Finance Minister Bill English has delivered a tiny surplus – just 0.3% of GDP. Unlike Budget 2015, he’s not making a big deal of this. Once bitten, twice shy?

The numbers are good but they don’t scream a $3 billion tax cut in 2017 to us. The purse strings have loosened a little, with net new operating spending averaging $1.6 billion per year, the highest under the current National-led government.

This is a balanced budget, seeking both to meet today’s needs and to build a strong foundation for the future. Is the Government managing this balancing act?

Finance Minister Bill English is attempting to deliver on a 20 to 30 year view. That’s shown in his choice of themes and targets – Innovative New Zealand, infrastructure, social investment and health. He’s seeking to set in place the building blocks for a sustainable future.

But has he done enough to meet today’s needs around infrastructure and housing?
Although the Government is spending another $2.6 billion on infrastructure, there is little new in the Budget to address two of the key infrastructure issues facing Auckland: transport and housing.

More than a third of the new infrastructure spending is on transforming Inland Revenue and the tax administration system. On transport, $115 million is to be spent on regional roads in Gisborne, Marlborough and Taranaki and $190 million for KiwiRail to operate its existing rail network. While this is money that needs to be spent, it will not reduce the huge costs the country pays each year from having people and goods sitting on clogged Auckland arterial roads and motorways throughout the day.

Despite hopes there might be some good news on housing, the reality is there is little the government can do on solving Auckland’s housing problems in the short term. It has freed up both surplus land and $100 million of money in the current Budget to move things along, but this will only make a small impact on Auckland’s housing supply given building consents are currently running at $4.1 billion per year at the moment. Perhaps the bigger impact will come from the National Policy Statement on Urban Development the Minister of Finance announced which will, in his words, “direct councils to allow more housing development where necessary and to measure the impact of their decisions on house prices”. This should be taken as a shot across the bows of the Auckland Council that if the finalised unitary plan does not look like addressing Auckland house supply issues, the Government will step in.

The centerpiece of Budget 2016 is a series of 25 initiatives collectively called Innovative New Zealand, to which the government is committing $761 million over the next four years. The aim of this package is to boost science and innovation and upskill New Zealand workers. The scheme will fund a further 5,500 apprenticeships by 2020 and provide $411 million for science and innovation, focused on the Marsden Fund and the Health Research Council. $94 million of the Innovative New Zealand spending is aimed at benefiting regional communities through boosting the Government’s Regional Growth Programme and to develop more regional research institutes – an initiative of Budget 2015 – across New Zealand.
The Innovative New Zealand package is an important step in addressing the problem New Zealand faces trying to get people with the right skills in the right places. High net-migration of skilled workers is currently filling a gap, but it is widely accepted that the current migration levels are not sustainable indefinitely. New Zealanders need the right signals and the right opportunities to upskill for the changing work environment. Hopefully the money in the new package – combined with a clear focus on science, engineering and agriculture – can help New Zealanders make this change.

Headroom for tax cuts?

Despite these constrains and the very hard times that dairy is facing, the New Zealand economy continues to do well. Growth continues to bubble along at a respectable 2.8%, unemployment is forecast to fall to 4.6% and the average wage to rise to $63,000 by 2020. If all of this comes through, the government is forecasting a fiscal surplus of $6.7 billion by 2020. This has allowed the government to shift its focus from generating a surplus to paying down debt. However, forecast surpluses for both the 2016 and 2017 years are a rather modest $700 million. This would not seem to give the Government anywhere near the headroom it would need over the next few years to fund anything like the $3 billion tax cut Mr Key has said he would like to see. Even out to 2020, surpluses are currently fully committed to paying down debt. If there are going to be tax cuts, something’s got to give.
Economic comparison

Australia’s our biggest trading and investment partner. The outwards flow of New Zealanders is well down. Our head-to-head comparison shows the reasons why.

<table>
<thead>
<tr>
<th></th>
<th>New Zealand</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deficit/Surplus</strong></td>
<td>2016 Surplus $0.7 billion (0.3% of GDP)</td>
<td>2016 Deficit A$39.1 billion (2.4% of GDP)</td>
</tr>
<tr>
<td>Paying down debt slowly – 20% by 2020 still a tough ask</td>
<td>2017 Surplus $0.7 billion (0.3% of GDP)</td>
<td>2017 Deficit A$37.1 billion (2.2% of GDP)</td>
</tr>
<tr>
<td></td>
<td>Rising surpluses from 2018</td>
<td>Declining deficits projected until 2020</td>
</tr>
<tr>
<td><strong>Net Debt</strong></td>
<td>2016 25.1% of GDP</td>
<td>2016 17.3% of GDP</td>
</tr>
<tr>
<td>We’re tracking down, but Australia on the up</td>
<td>2017 24.9% of GDP</td>
<td>2017 18.9% of GDP</td>
</tr>
<tr>
<td><strong>Real GDP Growth</strong></td>
<td>2015/16 2.6%</td>
<td>2015/16 2.5%</td>
</tr>
<tr>
<td>New Zealand nudges ahead</td>
<td>2016/17 2.9%</td>
<td>2016/17 2.5%</td>
</tr>
<tr>
<td></td>
<td>2018/19 3.2%</td>
<td>2017/18 3.0%</td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td>0.4%</td>
<td>1.3%</td>
</tr>
<tr>
<td>Under in both countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Interest rates</strong></td>
<td>2.25%</td>
<td>1.75%</td>
</tr>
<tr>
<td>How low can we go?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Average full time wage</strong></td>
<td>$1,110.59 ordinary time average weekly earnings per FTE</td>
<td>Full time adult weekly wage Nov 2015 A$1,145.70</td>
</tr>
<tr>
<td>Wages have a long way to catch-up</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Unemployment</strong></td>
<td>June 2106 forecast 5.6%</td>
<td>April 2016 5.7%</td>
</tr>
<tr>
<td>We’ll call this one a tie</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Taxation comparison**

New Zealand’s relatively efficient business tax system is a major national asset. We’re pleased to see investment in Inland Revenue’s multi-year Business Transformation upgrade. We’re even more pleased to see that English hasn’t bowed to pressure to copy Australia’s diverted profits tax.

<table>
<thead>
<tr>
<th>Tax/GDP ratio</th>
<th>New Zealand</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016 27.9%</td>
<td>2016 24.0%</td>
<td></td>
</tr>
<tr>
<td>Steady as she goes</td>
<td>Hovers around 28% to 2020</td>
<td>Projected rise to 25.9% by 2020</td>
</tr>
</tbody>
</table>

### Headline budget measures

**Digital future ahead**

<table>
<thead>
<tr>
<th>Business Transformation</th>
<th>New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>$857 million over four years to deliver a modern tax system</td>
<td>$503 million new operating funding</td>
</tr>
<tr>
<td>$354 million capital funding</td>
<td>$284 million of savings for Inland Revenue and $280 million in additional tax revenue from greater compliance</td>
</tr>
</tbody>
</table>

- **Ten Year Enterprise Tax Plan**
  - Businesses with turnover of less than $10m will have their tax rate reduced to 27.5%. All company tax rates to decrease to 25% over next ten years.
  - Increase threshold for 37% marginal tax rate from $80,000 to $87,000. Around 500,000 individuals will no longer face 37% marginal tax rate.
- Better targeted superannuation tax
- **Simplifying the tax system**
  - Including rules for taxing financial arrangements
- **Encouraging investment in Australia**
  - Two new forms of investment vehicles
  - Ensuring same tax treatment for asset-backed financing as conventional financing.
- Four annual 12.5% increases in tobacco excise.

### International tax avoidance measures

We were concerned that we’d see a rushed reaction. Taking a careful look at our international tax settings is the right approach for New Zealand.

- None. That’s a good call.
- **New Diverted Profits Tax**
  - Estimated increase in govt revenue of $100m/year from 2018-2019.
  - 40% penalty rate of tax on multi-nationals that attempt to shift Australian profits offshore.
  - Additional $679m in funding for Tax Avoidance Taskforce with strong focus on multi-nationals. Expected to raise $3.7billion over next 4 year.
  - New Voluntary Tax Transparency code for large corporations
  - Introduction of protections for whistleblowers of tax misconduct

### Personal tax rates 2016-17

<table>
<thead>
<tr>
<th>New Zealand</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>$14,000 – 10.5%</td>
<td>$18,200 – nil</td>
</tr>
<tr>
<td>$48,000 – 17.5%</td>
<td>$37,000 – 19%</td>
</tr>
<tr>
<td>$70,000 – 30%</td>
<td>$87,000 – 32.5%</td>
</tr>
<tr>
<td>Above $70,000 – 33%</td>
<td>$180,000 – 37%</td>
</tr>
<tr>
<td>Above $180,000 – 45%</td>
<td></td>
</tr>
</tbody>
</table>
Business Transformation

Today's announcement has the long game in mind. Business Transformation aims to make it easier for every New Zealander to meet their obligations. Revenue Minister Michael Woodhouse has secured a net $857 million to deliver a modern tax system over the next four years.

Over the period to 2020, Budget 2016 invests $503 million of new operating funding and $354 million of new capital funding for Inland Revenue’s new tax administration system. As Woodhouse says: “It is important that our tax system keeps pace with changes in New Zealanders’ expectations and changing business models.”

Efficient running of our tax system isn’t sexy. No-one ever won a popularity poll on making it easier to pay out money, but a great tax system does matter for our economy. Updating our approach for the digital age is the right call.

Woodhouse aims for small business to be able to devote more time to business rather than tax. “Businesses will find that meeting tax obligations will become part of their normal processes, rather than a separate activity.”

Cuts to existing Inland Revenue budget

What Woodhouse chooses not to emphasis is the extent to which Business Transformation depends on finding savings from Inland Revenue today. As well the $857 million additional funding, Inland Revenue’s existing budget will be cut by $284 million by 2020. That saving will be recycled back into Business Transformation.

What that means the shape of the existing department isn’t yet clear. Our take is that it will mean cuts in staffing. Less need for document processing centres, increased digital and automated compliance meaning fewer overdue debt collectors, fewer auditors and reduced corporate overhead. Inland Revenue will look very different in five years’ time.

A pound of fiscal flesh on the way

It would be a mistake to ignore the main purpose of the tax system: to raise money. The government expects $250 million extra tax through better compliance as a result of Business Transformation. That revenue is kicking in from 2019. English has already booked the money.
International tax

No changes today, but we have been warned. English sets out his position in stark terms..."we are making further changes targeted at multinational companies" He hasn’t specified what these changes will be but it’s clear that information exchange is high on the list following the government’s recent signature of the multilateral competent authority agreement to apply a common reporting standard with other tax authorities.

We were concerned that we’d see a rushed reaction. Taking a careful look at our international tax settings is the right approach for New Zealand.

Tobacco excises

Increasing the price of tobacco is the single most powerful tool to reduce smoking. Tobacco excises have been rising by 10% per annum for the last six years. The 10% rises will continue for the next four years.

This will raise $425 million over the next four years, showing the government’s dilemma over tobacco excises. If smoking reduces, then revenue will need to come from elsewhere.

Tax simplification for SMEs

The main SME tax package was announced in April 2016. It’s part of the wider Business Transformation programme. It includes a pay-as-you-go option for provisional tax for small businesses from 2018 onwards and eliminating or reducing use of money interest for a number of taxpayers. Contractors will also be able to choose a withholding rate, rather than having one set for them. New debt incurred from 1 April 2017 onwards will not be subject to the 1% monthly penalty, being subject to only immediate penalties and interest charges for late payments. This package is expected to cost $187 million over the next 4 years.
The focus here is on innovation. The government wants to encourage entrepreneurship, skills and economic growth.

The Innovative New Zealand package of 25 initiatives will see $761.4 million spent over the next four years in science, skills, tertiary education and regional development initiatives.

The package includes:

- $410.5 million for science and innovation
- $256.5 million for more tertiary education and apprenticeship programmes, particularly in the areas of science, engineering and agriculture.
- $94.4 million to support regional economic development with initiatives to unlock business opportunities and benefit regional communities.

Science and Innovation

We’ll highlight a couple of items in a multi-pronged package.

The biggest single investment is $113.8 million over four years for the new Endeavour Fund, previously known as the Ministry of Business Innovation and Employment Contestable Fund, which has been re-focused towards longer-term, high impact, mission-led programmes of science.

The Endeavour Fund will invest in science that has a strong potential impact on New Zealand’s economy, environment and society. The Fund will increase in size from $182.7 million in the 2015/16 year to $200.4 million by 2019/20.

Buried in the small print is a $4 million spend on the Maori investment fund. This will help more Māori enterprises gain the skills, knowledge and networks they need to get new ventures off the ground and grow existing businesses and asset bases.
You told us that “Faster infrastructure development” is the single biggest thing the government can deliver for business. Budget 2016 delivers a major infrastructure package, which, including Inland Revenue’s Business Transformation will cost $2.1 billion over the next four years. But that infrastructure focuses on tax and schools, not on housing or (to a lesser extent) transport.

As well as Business Transformation, other highlights include:

- $883 million additional investment in school property with nine new schools, 480 new classrooms, two school expansions, and rebuilding of three schools and a kura.

- Regional roading - $115 million for roading projects in Gisborne, Marlborough and Taranaki.

- $190 million for KiwiRail as part of the two year package announced last year.

- $37 million to upgrade and extend the New Zealand Cycle Trail and for community smaller-scale infrastructure projects.

All worthwhile items. Education in particular is our future, but it’s not clear to what extent the spend will contribute to getting Auckland moving or to resolving housing concerns.

As we’ve said before, sorting out New Zealand’s infrastructure deficit is a long game.
Budget 2015 launched the social investment approach.

Social Investment is about improving the lives of most vulnerable people by intervening early and tailoring public services to their needs.

The government sees a series of data driven shifts in the pipeline, with application for education, vulnerable children and targeted interventions.

Budget 2016 continues this approach with a $652 million Social Investment package.

The government has committed $347.8 million over this year and the next four years for the care and protection of vulnerable children and young people.

The recently-announced major overhaul of care and protection will deliver a new child-centred approach by March 2017, with a single point of accountability focused on prevention, intensive intervention, care support services, transition support and preventing youth offending and reoffending.

New funding includes:
- $144.9 million over four years to meet cost pressures and increased demand for services from more children and young people in care.
- $199.9 million over four years, of which $141.5 million is in contingency, plus $3 million in 2015/16 for the transformation programme and for the new child-centred operating model. This includes developing an independent youth advocacy service, raising the age of care and protection, caregiver recruitment and training, workforce training and development, and better access to support for caregivers.

Other elements of the social investment package include
- $61 million to extend Youth Services
- $50 million to reduce barriers to employment
- $43 million to schools to increase support for those 150,000 students most at risk of educational failure
- $40 million for Whanau Ora
Housing and other social investment

Housing

A case of expectations getting ahead of reality?

On housing, the government’s view is that obstacles to the supply of land and housing are the main issues facing the housing market. Budget takes an incremental approach on improving supply. It does not deliver any game changing initiatives. We’re seeing funding to free up land in Auckland and to provide 750 more places to live for those with the most pressing needs.

Health

Any budget needs to spend on Health just to stand still, given demographic and technological change.

Budget 2016 places a further $2.2 billion in health services over the next four years. This funding is mostly routed through District Health Boards.
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