

# **AUCKLAND BUSINESS**

---

Submission on the Auckland Regional  
Council's Draft Long-Term Council  
Community Plan 2006-2016

---

**APRIL 2006**

# AUCKLAND REGIONAL COUNCIL'S DRAFT LONG-TERM COUNCIL COMMUNITY PLAN 2006-2016

## 1 Overview

- 1.1 This submission on the Auckland Regional Council's draft long-term council community plan 2006-2016 (the LTCCP) is made by the a coalition of Auckland business organisations (Auckland Business).<sup>1</sup> Auckland Business is led by Employers and Manufacturers Association (Northern). Other participants are listed below:
- the Auckland Regional Chamber of Commerce and Industry;
  - the Heart of the City;
  - the New Zealand Business Roundtable; and
  - the Property Council of New Zealand.
- 1.2 The members of these organisations have a vital interest in local government in the Auckland region. They are among the ARC's largest ratepayers.
- 1.3 Although Auckland Business is a business sector umbrella group, its perspective is that of the overall interests of the community, not the specific interests of business.
- 1.4 Auckland Business focuses on rating issues. The consortium was formed to examine whether the ARC's rating policy was justified on public policy grounds following the introduction of a differential business rate in 2004/05.
- 1.5 Some members of the consortium are making separate submissions on the LTCCP.
- 1.6 The grounds for the business differential rate have been examined extensively over the last few years.<sup>2</sup> The onus is on the ARC to demonstrate that its rating policies are justified on valid public policy grounds. It has failed to do so. The differential rate lacks any

---

<sup>1</sup> Auckland Regional Council (2006), *Your Region, Your Future: Draft Long Term Council Community Plan 2006-2016*, Auckland Regional Council, Auckland.

<sup>2</sup> Independent reports were prepared by Associate Professor Basil Sharp and Greg Dwyer, see Sharp, Basil (2005), *Beneficiary Assessment for Council Services: Report to the Auckland Regional Council*, Supporting Information Auckland Regional Council – Annual Plan Hearings, 25 May, Auckland Regional Council, Auckland and Dwyer, G E (2005), *Rating Business: A Review of The Sharp Report and An Auckland Regional Council Memorandum on Rating Policy*, report prepared for Employers & Manufacturers Association (Northern) Inc et al, Auckland.

principled rationale and simply reflects an arbitrary decision to impose rates on a section of the community that is poorly represented at the ballot box. Auckland Business submits that the business differential should be phased out over, say, 5 years. The impact on the residential sector can be reduced by applying strict value for money criteria to all spending.

## **2 Rating policy**

2.1 The ARC's rating policy was changed in 2003/04 when it began collecting rates directly from ratepayers rather than via territorial local authorities in its region:

- Before 2003/04 rates were levied at a uniform rate (flat rate in the dollar) on a land value basis. There were some minor exceptions.
- In 2003/04 the ARC adopted the capital value basis except for the biosecurity rate which continues to be set on a land value basis. This change imposed a higher share of total rates than otherwise on the business sector. A uniform rate in the dollar was generally applied.
- In 2004/05 the ARC introduced a business differential rate of 1.5 which was increased to 1.6 in 2005/06. The ARC proposes to retain it at 1.6 in 2006/07. This means that the level of rates payable by a business ratepayer is 1.6 times the rate payable by a residential ratepayer in respect of property with the same capital value. The business differential rate applies to general, biosecurity, parkland purchase and transport rates.

2.2 The main reason stated for the introduction of the business differential rate was that the business sector benefited more than proportionately from the services supplied by the ARC.<sup>3</sup> The draft annual plan for 2005/06, for instance, reported:

The Council has considered the application of a differential on business rates and proposes that the business sector pays a differential of 1.6 times the rate in the dollar applying to other sectors. The Council has based its decision on its assessment of the beneficiaries of the services it provides, the increased expenditure related to the delivery of the Auckland Regional Economic Development Strategy (AREDS) and its assessment of the most equitable allocation of [the] rating burden across the business and non-business sectors.

---

<sup>3</sup> In announcing its decision on 29 June 2004, the ARC stated, "The Auckland Regional Council's introduction of a 1.5 times business differential reflects the Council's view that businesses should pay more for the services they receive."

Some other grounds for the differential rate were also noted.

- 2.3 From the time when a differential business rate was first mooted, members of Auckland Business have pressed the ARC to demonstrate that the business differential rate is justified on the grounds claimed or on other valid public policy grounds. Auckland Business put forward several suggestions to progress this matter with the ARC as it believed that it could be resolved by objective analysis. The ARC declined all such approaches.
- 2.4 On the same day that the decision was taken to adopt a business differential rate (28 June 2004), the ARC resolved to commission a report to assess whether there were additional benefits received by businesses that justify a differential over and above the capital value rating system. Associate Professor Basil Sharp of The University of Auckland was eventually asked to prepare the report. Professor Sharp produced a very competent report which was circulated to councillors in May 2005.
- 2.5 Professor Sharp classified benefits generated by the ARC's activities as general benefits (those attributed to a broad section of the regional community) or direct benefits that accrue to business ratepayers. Most benefits (76 percent by number) were judged to be general benefits. Most activities (79 percent by number) were assessed to have a low likelihood of providing a direct benefit to businesses. Fourteen percent of activities were judged to provide a medium probability of providing a direct benefit to businesses while just 7 percent were deemed to provide a high benefit.
- 2.6 Neither direct benefits nor general benefits were quantified by Professor Sharp. Unless benefits are quantified it is impossible to know whether they are small or large. It is also impossible to assess accurately whether the level of benefits derived by each ratepayer approximates the level of rates paid and whether each category of ratepayers is bearing an appropriate share of total rates. As a consequence, Professor Sharp's report did not provide the assessment that was to be undertaken and it did not immediately assist in resolving the central issue of whether a business differential rate is justified on the main ground cited by the ARC.
- 2.7 Two ARC officers prepared a memorandum to provide some context to the Sharp report for councillors and "to expand" the analysis to reflect the cost of activities that the ARC undertakes. The ARC memorandum ignored the explicit advice in Professor Sharp's report that benefit cannot be equated with the cost of ARC services and could not be quantified within the scope of his study. Several other mistakes were made. The ARC memorandum contained a very low quality analysis.

- 2.8 The real purpose of the ARC memorandum seems to have been to undermine the Sharp report because Professor Sharp did not validate the main argument which the ARC had advanced for the business differential rate. We understand that Professor Sharp asked for an opportunity to present his report to the Council but he was not given an opportunity to do so.
- 2.9 Greg Dwyer was highly critical of the ARC memorandum in his review of the Sharp Report and the ARC memorandum.<sup>4</sup> He examined a large range of papers on the ARC's rating policy which were supplied by the ARC and all arguments advanced by the ARC for a business differential rate. Dwyer reported that none of the papers examined contained an analysis that would justify a business differential rate on the capital value rating basis. Similarly, none of the grounds advanced by the ARC for a business differential were found to be valid.
- 2.10 While Dwyer broadly endorsed Professor Sharp's analysis, he argued that the application of the benefit tax approach, consistent with the framework adopted by Professor Sharp, would be infeasible, except in some limited circumstances. Professor Sharp had suggested that empirical studies would enable the approach to be applied to quantify benefits. The ARC has not, however, undertaken studies along the lines suggested by Professor Sharp and thus the benefit approach cannot be applied on a conceptually and empirically sound basis.
- 2.11 The funding profiles outlined on pages 153 to 169 of the LTCCP purport to allocate the benefits of ARC activities among certain beneficiaries. The analysis seems to take no account of Professor Sharp's analysis. The allocations, though not quantified in most cases, are arbitrary.<sup>5</sup>
- 2.12 Although the main claims underpinning the imposition of a business differential rate in 2004/05 and 2005/06 are impossible to sustain in the light of the Sharp report, the ARC's rating policy for 2006/07 is essentially unchanged. The claimed rationale for the differential has, however, changed substantially. It is now so vague that the criteria are not fully identified:

... Section 101(3) of the Local Government Act 2002 sets out the range of factors that the Council must consider when assessing the appropriate funding sources for its activities. The Council must consider its total rating policy on various groups of ratepayers, and has balanced a range of factors in developing its policy, including equity, exacerbator pays, fairness and benefit received *amongst other criteria*. The Council has balanced a

---

<sup>4</sup> Dwyer (2005), *op cit*.

<sup>5</sup> There are other problems with the analysis.

range of criteria and determined that a business differential of 1.6 is appropriate and reasonable in the context of its overall rating policy.

The Council has also assessed the aggregate rating impacts of its policy in line with the requirements of section 101(3)(a) of the Local Government Act where the Council is required to consider the impact of the allocation of rating liability on the social, economic, environmental and cultural well-being of the community.

The Council has further considered the share of the rating burden applicable to residential and business sectors. With the business differential of 1.6, the business sector will pay approximately 28% of the ARC's rates. ... The current allocation represents a similar share across the different sectors.<sup>6</sup>

- 2.13 The probability that a differential of 1.5 and 1.6 could be justified on the grounds stated in 2004/05 and 2005/06 respectively and that a 1.6 differential can also be justified on the new grounds listed must be close to zero. For instance, implausible claims that spending on particular programmes such as AREDS justified the differential have now been omitted.
- 2.14 It is impossible to escape the conclusion that the business differential rate lacks any principled rationale. It simply reflects an arbitrary decision dressed up by ill-defined and meaningless references to statutory and 'other' criteria.
- 2.15 In the past some councillors have argued that businesses are advantaged relative to residential ratepayers because they can deduct rates for income tax purposes and claim a credit for GST paid on rates. This tax argument may be among the 'other criteria' referred to in the LTCCP. Such claims have been examined over past decade or so by the Audit New Zealand, several tax experts and by Professor Sharp and have been shown to be faulty for the following reasons:
- A firm can only claim a tax deduction for rates because its income is subject to tax. Nobody seriously argues that it is an advantage to be subject to income tax. There was a storm of protest from homeowners to an initial suggestion from the McLeod Tax Review 2001 that income on owner-occupied housing might be brought within the income tax net. Councils are not lobbying the government to make all their activities taxable.

---

<sup>6</sup> Auckland Regional Council (2006), *op cit*, p 148 (emphasis added).

- A GST registered person or firm can claim a credit for GST paid on inputs because supplies (outputs) are subject to GST. The net GST collected is paid to Inland Revenue. There is no advantage for firms. Instead the approach allows GST to be collected in stages without the tax cascading. Councils are broadly treated the same as firms for GST purposes. Are they advantaged by claiming a credit for GST paid on inputs?
- 2.16 The main reason for increasing the level of the differential in 2005/06 was that the share of rates otherwise payable by the business sector would fall from its level in 2002/03. If the same approach were to be applied in 2006/07, the differential would be reduced to 1.5. The ARC claims that the share of rates paid by business and residential sectors are now forecast to be 'similar' to what they were in 2002/03. On the same basis, the shares would have been 'similar' had the differential been retained at 1.5 in 2005/06.
- 2.17 The view that business and residential sectors should pay the same share of total rates as in 2002/03 has become an argument to ratchet up the business differential. The share of rates payable by each sector might be of some relevance in evaluating short-term adjustment caused by changes in property values and aggregate rating requirements. It is, however, of little relevance to a principled approach to rating. What is more, the shares in 2002/03 take no account of the subsequent growth of each sector. The ARC will eventually have to reduce the significance of this factor in its rating decisions.
- 2.18 The grounds for the business differential rate have been examined exhaustively over the last few years. The onus is on the ARC to demonstrate that its rating policies are justified on valid public policy grounds. It has failed to do so. Auckland Business submits that compelling grounds for the business differential have not been established. It should be phased out over, say, 5 years. The impact on the residential sector can be reduced by applying strict value for money criteria to all spending.

### **3 Conclusion**

- 3.1 Auckland Business submits that compelling grounds for the business differential have not been established. It should be phased out over, say, 5 years. The impact on the residential sector can be reduced by applying strict value for money criteria to all spending.