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New Zealand

2020 BUDGET REPORT

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Prepared by
Wolters Kluwer
in-house analysts
with the assistance of
specialist practitioners
from Bell Gully

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This 2020 Budget Report has been prepared by Wolters Kluwer in-house analysts with the assistance of specialist practitioners from Bell Gully. It covers announcements of interest to tax practitioners and the business community.

About Wolters Kluwer

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Utilising the latest technologies, we ensure that our customers have the solutions they need, when they need them, and in the media best suited to their requirements.

Bell Gully

Bell Gully is a leading New Zealand corporate law firm with extensive commercial, corporate, taxation, finance, banking, litigation and commercial property experience.

We are consistently recognised as the market leading legal tax team in New Zealand. From general corporate tax advice, including corporate restructuring, acquisitions and divestments, securitisation and financing to helping clients resolve tax disputes at all levels, customs and excise matters and set up trusts, our clients rely on our tax specialists for their technical excellence, commercial sense and ease of doing business.

In this Budget Report

Budget highlights

Jobs the focus as black clouds gather on the horizon

The Government's response to the COVID-19 pandemic dominates Budget 2020, with much of the focus on injecting funds into the economy to create and sustain employment. Tax measures, which featured heavily in the COVID-19 response during the past six weeks, are noticeably absent.

Painting a sobering outlook for 2020 and beyond, Finance Minister Grant Robertson notes that "this budget is about jobs". The Budget spend reflects that theme with infrastructure investment, business support, funding for housing development and construction, an environmental jobs package, and a trades and apprentices package.

New support measures for businesses affected by the COVID-19 crisis include:

- **A targeted extension of the Wage Subsidy Scheme**. The extension is available for a further eight-week period (ie further to the 12-week period of the existing scheme) for those who have suffered a 50% reduction in turnover in the 30 days prior to application as compared to 2019.
- **Loan scheme for R&D programmes**. A $150 million short-term temporary loan scheme will be launched to incentivise businesses to continue R&D programmes that may be at risk due to COVID-19. The loans will provide one-off finance and will be administered by Callaghan Innovation.
- **Further business support** by way of a $216 million boost to New Zealand Trade and Enterprise to assist exporting firms, and $10 million earmarked for small businesses to improve their e-commerce capability.

Other announcements of note include:

- a $1 billion package to create 11,000 environment jobs (including regional environmental projects, biosecurity, weed and pest control, and additional DOC jobs)
- 8,000 additional public and transitional homes to be built, expected to create $5 billion of construction activity
- a $1.6 billion trades and apprentices package to provide opportunities for New Zealanders of all ages to receive trades training
- a $400 million injection into the Tourism Sector Recovery Plan
- a $3 billion contingency boost for additional infrastructure investment (ie on top of the $12 billion infrastructure scheme announced in January).

Budget overview

Budget 2020 poses unique challenges

The cover of the 2020 Budget announced by the Minister of Finance, the Hon Grant Robertson, features a range of snow-covered mountains. The image is appropriate, for the Coalition Government certainly has a number of mountains it must climb if it is to lead the country to a better economic future. Perhaps it is an omen that the world's highest peak was scaled by a New Zealander.

The arrival of the COVID-19 virus has thrown all previous fiscal forecasts out the window. For the last two months the immediate goal has been ensuring public health is maintained. Now that the spread of the virus appears to be under control (on Budget day there were no new reported cases for the third day in succession), limited business activity has been permitted under Alert Level 2 operations. The Government's attention can now turn to long-term economic rebuilding.

Budget 2020 can be described as a "rainy day" affair. The Government has allocated $15.9 billion for key areas intended to restart the economy. There is a strong focus on infrastructure, together with the preservation and creation of jobs. Notable in this strategy is the extension of the Wage Subsidy Scheme, with an additional $3.2 billion for a further eight weeks. There is also funding for apprenticeships and training. The area of jobs also has a green aspect, with amounts devoted to environmental projects such as pest eradication, waterway improvement and construction of tracks and huts in the conservation estate. The latter approach can be expected to have long-term benefits for tourism, both domestic and international, and reflects the "Wellbeing" approach of an economy that is both productive and sustainable.

Infrastructure will benefit from funding of $3 billion, which will be directed at specific projects to be identified via the Infrastructure Reference Group. Because there will be a regional focus, provision is made for working in partnership with local bodies and the Provincial Growth Fund.

Housing is another key area addressed, with an ambitious target of 8,000 new houses over the next four to five years.

Tourism at the domestic level is intended to be an important part of the economic revival; indeed, it is the only way forward for that sector. The prospect of New Zealand becoming a safe haven in a COVID-19 world may act as a strong incentive for Kiwis to holiday nearer home.

The Budget speech contains no further messages about one potential lifeline for New Zealand — the trans-Tasman bubble. This strategy would see travel restrictions between Australia and New Zealand eased when it is safe to do so. The Prime Minister, the Hon Jacinda Ardern, raised the matter with her Australian counterpart in early May 2020 but further details are evidently yet to come.

Some Budget expenditure items are relatively small but could make a difference for many. Provision for adult education and assistance to those involved in surf lifesaving and Coastguard New Zealand are examples.

Finally, it may be observed that the Budget papers are silent on the topic of payment for the $62.1 billion COVID-19 response package. The papers set out, within broad parameters, how the $62.1 billion is to be spent whilst maintaining a discreet silence on the method of its funding.

From one perspective, this may be thought to be appropriate. Since the COVID-19 pandemic is still unfolding, it is impossible to reliably predict its cost. Perhaps it is more appropriate to decide how the piper is to be paid when the size of the tab is reasonably ascertainable.

For the moment, the approach seems to have been taken that the $62.1 billion will be funded by Government borrowings. However, it would be wishful thinking to believe that the matter will end there. The huge spike in sovereign debt inevitably leads to the question of whether the citizenry will be called upon to help ameliorate the position through increased taxation.

New Zealand will not be alone in confronting this question. Indications from the fourth estate are that most countries in the world will need to grapple with the question of how the sharp increase in Government debt is to be dealt with. Will the taxation lever be pulled, or will there be a reliance on future economic expansion to generate enhanced taxation flows? Once COVID-19 is defeated, this question will no doubt be one of the issues that will dominate political debate around the world.

Economic and Fiscal Update

The Economic and Fiscal Update published by Treasury as part of the Budget papers outlines what the country might see over the next four years. The object is to give an indication of what the economy is most likely to do over the four-year forecast period.

The Update starts with the caveat that drastic uncertainly creates significant challenges when forecasting the economic, tax and fiscal outlook. That uncertainty is compounded by Treasury's view that it will be some time before an effective COVID-19 vaccine is readily available.

The Update observes that $62.1 billion has been made available to support the COVID-19 response. That comprises the $12.1 billion to date and the $50 billion COVID-19 Response and Recovery Fund. Of the latter, some $10.7 billion is committed to extend the Wage Subsidy Scheme and further tax changes (such as $1.6 billion for the loss carry-back measure). It is anticipated that some $20 billion in fiscal support will be allocated in the year to 30 June 2020 (mainly in the June quarter).

The tax policy changes incorporated in the COVID-19 responses announced to date are costed to result in reductions in tax revenue of $1.2 billion for the year to 30 June 2020 and $2 billion for the year to 30 June 2021.

Economic outlook

Treasury expects real GDP to contract by 25% in the June 2020 quarter. This reflects the time spent in Alert Level 3 and Alert Level 4. Economic activity would recover as restrictions are lifted so that by 31 December 2020 economic activity is around 10% lower.

Treasury assumes that by 1 April 2021 all restrictions will be lifted, including border restrictions. Nonetheless, economic activity in the June 2021 quarter is predicted to be 7% lower than the last forecast before COVID-19.

Treasury estimates that the different alert levels constrain economic activity as follows:

Alert Level 4: by 40%

Alert Level 3: by 25%

Alert Level 2: by 10% to 15%

Alert Level 1: by 5% to 10%

In relation to the international outlook, Treasury notes that the IMF is forecasting the global economy to contract by 3% in the year to 31 December 2020. Global growth is expected to rise to 5.8% in the year to 31 December 2021 (although there is extreme uncertainty around the strength of the global economic recovery).

Household balance sheets

Treasury, perhaps unsurprisingly, observes that COVID-19 will have a significant impact on household balance sheets. Household debt is at historic highs, and indebted households may struggle to meet their repayment obligations as incomes fall. It was added that, despite high levels of debt, debt servicing as a percentage of disposable income is at its lowest level on record. Moreover, some alleviation of pressure can be expected from the intention of the Reserve Bank to keep the official cash rate at 0.25% for at least 12 months (that is, at least until March 2021).

Treasury is hopeful that most households will be able to weather the storm.

Discretionary spending by households is also predicted to fall. Discretionary spending is usually 46% of private consumption. Spending on recreation and culture (11% of private consumption) and restaurants and hotels (6% of private consumption) is likely to be particularly depressed in the near term.

Crown tax revenue

Core Crown tax revenue is forecast to be $82.3 billion for the year to 30 June 2020 (previously forecast to be $88.7 billion), $80.1 billion for the year to 30 June 2021 (previously forecast to be $94.3 billion) and $87.3 billion for the year to 30 June 2022 (previously forecast to be $99.2 billion). In other words, for the first two years, the forecast reduction in core Crown tax revenue is $4.2 billion and $2.2 billion respectively. For those two years, the reductions in corporate tax are expected to be $3.6 billion (2020) and $1.8 billion (2021).

Interestingly, PAYE source deductions are expected to grow by $1.8 billion in 2020 and $0.2 billion in 2021. Although fewer people may be in employment, there is a positive offset through wage growth and fiscal drag.

The impact of tax policy changes is also costed. The policy changes, and their costing, are estimated to be the following:

- building depreciation for industrial and commercial property — nil costs for 2020 and 2021, with a cost of $1 billion for 2022
- loss carry-back of losses made in 2019/20 and 2020/21 — $1.2 billion in 2020 and $1.9 billion in 2021, and
- increasing from $1,000 to $5,000 the threshold for expensing capital purchases — $0.1 billion in 2021 and $0.8 billion in 2022.

For the future, Treasury forecasts that new rules on the allocation of the purchase price across business assets in a purchase transaction will increase core Crown tax revenue by $0.1 billion in each of 2023 and 2024.

Crown expenses

Treasury notes that New Zealand superannuation numbers are expected to increase by 17.5% over the 2020 to 2024 period from 767,000 to 901,000. At the end of 2024 New Zealand superannuation will be around one half of core Crown social assistance and 16.8% of core Crown expenditure.

Contributions to the New Zealand Superannuation Fund are forecast to be $1.5 billion for 2020 and $0.4 billion for 2021. Part of the contributions will be invested through the New Zealand Venture Investment Fund.

Crown finance costs are forecast to grow by around $0.8 billion by 2024. This is primarily because of the interest on the borrowings raised to meet spending. A net operating cash deficit of $21.8 billion is expected for 2019/20.

Tax policy changes

Treasury notes the proposal to relax the loss continuity rules in order to encourage the growth of start-up companies. A discussion document on the topic is foreshadowed.

In relation to other possible tax policy changes, Treasury observed that the focus of the Inland Revenue work programme will be on supporting New Zealand businesses through the COVID-19 crisis and facilitating the recovery.

Treasury also noted that tax in dispute under challenge proceedings is $141 million as at 31 March 2020. This is a slight increase from the $134 million tax in dispute as at 30 June 2019.

Borrowings

Treasury is forecasting that for the year to 30 June 2020 Government borrowings through bonds and bills will be $74.29 billion (previously forecast to be $65.33 billion). The borrowings for these items are forecast to be $112.67 billion for 2021.

Borrowing through settlement deposits with the Reserve Bank are expected to be $35.75 billion for 2020 and $66.83 billion for 2021.

After some adjustments, gross sovereign-issued debt (exclusive of Reserve Bank settlement cash and bills) is expected to be $99.7 billion for 2020 and $138.1 billion for 2021.

Tax take

Treasury projects that the tax revenue from individuals, corporates and GST for 2020 and 2021 will be the following:

- individuals — $39.1 billion (2020) and $38.6 billion (2021)
- corporates — $12.4 billion (2020) and $8.9 billion (2021)
- GST — $19.6 billion (2020) and $19.7 billion (2021).

ACC levies are forecast to raise $2.9 billion in 2020 and 2021.

Wellbeing Budget 2020: Rebuilding Together

Ministerial statement

> *The COVID-19 Response and Recovery Fund, established through this Budget, will be used to support New Zealanders through each stage of the impact of the virus. It is designed to not only support the immediate response but also provide support, as necessary, over the longer term to rebuild our economy and society.*
>
> *We have already committed $13.9 billion of the Fund to previously announced initiatives, including funding for the Wage Subsidy Scheme, the essential workers leave scheme, SME support measures, the Business Finance Guarantee Scheme, and additional packages to support the health response, and resources for those in need.*
>
> *Today we are announcing a further $15.9 billion in funding focused on key areas that will kick-start the economic recovery, create decent, sustainable jobs, ensure the security of our most vulnerable, and lay the groundwork for us to rebuild a better nation together.*

Editorial comment

In the eight weeks leading up to Budget 2020, the New Zealand Government made several key legislative and policy announcements in response to the COVID-19 pandemic. These earlier measures focused on business support and ranged widely to include a wage subsidy scheme, significant tax relief, an interest-free loan scheme, and temporary relaxation of some statutory obligations in relation to insolvency and compliance.

Budget 2020 formally establishes the $50 million COVID-19 Response and Recovery Fund. Noting that $13.9 million has already been committed, Minister Robertson has announced a further $15.9 million in funding, which includes:

- a targeted extension of the Wage Subsidy Scheme (ie an eight-week extension to the already established 12-week period) for those who have suffered a 50% reduction in turnover in the 30 days prior to application as compared to 2019
- a loan scheme for R&D programmes (being a $150 million short-term temporary loan scheme to incentivise businesses to continue R&D programmes that may be at risk due to COVID-19)
- further business support by way of a $216 million boost to New Zealand Trade and Enterprise to assist exporting firms, and
- $10 million earmarked for small businesses to improve their e-commerce capability.

Ministerial statement — Health

> *Investment in the health sector has never been more critical. To ensure the sector is able to respond to the pandemic while maintaining the sustainable delivery of existing services, Budget 2020 invests significantly in areas that we know will make a difference to the wellbeing of New Zealanders.*

Editorial comment

Budget 2020 allocates $5.6 billion in services and $755 million in capital investment. The Budget also provides a $160 million increase to PHARMAC's budget.

Funding of $832.5 million is allocated for services to people with long-term physical, intellectual and/or sensory impairment. Maternity services are also singled out, with $177 million to address cost and volume pressures.

Acknowledging the COVID-19 crisis once again, the Government has earmarked $37 million to sustain laboratory testing capacity and provide additional support for ambulance, aged care, disability and hospice services. The Minister also notes that the Government expects "to provide further support to our health sector in the coming months".

Ministerial statement — Primary Industries

> *New Zealand's primary industries play a critical role in growing our economy. As we move further into the post-Covid-19 economic recovery, our primary sector is more important than ever. The core package invests nearly $500 million in initiatives that will ensure our primary industries are supported and sustainable now, and into the future.*
>
> *Funding in the package will support our primary industries with their existing operations and preventing or mitigating the impacts of biosecurity threats and enabling implementation of climate change and ETS reforms.*

Editorial comment

The Government has also pledged $193.5 million to continuing the Mycoplasma Bovis Eradication Programme. The funding supports operational activities (including surveillance, tracking, movement controls and culling infected animals) and contributes to farmers' compensation costs.

Earlier in the year (March 2020) the Government also signalled its intention to introduce tax relief measures for farmers affected by the Mycoplasma bovis outbreak. Farmers who have culled their breeding livestock (including growing replacements) because of Mycoplasma bovis would be allowed to spread the additional income derived as a result of the cull of that stock over the following six years, provided those farmers have:

- used, and continue to use, the national standard cost scheme or the self-assessed cost scheme for their breeding stock, and
- substantially replaced that culled livestock within 12 months.

The proposal will be contained in a tax Bill to be introduced later in 2020. When passed into law, the legislation will have retrospective effect from the 2018 income year.

The Government has also earmarked $43.4 million operating total and $36.2 million total capital for rebuilding forestry Emissions Trading Scheme (ETS) infrastructure. This initiative provides funding to enable the implementation of "new business processes" and implements the reforms set out in the Climate Change Response (Emissions Trading Reform) Bill.

Ministerial statement — Transport

Transport Budget 2020 builds on investment made through the New Zealand Upgrade Programme and includes more than $1 billion to improve transport across the country. This investment will enhance the resilience and reliability of national rail and ferry networks and, over time, contribute to efforts to reduce our carbon footprint through decreasing emissions.

Editorial comment

Budget 2020 builds on the $6.8 billion investment made through the New Zealand Upgrade Programme and includes $197.1 million operating total and $1.1 billion total capital to improve transport across the country.

Included in this allocation is:

- $399.5 million to replace the ageing inter-island ferries, and
- $421.7 million to replace ageing railway locomotives and upgrade mechanical maintenance facilities.

Ministerial statement — Justice Sector

A key initiative in this package is the Next Generation Critical Communications programme which will invest in bringing state of the art communications capabilities to Police, Fire, and Ambulance, supporting healthier, safer, and more connected communities. This will see our emergency services finally able to communicate with the public and with one another all over New Zealand in a safe and reliable manner.

The package also provides funding to enable continued access to justice services, such as funding for legal aid, community law centres, and the Canterbury Earthquakes Insurance Tribunal. Additionally, it provides funding for the newly established Criminal Cases Review Commission.

Editorial comment

Department of Justice court buildings around New Zealand receive a $163.5 million capital upgrade to meet health and safety requirements. The "Next Generation Critical Communications" programme that services New Zealand's emergency services receives $47.8 million in funding to invest and upgrade its network.

Ministerial statement — Education

This Budget invests nearly $1 billion to support the core provision of education services. This will provide substantial support to students across all levels of education, while also targeting investment in areas that we know will benefit students who need it the most.

The Education package makes a significant investment in our early childhood sector. The sector has been placed under particular strain in recent years, and this has been exacerbated by COVID-19. The Budget includes cost adjustments for ECE subsidies and a pay boost for early childhood teachers. The government will make further announcements on support [for] this sector in the near future.

Editorial comment

The education sector also receives $186 million as part of the COVID-19 Response and Recovery Fund, specifically for supporting distance learning for students during lockdown.

Further allocations include:

- capital injections for school properties ($119.5 million)
- learning support for students with high health needs and English for Speakers of Other Languages teaching staff ($79.7 million)
- funding for Early Childhood Education (ECE) subsidies, schools operations grants, trades academies and tertiary education subsidies ($375.1 million)
- a 3.5% pay rise for Qualified Early Learning Education (ECE) teachers and ongoing funding for Kohanga Reo and home-based educators ($291.6 million).

More to come

The Budget papers make it clear that the announcements of 14 May 2020 are not the final word. Treasury observes that the swiftly evolving impact of COVID-19 has meant that the documents released on 14 May do not capture all of the Government decisions with fiscal implications that have been made up until that date.

Decisions that have not been captured in the Budget papers are scheduled to be incorporated in the 2020 Pre-Election Economic Fiscal Update.

The Update is due to be published between 10 and 21 August 2020.

It was indicated that the Update is likely to have only a minor impact given that the adjustments are likely to be for individual decisions taken within the $62.1 billion of expenditure to support the COVID-19 response and recovery. Treasury expects to announce on 22 May those initiatives that were not able to be incorporated in the Budget papers released on 14 May.

Treasury added that expenditure for the 2020/21 fiscal year that does not have existing Parliamentary approval will be the subject of further legislation. The appropriate Estimates Bill will be introduced into Parliament on 14 May 2020.

Some adjustment to the Parliamentary appropriations for the 2019/20 fiscal year may also be necessary. Legislation on that topic is expected to be introduced into Parliament in mid-June 2020.

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