



# Inland Revenue Department, Long-Term Insights Briefing 2022

Report of the Finance and Expenditure  
Committee

June 2023

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Ingrid Leary  
Chairperson

# Inland Revenue Department, Long-Term Insights Briefing 2022

## Recommendation

The Finance and Expenditure Committee has considered a long-term insights briefing from the Inland Revenue Department—*Tax, foreign investment and productivity*—and recommends that the House take note of its report.

## About long-term insights briefings

The Public Service Act 2020 requires chief executives of government departments to develop and publish long-term insights briefings at least once every three years. The briefings must be produced independently of the relevant Minister, and the chief executive must consult the public on both the subject matter of the report and a draft version.

The purpose of the briefings is to inform the public about medium- and long-term trends, and future risks and opportunities facing New Zealand. The briefings should provide information, impartial analysis, and potential policy responses to the challenges identified in the briefing.

We held a hearing with the Inland Revenue Department (IRD) to discuss its long-term insights briefing. We invited 32 individuals and organisations to submit on the long-term insights briefing, so we could gain insight into the perspectives of experts and stakeholders on the topic. We received six written submissions and heard oral evidence from five submitters.

## About IRD's report: *Tax, foreign investment and productivity*

IRD published its first long-term insights briefing (LTIB), entitled *Tax, foreign investment and productivity*, in August 2022.<sup>1</sup> IRD undertook public consultation on the scope of the LTIB from August to September 2021 and sought public feedback on its draft from February to April 2022.

The LTIB seeks to understand the relationship between New Zealand's tax settings and its productivity and economic performance. Despite longstanding concern about New Zealand's poor performance on productivity, there has been little research on the effect taxes have on productivity. The LTIB aims to shed light on this issue and bring attention to how both foreign investment and productivity could influence long-term living standards in New Zealand.

The LTIB explores the likely effects New Zealand tax settings have on the cost of capital,<sup>2</sup> and the relationship this has to foreign investment in New Zealand (inbound investment). It

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<sup>1</sup> [Tax, foreign investment and productivity: long-term insights briefing | IRD](#).

<sup>2</sup> Cost of capital refers to the minimum pre-tax rate of return an investment must generate for it to be considered attractive after-tax. Cost of capital calculations are used to determine financial risk and whether an

finds that New Zealand has high taxes on inbound investment in comparison to other OECD countries. This means that foreign investors are likely to require a higher rate of return on their investments to make up for the New Zealand tax. This is likely to result in relatively higher costs of capital for investment into New Zealand. This tends to lower capital stock,<sup>3</sup> which may have negative effects for labour productivity.

The report *Tax, foreign investment and productivity* also analyses different avenues for reducing costs of capital. It examines the pros and cons of different options but does not make any recommendations, noting that it is unlikely there will be a “single ‘silver bullet’” solution.<sup>4</sup>

IRD’s findings are consistent with OECD studies. Other New Zealand agencies are also undertaking similar research on productivity, including the Ministry of Business, Innovation and Employment’s LTIB, *The future of business for Aotearoa New Zealand*.<sup>5</sup> IRD’s LTIB aims to complement this work.

If tax settings have negative effects on productivity, this has significant implications for living standards and well-being in New Zealand. We understand that New Zealanders work longer hours but produce less compared with workers in some other OECD countries. On average, New Zealanders work 34.2 hours per week, compared with the OECD average of 31.9 hours per week. New Zealand has an average output of \$68 per hour, compared with an average output of \$85 per hour in other OECD countries.<sup>6</sup>

Improving productivity could contribute to increased leisure time and higher material living standards for New Zealanders. As well, the LTIB notes that greater inbound investment could help to build management and business expertise in New Zealand and provide access to international production chains. An increase in the capital stock could support higher wages and incomes for New Zealanders.

The overall aim of the LTIB was to start a conversation on these issues. The overall consensus from submitters was that the LTIB forms a good basis for discussion. We look forward to contributing to that dialogue.

## How tax settings affect foreign investment into New Zealand

The LTIB explains that two main elements of New Zealand’s tax settings are contributing to its high effective marginal tax rate (EMTR) on inbound investments. These are the company tax rate and depreciation settings. We note that these are not the only factors. There are many variables and other tax considerations that could influence incentives to invest.

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investment is justified. For more information see: [Tax, foreign investment and productivity: long-term insights briefing | IRD](#), pg. 21.

<sup>3</sup> Capital stock refers to the total physical capital existing in an economy at any moment of time.

<sup>4</sup> [Tax, foreign investment and productivity: long-term insights briefing | IRD](#), pg. 9.

<sup>5</sup> [The future of business for Aotearoa New Zealand | MBIE](#).

<sup>6</sup> [Productivity by the numbers | New Zealand Productivity Commission](#).

## The company tax rate

Company tax is the major tax on foreign investment into New Zealand. In its 2022 Economic Survey of New Zealand, the OECD noted that New Zealand's company tax rate and average level of EMTRs were high in comparison to other OECD countries and to other small, advanced economies.<sup>7</sup> The company tax rate in New Zealand is 28 percent, compared to the OECD average of 23.57 percent. Previously, however, New Zealand's company tax rate was low relative to other countries. Since the early 1990s, many other OECD countries have made significant cuts to their company tax rates to encourage foreign investment and reduce domestic tax avoidance.

## Depreciation provisions

The LTIB finds that New Zealand's tax system produces biases between different types of investments and between investments that are financed in different ways. For example, New Zealand's depreciation settings allow a tax deduction for an asset's depreciation.<sup>8</sup> Tax depreciation rates (the deduction amount) are intended to reflect economic depreciation (the cost of an asset's value decreasing over time as it is being used for business).<sup>9</sup> In New Zealand, the calculation for depreciation rates does not take inflation into account.

For an example, imagine someone buys a tractor for \$1,000 and that the economic depreciation rate is 20 percent. Without inflation, after one year this tractor will be worth \$800, after two years it will be worth \$640, and so on. This means that the tractor owner is able to claim \$200 of depreciation over the first year, \$160 over the second year, and so on. However, if there is 2 percent inflation per annum the real value of money is falling by 2 percent each year. To be able to actually receive the real cost of depreciation, the tractor owner would need to be able to deduct \$204 over the first year, not \$200. New Zealand's depreciation settings mean that inflation is not taken into account here.

As a result, inflation tends to increase the costs of capital and EMTRs for "depreciable property". In comparison, for assets that are not "depreciable property" (such as land or trading stock), inflation may reduce the costs of capital and EMTRs. This creates a bias between different types of investment.

## Possible tax changes considered in the LTIB

The LTIB explores several options for how costs of capital and EMTRs could be reduced. The report evaluates the benefits and disadvantages of each option, attempting to provide context that might help inform future discussion.

The options covered in the report include:

- lowering the company tax rate

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<sup>7</sup> [OECD Economic Surveys: New Zealand 2022 | OECD](#).

<sup>8</sup> This is only if an asset is "depreciable property". Depreciable property refers to any asset which might reasonably be expected to decline in value while it is being used for business. This includes things such as buildings or machinery but does not include assets such as land and trading stock.

<sup>9</sup> However, due to difficulties in accurately measuring and applying economic depreciation, this equation does not always work out perfectly in reality.

- introducing accelerated depreciation provisions
- indexing the income tax base for inflation
- loosening the thin capitalisation rules by allowing for a higher safe harbour threshold
- providing an allowance for corporate equity
- introducing specific incentives for different types of business investment
- moving to a dual income tax system.

The LTIB report devotes a chapter to each of these options for possible tax changes, analysing the potential pros and cons.

### **Reducing the company tax rate**

IRD told us that reducing the company tax rate would reduce the costs of capital and EMTRs on inbound investment. However, lowering the company tax rate could increase the incentives for high earners to shelter income in companies to avoid the top personal tax rate. The top personal tax rate is currently set at 39 percent, 11 percent higher than the company tax rate. Unless the personal tax rate was lowered at the same time, reducing the company tax rate would increase the gap between the company tax rate and the higher personal tax rates. IRD said that this could pose risks to the integrity of the tax system.

IRD also mentioned that a cut in the company tax rate would give a windfall gain to foreign investors who are already investing in New Zealand, who were expecting to be taxed at a higher rate. This would reduce revenue received from existing investment. IRD said that it would be important to consider whether this loss of revenue would be offset by new investments into New Zealand.

### **Accelerated depreciation**

Accelerated depreciation allows for greater depreciation to be claimed in the early years of an asset's life (instead of being spread across its life). We noted that previous accelerated depreciation provisions were removed from New Zealand tax settings in 2010, and inquired about the reasoning behind this decision. We asked what the advantages and disadvantages for introducing new accelerated depreciation provisions might be.

We heard that the removal of accelerated depreciation provisions in 2010 had contributed to financing a reduction in the company tax rate, along with other changes made to the tax settings at that time. IRD told us that, at that stage, there had not been comprehensive research on potential issues related to costs of capital in the New Zealand context. It said that since then it has been revealed that New Zealand is an outlier in terms of high costs of capital and EMTRs relative to other OECD countries.

IRD told us that accelerated depreciation provisions have the potential to successfully reduce costs of capital without creating risks to the integrity of the system. However, it said that accelerated depreciation could incentivise inefficient investment.

### **Industry-specific incentives for investment**

One submitter gave the example of the Digital Games Tax Offset in Australia as a tax policy that incentivises investment in a specific industry. The Treasury Laws Amendment (2022

Measures No. 4) Bill 2022 is currently being considered by the Parliament of Australia.<sup>10</sup> Among other things, the bill proposes to introduce a refundable tax offset for companies that develop digital games in Australia. This policy aims to support the digital games industry in Australia, provide development opportunities for Australians in the creative sector, and attract foreign investment.

The submitter told us that it would be worth having a debate in New Zealand about whether similar policies might be beneficial here. They suggested that this may be a useful approach to explore in terms of improving productivity. We asked about the tension between maintaining simplicity and neutrality in the tax system and introducing specific incentives for investment in certain industries. The submitter responded that it would be well worth exploring that dynamic when considering how we want to encourage investment in future.

We note that, in Budget 2023, the Government committed \$160 million towards establishing a 20 percent tax rebate for video game developers. The final design of the scheme will be subject to future consultation.

IRD told us that New Zealand's approach in recent history has been to keep the tax base as broad and neutral as possible, with few exceptions. It said that this option would not reduce costs of capital and EMTRs generally, but instead would provide tax cuts to specific investments. IRD told us that one risk of this approach was that targeted incentives could distort investment decisions or divert investment into less productive areas.

### **Moving to a classical company tax system or dual income tax system**

We noted in our hearing with IRD that one person who took part in consultation on the scope of IRD's briefing suggested that New Zealand should move to a classical company tax system, which is a more common system overseas. Under a classical company tax system, profits are taxed first at the company level and then taxed again when dividends are paid to shareholders. New Zealand has an imputation tax system. Under an imputation system, profits are only taxed once, as shareholders are passed on a credit for the income tax that the company has already paid. We asked what the advantages and disadvantages of moving to a classical company tax system would be.

IRD told us that adopting this approach would allow New Zealand to reduce the company tax rate, which might attract new inbound investment into New Zealand. However, as discussed earlier, a cut in the company tax rate provides a windfall gain to foreign investors who are already investing in New Zealand. IRD said that it did not examine the possibility of moving to a classical tax system in the LTIB.

IRD did consider the option of a dual income tax system for New Zealand in the LTIB. Under a dual income tax system, labour income (such as salaries or wages) is taxed separately and at a higher rate than capital income (such as interest or capital gains). IRD concluded that adopting a dual income tax system could offer a way to reduce the company tax rate without creating risks to the system's integrity. However, it explained that this would

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<sup>10</sup> [Treasury Laws Amendment \(2022 Measures No. 4\) Bill 2022 | Parliament of Australia.](#)

represent a complex tax change. There would be a lot of complicated and detailed issues to work through before such a change could occur.

## **Other factors that affect foreign investment**

We heard from some submitters that considered the focus on costs of capital and EMTRs in the LTIB too narrow. Some submitters emphasised that there are more factors that influence foreign investors' decisions to invest in New Zealand or not. They felt that the LTIB did not give adequate attention to these factors. Submitters referred to profitability, tax certainty, compliance costs, and the ease of doing business as equally important considerations for investors. Of these, submitters highlighted certainty as a key issue.

We heard that if tax settings tend to result in uncertain or unexpected outcomes, investors require the rate of return on investment to be higher to make up for the increased business risk. Submitters suggested that it would be wise to have a degree of consistency in tax settings to provide assurance to investors. Submitters also said that if New Zealand's tax settings differed too much from overseas this could lead to confusion and uncertainty for foreign investors. One submitter explained that tax settings must be administered and interpreted consistently and reliably to provide certainty.

We agree with submitters about the fundamental importance of certainty.

## **The role of IRD**

One submitter discussed the roles and responsibilities of IRD. The submitter said that it was unusual, compared with other countries' systems, that IRD had both policy and operational responsibilities. We discussed whether this arrangement created risks. The submitter suggested that this arrangement tends to result in legislation that includes broad, catch-all provisions. The submitter said that this could overreach and capture more than what was intended. Another submitter suggested that there are benefits to IRD maintaining both responsibilities. This submitter said that it was good for the same entity to be able to identify enforcement problems, see compliance problems, and then form policy solutions. The submitter said this was easier than having separate entities that can each only see part of the picture.

We also discussed another recent publication from IRD, the *High-wealth Individuals Research Project*.<sup>11</sup> One submitter suggested that the findings of report were made applying transparent methodologies and principles that are the same as were used in the LTIB.

## **Future IRD long-term insights briefings**

We asked IRD how it had found the new requirement to develop a long-term insights briefing and what it had learnt from the process. IRD told us it had found the process extremely useful and had enjoyed the opportunity to investigate long-term future issues, rather than just immediate concerns. It said that it had been great to work on something that would help inform public discussion on tax policy for years into the future.

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<sup>11</sup> [High Wealth Individuals Research Project | IRD](#).

We inquired whether IRD had any direction for its next LTIB, due within three years. It said that it plans to undertake consultation on what the topic and scope of its next LTIB will be.

## **Our response and conclusion**

We thank the Inland Revenue Department for its long-term insights briefing. We appreciate how it explores the relationship between tax settings and productivity, and consider that this area should be a priority for future research. We agree that the briefing forms a useful basis for discussion, and thank IRD for starting this very important conversation. We strongly recommend that further work be done to investigate the relationship between New Zealand's tax settings and competitiveness, productivity, and foreign investment.

We believe that LTIBs are useful tools to examine future issues and priorities for New Zealand, and hope that this briefing will help to inform consideration of tax settings and foreign investment for years to come.

We encourage others to read IRD's long-term insights briefing.

## Appendix

### Committee procedure

We met between 30 August 2022 and 7 June 2023 to consider this long-term insights briefing. We received evidence from the Inland Revenue Department, the Bank of New Zealand, Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group, John F Cantin, KPMG, and Mayne Wetherell.

[The long-term insights briefing is available here.](#)

### Committee members

Ingrid Leary (Chairperson from 17 April 2023)

Hon Rachel Brooking (Chairperson from 8 February to 12 April and member until 3 May 2023)

Hon Barbara Edmonds (Chairperson and member until 8 February 2023)

Andrew Bayly

Glen Bennett (until 8 February 2023)

Hon Dr David Clark (from 8 February 2023)

Shanan Halbert (until 3 May 2023)

Anna Lorck

Dan Rosewarne (from 3 May 2023)

Damien Smith

Chlöe Swarbrick

Hon Phil Twyford (from 8 February 2023)

Simon Watts

Helen White (until 8 February 2023 and from 3 May 2023)

Nicola Willis

### Evidence received

The documents we received as evidence and advice for this long-term insights briefing are available on the Parliament website, [www.parliament.nz](http://www.parliament.nz).

You can watch our hearings related to this briefing below:

- [Hearing of evidence from submitters \(3 May 2023\).](#)
- [Hearing of evidence from Inland Revenue Department \(16 November 2022\).](#)