AUSTRALIA NEW ZEALAND LEADERSHIP FORUM

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Dear Chairmen

Submission to: Strengthening Economic Relations between Australia and New Zealand

Further to our submission of May 2012, we submit this follow-up paper for your consideration.

As you are aware the Australia New Zealand Leadership Forum (ANZLF) has a keen interest in the continuing development of stronger economic relationships between our two countries, and in particular in deepening the Single Economic Market. While much progress has been made in the markets for goods and services there remain barriers to the free flow of capital. The most crucial of these has been the double taxation of dividends on trans-Tasman investment. This has been an on-going concern for businesses on both sides of the Tasman and has repeatedly been brought to the attention of Ministers by the Forum.

Past debates on this topic have not been supported by any empirical work on the costs and benefits of removing double taxation on trans-Tasman investment returns. The ANZLF has facilitated the conduct of independent research on the costs and benefits of mutual recognition of franking and imputation credits, the preferred approach to removing the double taxation. The research was conducted by the NZIER and Centre for International Economics and their independent report is enclosed for your consideration.

As part of the process for development of the report the research team presented to a joint meeting of the Productivity Commissions and subsequently CIE provided further detail in respect of the modelling approach. These interactions were valuable and we thank the Productivity Commissions for making the time available.

The report concludes that the benefits of eliminating the double taxation of investment returns outweigh the costs, both in terms of enhanced GDP and net trans-Tasman welfare.

The following points are important to reinforce:

1. Both Australia and New Zealand gain in GDP and net welfare terms from mutual recognition. These gains are after accounting for the loss of revenue that flows from mutual recognition. Importantly mutual recognition meets the stated goal for SEM initiatives to consider the net trans-Tasman benefit that may arise.

2. The modelling approach taken is conservative in the application of assumptions, particularly with respect to the level of profit distribution. No dynamic gains are modelled (such as those that may arise from improved product market efficiency, reduced compliance costs, removal of streaming incentives and improved tax system efficiency) and these may well be significant.

3. The modelling indicates that mutual recognition generates more trans-Tasman investment, but not at the cost of any significant diversion from third country markets – these impacts are shown to be very small.

4. Mutual recognition sees an increase in savings and investment in both countries, an important outcome given the policy support in both countries for stronger savings and investment by households.

5. The sensitivity analyses conducted show that the net trans-Tasman benefits and national benefits for both countries remain positive under all scenarios tested. The choice of tax used to replace the initial tax foregone has very little impact on the results.

6. While there may be differing technical views about the application of the modelling technique to the double taxation problem it is the most appropriate and robust approach available. The results for both countries are broadly in line with those that were expected given the problem definition and assumptions made.

The ANZLF recognises that implementing mutual recognition is likely to take two or so years. This means that its implementation would be unlikely to take effect before both countries plan to return to fiscal surplus. Some consideration has been given to whether or not implementation can be phased. The view is that this is not desirable as it would add significant administrative complexity and uncertainty for business, and reduce the benefits available.

In summary the economic analysis clearly shows that double taxation of trans-Tasman investment returns acts like a tariff and creates allocative inefficiencies that adversely impact GDP and national welfare in both countries. Introducing mutual recognition materially addresses these inefficiencies. While it is acknowledged that the quantum of benefit should not be viewed as being overly precise the direction is clear; there is net trans-Tasman benefit. As such the arguments for mutual recognition are persuasive.

Should you wish to discuss aspects of this submission and the accompanying independent report further we would be happy to do so.

Yours sincerely

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Co Chair

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Co Chair