

New Zealand

# Budget Report

18 May 2006



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The Treasurer and Minister of Finance, the Hon Dr Michael Cullen, presented the 2006 Budget Statement to Parliament on 18 May 2006. This CCH Budget Report has been prepared with the assistance of specialist practitioners from Ernst & Young and Bell Gully. It covers announcements of interest to tax practitioners and the business community.

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## 2006 Budget overview

The 2006 Budget contains little in the way of positive announcements for the business sector. Although there is some assistance for export marketing and the Venture Investment Fund, the main emphasis is on the three themes of improving transport infrastructure, extending the Working for Families package and reinforcing national identity.

The concept underlying the 2006 Budget appears to have a number of planks. First and foremost is the commitment to maintain current levels of taxation. The recent Australian example of significant reductions in personal income tax is ignored.

Secondly, spending on health, education and other social policy measures is to be expanded. Building on the dramatic expansion during the 2005 election campaign of the Working for Families regime to benefit upper income families, this package is scheduled to increase by \$1.85 billion over four years (out of a total increase of \$5.8 billion in family assistance over the same period).

Thirdly, there appears to be an awareness that it has now become necessary to make significant contributions to upgrading the nation's roading. An additional \$1.3 billion will be committed to land transport spending over the next five years.

The Government considers that the strength of its finances is due to its wise economic management, in particular the reduction of its indebtedness. The healthy state of Crown finances in turn can be attributed in part to the presence of the New Zealand Superannuation Fund. The Budget papers indicate that the balance of the Fund at 30 June 2006 will stand at \$6.4 billion, increasing to \$12.4 billion by the end of the 2010 financial year.

Little is said about the intergenerational issues raised by the New Zealand Superannuation Fund. The justification for the Fund is to accumulate financial resources today in order to service the Crown's superannuation obligations in some 30 to 40 years. The consequence is that the taxpayers of today provide for the retirees of some time well out into the future. It is highly unlikely there will be any significant commonality of personnel between the two groups.

An alternative, and possibly fairer, approach could have been to relieve the tax burdens of today with the reduction channeled into each taxpayer's provision for retirement.

In his Budget speech the Minister was able to observe that: "The fool who spends on the upturn will find himself broke on the downturn." This expression could suggest that pruning Government expenditure to facilitate tax cuts would be preferable to increased borrowing.

Few would quibble with the announced infrastructure bonds for the purpose of capital expenditure on roading. However, any wider application of the precedent appears to have been ruled out as contrary to the policy of keeping Crown borrowings to a minimum.

In common with arrangements made for funding future superannuation payments, the topic of borrowing also has an intergenerational dimension, particularly in relation to structural assets such as roading. Borrowing to build roads today can be serviced by the taxpayers of tomorrow who use those roads.

Such an approach can be regarded as more fairly matching payers with users.

No further new measures were announced to encourage superannuation or savings. This is in direct contrast to the Australian Government's approach of providing strong incentives to encourage superannuation and savings. The availability of increased savings in New Zealand would undoubtedly assist investment in local businesses and continued local ownership as well as providing retirement benefits to the population.

## Education

### Ministerial statement

"The most important contributor to economic growth in a modern economy is human capital."

### **Editorial comment**

The Budget documents outline a number of expenditure increases directed at improving education and skill levels. These include:

- providing extra registered teachers and 20 hours per week free early childhood education for three- and four-year-olds;
- boosting teacher numbers and school resources;
- increasing the number eligible for student allowances and available bonded merit scholarships;
- providing new operational funding for the tertiary sector for student loans, improving literacy, numeracy, language skills, training for industry, career services and the Performance Based Research Fund; and
- increasing workforce skill levels by expanding apprentice schemes and structured workforce learning.

## **Infrastructure**

### ***Telecom***

#### **Ministerial statement**

“The Government’s announcements two weeks ago on telecommunications included unbundling the local loop, provision for naked DSL, removing the upstream limit on bitstream unbundling and increasing the powers of the Commerce Commission.”

#### **Editorial comment**

The merits of more radical changes are expected to be considered by the Select Committee considering the draft legislation. The Government has already signalled a willingness to effect a structural separation of Telecom. With its adverse implications for investor confidence, this could be taken to suggest indifference or worse to this sector.

## *Energy*

### **Ministerial statement**

“The Government is also aware of the importance of electricity generation and supply issues for business confidence and economic transformation.”

### **Editorial comment**

Increased energy efficiency alone may not be enough; the serious consequences of global warming, high oil prices and uncertain gas supplies suggest the need to increase energy production from renewable resources.

Contingency funding of \$100 million has been budgeted in 2006/07 for working on energy supply solutions and broader climate change policy initiatives.

## *Roading*

### **Ministerial statement**

“The government’s land transport spending is increasing to \$13.4 billion over the next five years to guarantee and accelerate New Zealand’s largest ever road building programme.”

### **Editorial comment**

The package meets the projected five-year shortfall of \$862 million for the previously announced National Land Transport Programme.

Transit New Zealand will separately announce its key deliverables from this funding.

The Minister announced that \$1 billion in infrastructure bonds may be issued to provide a cushion and to fund various major projects including:

- Warkworth Improvements Stage 1;
- Manukau Harbour Crossing (Auckland Western Ring Route);
- Tauranga Eastern Motorway;

- Investigation of Transmission Gully (Wellington Western Corridor);
- Christchurch Southern Motorway; and
- Arahura Bridge replacement.

The adequate supply of appropriately skilled labour will be a challenge that needs to be met if this extensive roading work is to be completed on time and within budget.

### ***Public transport***

#### **Ministerial statement**

“Meanwhile, the Government will continue to work with Auckland and other local authorities on efficient and effective improvements to the public transport system.”

#### **Editorial comment**

This will include enabling local authorities to contribute to the costs of public transport improvements. The national rail network also requires further investment.

## **Review of regulatory frameworks**

#### **Ministerial statement**

“One of the planks of the economic transformation agenda is ensuring that we have a regulatory environment that is appropriate to New Zealand’s unique identity as a small dynamic economy distant from its markets. At the same time it must provide assurance to international investors that New Zealand is a great place to do business and to invest in. The Government’s latest move is to initiate a review of our regulatory frameworks. This review will have both breadth and depth and will be largely informed and driven by those at the coalface.

The review of regulatory frameworks, to be led by the Minister of Commerce and Small Business, signals this Government's commitment to a regulatory environment that promotes economic growth, business confidence, globally competitive firms and social wellbeing.

The review, which will be announced in full by the Minister of Commerce next Monday, will look at issues in existing regulatory frameworks that may be unnecessarily constraining business development and economic transformation.”

### **Editorial comment**

This is a rather mysterious announcement. Presumably the Minister of Commerce and Small Business had been advised that the Budget was being presented on 18 May and not 22 May. However, no explanation was forthcoming of the delay in announcements.

It remains to be seen how wide-ranging the review will be. Public debate on regulatory constraints tends to centre on the Resource Management Act and the impediments it allegedly creates. Time will tell whether this topic will be addressed.

## **Export assistance**

### **Ministerial statement**

“...there will be a \$64.2 million increase in market development assistance for firms operating in offshore markets over the next four years, and a \$60 million boost to the venture capital market through the Government’s Venture Investment Fund.

Both are aimed at helping more New Zealand businesses to be globally competitive. By supporting firms to implement their marketing strategies in new markets, we will help grow New Zealand’s export sector. This is crucial to our economic prosperity.

The scheme supports firms to undertake market development initiatives such as market visits, in-market representation, advertising, promotion, and marketing collateral, exhibiting at trade fairs and events, and market research.

It pays up to 50 per cent of a market development project, up to a maximum of \$100,000 a year.”

### **Editorial comment**

The Budget papers explain that the \$64.2 million will be disbursed as Enterprise Development Grants. Any such grant will be a contribution of up to 50% of a market development project, subject to a maximum of \$100,000 per annum and \$500,000 overall. The grant may be made available for expenditure on market visits, in-market representation, advertising and marketing, exhibitions at trade fairs and market research. Eligibility for a grant will be expanded to businesses with an annual turnover of up to \$50 million (previously \$20 million). The papers add that the \$64.2 million comes from a reallocation of existing funds although there is no indication of where the reduction has been made.

## **Research spending**

### **Ministerial statement**

“Budget 2006 commits \$100 million extra into Research, Science, and Technology. \$81 million goes to supporting key industries with further investment in pastoral, energy, biodiversity and biosecurity research and research capability in Crown Research Institutions. \$16 million goes to accelerate the commercialisation of research.

A greater proportion of research investment will be moved into longer term funding arrangements. This will lead to a growing emphasis on a multi-year funding approach to research, science, and technology.”

### **Editorial comment**

This announcement indicates a significant injection of \$81 million into Crown Research Institutions (CRIs). No further explanation is given concerning the application of these funds.

The budget papers show that the Crown anticipates expenses of \$981 million for CRIs for the 2006 financial year. The papers also anticipate that the Crown will receive \$18.3 million in dividends from these entities.

## **Tax adjustments**

### **Ministerial statement**

“Taxation policy clearly has a role to play in economic transformation. The coming fiscal year sees the full impact of the large changes to depreciation and other business taxation matters which came into force on 1 April. Only now is the significance of these beginning to be understood in some quarters.

Further moves provided for in this year’s Budget include the payment of a subsidy for the use of a payroll agent by employers. This will be at a flat rate of \$2 per pay period per employee for up to five employees. This will cost \$79.4 million over four years.

The other major change is the implementation of the Labour-New Zealand First agreement to lift the economic performance of the racing industry by the alignment of the racing gaming duty with that paid by casinos and by accelerating depreciation for bloodstock. This will cost \$136.5 million over four years.

Attention will now turn to the review of business taxation being prepared by Hon Peter Dunne and me as a result of the Labour-United Future confidence and supply agreement. A discussion document is being prepared with a range of possible initiatives for consideration and debate. Changes will be introduced from 1 April 2008.”

### Editorial comment

For the first time in many years a Budget Statement has very little to announce in respect of the topic of taxation. In the year to 30 June 2006 the Crown expects to collect \$49.46 billion in tax (comprising \$23.59 billion from individuals, \$8.9 billion from companies, \$10.35 billion in GST and \$4.66 billion in indirect tax). Despite the massive revenues the only two tax changes reported in the Budget are the \$2 per day subsidy for payroll agents and the reduction in racing duty of \$32 million per annum.

One topic that is omitted is the limited adjustment to the tax rates announced in the 2005 Budget. Under the earlier announcement it was proposed that there would be minor adjustments to compensate for inflation so as to confer a maximum reduction of \$534 per annum. The adjustments were scheduled to commence on 1 April 2008. In the absence of an affirmation of the proposal it is not obvious what the fate of this measure will be.

Nonetheless the Budget Statement exhibits some sensitivity to this topic. A defence of current taxation levels is mounted with the comment that the projected \$3 billion increase in health spending would be jeopardised by large tax cuts. The contention appears to be that tax cuts beyond last year's modest proposals (due in two years' time) would result in reduced spending on health.

The plausibility of this contention deserves closer scrutiny. In Australia the Federal Treasurer was recently able to announce personal tax cuts totalling \$A36.7 billion over four years. At the same time the Treasurer did not find it necessary to announce reductions in Government spending in the health sector. Indeed, an additional \$A1.9 billion was allocated to health and medical research. In New Zealand, by contrast, the position is alleged to be that any dramatic reduction in taxation revenue must be at the expense of Government spending in sensitive areas such as health.

It is clear that the issue of the appropriate levels of taxation is a political one. It is one of the few issues that provides a substantial point of difference between the political parties.

It is also an issue that can be expected to dominate political debate for some time to come.

The position as it appears to be at the moment is that the present Administration is happy to maintain the current high levels of taxation. For example, the Budget papers show Crown revenue over the period from 2001 to 2006 increasing from \$38.4 billion to \$47.4 billion (resulting in an increase in the Crown's net worth from \$9.7 billion to \$37.4 billion). With the funds in hand the Administration is alleged to be best placed to determine how these revenues should be disbursed. The announcements noted earlier in this report, for example, indicate a new awareness that there needs to be an enhanced commitment to the nation's infrastructure.

The unanswered question is whether taxpayers will accept this approach. The wealth creators in the economy, as those who bear the burden of the policy, may develop the perception that the system has the consequence that a fair reward for their labours cannot be obtained.

Relocation to a more benevolent jurisdiction may be undertaken. In that event the measures noted earlier in this report to upskill the labour force will be fruitless in the absence of employment opportunities.

## Family health

### Ministerial statement

"It is vital that all families, young and old, enjoy more opportunity and security and share in the progress New Zealand is making."

### Editorial comment

Health is mentioned as the biggest investment in families.

Specific new expenditure initiatives in the area of health include:

- a rebuilding of the School Dental Service;
- health checks for four-year-olds and an expansion of well child checks for preschool children;
- more houses for the state housing networks;

- a four-year campaign to fight obesity;
- increased funding for home-based and residential care for the elderly; and
- programmes to help reduce violence, targeting at-risk school leavers, truancy and child behavioural problems.

## Arts and culture

### Ministerial statement

"We are seeing a strong and confident cultural identity emerging and this investment will help our leading arts organisations continue to produce world-class performances with a uniquely New Zealand flavour."

### Editorial comment

Increased funding was announced for Creative New Zealand and NZ on Air for local programming.

## Tourism

### Ministerial statement

"There is no doubt that offshore marketing helps to attract more visitors. In a competitive global tourism market it is vital we do more to ensure New Zealand remains at the forefront of the minds of potential visitors."

### Editorial comment

Extra funding will enable Tourism New Zealand to expand its marketing efforts.

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