Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

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This submission is made on behalf of the Talley's Group Ltd.

Talley's operate principally in New Zealand's primary production sectors of the Seafood, Meat and Dairy industries.

Our submission is focused on reviewing the tax regime governing the depreciation of assets used in New Zealand's primary industries.

<u>Why Change</u>

Investment reform is urgently required if we are to arrest the decline in New Zealand's international competitiveness as observed by the IMF's World Competitiveness Centre. We have slipped from 3rd to 21st place.

New Zealand's economy in the past eight years has been 'propped up' by the Auckland housing programme and the Christchurch rebuild. Neither of these two economic drivers have the potential to power our economy for much longer and when the stimulus of these projects begins to wind down there is little dynamism elsewhere in the economy.

If we want to achieve our annual growth targets it will require a major re-think as how to kick start our economy. New Zealand has to continue to improve its competitive advantage in the meat, dairy, seafood, forestry and other export industries. Our international competitiveness in these key industries underpins the countries standard of living. Currently both our competitiveness and standard of living are currently declining. More importantly investment in regional New Zealand is diminishing with a corresponding loss of job opportunities in the regions.

The accelerated depreciation scheme should be introduced as a targeted incentive scheme designed solely to stimulate growth in regional New Zealand in particular Industries.

<u>Australia versus New Zealand</u>

It is a very simple formula. Unless we maintain and improve our competitiveness as a nation our living standard will fall. Our standard of living is already 35% below Australia's.

- New Zealand is poorer than Australia because we tend to work in low-wage activities. New Zealand's GDP per capita is NZ$120,000 per employee whereas Australia's is NZ$174,000 per employee – ie: (NZ is 31% behind Australia).

- For example tourism in New Zealand earns only $82,000 revenue per employee, which is only 2/3rds of what is needed to maintain our current per capita of GDP. Tourism will not provide a route to greater prosperity. Low paying jobs will not provide the incentive to retain our youth in New Zealand.

- Productivity is not just about how hard people work it is about the nature of the work they do.

To appreciate the problems with the New Zealand economy it is necessary to study why we are falling so far behind Australia's economy.

It is an argument of convenience to simply state that *"Australia is the lucky country they have the mining industry"*. The fact is that the New Zealand Dairy Industry, the engine room of our economy constitutes a larger slice of our GDP than the Australian mining industries share of their GDP.

The Australian mining industry only contributes around 5% of their GDP – employing 1% of their workforce certainly not enough to explain the difference.

The big difference between New Zealand and Australia is labour productivity. Australian workers produce a third more wealth for every hour worked than New Zealand. Largely because they have more capital (Machinery and Technology) to work with.

Our business infrastructure in New Zealand is not well capitalized. Our factories are more reliant on high labour inputs as opposed to automation resulting in low productivity.

Government desperately needs to incentivize New Zealand companies to re-invest in plant and machinery and new technologies.

What can be done?

In our submission there are 2 options:

Option (a) Re-introduction of Accelerated Depreciation on targeted New Capital Assets.

- Accelerated depreciation is effectively cost neutral to Government revenues. It is principally a timing issue for tax collection.

- Only selected assets should qualify.

- The accelerated depreciation scheme could be confined to specified items of new plant and machinery. By limiting the regime to selected plant and machinery the Government could 'steer' the economy into business sectors where there was a proven track record of job creation and export productivity and more importantly export competitiveness.

Two examples would include:

a) Renewal of New Zealand's Ageing Fishing Fleet

b) Expansion of Wood Processing Facilities

a) **<u>Ageing Fishing Vessels</u>**

Currently in New Zealand we have 1292 registered fishing vessels. Many of which are well past their 'used by' date in terms of fuel efficiency and labour productivity. The average age of the New Zealand fishing fleet is now over 30 years.

A new fuel efficient fillet trawler provides work opportunities for 90 crew – on a trip on / trip off rotational employment basis. These fillet trawlers are designed to stay at sea for 55 days duration and operate 24 hours per day, 7 days per week.

- The annual wage bill of a modern factory fillet trawler is between NZ$7 and NZ$8 million per annum.

- These vessels are very capital intensive. A new 70 meter factory trawler costs NZ$55 million to build and equip for fishing in New Zealand waters.

  A 70 meter factory trawler would have a annual catch value of between NZ$25 million and NZ$30 million – 95% of which would be destined for the export market - ie: these vessels are capable of generating their capital value in export receipts in less than 3 years.

- Our suggestion is for a 40% accelerated depreciation schedule to apply to newly constructed fishing vessels that can meet the performance criteria as outlined above.

There are currently 12 joint venture fishing vessels operating in the NZEEZ. Combined these vessels employ over 600 foreign crews sourced from:

- South Korea
- Philippines
- Indonesia
- Ukraine

In order to entice the New Zealand companies who operate these foreign crewed vessels the Government needs to offer incentives to re-flag to vessels suitable for crewing by New Zealanders.

When evaluating the benefit of this policy change it is important to note the employment multiplier factor involved with fisherman at sea. Replacement of these joint venture vessels (JV's) could in effect create over 4,000 new job opportunities for New Zealanders.

For every fisherman at sea an additional 7 work opportunities are created in the shore based support industries of –

- Maritime engineering services
- Carton and packaging manufacturers
- Vessel management services
- Accounting and legal support staff
- Retail sectors in the base port of domicile for the vessels
- Food and service sector
- Employee training and other educational services

b) <u>Wood Processing</u>

The wood processing sector desperately requires incentives to stimulate new plant and equipment to capitalize on our maturing pine forests.

Sawn Timber Millers were once one of the largest employees throughout regional New Zealand. Unfortunately that is no longer the case.

Capital investment in this sector needs to be increased by around $100 million per year. It will not happen without regional investment support for plant and machinery.

These tax deferrals will give New Zealand foresters the 'leg-up' that they desperately need to invest in growing our on-shore wood processing capacity and stop the export of jobs.

New Zealand wood processors have been struggling in recent years, with a spate of mills shutting down, as Chinese demand for logs has driven up prices and created a huge increase in raw log exports from New Zealand.

It is further suggested that the accelerated depreciation regime has a life span of 5 years to enable its effectiveness to be fully evaluated before a time extension beyond five years is granted.

Option (b) Depreciation Recovered Scheme

There is an abundance of plant and machinery items in the New Zealand primary sector that require replacement or upgrade.

Owners of older plant and machinery are in a dilemma owing to the impingement on cash flow following the sale of used plant.

For example a 22 year old fishing vessel with a sale value of $20 million and a book value of only $4 million, would generate a tax liability when sold of $5 million owing to depreciation recovered. This $5 million should rightfully be available for the replacement of the asset.

In our submission to incentivize investment there should be a provision in the tax regime for the full sale value of used plant to be debited to the capital value of the new replacement plant.

Conclusion on Depreciation Incentives

The combination of these two tax policies would provide sufficient incentive to immediately upgrade the aging New Zealand fishing fleet and more importantly replace the fleet of foreign crewed Joint Venture vessels that currently operate within the NZEEZ. They would also go a long way to encouraging much needed investment in our wood processing sector.

Both of these depreciation schemes are cash neutral to the Government and the employment opportunities for New Zealander's and associated PAYE tax revenue would be beneficial to the New Zealand economy.

General

Capital will flow to where its best treated and that place is currently not in New Zealand.

In Australia the depreciation rate is 100% on some selected items of plant. All we have in New Zealand is a 20% loading factor. The 20% loading factor is actually only a loading on the 10% basic depreciation rate. For example: with a palletizing robot the DV rate is 10% and when the 20% loading factor is applied it increases the depreciation rate to only 12%. A 12% rate of depreciation is insufficient to entice the business sector to take equity risks in this current economic climate.

If businesses are offered the opportunity to increase the write off assets on acquisition there would be no loss of tax revenue to the Crown. It would be a timing issue with only minimum interest costs incurred over the extended collection period. However to offset the delay in tax payments the Crown would benefit from the increase in PAYE as a result of the increase in the additional jobs so created *(or preserved)*.

We need to think "outside the square" if we are to maintain a growing economy. The benefits are numerous:

a) The increased investment in plant and machinery made possible with the introduction of an accelerated depreciation scheme will lead to more jobs thereby increasing the Governments tax take via increased PAYE collection. Automation is not about replacing jobs, it is about increasing our global competitiveness to <u>create</u> jobs.

b) Consumer spending will increase causing a multiplier effect in the economy with the associated GST and tax payments.

c) The increased installation of technical equipment will increase productivity and create higher paid jobs particularly in regional New Zealand.

d) It will increase New Zealand's global competitiveness.

e) The increase in economic activity will translate into lower unemployment benefits and a reduced number of social welfare costs.

The accelerated depreciation scheme would act as a catalyst to entice added investment back into the primary sector. In this current economic environment many investment decisions have been put on hold until we can develop policies that will "jump start" the economy.

Yours sincerely,

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