NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Finance and Expenditure Committee

on the

Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill

3 February 2012

NEW ZEALAND BANKERS ASSOCIATION
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Submission by the New Zealand Bankers' Association to the Finance and Expenditure Select Committee on the Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill

About the New Zealand Bankers' Association

1. The New Zealand Bankers' Association (NZBA) works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

2. The following thirteen registered banks in New Zealand are members of NZBA:
   - ANZ National Bank Limited
   - ASB Bank Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - The Co-operative Bank Limited
   - Citibank, N.A.
   - The Hongkong and Shanghai Banking Corporation Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited.

Issues

3. The matter on which NZBA wishes to submit is the proposal to increase the minimum tax equity threshold, which applies for the purposes of the thin capitalisation regime applicable to foreign-owned New Zealand banking groups. The proposed legislation will increase the minimum tax equity threshold from 4% to 6% of risk-weighted exposures (RWE) effective from 1 April 2012.

4. NZBA does not wish to make an oral submission to the Finance and Expenditure Committee (the Committee) on this matter.

5. The thin capitalisation regime which applies to foreign-owned New Zealand banking groups was introduced in 2005. The design of the regime drew heavily from the capital adequacy framework set by the Reserve Bank in a number of aspects, notably for present purposes in aligning the minimum tax equity threshold at 4% with the regulatory minimum of 4% set by the Reserve Bank. Other areas of alignment between the two regimes can be seen in the use of RWE as the calculation base and in the formula for calculating tax equity (and in particular the deductions from it). NZBA believes that the alignment of the minimum tax equity with the minimum regulatory capital requirement was a key element in the design of the tax regime.

6. Given that background, NZBA considers that the first best policy outcome is for there to be continued alignment between the minimum tax equity required for tax purposes and the minimum regulatory capital required under the Reserve Bank framework. While it may be argued that the aims of banking regulation and tax regulation serve different purposes, NZBA considers that there should be a high degree of

congruence between what both sets of regulation stipulate as the minimum equity required in order to undertake a banking business, given that both seek to answer the same or a similar question.

7. Consistent with the above, given that the Reserve Bank is currently considering the capital adequacy framework that it applies and how New Zealand will respond to the transition to Basel III, NZBA believes that ideally any changes to the minimum tax equity are aligned with the timing of any changes to the Reserve Bank capital adequacy framework.

8. The current approach, in moving the minimum tax equity threshold from 4% to 6%, departs from this core principle of alignment.

9. In the circumstances of a pending transition to Basel III capital adequacy framework and the increased levels of capital held by banks in a post global financial crisis world, NZBA's members do not oppose this change. However, NZBA is concerned that any ongoing increases to the minimum tax equity requirements, in isolation from alignment with wider banking regulatory reform, has the real potential to undermine the predictability of doing business in New Zealand. This concern reflects that capital is fundamental to the operation of the banking system, and it is critical that participants in the banking industry have certainty as to the capital requirements that will be imposed on them.

10. NZBA believes that any change to something as fundamental to the banking system as capital needs to continue to be robust in terms of its constituent parts and also the wider regulatory framework. If predictability of business outcome is threatened then this will increase the risk premium associated with doing business in New Zealand. Consequently NZBA believes that there needs to be a commitment to ensuring that banking minimum tax equity requirements are aligned with the Reserve Bank's capital adequacy framework.

11. NZBA would strongly caution against ad hoc changes to the minimum tax equity in isolation from wider regulatory framework and would welcome the Committee noting this concern.

12. NZBA would also like to acknowledge and thank Inland Revenue Department Policy officials for their commitment to rigorous discussion of issues during the consultation process. NZBA believes that such dialogues can only lead to better outcomes for all parties.

13. Please do not hesitate to contact me if you have any further queries.

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