



24 June 2021

Attn: Submissions analysis team
Infrastructure Commission
BY EMAIL

Dear Infrastructure Commission

2021 STRATEGY DOCUMENT FOR CONSULTATION

Introduction

1. The Corporate Taxpayers Group ("**the Group**") welcomes the opportunity to submit on the Infrastructure Commission's ("**Commission's**") May 2021 *He Tūāpapa ki te Ora Infrastructure For A Better Future* consultation document. Reflecting the Group's expertise and objectives, the Group's submission will focus in particular on the role the tax system may play in supporting the achievement of the Infrastructure Strategy for New Zealand.

About the Group

2. The Group represents 46 of New Zealand's largest businesses and contributes to the development of tax policy and administration, with a particular focus on business taxes. The Group is an active participant in the tax policy process and believes (given the breadth and depth of experience and knowledge of the Group's members and advisors) that it can provide an excellent sounding board on tax policy-related issues, and a private sector perspective on advice from officials to the Government.
3. The Group assesses tax reform from four perspectives:
 - Contribution: does the reform make a positive contribution to the tax system?
 - Competitiveness: how does the reform improve the competitiveness of the tax system internationally, and how does the reform lead to increased productivity or innovation?
 - Compliance costs: does the reform reduce compliance costs, or does the tax in question warrant the compliance costs imposed?
 - Certainty: are the rules clearly drafted and easy to understand and comply with?

These principles guide the Group's interaction on policy issues and in this submission, provide context to the Group's views in relation to how the tax system can assist in an infrastructure setting.

Contact the CTG:

██████████ Deloitte

██████████

████████████████████

DDI: ██████████

Email: ████████████████████

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.



Summary of submissions

4. The Group strongly believes that the tax system has a role to play in aiding and supporting infrastructure projects in New Zealand, particularly by removing the barriers in the tax system. The Group believes that spending appropriate time considering and implementing some of the changes to the tax settings mentioned in this submission will facilitate investment into infrastructure projects and develop the specialised skills required to produce the best outcomes for infrastructure projects and New Zealanders. These changes aren’t necessarily wholesale and many of them simply suggest fixing inefficient parts of the tax system i.e. removing barriers to investment, so that compliance costs are reduced and certainty is increased.
5. The Group has three key submissions on issues that should be a key focus to assist the successful delivery of infrastructure projects:
 - a. First, the Group considers that the cost of compliance with various rules for non-resident labour (and the corresponding liability if the rules are not met) is an issue for businesses that causes significantly more issues than the tax it brings in. In a survey of the Group this was raised as one of the key outstanding issues to be addressed in the tax system (more generally, outside of an infrastructure context). The Group would like to see some of these rules simplified or addressed, to reduce compliance costs and so the rules do not act as a barrier to getting the specialised labour required for some of these projects. Now is an opportune time to get effective rules in place prior to borders reopening to more skilled labour.
 - b. Second, the Group considers that the current thin capitalisation settings (being the level of allowable debt relative to assets) unnecessarily constrain participation and funding in infrastructure projects, to the detriment of the projects themselves, slowing progress in the infrastructure space and reducing the pool of experienced capital and expertise that can be called upon. The Group would like to see proper consideration given to a third party debt test. That is, debt should be evaluated on the basis of whether or not it represents a substitute for equity; third party debt does not.
 - c. Third, the Group would support the introduction of a projects of national significance regime, as considered and supported by the Tax Working Group. Countries such as Australia have a reduced rate of headline taxation for significant infrastructure projects and it is important that New Zealand remains competitive when international infrastructure businesses are choosing global projects to invest in and work on.
6. Further detail on the Group’s submissions can be found in the attached Appendix, being a letter the Group sent to Inland Revenue and Treasury Officials in July 2020, following a meeting to discuss infrastructure tax issues. This includes the abovementioned issues, as well as other issues the Group believes should also be considered.
7. The Group is happy to discuss the above points in more detail, and address any questions you may have.



8 July 2020

Policy & Strategy
Inland Revenue Department
WELLINGTON

Tax Strategy
The Treasury
WELLINGTON

Dear [REDACTED]

CORPORATE TAXPAYERS GROUP – INFRASTRUCTURE ISSUES

The Corporate Taxpayers Group (“the Group”) is writing to thank Officials for their time at the meeting on infrastructure tax issues on 9 June 2020. The Group found the meeting to be constructive and continues the dialogue from previous meetings covering similar issues.

As discussed at the meeting, this letter has been prepared to provide a list of the Group’s priorities in relation to the infrastructure tax issues raised. The Group has set out the issues raised in three different levels of priority:

1. High priority – *the issues the Group sees having the biggest impact and should be progressed immediately to help New Zealand recover and thrive*
2. Medium priority – *the issues that the Group believes need to be progressed in due course as they will assist New Zealand in moving its economy forward*
3. Low priority – *the issues the Group believes should be considered, particularly if Government priorities change*

The Group’s list of priorities can be found further below, including some detail regarding each of these issues.

The Group strongly believes that the tax system has a role to play in aiding and supporting infrastructure projects in New Zealand. The Group believes that if appropriate time is spent considering and implementing some of the changes to the tax settings mentioned in this letter, this will facilitate investment into infrastructure projects and develop the specialised skills required to produce the best outcomes for infrastructure projects and New Zealanders. These changes aren’t necessarily wholesale and many of them simply suggest fixing inefficient parts of the tax system i.e. removing barriers, so that compliance costs are reduced and certainty is increased.

Also attached to this letter as Appendix One is a note commenting on the issue of tax neutrality as has been raised by Officials in relation to infrastructure. This note highlights that in the international tax area, theoretical, practical, political, and international law restraints make it unlikely any country would aim for the same effective tax rate on inbound, outbound and domestic investment, and that discussions should proceed on this basis. Absent such, there is a high risk that tax will act as a barrier in seeking to attract

Contact the CTG:

[REDACTED] Deloitte

[REDACTED]

[REDACTED]

DDI: [REDACTED]

Email: [REDACTED]

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.



the international investors with the necessary skills to undertake infrastructure investment in New Zealand when other jurisdictions offer clearer and more explicit pathways.

Priority Issues

1. High priority

These three high priority issues have been chosen as they either represent a significant existing barrier facing infrastructure projects in New Zealand, or they represent what should be a key focus to assist infrastructure projects to move forward (note these three issues have been presented in no particular order). These are the issues the Group sees as having the biggest impact and should be progressed as a priority to help New Zealand recover and thrive.

- *Non-resident labour costs.* The cost of compliance with the various rules for non-resident labour (and the corresponding liability if the rules are not met), has consistently been an issue for members of the Group that causes significantly more issues than the tax it brings in. In a recent survey of CTG members this was raised as one of the key outstanding issues to be addressed in the tax system (more generally, outside of an infrastructure context). The Group would like to see some of these rules simplified or addressed, so that compliance costs are reduced and so the rules do not act as a barrier to getting the specialised labour required for some of these projects.
- *Thin capitalisation.* The current thin capitalisation settings unnecessarily constrain participation and funding in infrastructure projects, to the detriment of the projects themselves, slowing progress in the infrastructure space and reducing the pool of experienced capital and expertise that can be called upon. The Group would like to see proper consideration given to a third party debt test. That is, debt should be evaluated on the basis of whether it represents a substitute for equity; third party debt does not.
- *Projects of national significance.* The Group would support the introduction of a projects of national significance regime, as considered and supported by the Tax Working Group. Countries such as Australia have a reduced rate of headline taxation for significant infrastructure projects and it is important that New Zealand remains competitive.

2. Medium priority

These are the issues that the Group believes need to be progressed in due course as they will assist New Zealand in moving its economy forward.

- *Other labour issues (including accommodation).* It needs to be ensured that the existing travel and accommodation rules do not prevent labour flexibility. If we increase infrastructure activity around New Zealand, our workforce will have to retain flexibility to be more mobile – our tax system should mirror this. There is precedent for (temporary) changes such as occurred during the Christchurch rebuild.
- *Pass-through vehicles.* An option for a widely-held tax pass through company would recognise that different investors have different tax profiles and want to be taxed in the same way as if they invested directly.
- *BEPS (including restricted transfer pricing rule).* New Zealand's recent BEPS changes introduced complexity into the tax system, including in relation to the sourcing of foreign capital. There needs to be an appropriate balance between discouraging



avoidance behaviour and encouraging genuine commercial activity. New Zealand's restricted transfer pricing rule (which departs from international norms and can create double taxation) should be reconsidered i.e. an infrastructure exemption.

- *Allowing PIEs to invest in key infrastructure projects.* A select group of PIEs could be allowed to invest in infrastructure projects, to broaden the areas in which a PIE can invest and diversify, as well as to open up another source of funding for infrastructure projects. This would also allow those New Zealanders with money invested in PIEs to help contribute to New Zealand's infrastructure.
- *Depreciation on assets used.* Where infrastructure assets have spill-over benefits to New Zealand, private sector participation could be stimulated through enhanced depreciation rates. This requires the identification of areas of infrastructure where there are both spill over benefits and under investment. In such a case an accelerated depreciation could be used to accelerate activity.

3. Low priority

Additional issues the Group believes should be considered include:

- *BEPS (including hybrids).* Consider how to simplify the hybrid mismatch rules as these require the examination of foreign tax treatments to determine whether a New Zealand interest deduction can be taken, even for some relatively ordinary arrangements.
- *FA rules.* Projects need to manage the volatility of taxation and this can sometimes be achieved by structuring into the financial arrangement rules. Should there be an ability to elect to have the financial arrangement rules apply (or some other similar outcome) to ensure that the tax profile reflects the economics of a profit over time? A simpler or clearer path to provide the same outcome would assist certainty.
- *GST issues in relation to housing.* GST has proven to not only be a barrier, but a deal breaker for investors in relation to social housing projects. If social housing is to be a priority then consideration should be given as to revisiting the rules.
- *Depreciation on designated infrastructure assets.* Infrastructure spend will see builders and funders need to scale up on capital investment. A lot of this investment pay back will be linked to the specific projects and tax depreciation should align with that project timeline.
- *Training / re-training incentives.* There will be greater demand for jobs in certain industries, where there may be some upskilling required. For example organisations may consider up/reskilling their own engineers to move between areas and should we consider enhanced tax deductions for upskilling costs?
- *Other blackhole expenditure.* To ensure no black hole expenditure arises. Despite recently proposed changes in relation to feasibility, black hole expenditure will still be possible in some areas including in relation to remediation expenses and prevention expenses for the environment.

As always, the Group is happy to discuss the above points in more detail, and address any questions you may have.

Section	Question	Yes (%)
Business	1. Has your business experienced a significant decline in revenue?	45
	2. Have you had to lay off employees or reduce staff?	40
	3. Has your business been forced to close temporarily?	35
	4. Have you had to change your business model or operations?	30
	5. Have you experienced a significant increase in expenses?	25
	6. Have you had to seek financial assistance or loans?	20
	7. Have you experienced a significant loss of customers or clients?	15
	8. Have you had to change your pricing strategy?	10
	9. Have you experienced a significant increase in competition?	10
	10. Have you had to change your marketing strategy?	10
	11. Have you experienced a significant loss of inventory or assets?	10
	12. Have you had to change your location or premises?	10
	13. Have you experienced a significant increase in debt or liabilities?	10
	14. Have you had to change your business partners or suppliers?	10
	15. Have you experienced a significant loss of intellectual property or trade secrets?	10
Personal	16. Has your personal life been significantly impacted by the pandemic?	60
	17. Have you experienced a significant loss of family or friends?	55
	18. Have you had to change your living arrangements?	50
	19. Have you experienced a significant increase in stress or anxiety?	45
	20. Have you had to change your diet or exercise routine?	40
	21. Have you experienced a significant loss of sleep or energy?	35
	22. Have you had to change your social life or hobbies?	30
	23. Have you experienced a significant increase in isolation or loneliness?	25
	24. Have you had to change your work-life balance?	20
	25. Have you experienced a significant loss of motivation or interest in life?	15
	26. Have you had to change your financial habits or spending?	10
	27. Have you experienced a significant increase in health issues or medical expenses?	10
	28. Have you had to change your travel plans or habits?	10
	29. Have you experienced a significant loss of hope or optimism?	10



APPENDIX ONE

Note on the Tax Working Group Report and Proposals for New Zealand to Change Income Tax Rules to Encourage Infrastructure Investment

In a submission to the 2018-19 Tax Working Group (TWG) the New Zealand Superannuation Fund (NZSF) suggested changes to New Zealand's tax rules to encourage investment in infrastructure. In particular NZSF suggested a half standard company tax rate on profits on nationally significant infrastructure projects where investors have unique international expertise in funding and managing such projects. Officials in their advice to the TWG opposed this, but the TWG in its Final Report (February 2019 page 78) concluded that NZSF's suggestion "has merit" and recommended "that the Government consider the development of a carefully designed regime to encourage investment into large, nationally significant infrastructure projects that both serve the national interest and require unique international project expertise to succeed." This note reviews the basis of official advice on this issue and why the TWG came to a different view, all in the context of ongoing discussions with officials on tax and infrastructure.

The conclusion reached in this Appendix is that it is misguided to debate this issue in terms of whether tax concessions for infrastructure projects are contrary to a notion of tax neutrality that is fundamental to New Zealand tax policy. References in this context to "tax neutrality" as a policy objective are inconsistent with the international tax policy economic literature and with the Government's own stated policy framework for considering international tax policy issues.

Put another way, tax neutrality might be useful when developing policy towards a chosen tax base. However, when, as a matter of policy decision, one base is favoured relative to another that will introduce a non-neutrality between tax bases. That is the intended outcome; not a policy error. For example, most tax economists probably favour taxing capital income less than labour (see Australia's Future Tax System Review, informally known as the Henry Tax Review published in 2010). This is a non-neutrality between two types of income; but such non-neutrality is intended. In the international tax area, theoretical, practical, political, and international law restraints make it unlikely any country would aim for the same effective tax rate on inbound, outbound and domestic investment.

The Government has stated that it wants to consider a special set of tax rules for certain infrastructure investment. We need a process under which that consideration can usefully take place. Discussions should not be on the basis that tax neutrality pre-supposes no tax concessions unless they can be clearly justified on the basis of factors such as spill-over benefits/externalities. Instead we need to agree a process that involves the following:

- Consideration should be given to whether factors such as the presence of location specific economic rents and foreign tax credits could reasonably lead to the view that any tax on inbound investors in infrastructure would be likely to lead to any tax being borne by inbound investors (and not passed on to costs of the project) – that is tax is not grossed up.
- The next question is whether it is practical and sustainable to identify adequately investment into nationally-significant infrastructure projects and provide lower effective tax rates for such projects.



- If the above questions are answered in favour of lower taxation of investment into nationally-significant infrastructure projects, then the issue is designing the details of such a regime.
- An alternative to implementing lower effective tax rates on investment into nationally-significant infrastructure projects would be to reconsider the judgements leading to the suite of measures over recent years that have increased tax on inbound investment generally.

The Applicability of Tax Neutrality to the Question of How Much to Tax Inbound Investment

Officials' reasons for opposing the NZSF proposal were set out in the Inland Revenue and Treasury paper "Issues Raised by New Zealand Superannuation Fund" of October 2018. Officials' views can be summarised by the following sentences (para 3.7):

"The Secretariat believes that capital productivity is likely to be enhanced by taxing investments as neutrally as possible, which will encourage investment to flow to the areas which generate the highest pre-tax rates of return. It considers that there should be a high burden of proof before moving away from neutral tax settings and does not believe that this burden of proof is satisfied in this case."

This is the orthodox argument for tax neutrality – if taxes subsidise an activity or investment, the investment or activity has the same expected social return (the tax subsidy does not increase the overall return to society) but it does increase the expected private return to the investor so that investments or activities with low social returns take place.

Underlying that orthodox argument is the Diamond–Mirrlees production efficiency result¹. This holds that governments in their policies (including tax policies) best maximise welfare by preserving production efficiency. Production efficiency occurs when units of goods are being supplied at the lowest possible average total cost. This condition is satisfied if the equilibrium is at the minimum point of the average total cost curve. This is the case for the long run equilibrium of perfect competition.

In essence the argument is that the tax system should be as neutral as possible in its impact on investment decisions with issues about how income is distributed being managed through other mechanisms. This still leaves open room for tax concessions etc. where the market produces private returns lower than social returns – spill-over effects, externalities and Pigouvian taxes etc.

These are the arguments for not having concessionary tax treatment for infrastructure put by officials to the TWG but not accepted by the TWG. These are the same arguments presented in post-TWG discussions. Officials have indicated that they are unlikely to support tax changes for infrastructure unless clear spill-over benefits / externality benefits could be identified and, in their view, this had not been shown.

These arguments are relevant for tax policy in a purely domestic context – tax all investment returns at the same effective tax rate to the extent possible, subject to a clear demonstration of the presence of externalities etc. These neutrality arguments are not as relevant in an international context. In the international context the inbound investor faces the tax of two different jurisdictions – its home residence tax and New Zealand source tax. There are DTA based constraints on the extent to which resident

¹ Diamond, Peter A.; Mirrlees, James A. (1971). "Optimal Taxation and Public Production I: Production Efficiency". *The American Economic Review*. 61 (1): 8–27.



country and source country can tax. Should tax neutrality (the same effective tax rate for different investments) be measured by only New Zealand source tax or combined New Zealand plus resident country tax?

International tax economics literature therefore considers efficiency of tax under a different lens with different concepts of neutrality. There is:

- **Capital export neutrality** – Capital export neutrality occurs when the resident country tax burden on capital owned by residents of a particular country is the same whether that capital is invested at home or abroad. Effective tax rates will vary depending on the tax levied by the source state. Capital export neutrality has generally been associated with worldwide taxation coupled with a credit for foreign income taxes. It is sometimes referred to as global welfare maximising since it treats all taxes equally (source and resident) but is not neutral if, as is inevitable, international tax rates vary between jurisdictions. Investments in high tax countries face a higher effective tax rate than investments in low tax countries.
- **Capital import neutrality** – Capital import neutrality is about savings. It requires that all investments in a given country pay the same marginal rate of tax regardless of the residence of the investor. This means that all business activity within a country is subject to the same overall level of taxation. Capital import neutrality tends to be associated with territorial tax systems where the residence country does not tax at all the income derived by residents from offshore. Offshore investors then face one level of tax – the tax of the source state. This is neutral in terms of the source state but obviously not in terms of the resident state – if the source state tax is low the effective tax rate on offshore investment is lower (and not neutral) than if the investment was domestic.
- **The national welfare maximising approach** – The national welfare maximisation approach aims to equalise the social return on investments anywhere in the world from the perspective of the resident (but not the source) state. Resident tax is levied on worldwide income (as per capital export neutrality) but the resident state does not allow credits for foreign taxes and instead treats foreign taxes as a deductible cost.

In addition there are arguments such as the so-called see-saw principle². This argues that for an efficient outcome there is a relationship between the tax on inbound and output investment. Put simply, the *higher* outbound investment is taxed (national welfare maximising) the *lower* inbound investment should be taxed. At the extreme, full tax on outbound investment should be associated with no tax on inbound investment.

All these concepts have support in the economic literature. It is evident that the simple notion of tax neutrality (all investments inbound and outbound facing the same effective tax rate) is not a reliable guide in the international context.

The above seems to be in line with the framework of international tax policy New Zealand has adopted. This was the framework adopted by the McLeod Tax Review 2001³. The essence of the Review conclusion seems to be that the above theory should guide policy in this area but there needed to be a heavy overlay of *pragmatism* in doing so. Nevertheless, the McLeod Review does not support basing international tax policy based on the notion that the policy objective should be “tax neutrality” as is broadly the accepted view with respect to domestic taxation. The position adopted by the McLeod Review seems consistent with the Inland Revenue and Treasury June 2016 paper “New

² The Seesaw Principle in International Tax Policy - Joel Slemrod, Carl Hansen, Roger Procter NBER Working Paper No. 4867 Issued in September 1994 *Journal of Public Economics*, Vol. 65, no. 2 (August 1997): 163-176

³ Issues Paper June 2001 Chapter 6



Zealand's taxation framework for inbound investment – A draft overview of current tax policy settings".

An Alternative – Neutral Taxation of all Forms of Inbound Investment

In discussions Officials seem to have accepted that the above theoretical framework is in fact consistent with lower taxes on inbound investment (including investment in infrastructure) relative to tax on domestic investment. It has been suggested, however, that this supports non-neutrality (lower taxes on all inbound investment) not selective lower taxes for particular types of inbound investment such as infrastructure. This is true with the theoretical international tax literature but it does not take into account the pragmatic overlay recommended by the McLeod Review and endorsed by the 2016 New Zealand inbound investment taxation framework paper.

Economic theory can support zero tax across the board on inbound taxation. The reasoning is that New Zealand taxation of inbound investment is an additional layer of tax (i.e. cost) on such investment that would not apply if such investment were not into New Zealand (this is especially the case where the investor is not subject to tax, has tax losses, or for whatever reasons sees tax as a cost that is not creditable). This raises the total effective tax rate on such investment relative to investments elsewhere.

For the investment to be undertaken by a non-resident they need a competitive post tax rate of return compared with other investment options where there is no New Zealand tax layer. This means the rates of return on New Zealand investment need to be grossed up to offset the New Zealand tax. That means less investment in New Zealand and lower wages for New Zealand workers. The theoretical end result of taxing inbound investment is that the tax burden is borne by New Zealand workers; the foreign investor bears none of the tax burden; but New Zealand resident investors benefit from the gross up in the tax impost by way of higher rates of return on capital. Thus taxing inbound investment simply increases the share of national income going to capital owners and reduces the amount going to labour. Presumably, the opposite outcome than what proponents of taxing foreign investors expected.

However, as emphasised by the 2016 New Zealand inbound investment taxation framework paper, this theoretical framework is subject to several assumptions as to how the real world operates. The paper placed considerable emphasis on location specific economic rents foreign investors may be able to obtain from investing in New Zealand. Location specific economic rents means investors can obtain a higher rate of return than is required for them to invest into New Zealand and higher than they can obtain from alternative investments elsewhere. New Zealand can tax such returns without reducing investment or increasing the required rate of return on capital. The burden of tax on inbound investment is then borne by the foreign investor and not passed on through lower wages.

With this pragmatic overlay, the theoretical argument for keeping the effective tax rate on foreign investors neutral (with the level of the effective tax rate determined by judgements as to the application of the underlying model assumptions) is replaced with a strong argument for non-neutral different effective tax rates depending on the extent of the underlying model assumptions (such as the ability of the foreign investor to access foreign tax credits to offset any New Zealand tax and the presence in New Zealand of location specific economic rents from the intended investment).

Under this approach, where there is clear evidence that the imposition of tax on inbound investment is reflected in a gross up of the cost to New Zealand (or the equivalent requirement for a higher rate of return on the investment), tax should not be imposed or should be imposed at a lower rate. Commentaries note that it is often not easy nor



sustainable to distinguish between different activities for tax purposes and that can be a reason for applying a standard effective tax rate across activities where there is a gross up for tax and those where there is not.

However, there are cases where the government has deliberately removed tax selectively based on a gross up argument. An example is section CW 57 of the Income Tax Act. This section exempts tax on income from such things as leasing of oil drilling equipment. This is on the basis that if tax is imposed such a tax would simply be reflected in higher lease fees because the equipment is internationally mobile. Originally the exemption applied from 2005-06 to 31 December 2014, but the expiry time was extended first to 31 December 2019 and then 31 December 2024.

Factors Specific to Infrastructure Investment

In discussions at the TWG Officials argued, nevertheless, that even if there is a gross up for tax for infrastructure investments, full tax should still be imposed because of the nature of infrastructure spending. This is funded by Local Authorities and the Crown. Both will gross up payments for tax so that (unlike private sector investments) the projects will go ahead despite any tax impost albeit at a higher recorded cost. In other words because they are government, they are not driven by private hurdle rates of return and can factor in the tax into investment calculations.

It was pointed out, however, that local authorities are constrained in their ability to raise funds (debt level constraints and limits on the rating base) some of which is imposed by central government. Officials suggested the Crown could simply make up the difference – for the Crown there was a substitution for higher costs to gross up for tax on foreign investors and extra tax revenue. The Crown should be comfortable grossing up its contribution to meet the higher costs arising from imposing tax on investors because it gets a direct offset by way of higher tax revenue. This, in their expressed view, had the advantage of greater transparency of the true costs of projects – the Crown contribution to projects was not hidden in tax subsidies.

The TWG was not persuaded of this transparency argument. For one thing, if in economic terms the tax should not be levied (because while the payment of tax was levied on foreign investors the burden of tax was passed on to New Zealanders, being the Crown in this case), it was not obviously more transparent to levy the tax and have the Crown offset this with a gross up in contract payments thereby inflating project costs relative to what they would be if tax followed economic principles. That seems on the face of it a distorted, not transparent, presentation of project costs.

In addition, and very persuasive to the TWG, was the argument that if the Crown met the additional project costs of tax by way of grossing up contract prices to cover tax based on the dubious transparency argument, there would be a net additional cost to the Crown, and New Zealand as a whole, if in fact the tax was not collected (either because of the impact of current tax settings or the project does not go to plan i.e. delayed and / or over budget). Inbound investors are usually managing a myriad of different jurisdictional complex tax rules. This often provides several potential avenues to structure investments to not be subject to the full tax intended to be imposed by a source state (through interest charges, consultancy and employee fees, overhead allocations and charges on the use of assets etc). If the Crown grosses up contractual payments for the tax it levies because of stated transparency principles, but does not get the tax offset, there is a clear cost to the Government that seems hard to justify.



Implications

In response to the recommendation of the TWG that the Government consider developing a regime that encourages investment into nationally-significant infrastructure projects, the Government has stated that this will be considered as a high priority issue for inclusion on the tax policy work programme.

In considering this issue, Officials should not argue against lower tax on infrastructure projects on the basis that this would result in tax concessions contrary to the tax neutrality and broad base objectives of tax policy. It should be recognised that the economic literature and explicit international tax policy frameworks that successive New Zealand governments have adopted are not consistent with a tax neutrality argument that would require the effective tax rates on inbound infrastructure investment to necessarily be the same as the effective tax rate applying to purely domestic investment projects.

It is accepted that the literature and accepted frameworks do not necessarily conclude that tax on inbound infrastructure investment should be lower than applying to domestic investment. In considering whether the Government should adopt a tax regime that encourages investment into nationally-significant infrastructure projects, consideration should be given to whether factors such as the presence of location specific economic rents and foreign tax credits could reasonably lead to the view that any tax on inbound investors in infrastructure would be likely to lead to any tax being borne by inbound investors (and not passed on to costs of the project) – that is, tax is not grossed up. In the case of a tax exempt (in its state of residence) sovereign wealth or pension fund bidding for competitive infrastructure tenders attempting to reach close to their normal hurdle rate of return, it is difficult to see these conditions for lower tax being imposed not being met.

If that is the case, the next question is whether it is practical and sustainable to identify particular suitable investment into nationally-significant infrastructure projects and provide lower effective tax rates for such projects in the light of the comments of, for example the McLeod Tax Review, that question the viability of this in a practical sense. Clearly the TWG considered this possible and suggested that this could be achieved through a process involving identifying qualifying projects that serve the national interest and that require unique international project expertise to succeed.

If the above questions are answered in favour of lower taxation of investment into nationally-significant infrastructure projects, then the issue is designing the details of such a regime. NZSF in its submission to the TWG suggested a concessionary tax rate of 14% (half the 28% company tax rate). That is one option but others could be considered.

It is noted that the above is in the context of New Zealand's international tax policy settings that have over recent years seen several measures designed to *increase* the effective tax rate on inbound investment. Presumably this is on the basis of judgements that the assumptions under which the extreme case of no tax on inbound investment generally do not hold true and factors such as the widespread availability of location specific economic rents is such that higher tax rates on inbound investment are justified from a national welfare maximising point of view. In other words, the widespread presence of location specific economic rents is thought to mean that increases in the effective tax rate on inbound investment is not likely to lead to lower inbound investment and higher hurdle rates of return on capital generally. That seems to be the conclusion of the 2016 New Zealand inbound investment taxation framework paper.



To a significant extent it is these measures increasing tax on inbound investment that has led to concerns that these more stringent tax policy settings inhibit the ability to attract inbound investment in infrastructure projects. An alternative to implementing lower effective tax rates on investment into nationally-significant infrastructure projects would be to reconsider the judgements leading to the suite of measures that have increased tax on inbound investment generally. This would recognise that these are judgement calls. Our empirical evidence upon which these judgement calls need to be made is necessarily limited and, as the McLeod Review and others have noted, there is no unambiguous answer as to what are the exact international policy settings that most enhances New Zealand's overall welfare.