

31 May 2012

New Zealand Productivity Commission
PO Box 8036
The Terrace
Wellington 6143
New Zealand

Submission by the New Zealand Venture Capital Association on Mutual Recognition of Imputation and Franking Credits between Australia and New Zealand

1. The New Zealand Venture Capital Association (**NZVCA**) is grateful for the opportunity to present this submission to the New Zealand Productivity Commission, in response to the joint issues paper released by the New Zealand and Australian Productivity Commissions on strengthening economic relations between the two countries.
2. NZVCA supports the goal of strengthening economic relations between Australia and New Zealand and considers the full mutual recognition of imputation and franking credits with Australia would enhance the move towards a Single Economic Market. In particular, mutual recognition should reduce the impact tax has on New Zealand and Australian investors when making decisions on where to invest (which is currently biased to home country investment to maximise useable tax credits and avoid potential double taxation) and how to invest (eg the incentive Australian companies currently have to use debt leverage in funding their New Zealand operations, in order to reduce tax paid in New Zealand).
3. NZVCA considers a full mutual recognition policy will provide benefits to New Zealand and its investors, including:
 - (a) A closer harmonisation of the New Zealand and Australian tax systems, consistent with the overall objective of moving towards a Single Economic Market: Such an approach should reduce existing tax distortions impacting on commercial decisions of corporates, such as choice of residence, location of debt funding and the streaming of profits to a preferred jurisdiction. It should boost product and service market competition, lower compliance costs for business (particularly the SME market) and generally promote the development of a Single Economic Market.
 - (b) Broadening potential trans-Tasman investment opportunities and free flow of capital and income by removing (potential) double taxation and bias towards home country investment: This again should lower compliance costs and associated costs of tax planning (where alternative complex structures may currently be used to reduce the impact of the current absence of mutual recognition) and lower the cost of equity for trans-Tasman investment.
 - (c) Achieving a potential tax revenue advantage for New Zealand by reducing the existing incentive for Australian corporates operating in New Zealand to minimise New Zealand tax paid: Australian companies are currently encouraged to debt fund New Zealand operations to the greatest extent possible (within thin capitalisation constraints) and focus on maximising tax deductions in New Zealand as a means of reducing New Zealand tax paid.

This has led to significant and economically inefficient tax disputes between Australian corporates and Inland Revenue.

- (d) Successful New Zealand businesses could keep their tax base in New Zealand, rather than facing pressure to relocate to Australia once their balance of earnings supports a change of jurisdiction due to the financial impact of the absence of mutual recognition.
4. NZVCA also endorses the joint 2008 Treasury and Inland Revenue paper on mutual recognition submitted to the review *Australia's Future Tax System* and in particular the wider macroeconomic benefits of mutual recognition identified at pages 7 – 12 of that document.
 5. NZVCA acknowledges that there are technical differences between the current New Zealand imputation and Australian franking credit regimes that will need to be reconciled under a full mutual recognition regime (eg different rules around shareholder continuity for the carry forward of credits, streaming of credits amongst shareholders, and refundability of credits). However these differences and others could readily be addressed by pragmatic negotiation and compromise, in the interests of promoting the broader objective of moving towards a Single Economic Market.
 6. Should the Australian Government not support a full mutual recognition policy, NZVCA considers the New Zealand Government should still consider a policy whereby a full tax credit is available in New Zealand for Australian franking credits. This policy may give rise to an initial revenue loss to the New Zealand Government. However NZVCA considers longer term benefits to New Zealand will outweigh any initial cost. In particular:
 - (a) For New Zealand businesses to expand into Australia, additional capital is required. For New Zealand investors providing this capital, and for the businesses themselves, the benefits noted above in respect of a full mutual recognition policy would be equally applicable.
 - (b) Further to (a), a unilateral recognition policy would encourage New Zealand businesses to grow and expand into the Australian market when similar growth opportunities are not available in the New Zealand market (eg. due to size of market). Without continued growth opportunities, New Zealand businesses may be sold to offshore (including Australian) investors before realising their full potential and value. Retaining these outbound businesses in New Zealand will provide ongoing economic benefits to New Zealand.
 - (c) Although the incentives for Australian corporates operating in New Zealand to reduce New Zealand tax paid will remain, NZVCA believes a unilateral move by the New Zealand Government would provide an impetus to the Australian Government to review its policy on mutual recognition. A unilateral first move by New Zealand should also encourage Australian corporates with New Zealand operations to look to the Australian Government for action.
 - (d) As with mutual recognition, successful New Zealand businesses could keep their tax base in New Zealand, rather than facing pressure to relocate to Australia once their balance of earnings supports a change of jurisdiction due to the financial impact of the absence of mutual recognition.
 7. As with a full mutual recognition policy, NZVCA acknowledges such a policy will require further evaluation and NZVCA would welcome the opportunity to assist officials in this regard.

8. We thank you again for the opportunity to make this submission.

Yours faithfully

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Executive Director