



Meat Industry Association of New Zealand (Inc)

Submission to Inland Revenue Department
on the

Business Taxation Review
Discussion Document

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I: About the Meat Industry Association

1. The Meat Industry Association of New Zealand Incorporated (MIA) is a voluntary trade association representing New Zealand meat processors, marketers and exporters. It is an Incorporated Society (owned by members) that represents companies supplying the majority of New Zealand sheepmeat exports and all beef exports, producing 16 per cent of our nation's exports by value (27 percent of New Zealand's primary sector export revenue). The New Zealand meat industry earned \$5 billion in export revenue in the year ended May 2006 and \$1.22 billion from domestic meat sales in the year ended March 2006.
2. MIA member companies operate approximately 80 processing plants dispersed throughout the country. The plants slaughter and process approximately 24 million lambs, 4.4 million sheep and 4.2 million cattle and calves each year. Ninety percent of this production is processed into value-added products. Approximately 800,000 tonnes or 85% of the production is exported to overseas destinations. Our affiliate members add to the depth of expertise available from the membership, with representation throughout the meat supply chain, including road and rail transport, shipping lines, ports, packaging firms, specialist product exporters, research and technology.
3. The Association advocates on behalf of its members and provides advice on economic, trade policy, market access, employment relations, business compliance costs and technical and regulatory issues facing the industry, with a particular focus on:
 - Food safety trends and developments in importing countries
 - Economic and trade aspects of market access to key overseas markets
 - Major public policy proposals that could impact on industry operations
4. The MIA is also the interface between the meat industry and government (i.e., it is the consultative body referred to in various New Zealand statutes, such as the Meat Board Act 2004, Meat Act 1981 and the Animal Products Act 1999).
5. The Association's mission is to:
 - Provide a forum for consideration of industry-wide commercial, human resource, marketing, and sanitary and zoosanitary issues; and
 - Provide the means of formulating a collective view on issues of industry wide interest, and of conveying that position to government, departments of state, trade bodies, and other appropriate external agencies and organisations.
6. A list of Association members is attached at Appendix 1.

II: Executive Summary

7. A reduction in the company tax rate from 33% to 30%, as a first step in an overall review is the most desirable and highest priority of the Business Tax Review. This programme should however contain plans and timetables for further reductions to bring New Zealand at least to parity with our major trading partners. New Zealand has one of the higher tax rates in the

OECD, where it is currently 23rd out of 30, where number 30 has the highest rate. Since 1997, the OECD company tax rates have fallen steadily and substantially¹.

8. The Controlled Foreign Company (CFC) tax regime should be aligned with the regimes of the majority of the OECD countries by taxing New Zealand companies operating in foreign markets at the rates applying in those jurisdictions, with no additional tax obligation. This would encourage New Zealand companies to expand internationally, and discourage them from relocating offshore.
9. The MIA supports the use of tax credits to increase the level of research and development (R&D) undertaken in New Zealand but notes the support proposed in the Discussion Document is modest when considering the correlation between R&D as a proportion of GDP, with labour productivity improvements, and the benefits accruing to the wider economy from “spill over” as the results from R&D are adopted more widely.
10. The MIA recommends the tax credit system is a volume based approach, to minimise the cost of administration for both government and business
11. The MIA also supports the use of tax credits over direct subsidies, as the latter approach introduces the risk that factors other than the potential future value and contribution of the R&D will be factors in the decision-making process. Research clearly demonstrates that the tax credit is preferred (by businesses) and is the most influential of all forms of government support².
12. The MIA recommends that if the Government implements tax incentive options, approval of claimed expenditure is carried out on a random audit basis.
13. The MIA agrees with the provision of tax incentives for eligible expenditure for export market development, but proposes the restriction limiting eligibility to companies with turnover exceeding \$50 million be removed.
14. The MIA also agrees with deploying tax incentives for skills enhancement, but sees this as a lower priority than both R&D and export market development, as existing industry training programmes are delivering results for the meat industry.
15. The MIA supports the proposal to increase depreciation loadings to 30% or 40% on both new and used assets to encourage investment and improve productivity, and recommends that this is made a high priority. Reducing depreciation loadings in order to redistribute the proceeds into other proposals is not supported.
16. The proposal to increase the threshold at which low value assets can be expensed is supported.
17. The MIA also agrees with the proposal to write off assets with low depreciated values once they reach a particular book value. The MIA recommends this value should be based on a percentage of the particular assets purchase price.

¹ KPMG International Corporate Tax Rate Survey 2004

² Journal of Australian Taxation: Reflections on Providing Tax Incentives for Research and Development: New Zealand at the Cross Roads

III: Tax Rate

Tax Burden

18. Tax reforms undertaken within the OECD since the mid 1980's have been motivated by fairness, greater simplicity, and the need to provide a competitive fiscal environment which encourages investment and provides the right work incentives. Governments have recognised that in today's global environment, capital, and highly skilled labour are more prepared to relocate in response to a range of factors, of which tax is an important consideration.
19. Tax reforms undertaken within the OECD to achieve these goals have included reducing corporate and personal tax rates, broadening the tax base and increased reliance on consumption taxes.
20. New Zealand has a relatively high tax burden as measured by tax revenue as a percentage of GDP, as evidenced by the table below. This measure is a widely used measure of the extent of state involvement in national economies.

The following table compares the tax burden of New Zealand with various OECD regions.

	Tax revenue as % of GDP
New Zealand	34.9
OECD America	26.1
OECD Pacific	29.3
OECD Europe	38.9
OECD Total	36.3

Source: OECD Tax Policy Analysis 2005

The tax burden in New Zealand is significantly higher than that of the Asia/Pacific countries, which are New Zealand's major competitors for investment. Europe, particularly Scandinavia stands out as having a tax burden greater than that of New Zealand, and skews the OECD Total data.

21. New Zealand is also moving against the overall trend. Comparing the 30 OECD countries between the years 2000 and 2003, 18 recorded a fall in tax revenue as a percentage of GDP, and 12, including New Zealand, recorded a rise³.
22. New Zealand is becoming less competitive as a country, in attracting foreign investment, as other competing jurisdictions continue to reduce their tax burden.

Tax Rate

23. New Zealand's company tax rate needs to be competitive with the company tax rates of other countries to attract investment and maximise growth. *Due to scarce domestic resources, high levels of Foreign Direct Investment are important for and common among small open*

³ OECD Tax Policy Analysis 2005

*economies like New Zealand*⁴. Countries now compete intensely for foreign investment, with investment analysis becoming increasingly sensitive to taxation⁵.

24. The New Zealand company tax rate has remained unchanged since 1989, while the company tax rates of many developed countries have reduced during this period. In 2000 Australia's company tax rate was cut from 34% to 30%, and average company tax rates in the OECD and EU have reduced steadily since 1997⁶.

Region Average Statutory Rate - %

EU	25.04
Asia Pacific	29.99
Latin America	28.25
New Zealand	33.00

Source: KPMG Corporate Tax Rate Survey 2006

25. Reductions in the company tax rate would improve New Zealand's productivity and growth in a number of ways. It would encourage increased inbound investment by firms that have decided to locate in New Zealand⁷. This additional investment would in turn boost labour productivity.
26. New Zealand's labour productivity levels measured as GDP per hour worked are at the low end of the OECD range, and about 20% below those of Australia. For New Zealand to catch up, the growth rate in labour productivity will have to exceed productivity growth rates in other countries⁸. Foreign Direct Investment has a key role to play in this, competitive company tax rates are an important factor in attracting foreign investment.
27. The Controlled Foreign Company (CFC) taxation regime determines the amount of tax that New Zealand companies need to pay on income generated by their international investments. Under the existing CFC regime New Zealand companies are taxed on their worldwide income with a credit for foreign tax paid. This means that New Zealand companies are taxed at the 33% company tax rate irrespective of the local tax rate. Therefore whenever the foreign company tax rate is less than 33%, New Zealand companies are at a disadvantage in that foreign market due to the fact they pay tax at a higher rate than their competitors. This is not the situation in "Grey List" countries where income earned is currently exempted from New Zealand tax.
28. Within the OECD, 21 countries currently enjoy a lower company tax rate than New Zealand, with the average tax rate in these countries being about 26%, while tax rates in many high growth Asian countries are less than this. As an example, a New Zealand company operating in Singapore (headline company tax rate of 20%) will be paying tax at a rate 65% higher than most other companies in that market⁹.

⁴ Economic Development Indicators 2005, MED, Treasury pp 72

⁵ Tax Perspectives, Business New Zealand, 2005, pp 8

⁶ Business New Zealand, Tax Perspectives, September 2005

⁷ Business Tax Review discussion document pp 9

⁸ Economic Development Indicators 2005, Ministry of Economic Development, The Treasury, pp 34, 35

⁹ The New Zealand Institute, Developing Kiwi Global Champions August 2006 pp16

29. In general, OECD countries, including Australia, operate a system in which income generated from the productive operations of domestic companies in foreign markets is taxed only in the foreign jurisdiction with no additional tax obligation¹⁰.
30. There are two important effects of New Zealand's CFC regime
- (i) There is a disincentive for New Zealand companies to expand internationally as the CFC regime reduces their competitiveness in that foreign market through a higher tax impost.
 - (ii) It encourages companies who wish to expand internationally, to do so from a non-New Zealand corporate base.

The MIA submits the CFC taxation regime should be aligned with the majority of OECD countries.

IV: Tax Base

31. A feature of OECD tax reform since the 1980's has been a broadening of the tax base as it is simpler, fairer as more people contribute to the cost of services to everyone, and produces less tax induced distortions. This has been New Zealand's approach since the 1980's.
32. Tax base initiatives can be used to promote specific business activities such as R&D and export market development when there is under investment by businesses. Frequently delivery of assistance through the tax system can be the most effective mechanism to achieve the desired changes to activity levels.

Research and Development

33. Research and development is a key source of innovation and an important driver of long term productivity and growth, and higher standards of living, and is therefore integral to the government's economic transformation objectives.
34. Work by OECD on the impact of R&D on productivity performance in 10 major OECD countries concluded that R&D and its diffusion through the economy, as well as an open trade and investment regime are important elements in productivity performance¹¹.
35. A primary reason why businesses under-invest in R&D is they are unable to fully capture the benefits of their R&D as new processes and product types are quickly adopted more widely through the economy.
36. New Zealand's expenditure by business on R&D is 0.49% of GDP, is less than one third of the OECD average, and just over half of what Australia spends as a percentage of GDP.
37. New Zealand has one of the least generous R&D tax provisions in the OECD. The OECD has found that tax incentives can increase private R&D spending by an amount equal to the loss in tax revenue¹².

¹⁰ The New Zealand Institute, Developing Kiwi Global Champions August 2006 pp17

¹¹ Directorate of Science Technology and Industry, OECD, The Impact of R&D and Technology Diffusion on Productivity Growth: Evidence for 10 OECD Countries in the 1970s and 1980s; STI Working Papers 1996/2

¹² ANZ Market Focus 31 July 2006

38. The size of the proposed volume based incentive is small, being 0.06% to 0.12% of GDP at its commencement, and given there is a correlation between productivity growth and labour productivity¹³ a more generous incentive will have a greater national positive impact.
39. The MIA submits tax credits for R&D should be volume based to minimise the administrative cost on both companies and government and although it is more fiscally expensive, it avoids the creation of tax planning opportunities. Similarly a greater proportion of the overall incentive and administrative cost is used to promote R&D, rather than administer it.
40. Design of tax policy in respect of R&D should also accommodate companies in different stages of development, for example by allowing tax incentives to be utilised by companies without tax liabilities in any given year. It should also include provisions for the deduction of all qualifying R&D expenses in the year in which they are incurred. This has been shown to increase the additional research undertaken by companies.¹⁴
41. The MIA submits eligible expenditure for R&D tax credits be widened to include all labour costs directly related to R&D activity, contracted R&D with registered agencies and to equipment used for R&D to be depreciated over 3 years with deductions applying at the R&D tax deduction rate finally agreed, as per the Australian model. This would also cover R&D “black hole” expenditure, defined as capitalised expenditure on R&D which is subsequently abandoned or scaled back through lack of success.

Export Market Development

42. The MIA agrees the Market Development component of the Enterprise Development Grant scheme contains appropriate eligibility definitions from which to initiate tax credits for export market development, but seeks to widen the current eligibility criteria in one area.
43. Currently applicants must have a turnover of less than \$50 million per financial year including parent, subsidiary, associate or linked businesses. This criterion is too restrictive and eliminates larger operations many of which will provide more substantial returns from the benefits of international expansion. The MIA submits there should be no restriction on the size of businesses eligible for tax credits; however the alternative of a cap on the size of the tax credit remains an option.

Enhancing Skills

44. The philosophy and rationale of providing non targeted assistance through the tax system for skills enhancement is similar to the rationale for R&D. By adopting this mechanism, together with the use of appropriate eligibility criteria, businesses will select the best skills enhancement programmes that will most benefit their business, thereby providing the optimum returns for the assistance investment.
45. The MIA submits skills enhancement programmes should encompass broader definitions including skills which are industry specific, such as the food industry, but which are not company specific. An example of food industry based skills would be knowledge and application of food handling legislation and requirements.

¹³ ANZ Market Focus 31 July 2006

¹⁴ Reflections on Providing Tax Incentives for Research and Development: New Zealand at the Cross Roads, Journal of Australian Taxation 2005

46. The MIA further recommends that courses should not be restricted to those externally provided, but rather the eligibility should be defined by approved courses. Eligibility may be determined by joint approval of the specific industry and their ITO or with NZQA. Again a cap may be applied to the quantum of eligible spending.

Depreciation

47. It is accepted that research and development is a key source of innovation and an important driver of long term productivity and growth, but the benefit of that R&D will be only be fully realised if the corresponding investment in plant and new technology is equally encouraged.
48. The MIA agrees with the assertion in the discussion document that accelerated depreciation for taxation purposes promotes investment, which will lead to capital deepening and add to labour productivity and consequently increased GDP growth. The MIA supports increasing the current depreciation loading added to the depreciation rate for most new assets, from 20% to 30% in order to encourage increased investment in new productive assets, and similarly extending the application of this rate to second hand assets. Such a move would allow small and medium enterprises to take advantage of the availability of existing second hand plant to improve their labour productivity.
49. An increase in the loading above the economic rates of depreciation, for tax purposes, has several advantages. It does not reduce the tax base, it provides a benefit at the start of the project when the company has to fund the expenditure, and it is simple to administer. It can also be applied in a targeted way to encourage investments in certain asset types, for example assets which contribute to other New Zealand obligations, such as Climate Change.
50. The MIA does not support a reduction in depreciation loadings to 0% or 10% to free up revenue for other proposals presented, as this does not address the already uncompetitive tax burden experienced by New Zealand taxpayers.

Delivery Mechanism

51. To gain maximum impetus for the benefits, the assistance should be available to all companies whose expenditure meets the required criteria, irrespective of their financial status, i.e., loss making, tax exempt New Zealand entities, and companies registered in New Zealand for tax and GST purposes, operating in a commercial environment.
52. The MIA agrees the government continue to explore whether a refundable tax credit will achieve the desired outcomes and to ensure the tax credit will not be clawed back by other parts of the tax system.

Compliance Costs

53. The costs of doing business in New Zealand are increasing, and as a matter of principle, new provisions introduced into the business tax system should be designed to minimise its administrative and compliance cost.
54. The MIA supports increasing the threshold below which low-value assets can be expensed immediately, from \$500 to \$1000. This would further reduce compliance costs adding to the reduction achieved in Budget 2005.

55. Consistent with 54 above, items that have been depreciated to a low level should be able to be expensed when they reach a depreciated amount of \$1000, or a percentage of their purchase price, whichever is the greater. This would reduce the compliance burden allowing companies to focus more time on business operations contributing to improved productivity, further growth of their business and consequently add momentum to the economic transformation.
56. The MIA also agrees increasing the threshold at which fringe benefit tax (FBT) returns can be filed annually from \$100,000 to \$250,000 would reduce compliance costs, for a very modest cost to the government. This would benefit companies employing ten to twenty people, with the financial implication for the government being one off cash flow. The MIA submits the saving in time and resources is large when compared to the cost and therefore recommends this threshold be raised further, to \$0.5m as the aggregate tax collections in any fiscal year is not diminished. This would particularly benefit small to medium companies for whom compliance costs are a greater relative burden and who make up the majority of our employers. This provision need not be delayed to be initiated with the balance of the proposed changes.

Other

57. The current mechanism for the treatment of goods and services tax (GST) refunds is a constraint to growth in the export sector, due to the impact on company cash flows. Goods purchased domestically for export, e.g., livestock, attract GST, which is not included in the export sales price. The GST is refunded at the end of the GST period. Working capital is a necessity for export growth and together with rising interest costs the outstanding cash flow constitutes a burden and restriction on marketing companies.

V: Concluding Remarks

58. The ability to make submissions on prioritisation of the various proposals is restricted by the limited information on both the size of the package, and the costs of the various proposals. The highest priority is however an immediate reduction of the company tax rate from 33% to 30%, together with further planned reductions in the future. When these current proposals are implemented, if the existing trends continue, many other countries will also have implemented lower tax rates, thereby eroding some of the gains achieved through this review.
59. New Zealand has both a comparatively high tax burden as measured as a proportion of GDP, and company tax rate. Reducing the company tax rate will not of itself correct the tax burden, which must also be addressed through slowing the growth in the size of government.
60. For any queries relating to this submission, please contact Rowan Ogg (DDI 04 495 8374) or email: rowan.ogg@mia.co.nz in the first instance.

VI: Appendix 1 - MIA Members as at 1 July 2006

List of MIA Members and Affiliate Members (year commencing 1 July 2006)

Members
Advance Marketing Ltd
AFFCO New Zealand Ltd
Alliance Group Ltd
ANZCO Foods Ltd
ANZCO Green Island Ltd (ANZCO group)
ANZPAC Foods Ltd
APJ Meats Ltd
Auckland Meat Processors Ltd
Ballande New Zealand Ltd
Bernard Matthews New Zealand Ltd
Blue Sky Meats (NZ) Ltd
<i>Brookland (NZ) Ltd (in receivership)</i>
Canterbury Meat Packers Ltd (ANZCO group)
CMP Rakaia
Columbia Exports Ltd
Crown Marketing Ltd (ANZCO group)
Crusader Meats New Zealand Ltd
Dairy Meats NZ Ltd (AFFCO group)
Davmet New Zealand Ltd
Fern Ridge Ltd
Frasertown Meat Company Ltd
Garra International Ltd
Glovers Foods Ltd
Greenlea Premier Meats Ltd
Harrier Exports Ltd
Horizon Meats New Zealand Ltd (wholly owned subsidiary of Blue Sky Meats (NZ) Ltd)
Hygrade Casings Company (wholly owned subsidiary of New Zealand By-Products)
Lamb Packers Feilding Ltd (wholly owned subsidiary of Bernard Matthews NZ Ltd)
Land Meat (NZ) Ltd (AFFCO group)
Lanexco Ltd
Lowe Corporation Ltd
Mathias International (Mathias Meats NZ Ltd)
New Zealand By-Products
Pilot (NZ) Ltd
Primary Producers Co-operative Society Ltd (PPCS)
Progressive Gisborne Ltd (wholly owned subsidiary of Bernard Matthews NZ Ltd)
Progressive Meats Ltd
Riverlands Ltd (ANZCO group)
South Pacific Meats Ltd
Tara Exports Ltd
Taylor Preston Ltd
Te Kuiti Meat Processors Ltd
Towers Thompson (New Zealand) Ltd
Universal Beef Packers Ltd (UBP)
Wallace Corporation Ltd

Affiliate Members
AgResearch-MIRINZ Centre
Aon New Zealand Limited
Carter Holt Harvey, Packaging
CentrePort Wellington
Energy for Industry (ex Meridian Solutions)
Hamburg-Sud New Zealand Ltd
Hapag Lloyd (New Zealand) Ltd
Maersk New Zealand Ltd
New Zealand Natural Casing Association Inc
Oceanic Navigation Ltd
Port of Napier
Port Otago Ltd
Port Taranaki Ltd (previously Westgate Transport Ltd)
ProAnd Ltd (Meatek Ltd)
Rissington Breedline Ltd
Sealed Air (New Zealand), Cryovac Division
Thompson Clarke Shipping Pty Ltd (ANZ Marketing Representative for the Port of Los Angeles)
Vero Marine Insurance