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Productivity Commission of Australia
Productivity Commission of New Zealand

By email: transtasmanreview@pc.gov.au
By email: transtasmanreview@productivity.govt.nz

Dear Sir/Madam

Mutual Recognition of Imputation Credits in Respect to Australia and New Zealand

CPA Australia represents the diverse interests of more than 139,000 members in 114 countries throughout the world. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background, we provide this submission in respect to the abovementioned topic.

Please accept our apologies for the delay in submitting this document.

Yours faithfully,

Paul Drum FCPA
Head - Business and Investment Policy

Submission to the Australian Government and New Zealand Productivity Commissions

Mutual Recognition of Imputation Credits In Respect to Australia and New Zealand

We note that the Commissions' Issues Paper of April 2012 on 'Strengthening economic relations between Australia and New Zealand'[1] raises the abovementioned issue at Question 28 of the Paper. In particular, the specific question posed is – What would be the costs and benefits of the mutual recognition of imputation credits?

Background

There is currently a limited arrangement between Australia and New Zealand for the mutual recognition of franking credits and details of this are available in the ATO's Trans-Tasman imputation overview fact sheet.

Unfortunately, more recent developments in this area have been somewhat mixed at least from Australia's end.

Recommendation 40 of the Australia's Future Tax System (AFTS)[2] stated that in the context of closer economic relations or CER (including a single economic market) between Australia and New Zealand, the harmonisation of business taxes between the two countries should be considered further. During the consultation process on the AFTS, the NZ Government encouraged the Review to consider allowing full mutual recognition of imputation credits between the two countries.

The reasons for this more general conclusion appears to reflect the AFTS's view of the need for Australia's imputation system to be reviewed with a view to replacing it at some time in the future. For example, Recommendation 37[3] of the AFTS stated that dividend imputation should be retained in the short/medium term but that consideration should be given to alternative company tax options further down the track. It appears though that there is not much support for such a review at this stage as most relevant business groups/professional bodies (including CPA Australia) appear to support the current imputation system.

Recommendation 40 of the AFTS also stated that if increased integration of the Australian and NZ economies is desired, a broad examination of the appropriate degree of harmonisation of business tax arrangements between Australia and NZ should be undertaken.

Commissions' Issues Paper

This paper has noted that mutual recognition of imputation credits has been a key taxation issue between the two countries. Currently, imputation credits in Australia and New Zealand are available only for domestic company tax not foreign taxes, potentially creating a bias against offshore investment.

The Henry Review found that mutual recognition of imputation credits would have the potential to improve the allocation of investments between the two countries and reduce barriers to competition between Australian and New Zealand companies. It could also reduce incentives for firms to engage in profit shifting between the two countries. This would probably be to New Zealand's net benefit but there would also be fiscal and initial distributional implications, particularly for Australia.

The movement of financial capital between Australia and NZ can also be constrained by various regulations and reservations to the OECD Code of Liberalisation of Capital Movements, many of which are specific to certain industries. For example, investment in airlines is affected by limitations on foreign ownership of both Qantas and Air New Zealand. More broadly, investment across industries is affected by regulations, including consumer and competition laws in each country, although there are a number of reforms underway in these areas.

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[1] See http://transtasman-review.pc.gov.au/

[2] http://taxreview.treasury.gov.au/content/downloads/final_report_part_1/00_AFTS_final_report_consolidated.pdf at p.88.

[3] Ibid, p.88.

Mutual Recognition of Imputation Credits between Australia and New Zealand

CPA Australia supports the introduction of a Mutual Recognition Regime in respect of imputation credits between Australia and NZ.

Limitations of the current regime

The current trans-Tasman imputation regime partly ameliorates the double tax arising from triangular investment, by enabling trans-Tasman companies to allocate franking/imputation credits. However, this regime does not completely eliminate double taxation, because the shareholder is only able to utilise credits from his or her home jurisdiction, rather than receiving a full credit for the corporate tax paid.

Mutual Recognition

A single layer of economic taxation on trans/Tasman investment could be achieved by the introduction of a mutual recognition regime between Australia and NZ. This would allow for reciprocal imputation crediting, so that Australian individual shareholders in NZ companies could claim a credit for NZ tax paid, and NZ individual shareholders in Australian companies could claim a credit for Australian tax paid. The residence country would bear the cost of recognition.

The advantages and disadvantages of a mutual recognition regime are discussed below. These advantages have also been recognised by the NZ Treasury in its submission to the Henry Tax Review.

Advantages of a Mutual Recognition Regime (MRR)

Double taxation

No double taxation would occur because a shareholder would receive a fully imputed dividend. Receiving a full credit for corporate tax paid would ensure a single layer of economic taxation on trans-Tasman investment.

Bias in favour of domestic investment

The abovementioned bias would be eliminated. As a shareholder receives a fully imputed dividend, there would no longer be a difference between the tax paid on domestic investment and the effective tax rate applicable to trans-Tasman investment. There would, therefore, be no reason to favour domestic investment in NZ vis-à-vis investment in Australia.

Eliminating double taxation on trans-Tasman equity investment would also reduce the bias in favour of debt investment relative to equity investment. This bias would not be completely eliminated as companies would still not be entitled to claim a deduction for dividends paid.

Under a MRR, a trans-Tasman company would only be required to maintain one account (either a franking/imputation credit account) which is equivalent to the requirement imposed on domestic companies. It would be able to attach one type of credit to dividends paid to both its Australian and NZ shareholders. Both these factors would simplify companies' accounting requirements and reduce compliance costs. This outcome would appear to be consistent with the stated objectives of both the Australian and NZ taxation authorities.

Australia and NZ recognise that, in the trans-Tasman context, mutual recognition reduces barriers to cross-border commercial activity and accordingly contributes to the broader goal of achieving a single market for goods, services and capital.

Meet objectives of CER/SEM

Australia and NZ recognise the importance of mutual recognition in achieving the objectives of the CER (closer economic relations) and creating a SEM (single economic market). By its nature, a mutual recognition regime would meet the CER objective of strengthening and fostering links and co-operation in investment between the two countries.

A mutual recognition regime would also meet the tax objectives for a free flow of trans-Tasman investment because it removes the bias in favour of domestic investment, and also reduces the bias in favour of debt relative to equity investment.

Disadvantages of a MRR

Australia and NZ have previously rejected the idea of a mutual recognition regime for imputation credits because of the resulting revenue loss. In theory, however, mutual recognition could offer potential efficiency gains and, as a result, generate revenue gains that could offset the initial revenue costs. The net revenue effects are, however, uncertain and could be substantially negative.

This argument though should not be used as an excuse for not implementing such a regime since the elimination of double tax will by definition reduce tax revenue. Such a reduction in revenue is not used as a reason to retain double tax domestically and it should not be an excuse in the trans-Tasman context either.

National economic welfare

This is a related issue in the sense that where income is earned offshore by NZ residents, taxes paid to the NZ Government contribute to New Zealanders' overall well-being, while taxes paid to foreign governments do not. However, this concept is arguably redundant in the context of a SEM between the two countries.

Currently, dividends received by NZ residents from an Australian company are subject to double taxation in NZ, and vice versa. This double taxation should not be allowed to continue merely because it enhances economic welfare. Moreover, the reciprocal nature of a MRR would ameliorate any impact on national economic welfare, so not just one country has to bear the tax burden of the regime. Australia and NZ would both bear the cost of recognition, and both countries would enjoy the benefits of investment flowing between them.

It should be noted that any MRR is likely to be more costly for Australia than for NZ, given the greater Australian investment in NZ than vice versa. Solutions for addressing this would need to be considered as part of any MRR. One option could be to require each country to pay some form of subsidy to the other for the tax credits provided by the other country to its residents. This approach would address the higher cost of an MRR for Australia, thereby making it more economically viable for an MRR to be negotiated between the two countries.

Potential breach of anti-discrimination clause in double tax agreements

It could be argued that the anti-discrimination clauses in Australia's and NZ's DTAs with other countries may prohibit the granting of special status to Australia and NZ respectively (i.e. the status which would arise under an MRR) without granting a similar concession to other countries.

NZ has a non-discrimination article in 16 of its 31 DTAs with other countries while Australia only has such an article in its DTA with the United States. Australia is concerned that if it grants a tax credit for NZ tax, it would also have to grant a tax credit for taxes paid in other jurisdictions (i.e. the US). This concern appears to be ill-founded because few jurisdictions could offer comparable treatment. Moreover, Australia does have an imputation system, and it is therefore in the almost unique position of being able to fully reciprocate any credit that the NZ Government might give New Zealanders for Australian corporate tax.

Consequently, it is unlikely that an MRR between Australia and NZ would breach the non-discrimination article in their DTAs with other countries, principally because no other country would be able to engage in reciprocal imputation crediting with Australia and NZ. As residents in countries with tax systems that do not have a comparable imputation system to that of Australia and NZ are not in the same circumstances as residents of Australia or NZ, no discrimination should arise in this regard.

The above analysis seems sound since the existence of the CER and the SEM goal are unique as between the two countries. These objectives are not shared with any other country. This existing background in respect of trans-Tasman investment would further support Australia and NZ in not granting tax credits for taxes paid in other jurisdictions if a MRR regime is introduced.

Other options

Possible alternatives to an MRR include streaming of imputation credits or appropriate corporate structuring.

The main disadvantage though to these corporate structure options is that they are not provided for in legislation and so can only apply to the companies that create them. This effectively renders a corporate structuring solution complex, time consuming and expensive, and thus not a viable solution for everyone.