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The double-edged knife of tax cuts

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Perfect storm brewing in primary health

The double-edged knife of tax cuts

For some time the Government has whetted the public's appetite with a promise of tax cuts. Budget 2017 is widely expected to be the time these are delivered given the continued and growing surplus.

Conjecture and supposition is building as to what those cuts could mean. Adjustment to the tax rate brackets is seen as a minimum starting point of any change given the impact fiscal creep has had on tax paid by the average worker. Any additional adjustments will depend on how bold the Government wants to be.

Income tax brackets have not been adjusted since Budget 2010, when the Government lowered taxes and raised GST. According to Statistics New Zealand, the 2016 average weekly salary annualised is $58,760, and the marginal tax rate on that is 30%. Back in 2010 the marginal tax rate for the average annual salary was only 17.5%. People have been pushed into higher tax brackets, but their real earnings and purchasing power is still at the average, so they are receiving less in their hands in percentage terms.

Determining the adjustment to the brackets to keep everyone happy will be no mean feat. A simple adjustment to match the inflation effect over seven years will be perceived as what taxpayers are owed - putting people back to where they were. Too little a change, and the Government will suffer from the same backlash Sir Michael Cullen experienced in 2006 when he suggested CPI indexing the tax brackets; he was roundly scorned for only delivering enough to buy a packet a bubble gum.

There could also be targeted adjustments to the brackets, but where to target those is a conundrum.

A tax-free initial earnings bracket which also acts to remove the obligation to file tax returns on small sums of money is common internationally to deliver tax benefits to low income earners.

However, while a tax-free bracket can benefit everyone, there is a large portion of low income earners who pay no tax at all through compensating adjustments such as Working for Families. A lift in the top tax bracket - currently for earnings over $70,000 - will most likely be decried by opposition parties as a tax break for the rich.

And what about middle New Zealand - the perennial group that has historically missed out? Coming into an election year, this takes on greater significance. The battle lines have been drawn with Labour's strong-hold on lower income groups; the middle vote is up for grabs.

Households have an important choice come September. Budget 2017 is an opportunity for the Government to make good on its promise for tax cuts. The question is, how will the Government deliver on these competing pressures so that voters' expectations are meaningfully met?

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Superannuation proving to be a generational balancing act

After only a few months in the top job, Prime Minister Bill English has demonstrated strong leadership by taking on the political hot potato that is superannuation. The announcement that the retirement age will gradually increase to 67 in 2040 is welcomed after almost a decade of being off the table.

The simple fact is that superannuation has become increasingly unaffordable. The number of people in New Zealand aged 65 and over will double in the next 30 years to 1.4 million, which means that the cost of superannuation would triple in the next 20 years from $11 billion to $36 billion.

Making the announcement in an election year is a courageous political step by the Prime Minister. The expectation now is that the Government will also announce its intentions to resume contributions to the NZ Superannuation Fund much sooner than 2020. Even so, the NZ Superannuation Fund is merely designed to take a little of the heat out of the much bigger superannuation funding problem.

> "When the Government ceased contributions to the NZ Superannuation Fund in 2009 it lost out on billions. The fund has had double digit returns, averaging 16.8 percent over the past five years. Ironically the Fund has been one of the largest single contributors to the Government's income tax take for many of these years."

While these levels of returns are exceptional, even with uncertainty and volatility in global markets, the fund is still expected on average to earn a strong 8 percent to 9 percent a year.

The Government is able to contribute due to its strong economic management, resulting in the books being better than expected.

The OBEGAL surplus for the seven months to January 2017 is $1.1 billion. But Government contributions will only take us part of the way. The growth in nominal GDP and the increase in Government revenues are also critical to the funding equation. Superannuation net of PAYE deductions will cost around $11 billion in 2017.

This represents 15% of the core tax take of about $74 billion, on nominal GDP of $264 billion. However, in just 30 years Treasury forecasts the net superannuation cost to be $53 billion and growing, and this represents 21% of the Government's forecast 2047 core tax take of $256 billion on nominal GDP of $916 billion. Achieving this level of GDP growth is key to the forecast funding model, and even if this is achievable, the cost of superannuation as a percentage of the tax take is also rising.

To many, the Government's leadership is too little too late. Superannuation has always been a political hot potato, and not unexpectedly, opposition parties came out strongly against lifting the eligibility age.

The Government has argued that a gradual increase is a fair way to spread the costs and benefits of NZ Super across generations. But someone has to pay. Some say it's the younger population that has the right to feel sold out. However, under Bill English, they will pay in less than otherwise.

The generation divide is growing, perpetuated by high house prices and increasing cost of healthcare, and many blame baby boomers. The upcoming general election creates the perfect environment to push different agendas based on age demographics.

The calls from both sides of the superannuation debate will continue. But the further each side moves its ideology, the less likely the majority of the people will be with them. So perhaps the Prime Minister's retirement age increase will prove to be a master stroke which will take the majority of people with it.

We saw this happen with Brexit which sharply divided people along generational lines, with the younger generation overwhelmingly voting to remain in the European Union, while older voters preferred to leave.

People expect the Government to deal with long term issues like superannuation, but there are no easy answers in striking the balance between what is fair for all generations. The potato is still hot and it may get event hotter.

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Perfect storm brewing for primary health

Increasing demands on New Zealand's current model of primary healthcare will prevent our most vulnerable communities from receiving the services that they need. The storm clouds are gathering; the time for action is now.

The Government's annual investment in healthcare reached a record $16.1 billion last year; this funding is used in the areas you would expect - district health boards, pharmaceuticals, elective surgery, primary healthcare and other programmes. However, this is merely maintaining a system that isn't evolving with population growth, technological change, and that old chestnut of our ageing patient and practitioner population.

The new generation of GPs buying practices have different goals and aspirations than their predecessors. New Zealand's rapidly changing ethnic and aging demographic also means that, compared with the past, these GPs will be overseeing patients with different healthcare needs. If anything this will only make the role of a community GP even more complex. Addressing these issues effectively will be key to creating healthy communities and reducing the burden on secondary care.

The natural tension between primary and secondary care is an interesting one. Secondary care possibly gets more media attention and therefore more focus from Government. The squeakiest wheel always gets the grease first.

From working with numerous primary care businesses I see hard working practitioners toiling away year after year in very modest working conditions passionately doing their very best for their patients with limited resources. These practitioners could easily secure well-paid jobs in a corporate environment without the stress and financial risk of owning a business; in some cases they receive no greater return than a mere salary. There are few if any other privately owned enterprises in New Zealand that are constrained by Government as to what they can charge their customers despite their business operating costs rising at rates greater than the annual rate of inflation as determined by the Ministry of Health. Anyone in business will attest to the ever rising costs - staff and IT to name a few.

There is no doubt that the health sector generally is a priority for all Governments. This year in New Zealand, the right policy and funding decisions will influence the voting public; but simply adding modest amounts of funding to existing models of care won't be enough. Some bold leadership and collaboration between primary and secondary care is required to bring about real, meaningful change. This should involve re-directing funding to primary care initiatives that will make a real difference.

Priorities will vary from region to region; the rural sector is struggling to find practitioners to replace those retiring, and urban practices are dealing with changing needs of diverse population changes. The Royal New Zealand College of General Practitioners' 2016 workforce survey found that nationally, 44% of GPs want to retire in the next 10 years, an increase from 36% in 2013. In our rural communities 88% of South Canterbury and 53% of Northland GPs want to retire in the next decade which poses a significant issue given the current challenge of attracting medical professionals to run local practices. Similarly high rates of retirement have been signaled in many other regions.

Future delivery of primary care in those areas will have to start looking a little different. Some primary healthcare organisations are trying to tackle this issue with the Health Care Homes initiative which has been set up to connect communities with the wider health and social system. The desired outcome is to help people to achieve better healthcare outcomes; however the programme is still in its infancy and it is too early to gauge its impact.

The Government cannot stand still when the prognosis for our primary healthcare system is dire. Given the demand on services, shortages of GPs and nurses, and access to rural healthcare, it is clear we need to invest in a new, sustainable model of primary healthcare for New Zealand to weather the impending storm.

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Is a tax utopia nearly upon us?

Investing in Inland Revenue and our tax system is a smart move by the Government. We're getting much closer to the dream of a utopian tax system that is efficient, well-understood and well-managed.

In Budget 2016 the Government invested $503 million of new funding for Inland Revenue over the next four years, and $354 million of capital funding for its new tax administration system.

The new tax system project, also known as business transformation, will be a billion dollar plus project by the time it is completed. We are all hoping for a dream run from such a large investment, not a nightmare, and that the new IT system and processes will make life easier for all taxpayers.

However, be warned; this new system will mean greater scrutiny; it will protect and enhance the Government's ability to collect tax revenues from New Zealand owned companies and individual tax payers.

Inland Revenue's busy work programme is also increasingly focused on people who have offshore income and offshore assets, and the department has an army of international tax experts to enforce the rules.

Most New Zealand taxpayers only have local tax matters to deal with. However, many Kiwis who have travelled, worked and invested internationally now have more complicated tax issues to work through back in New Zealand. On top of this, record immigration has brought many people to New Zealand, and the complexity and grasp of our tax system on overseas assets and capital value gains takes many new arrivals by complete surprise. The new IT system and ever increasing internal expertise will no doubt assist in bringing many new taxpayers to Inland Revenue's door. Taxpayers with offshore interests can expect more attention from Inland Revenue if their tax obligations are not managed.

It can be challenging and the outcomes will be tough for some, but hopefully it does not have the unintended consequence of driving out those with the skills and capital that we have attracted from overseas – a key migrant demographic that our economy needs. For example, Inland Revenue has recently shined a spotlight on overseas pension and annuity schemes, and in some instances the department has sought to reassess cases that are over 10 years old. In the absence of records still being available or historic disclosures being filed, Inland Revenue's stance is to impose tax. While this may appear harsh, it signals to taxpayers that they have to be savvier in their record keeping with Inland Revenue. Even if a tax obligation doesn't exist, a disclosure of the position may be warranted to ensure a line is drawn in the sand, and that the four year statute bar of limitation on reassessments is in place.

Inland Revenue is also honing in on the tax obligations of New Zealand beneficiaries of foreign trusts who receive income or capital gains from those trusts. Migrants to New Zealand are likely to be affected by this renewed focus. Ignorance of the rules will be no excuse. The rules and Inland Revenue's focus in this specific area will extend to inheritances from overseas deceased estates. Record keeping and disclosures to Inland Revenue are critical to avoid potential disruption and tax risk later down the track.

Inland Revenue has the power and resources to look backwards. Data is now easily obtainable to identify historic inwards bank transfers; taxpayers who do not hold past records or who have not filed disclosures which demonstrate that such receipts did not give rise to a tax liability may have trouble arguing out of a reassessment despite the length of time that has passed.

Inland Revenue is not resting on its laurels and has the budget to invest in its systems. It is actively improving the efficiency of its tax collection. This may not be a utopia for some, but efficient tax collection in a well-performing economy with high performing businesses is what many countries can only dream about.

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Upping the stakes in tax hide and seek

If you were offered a 10 to 1 return on your investment, you would in all likelihood scoff at the very notion of such lofty returns. But the Government has been achieving that, through a proactive focus and an intelligence-led approach into specific areas of non-compliance.

Inland Revenue achieved great returns using its Budget 2012 and 2015 funding to focus on property transactions, complex technical issues, and the hidden economy. This was a clever investment.

In 2016 Inland Revenue exceeded the annual target with these investments contributing $349.1 million to the tax take, a return of $10 for every $1 spent.

As well as the financial returns, this type of activity also has the flow on benefit of a likely increase in compliance levels.

The 'hidden economy', is that part of the economy where people don't disclose their income to Inland Revenue. There are no reliable estimates of the level of lost tax in New Zealand, but it wouldn't be hard to imagine it being hundreds of millions of dollars per annum.

Recently, targeted advertising campaigns in the construction industry have attempted to address under-the-table jobs, with tag lines like 'declare it all or risk everything'. From all accounts the message is resonating. Some begrudge this approach to the 'little man' and think that Inland Revenue should be putting more focus on ensuring multinationals pay their fair share of tax instead.

I view things a little differently. Receiving income and choosing not to declare it, that's tax evasion – nothing short of theft. Anyone, regardless of their size or structure, should be held to account. Anyone justifying their participation in the hidden economy by saying that they already pay enough taxes, or think that if it's ok for Apple or Facebook then it should be fine for them, is simply wrong.

Multi-nationals are complying with the law – it is just that the law is outdated and no longer fit for purpose in today's marketplace. The Government has acknowledged this issue and is collaborating with over 100 countries to implement Base Erosion and Profit Shifting (BEPS) measures. The integrity of the tax system is paramount to it functioning efficiently. Because one part is broken is not a valid reason to deliberately evade your tax responsibilities. Everyone should comply.

Inland Revenue is getting far more sophisticated with its approach to tax collection through an increasing level of data and information. So what's the next area of focus? Property rental websites like Airbnb and Bookabach would seem ripe for the picking.

With a 10 to 1 return, there is guaranteed to be more money in this year's Budget to fund hidden economy initiatives. It is time to make sure we are all operating within the law, not just when it suits us.

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Balancing the battle of the sexes

Recently, Minster for Women, Hon Paula Bennett celebrated a milestone in the state sector as it reached its target of appointing women to 45% of its Boards; and the Minister is determined to increase this number even further.

This is no mean feat in a country where 37% of businesses have no women in senior management, and in a world where the proportion of senior business roles held by women is sitting at 25%; in New Zealand only 20% of these roles are held by women.

Those of you suffering from diversity fatigue might well be asking why women should be appointed to Boards and senior management – shouldn't the best person for the job get these appointments? And who wants to be the token female in a leadership team?

These are fair points, but the facts speak for themselves: women are now just as educated as men, and they're increasingly moving into more male dominated industries including science, technology, engineering and maths (STEM). Women are also just as capable as men, but they're not afforded the same opportunities as their male counterparts, or supported enough to advance their careers.

It will be interesting to see if the Deputy Prime Minister will use Budget 2017 as an opportunity to not only exceed her state sector governance target, but to promote and advance the role of women in the private sector as well.

If this issue made it onto the Budget 2017 agenda, what type of return on investment could be achieved for New Zealand's economy?

It's clearly evidenced that diversity in an organisation improves business performance. Research conducted by Grant Thornton in 2015 revealed that companies with diverse executive Boards offer higher returns on investment compared with those run solely by all-males. The study covered listed companies in India, UK and the US, and estimates the opportunity cost for companies with male-only executive Boards (in terms of lower returns on assets) at a staggering US$655 billion in 2014.

Balancing the different strengths that men and women can offer is a key advantage for companies in a global business environment that is becoming more uncertain and volatile.

A fundamental place to start is in the classroom where unintentional gender partiality can dictate the course of a child's life and subsequently, their career. Teachers can unwittingly convey unconscious biases to students, from tolerating different behaviour from boys than from girls, to praising girls for being neat and quiet, but commending boys for being active and speaking up.

Funding from Budget 2017 to negate unconscious bias in our education system, together with encouraging girls to study STEM, is a worthwhile investment that will reap rewards for our economy in the long term.

In the short term, we need to rapidly shift the number of women in senior management in the right direction; this could be achieved by funding education programmes that give women the confidence to advance their careers. Research from Grant Thornton's latest women in business report demonstrates that men are more confident at putting their name forward for new things even when they're not quite qualified, but women tend to wait until they can tick every box.

The rapid diversity shift achieved in the state sector, and the increased social investment in Budget 2017 are incredibly positive indications the Government is moving in the right direction on some important issues; hopefully there will be room at the table for our aspiring female business leaders too.

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The biggest tech revolution is coming

The world is in the throes of a technological revolution that shows no sign of stopping. We can all see changes in our workplaces and homes.

Technology presents many opportunities for New Zealand, however there are also economic and social costs, and it's concerning how many of our businesses are not aware of just how significant this technological revolution is going to be.

Technology is not just changing the global economy, it is transforming New Zealand's economy too.

Businesses need to consider both disruptive and sustainable technologies. Disruptive technologies can shake up industries, or create completely new ones altogether. Sustainable technologies on the other hand are improvements to those that are already established. They enable businesses to constantly innovate, improve business models and leverage efficiencies.

As change driven by technology accelerates, occupations that have not traditionally been impacted face high risks of automation. Overseas, tech executives are promoting the implementation of a universal basic income (UBI) to solve the widespread unemployment issue that automation is likely to cause. They're joined by tech giant and Tesla CEO, Elon Musk who says that in the future, a UBI will be necessary as,

"…there will be fewer and fewer jobs that a robot cannot do better."

Here in New Zealand, a report by NZIER, commissioned by Chartered Accountants Australia and New Zealand, explores how disruptive technologies may affect Kiwis. The research found that nearly 50 percent of New Zealand jobs are at risk of being automated in the next two decades.

But fear not. NZIER's report also revealed that New Zealand is well placed to respond to change, with our policy settings conducive to building a flexible, dynamic economy. We are also an attractive place to do business. The Government will need to keep an eye on the changes and adjust regulatory settings to ensure the opportunities that arise from technology can be taken.

Budget 2017 and subsequent Budgets should always earmark investment for an education and training system that is resilient, adaptable and inclusive to ensure we can overcome technological challenges. The increasing need for workers with soft skills means the Government must ensure our education system equips New Zealanders with both these and the hard skills necessary for our future jobs. A lift in the skill level of our workforce will elevate our economic performance and competitiveness.

Technology has many benefits for us, socially and economically. Our lives feel easier. We have more time to connect with our friends and families. At work we have more flexibility, we work collaboratively, and have time for the things that matter including people, strategic thinking, coaching.

The levels of innovation, creativity and advanced technology are unprecedented and set to skyrocket, particularly given our small size. Our businesses are well placed to grab the opportunities that are coming with the technological revolution. But for New Zealanders who face an uncertain future, we must invest in a revolutionary approach to ensure we are prepared for the future.

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Time for a rethink about renting

It's no secret that housing affordability is a significant issue for many New Zealand families and our economy as we move towards Budget 2017 and a general election in September.

When it comes to providing New Zealanders in need with quality, affordable housing, we're not quite there yet. According to Census statistics, homelessness is worsening in New Zealand; at least one in every 100 New Zealanders were homeless at the 2013 census, an increase from 1 in 120 in 2006, and 1 in 130 in 2001.

Last year, the Government announced $344 million in funding for emergency housing support for 8,600 people each year, and a key focus of its Social Housing Reform Programme is increasing affordable housing supply.

These are good steps to address the immediate needs of New Zealanders, but is enough being done for the long term?

Put simply, there are not enough properties being built to alleviate population pressure points, particularly in Auckland, not to mention the number of underutilised dwellings throughout the country which sat at just over 185,000 according to the last census; more than 33,000 of these were located in the Auckland region.

However, we must also create an environment and a culture in which New Zealanders are more than happy to rent. This change in mindset is overdue as homeownership is becoming beyond the reach of more and more people.

There are many benefits to renting; including flexibility to move, the ability to live in areas you might not be able to buy a property in, more capacity to invest in savings plans, and no additional costs for maintenance and rates.

A fundamental issue in New Zealand is that our regulations around renting do not encourage the provision of long-term contracts. It is worth looking at other countries to demonstrate that home ownership is not crucial to a healthy economy. Homeownership rates in the Netherlands, Germany and Switzerland rank among the lowest in the developed world; in these countries the rental market is robustly regulated to encourage long-term tenancies.

If implemented in New Zealand, this move would be a significant but beneficial culture change that would require the Government to introduce regulations to incentivise both landlords and renters to consider long term renting. The Government could amend tenancy agreement templates to include longer standard tenancy terms to, for example, 15 years. Setting criteria that provides some predictability for future rent increases would help ensure the quality and affordability of the rental market. This is standard overseas.

Housing quality is also an issue regardless of whether you're renting or buying. More robust regulation is needed to ensure housing meets minimum standards and a quality that long-term or lifelong renters expect.

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