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BUDGET 2014

Expert Analysis

CCH Budget Report

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In this Budget Report

Budget Highlights

Budget 2014 is either dull and dreary or steady-as-she-goes, depending on your point of view. Either way, there certainly isn't much in the way of surprises.

The much-trumpeted surplus is there, albeit not a large one: the forecast is for a $372 million surplus in 2014/15.

"Modest" tax cuts are signalled as a future option to the Government, provided economic conditions permit.

Cheque duty abolished

Cheque duty will be abolished from 1 July 2014.

Tax changes to research and development (R&D)

Two "new" tax measures that were signalled in last year's Budget are explained in further detail in the 2014 Budget:

- Loss-making start-up companies will be able to "cash out" up to $500,000 of their tax losses from R&D expenditure (ie instead of carrying forward the losses, they will receive a cash payment). This cap of $500,000 will eventually rise to a maximum of $2 million.
- Business will be allowed tax deductibility for R&D "black hole" expenditure that is currently neither deductible nor depreciable:
    - Capitalised development expenditure that relates to a patent, patent application or plant variety rights, and which results in a depreciable tangible asset, will be depreciable for taxpayers carrying out R&D.
    - A one-off deduction will be available for capitalised development expenditure that does not result in a depreciable intangible asset.

These measures take effect from the 2015/16 income year.

Changes to parental tax credit and parental leave

- From 1 April 2015, the Government will increase the parental tax credit from $150 a week to $220 a week, and the payment period will be extended from eight weeks to 10 weeks. This increases the total credit from $1,200 to $2,200.
- The abatement rules will also be changed to better target the parental tax credit towards low- to middle-income families.
- Paid parental leave will be extended from 14 weeks to 16 weeks on 1 April 2015 and to 18 weeks on 1 April 2016.
- Eligibility for paid parental leave is extended to "home for life" caregivers and to people in less regular jobs, including seasonal and casual workers.

ACC levy reductions signalled

No definitive decision has been made as to the exact rate of reduction, but the Minister of Finance has signalled that the average ACC levy for a private motor vehicle could fall by $130 a year from 1 July 2015.

Inland Revenue $48 million boost for tax compliance

Inland Revenue is given an additional $48 million in funding to bolster its tax compliance activities.

Duty-free tobacco allowances cut

- From 1 November 2014, the duty-free limit for passengers arriving in New Zealand will be cut from 200 cigarettes to 50 (or from 250 grams of tobacco to 50 grams).
- Tobacco products sent as a gift from abroad that were previously eligible for the $110 duty-free gift allowance are now subject to excise duty and GST.

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Overview

Taxation changes in Budget 2014 are only minor. There are only two changes directly relevant to the business community. One concerns the ability to convert a tax loss attributable to expenditure on research and development into a cash refund, subject to an annual cap on the refund and the possibility of clawback in the event of sale. The other concerns the ability to amortise black hole expenditure.

On the personal front the Budget expands the parental tax credit, proposes the repeal of cheque duty and foreshadows a reduction in levies payable to the Accident Compensation Corporation.

The Budget papers affirm the Government's commitment to "a broad-base, low rate tax system that minimises economic distortions, rewards effort, has low compliance and administrative costs and minimises the opportunities for tax avoidance and evasion". Some major changes concerning a reduction in tax rates, stricter rules for property and an increase in the GST rate were made in 2010 with rejection of other potential tax changes such as a land tax and a capital gains tax. The Budget papers added that "the Government is comfortable with the broad structure of the tax system and has no plans for further major reforms in the near term".

One aspect specifically mentioned was to raise the possibility of "modest" tax reductions at some time in the future. The Budget comments make it clear that any such reductions could occur only if there is an improvement in the Government's overall fiscal position.

Apart from announcing the tax changes, the Budget outlines the Government's thinking on four topics.

The first topic is responsibly managing government finances. Budget 2014 comes closer to delivering on the Government's promise of being back in the black by 2015, with a forecast surplus of $372 million. It is expected to continue running a tight fiscal policy for the foreseeable future, however, in pursuit of its target to reduce net core Crown debt to 20% of GDP by 2020.

Secondly, the Government has also made further investments in science and innovation, continuing one of the themes from last year's Budget. Additional funding has been allocated for infrastructure, including easing Auckland's transport problems and propping up KiwiRail. However, affordable housing received only scraps, namely through the temporary removal of duties and tariffs on certain building materials — expected to reduce the cost of a standard new house by a mere $3,500.

The third topic is the delivery of better public services. The aspects dealt with under this heading mainly concern increasing funding to existing health and education programmes. The modest expansion of paid parental leave from 14 weeks to 16 weeks is a further component of the announcements on public services.

The fourth and final topic addressed in the Budget is to mention continued support of the rebuild of Christchurch. The expected cost for the Government is stated to be $15.4 billion, $7.3 billion of which is to be contributed through the Earthquake Commission.

On Budget night, there was introduction of the Budget Measures (Miscellaneous Fiscal Matters) Bill (dealing with the repeal of cheque duty) and the Budget Measures (Financial Support for Newborn Children) Bill (proposing the announced changes to the parental tax credit).

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Tax changes

Ministerial statement

"The Government is also supporting innovation through two new tax measures. First, loss-making start-up companies will be able to cash out all or part of their tax losses from R&D expenditure. And second, all businesses will be allowed tax deductibility for R&D "black hole" expenditure that is currently neither deductible nor able to be depreciated.

These two measures will return an estimated $58 million in tax to innovative companies over four years.

Mr Speaker,

Cheque duty will be abolished from 1 July this year.

While fewer people now use cheques, they are still common enough for the duty to be a cost for many people and businesses. But the duty doesn't apply to other methods of payment and is simply a compliance cost.

Removing cheque duty will cost $15.5 million over four years.

The Budget also provides Inland Revenue with an additional $132 million over five years to bolster tax compliance. This funding is expected to generate a gross increase in Crown revenue of almost $300 million over five years."

"From 1 April 2015, the Government will increase the parental tax credit from $150 a week to $220 a week, and the payment period will be extended from eight weeks to 10 weeks. This increases the total credit from $1,200 to $2,200.

In addition, the abatement rules will be changed to better target the parental tax credit towards low- to middle-income families. A couple having their second child, for example, will not receive any payments if they together earn more than $99,847.

Boosting the parental tax credit will cost $42 million over four years."

Editorial comment

The only two business tax changes announced in the Budget concern the ability to convert into cash losses attributable to research and development expenditure, and extending allowable deductions to encompass black hole expenditure. The changes are scheduled to commence from the 2015/16 income year.

Research and development cash conversion

The Budget papers outline some of the main principles for the proposed conversion of research and development expenditure into a cash payment to the taxpayer.

These are:

- Twenty per cent of the company's salary and wage expenditure (including contractors) must be on research and development.
- Eligible expenditure must align with accounting standard definitions (such as NZIAS 38 Intangible Assets) of research and development expenditure.
- The company must not be a look-through company, publicly listed or a special corporate entity.
- If the company is a member of a group of companies, the group must be in loss and total group staff costs must meet the 20% threshold.

If the eligibility criteria are satisfied, up to $500,000 of tax losses may be converted into a cash payment. At a 28% tax rate the maximum payment would be $140,000.

The $500,000 cap increases by $300,000 per year to reach a maximum of $2 million (a cash payment of $560,000). Presumably any such cash payment will be classified as an item of excluded income.

There is potential for clawback of the cash payment. There is recovery of the cash payment where:

- the company sells intellectual property
- 90% of the company's shares are sold
- non-resident status is assumed, or
- liquidation occurs.

Black hole expenditure deductible

A number of changes that are proposed in the area of black hole expenditure involve outgoings that do not attract status as an allowable deduction under current tax rules. The proposed changes are:

- Patent, patent application and plant variety rights research and development outgoings incurred after 6 November 2013 become an addition to the depreciable cost base.
- Capitalised development expenditure incurred after 6 November 2013 becomes deductible when the associated intangible asset is written off for accounting purposes (subject to clawback if the intangible asset becomes useful or is sold).
- The cost of registered designs will be depreciable over 15 years.
- Application costs for a registered design will be a current-year deduction if the application is unsuccessful.
- The cost of copyright in an artistic work that is used industrially will be depreciable over 16 years (product designs and casting moulds) or 25 years (works of craftsmanship).

A further measure in this area will be to clarify that the deduction by way of depreciation is available for the successful development of computer software for the taxpayer's own business use.

The appropriate statutory amendments are to be incorporated in the next omnibus tax bill.

Cheque duty abolition

Under Budget night legislation cheque duty is to be repealed as from 1 July 2014.

It may be anticipated that cheque books issued after 30 June 2014 will not have been charged cheque duty. For cheques issued and unused before 1 July 2014 a refund may be available. The cheque book holder will be able to apply to the issuing bank for a refund. The bank will be able to finance the refund out of a reduction to the cheque duty otherwise payable in the bank's final cheque duty return for the period ending 30 June 2014.

Parental tax credit

For children born after 31 March 2015, the parental tax credit will increase from $150 per week to $220 per week (increasing the maximum tax credit from $1,200 to $2,200). In addition, the rate of abatement of the tax credit will increase from the current 3.26 cents in the dollar of additional income to 21.25 cents in the dollar of additional income.

The additional income threshold at which abatement starts depends on the number of children. For example, for a first child abatement starts at family income of $73,724, with the tax credit extinguishing when family income reaches $84,077.

For the third child the comparable figures are $105,263 and $115,616.

ACC levy changes

The Budget indicates that there is scope to reduce ACC levies by some $480 million for the 2015/16 levy year. The Budget observes that this could result in the average levy for a private motor vehicle reducing by $130 as from 1 July 2015.

The final scope of the reduction is to be determined following public consultation by the Accident Compensation Corporation. The Budget papers also note that for the 2014/15 levy year reduced levy rates will result in a reduction of $400 million in levy income for the Corporation.

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Fiscal and economic update

Ministerial statement

"The Government is on track to meet its two key fiscal targets. First, the operating balance before gains and losses is forecast to be in surplus in 2014/15, by $372 million."

"Longer-term projections show net debt dropping to 20 per cent in 2019/20, in line with the Government's target."

Editorial comment

The long-promised fiscal surplus is creeping closer as Bill English's sixth Budget forecasts an operating surplus of $372 million in the 2015 fiscal year. Although still only 0.5% of total operating revenue of $72.5 billion, it would nevertheless be greater than the $75 million wafer-thin surplus forecast in Budget 2013.

The operating surplus is expected to subsequently increase by approximately $1 billion per year, with the outlook for 2018 forecast to be a relatively considerable surplus of $3.5 billion.

The Government has significantly improved its fiscal position from an operating deficit of $4.4 billion in 2013 and expected deficit of $2.4 billion in 2014. This turnaround can largely be attributed to the Government's fiscal restraint, although some favourable tail winds — such as the Canterbury rebuild — also give rise to increasing GDP growth and higher forecast tax revenues.

Real GDP growth is forecast to peak at 3.9% in 2015 before declining to 2.2% by 2018 as the rebuild tails off. Tax revenue is assumed to grow at a decent 5.8% until 2018, although this may be somewhat optimistic given weaker tax revenue than expected in the current year and lower real GDP growth from 2016 onwards.

The expectation of a series of fiscal surpluses has enabled the Government to forecast a reduction in net core Crown debt as a percentage of GDP, which was $55.8 billion (26.2% of GDP) in 2013. In dollar terms the debt is expected to increase to $65.5 billion in 2017; however, as a percentage of GDP it is forecast to steadily decline to 20% by 2020. Budget 2014 reiterates the Government's intention to resume contributions to the New Zealand Superannuation Fund once the 20% target has been achieved.

Although the purse strings have loosened somewhat, the Government intends to maintain a relatively tight fiscal policy over the coming years. The current Budget allowance of $1 billion is set to increase to $1.5 billion in next year's Budget and increase slightly thereafter. This is the Treasury's estimate of the upper limit of Crown spending that is considered to be feasible without having a material impact on interest rates through inflationary pressures. Consequently, Consumer Price Index inflation is forecast to peak at 2.6% in 2016 — well within the Reserve Bank's target band of 1% to 3%.

The prevailing message in Budget 2014, therefore, is one of a job half done. Next year's forecast surplus is expected to be the first of many in order to reduce Crown debt to the Government's target of 20% of GDP by 2020. There is a long way to go yet.

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Building a productive economy

Ministerial statement

"The Government's second priority is to build a more productive and competitive economy that supports higher incomes and more jobs."

Editorial comment

Budget 2014 increases the Government's contribution to New Zealand Trade and Enterprise to support domestic businesses seeking to break into overseas markets, especially in typically underdeveloped markets such as China, South America and the Middle East.

Continuing one of the themes of last year's Budget, the Government appears to remain firmly focused on boosting innovation to develop New Zealand's productivity. Along with the tax changes to research and development losses and black hole expenditure, Budget 2014 allocates a further $57 million to support research in science and innovation and $53 million to establish three more research centres.

Similarly, tertiary education in science and agriculture gets an additional $83 million of operating funding for tuition subsidies, which will be expected to further increase the university funding bias towards the sciences and away from other — less productive? — subjects.

Auckland transport will receive a $375 million interest-free loan to push forward a number of new transportation projects being undertaken. In contrast, a relatively paltry additional $20 million has been provided for environmental measures, including helping manage the natural environment. This disparity clearly shows where the Government's priorities lie, although a further investment of $26 million to fight kauri dieback disease is significant.

The combined proceeds from share sales in Genesis Energy and other power companies amounted to almost $4.7 billion, of which Budget 2014 allocates $1 billion to various infrastructure projects. The main investments include $200 million for a West Coast hospital and $172 million for building and upgrading schools, including in Canterbury. Another $198 million has been sunk into KiwiRail with the long-term goal of returning the rail business to profitability.

However, Budget 2014 includes little assistance for the 76.4% of respondents in a recent Stuff.co.nz/Ipsos poll who answered that more help buying a first home would be good for New Zealand. The Government's response in the Budget has been to temporarily remove duties and tariffs on many imported building materials by 1 July 2014 for at least three years, which is anticipated to reduce the cost of a standard new home by $3,500. This will be helpful but hardly game-changing for those struggling to buy in the Auckland housing market.

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Better public services

The third priority set out in the Budget concerns the delivery of better public services. This is a wide-ranging topic encompassing various items of social spending. The list of items includes:

- increasing paid parental leave from 14 weeks to 18 weeks (starting with an increase to 16 weeks on 1 April 2015 followed by an increase to 18 weeks on 1 April 2016) with an expansion of eligibility to seasonal and casual workers, workers with two employers and workers who have recently changed jobs
- free doctor visits and medicine for children under 13
- an additional $156 million over four years in funding for early childhood education
- new funding of $33 million to help identify "at risk" children
- $1.8 billion over four years for new health initiatives ($110 million for elective surgery, $33 million for cancer screening and $20 million for rheumatic fever detection)
- $858 million over four years on education ($359 million on teacher performance awards, $85 million on school operational grants and $111 million on school development and maintenance)
- $100 million over four years on helping beneficiaries move to paid employment
- $30 million on housing for high-need families
- $80 million to assist with the greater use of community housing providers, and
- $535 million over four years to be contributed to the operational funding of the New Zealand Defence Force.

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Rebuilding Christchurch

Ministerial statement

"Budget 2014 provides $50 million of additional funding over the next two years for the Canterbury Earthquake Recovery Authority, in addition to $19 million funded from existing contingencies established in Budget 2013.

As previously announced, funding of $13.5 million will be provided over the next four years to continue the Earthquake Coordination Service, including counselling services and the Canterbury 0800 support phone line.

These initiatives bring the Government's spending and commitments to rebuilding greater Christchurch to $15.4 billion by 2018."

Editorial comment

The fourth priority stated in the Budget concerns the continued support of the rebuild of Christchurch remediating its earthquake damage.

The Budget observes that the estimated cost of rebuilding Christchurch is $40 billion. The contribution of the Government is expected to be $15.4 billion, $7.3 billion of which will be incurred by the Earthquake Commission. Half of the $40 billion estimate is expected to have been outlaid by 30 June 2018.

A number of anchor projects are scheduled to start in 2014, including the $300 million Justice and Emergency Services precinct. Government departments are expected to take up accommodation in the central city in 2016 with the continuation of programmes for the building of new homes and the repair of existing ones.

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