replaced by ad hoc funding for a limited number grants and prizes and a $40 million increase in funding for Crown Research Institutes.	The Government has bolstered its R&D regime, changing from a tax deduction system to a tax credit regime, to mirror the regime NZ has just repealed. The net tax credit benefit to companies with a turnover of less than $20m will be 15c for every dollar of eligible expenditure, effectively doubling the benefit of the current R&D concession For businesses with a turnover of more than $20m, the benefit will be 10c for every dollar of eligible expenditure.
Personal tax rates	The Government has deferred previously legislated tax rate reductions that would have applied in 2010 and 2011. The signal is that these reductions will still occur, but its not possible at this stage to put a time frame on this,	The Government has left unchanged the previously legislated tax rate reductions for 2009 and 2010.

Whatever it takes

	New Zealand	Australia
Infrastructure incentives	The Government has boosted its own funding in certain areas of infrastructure spending. However, to date there have been no initiatives which signal an intention of the Government to incentivise private sector infrastructure investment.	The Government has previously announced a 30% tax break on assets purchased by businesses with a turnover of less than $2 million. The Budget increased this from 30% to 50% for these taxpayers and maintained a 30% incentive for other businesses. As this is aimed as a current stimulus it requires commitment to the purchases within the next 6 months and installation or use within the next 12-18 months.
Capital gains tax	New Zealand remains without a full blown capital gains tax; however the fall off in revenues may lead the Government to investigate this option but Budget 2009 gave no clear signal of a movement down this path.	Australia has a comprehensive capital gains tax regime which remains unchanged by the Budget. However in recent years Australia has amended its rules to make them more favourable for non residents investing into Australia.
Superannuation	Only one change to KiwiSaver was announced in the Budget, being the repeal of the little used Mortgage Diversion scheme. KiwiSaver remains a voluntary scheme under which employers, employees and the government make contributions.	Superannuation in Australia is compulsory. This has led to the creation of massive superannuation schemes which are able to buy assets for the benefit of members, including New Zealand assets. There are a myriad of concessions available to scheme members. These are under ongoing review.
Review of tax system	A Tax Policy Working Group has been set up to review the structure of the New Zealand tax system.	In 2008 a wholesale review of Australia's tax system was commenced, named "Australia's Future Tax System", which is led by the Secretary of the Australian Treasury.
International tax	New Zealand is in the process of introducing a new tax regime for Controlled Foreign Companies. Despite best intentions, the practicalities of the proposed regime are such that there may still be material compliance costs when investing offshore.	Australia announced in its Budget that it will simplify its international tax rules, narrowing the range of foreign income subject to attribution and repealing its FIF provisions.

A Tax Policy Working Group has been set up to review the structure of the NZ tax system

Research and Development

Has Australia stolen our Kiwi ingenuity?

Moves in Australia to use the tax base to substantially increase incentives for R&D carried out by businesses contrast sharply with the New Zealand approach.

The National Government honoured its electioneering promise to axe the New Zealand R&D tax credit regime while it was still in its infancy – leaving business with a one time opportunity to be rewarded for R&D without going through a time consuming grant application process.

In discontinuing the R&D tax credit, the Government has chosen to fund additional R&D directly. The $315 million of savings from dropping the tax credit was earmarked at the time for increased research funding in Crown Research Institutes, universities and private research institutions.

Budget 2009 has delivered the following:

- An extra $40 million over four years for Crown Research Institutes
- Providing $36 million over four years to the "Marsden Fund"
- $32 million over four years for health specific research
- A new prize pool of $4 million for the Prime Minister to allocate in Science Prizes
- Establishment of a new Primary Growth Partnership which is expected to be operating in 2012/13 with Government investment of $70 million annually for primary sector innovation

Kiwi ingenuity has been stated as one of the three New Zealand assets for facing future challenges, but it seems funding for this isn't a priority. Our trans-Tasman neighbours have taken a clear lead here.

Australia's 2009 Budget includes Federal Government plans to boost investment in science and innovation by 25%. The increase takes the Government support for science and innovation from A$6.9 billion in 2008/09 to A$8.6 billion in 2009/10. Part of Australia's plan is changing its R&D tax concession into a tax credit regime.

It's ironic that just as New Zealand has abandoned its R&D credit, Australia has moved to adopt the best of our regime.

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Snippets

Budget at a glance

We summarise below what else was in the Budget that may be of interest to business.

- Negative
- Neutral
- Positive

Tax Announcements		
Personal Rates		As anticipated the Government has delayed the next two phases of personal income tax cuts. The cuts, which were originally scheduled to take effect from 1 April 2010 and 1 April 2011, will be assessed for affordability as part of future budget processes. Legislation for this change was introduced into the House today.
KiwiSaver		From an employer's perspective, one of the most significant aspects of the Budget was the lack of any major announcement regarding KiwiSaver. KiwiSaver has been amended on a number of occasions, including by the Government in December 2008. The only amendment announced by this budget is the closure of the mortgage diversion facility to new applicants from 1 June 2009, the legislation for this was tabled in the House today. Only 600 people have taken up the facility, and the Government has decided it is unnecessary compliance cost. The lack of further major change is positive, and will give the scheme time to settle as employers, employees and the Government adjust to how it is working.
R&D		The National Party announced during last years election campaign that if elected it would repeal the R&D tax credit regime and it followed through with that promise almost as soon as it took office. While the Budget does not contain any further R&D incentives through the tax system, the Government is putting an extra $40 million over four years into the Crown Research Institute Capability Fund, $36 million over four years into the Marsden Fund and $32 million over four years for health research.
Oil exploration		As announced in early May, the Budget extends a current exemption from tax on the profits of non-resident operators of offshore rigs and seismic vessels. This exemption was introduced in 2004 to encourage oil and gas exploration, but was set to expire at the end of this year. The exemption has now been extended until 2014 and is a positive move by the Government to help stimulate the search for oil and gas. Having facilitated a number of submissions on this matter, this change was well received.
IRD funding		The majority of Government departments have been delivered a decrease in funding by the Budget, and Inland Revenue is no exception, with overall funding decreasing from approximately $660 million to approximately $627 million (a 6% decrease). This comes after 250 redundancies were announced by Inland Revenue earlier this year. Taxpayers may at first breath a sigh of relief, as a significant portion of the decreased funding comes from taxpayer audit; however it remains to be seen whether the Inland Revenue auditors will simply be less flexible.
SME's		While the Budget does not specifically contain any positive announcements for SMEs, the Government has indicated that it is continuing to consider a raft of measures that were the subject of a consultation document in 2007.

Continued overleaf...

Budget at a glance

Fiscal Risks		The Fiscal Risks section of the budget document is always a good place to see what keeps officials up at night. This year quantified fiscal risks included aligning the PIE rates with new personal tax rates, GST Business to business transactions, the student loan early repayment bonus, and the reinstatement of the deferred tax cuts. Un-quantified risks include the review of the imputation system, the potential mutual recognition of imputation credits with Australia and the current Australian tax review, and the alignment of resident withholding tax to take account of recent tax cuts.
PIEs		The tax rates for Portfolio Investment Entities will be aligned with the new personal tax rates.
GST		The Government is considering options around GST on property transactions, including both administrative and legislative changes which could increase revenue collections by up to $50 million per annum
Legal disputes		The Crown is currently in dispute with a number of financial institutions regarding the tax treatment of certain structured finance transactions. Some of the financial institutions involved in these disputes have deposited funds into Inland Revenue's tax pooling accounts to mitigate any potential use of money interest. As the result of these disputes is unclear, these funds may yet be refunded to the taxpayers, consequently these amounts paid in are not being banked as Government revenue.

Other Announcements		
Broadband		The Government has committed up to $1.5 billion for the roll out of ultra fast broadband to businesses, schools, hospitals and 75% of homes over the next 10 years. Budget 2009 allocates the first tranche of this funding, including $200 million for capital infrastructure investment and $34 million for making schools broadband-ready.
Roading		In a bid to boost productivity, the Government will invest nearly $3 billion in the State Highway network over the next 3 years. This is approximately $1 billion more than that allocated by the previous government. Priority projects will include the seven roads of National Significance that have previously been announced.
Superfund		The Government has decided to suspend automatic contributions to the New Zealand Superannuation Fund to avoid further increasing debt. The Government will make a partial contribution of $250 million in 2009/10. This will not effect national superannuation contributions which remain at 66% of the average wage.
Home insulation		In some good news for the building industry, the Budget allocates $323 million over four years for a campaign to fit homes with insulation and clean heating devices. The scheme, which is open to owners and occupiers of houses built before 2000, will start on 1 July 2009. The Government is offering to pay a third of the costs of installing the installation, up to $1,300 with an additional $500 available for clean heating devices.

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