New Zealand Productivity Commission

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Submission Re: Trans-Tasman Mutual Recognition of Imputation Credits.

I wish to submit in favour of trans-Tasman mutual recognition of imputation credits (TTMRIC) on the basis that lack of TTMRIC is a particular obstacle to the operation of small and medium trans-Tasman businesses. This is illustrated by an example drawn from my practical experience as a tax adviser.

Both Australia and New Zealand operate imputation systems so that, unlike the classical tax system, they impose only one level of tax on income derived through the corporate form and ultimately distributed to individual share owners. This prevents the double taxation penalty applying to the use of the corporate form under the classical company tax system. However, in the absence of TTMRIC, this penalty is re-imposed on trans-Tasman businesses. The options taxpayers then have are:

- Not to use the corporate form and to forgo all the organisational efficiencies relating to the use of a separate company;
- Reallocate income and expenses so that net profits are derived and tax is paid in the company where shareholders live and in which credits can therefore be used;
- Cease operating as a trans-Taman business.

For small and medium sized businesses, the option of reallocating income and expenditure is often not viable. They are left with the choice of either ceasing to operate in the corporate form or ceasing to operate as one trans-Tasman operation.

The following is an example. A consultancy firm (so the issue of capital movements is not significant) operates on a trans-Tasman basis providing advice to clients who operate trans-Tasman and thus find it valuable to have joined-up trans-Tasman advice. Revenue is 50/50 Australia and New Zealand and consequentially key consultants are also 50/50 Australia and New Zealand. To retain long-term commitment to the firm, it is commercially necessary for key consultants to have an equal equity share in the firm and to be remunerated from long-term profits.

The business grew out of a New Zealand operation and is established in the form of a New Zealand company. The problem is that if key consultants are shareholders and share in profits through dividends the New Zealand consultants will be remunerated by way of imputed dividends while Australian consultants will receive unfranked dividends. If the company instead operated as an Australian company, the opposite would happen. While consultants are prepared to accept the tax consequences flowing from where they live (different tax rates on the same income levels) it is simply not viable for consultants on one side of the Tasman to receive greatly different income levels

because of the imposition of double taxation on one side of the Tasman but not the other when contribution to profit is similar.

The options for this firm are:

- Cease using the corporate form – use partnership, look-through company rules, limited partnerships etc. The problem is that the corporate form is simpler and has many commercial advantages especially for a firm focusing on long-term growth.
- Break up the firm and operate separately with contractual agreements to try to retain the trans-Tasman service that client's value.

It is non-sensible for the tax system to impose such restrictions on businesses. The tax system should not dictate the form organisations take.

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