

EMBARGOED UNTIL 2.00 P.M. FRIDAY 21 NOVEMBER 1997

BUSINESS LEADERS' LUNCHEON

REFLECTIONS ON THE WINEBOX

DOUGLAS MYERS
CHAIRMAN
LION NATHAN LIMITED

AUCKLAND
21 NOVEMBER 1997

REFLECTIONS ON THE WINEBOX

One of the marks of the best of politicians is that they can distil the essence of an issue and give the public a lead at times of great confusion. A reason I admire Mike Moore is that he has this gift, and has been prepared to say things that are true, even when deeply unpopular in many quarters.

Writing about the winebox affair shortly after the report of the Commission of Inquiry came out, Mike Moore described it as a dark and ugly period in New Zealand's history, which changed our political, social and business landscape. He said the public hysteria engendered by political opportunism was one of the main reasons New Zealanders voted for MMP. The fallout for business, the economy and our political institutions has been massive.

The winebox will rightly be the subject of studies and debates in schools of politics, law, management and journalism for many years to come. Books will be written about it. In the interests of the community, we must hope that the right conclusions will be drawn. Today I cannot hope to do more than sketch a few broad perspectives on how it might come to be viewed.

I need to make two points at the outset.

First, the legal process is not yet complete and more information may still come to hand. To this extent the jury may still be out. However, any such developments are unlikely to fundamentally affect the way we should judge these events and those involved in them.

Secondly, nothing that I have to say has anything to do with the current role of Winston Peters as Treasurer. In that capacity, the business community wants to see him succeed in promoting a dynamic, high growth, high employment economy. What business deeply resents, on the other hand, is Mr Peters' unfounded claims which tarnished the reputation of New Zealand business as a whole in the eyes of the public and abroad. This will be part of his record on which he will ultimately be judged in the court of public opinion.

We need to briefly recall what the winebox commission was all about and what it concluded. There were two elements to the Commissioner's terms of reference. The first was to determine whether state officials acted lawfully and competently in dealing with the tax transactions in the winebox, and the second was to consider whether the tax or criminal laws need changing.

The verdict of the commission was unambiguous. There was no evidence of corruption on the part of either the Commissioner of Inland Revenue or the Director of the Serious Fraud Office. There was no evidence of a conspiracy to pervert the course of justice. In respect of the four key transactions, two were judged not to be fraudulent, and in the other two there was no evidence of fraud. The report stated that Winston Peters "grossly overplayed his hand ... there is simply no evidence at all of the existence of such fraud as he alleged in any of the winebox transactions".

The finding that there was no evidence whatsoever of conspiracy or corruption was predictable to anyone who knew anything about the public service and business in New Zealand. Human error is always possible – we have to make judgments about the law in business every day, and we may get them wrong on occasions. But at least in the case of the individuals involved that I knew personally, the idea that they knowingly acted unlawfully and were in conspiracy with public servants was always utterly preposterous. For one thing, a lifetime of involvement in international business and surveys such as those of Transparency International have taught me that the general standards of business conduct in New Zealand are second to none, and that our public service is as free from corruption as any in the world. For another, Winston Peters had a track record of making claims – about things like a ferry touching the bottom of Cook Strait, a Russian cruise ship on a spy mission, and meeting Ronald Reagan – that completely lacked credibility.

How, therefore, can we understand the hysteria that developed over an issue that should have been stillborn? I think we need to explore that question at two levels: the economic environment of New Zealand at the time and the wider political climate.

The winebox transactions took place nearly a decade ago – in the latter part of the 1980s. New Zealand was emerging from decades of self-imposed insularity. Businesses were faced with the challenges and opportunities of operating in an open economy with open financial markets. With the removal of exchange controls, the development of tax policy struggled to keep pace with the internationalisation of the economy. Until October 1986 the top income tax rate was 66 percent and until April 1988 it was 48 percent. Before dividend imputation was introduced there was an extra layer of company tax.

New Zealand's tax system in the mid-1980s was hopelessly out of line with the needs of a more open and dynamic economy. Firms were operating with tax regimes which were relics of an insular, concession-ridden approach to economic policy. New Zealand was not on its own in facing these problems – many of the early Cook Islands transactions, for example, originated from Australia. Roger Douglas was determined to reform the tax system as rapidly as possible but in a principled and comprehensive way, not just to plug so-called 'loopholes' at random. Our international tax regime came in two years ahead of that of Australia, which removed its exchange controls two years before we did. Our accrual rules that govern the tax treatment of financial arrangements were brought in less than two years after the removal of exchange controls whereas Australia has still not got a comprehensive accruals regime. As early as 1989 the OECD was describing New Zealand as having probably the least distorting tax system in the OECD area. The idea that all of these moves ought to have been made simultaneously is other-worldly.

In the more open economic environment, firms had to respond to consumer and shareholder interests, and strive to reduce all the costs of doing business. Tax is one of the largest costs that businesses face. A string of court judgments have confirmed that there is nothing wrong with lawfully minimising tax. As Britain's most senior judge put it in a 1929 case:

No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or his property as to enable the Inland Revenue to put the largest possible shovel into his stores.

The sum total of the voluntary donations the Inland Revenue Department receives each year would not make anyone rich.

This background was poorly understood when the winebox documents were tabled in parliament in 1994. Nor were ordinary New Zealanders familiar with the kind of financing arrangements made possible by New Zealand's integration into international financial markets. These were benefiting firms and the economy by reducing the costs and risks of doing business, but they appeared complex and strange to many people. However, economic factors alone would not have produced the lethal cocktail of the winebox had they not been mixed with political elements that Mr Peters was able to exploit.

In the New Zealand context, these elements included the economic upheavals of the 1980s, the anti-business mentality of New Zealand's socialistic past, the sharemarket crash of 1987 which brought in its wake heavy investor losses, the belief that businesses were not paying their fair share of tax when in fact their profits were severely depressed, some isolated cases of corporate fraud, and the electorate's disgust with broken political promises and its desire to seek revenge. This climate had already led to the infamous 'For the Public Good' television programme with its false allegations about a conspiracy between politicians and business over state asset sales, and was to lead to Mr Peters' equally baseless claim that Mr Selwyn Cushing had attempted to bribe him. Elsewhere the idea that deregulatory changes in the 1980s had ushered in a 'decade of greed' was taken up by America's chattering classes and recycled by their counterparts here, despite the fact that high income Americans were paying more tax (on lower tax rates) than ever before, and that charitable donations rose faster than at any other time in the post-war era.

In such a climate, our political leadership did not prove equal to the task of withstanding Mr Peters' onslaught. Three years and tens of millions of dollars later, the inquiry confirmed that the winebox claims were "false and completely unjustified", but at a huge cost to individual reputations, business, and the political system. We must hope that at least some good comes out of it by way of lessons that all of us should remember.

Beyond the fundamental findings of the winebox commission, there are a number of other issues that need to be put in perspective.

First, some people are still inclined to say: "Well, maybe the transactions were lawful but were they ethical?" The first part of the answer to that question is that if the law is not consistent with generally accepted community standards of morality then there's something wrong with the law. Comments about "pushing the envelope" or "aggressive tax planning" rather miss the point. Your obligation as a company officer or director is no more nor less than your obligation as an individual: it is to abide by the law, and you should face penalties if you don't. But if the road code allows you to drive in normal circumstances at 50 kph you are not a more moral person if you opt to drive at 40 kph. The main difference between tax and many other laws, like the road code, is that it is sometimes harder to determine what the law means and whether your decision will stand up in court. I believe *The Sydney Morning Herald* summed up the position correctly when it wrote:

[W]hile some of the transactions in the Cook Islands may have involved doubtful ethics, corporations are allowed to regard taxes as costs which they have the right to minimise 'to the extent possible within the letter of the law'. This raises the issue, however, of what should be the letter of the law.

But morality does not necessarily end at the boundary of the law. We have to leave room for the operation of moral codes, and there is scope for public debate over what constitutes right conduct. People can and should determine the standards they wish to live by, and most people rightly do not condone artifice and deception. Things did happen in business in the 1980s which people should not be proud of, but above and beyond the law we must allow normal social and economic sanctions to operate. In a business setting, a loss of respect and reputation, and consequent difficulties in getting honest people to do business with you, are powerful sanctions on conduct which falls well short of being criminal or illegal. It is folly to try to legislate for morality, in business or anywhere else. That would be a recipe for a theocracy, not the kind of free society we all value. The law cannot deal with every problem, and

economically the costs of trying to completely eliminate things like tax avoidance by administrative and legal means would vastly exceed the benefits.

A second issue of perspective is that the impression created by Mr Peters and enthusiastically promoted by accomplices in the media was that a number of corporates were avoiding vast amounts of tax and "ripping off" ordinary New Zealanders who had to pay more tax to make up for it. The facts are that the total amount of tax in the winebox transactions assessed as payable by IRD is \$140 million. All of that amount is disputed, and moreover it is a one-off sum. Compare it with the \$100 million annually which the IRD estimates was being avoided when the superannuation surcharge was in place, the similar estimate for annual ACC fraud, and the \$700 million which welfare beneficiaries are estimated to owe the Department of Social Welfare. People rightly concerned about fraud and avoidance behaviour should recognise that such behaviour is not confined to people in their business capacities, and they should not engage in selective morality.

Thirdly, it is important to note that the inquiry found no basic fault with New Zealand's current income tax system. With moves such as the introduction of the controlled foreign company and foreign investment fund regimes and the removal of the inter-corporate dividend exemption, the tax base is now far more comprehensive and robust. There are still problems with the international tax regime, but they are not ones of avoidance. In addition, IRD now has the power to issue binding rulings so that taxpayers know where they stand in grey areas, and a penalties regime has been introduced for unreasonable interpretations of the law. Together with the reductions in tax rates, these initiatives have transformed the tax environment and eliminated many of the incentives and uncertainties that drove tax planning in earlier years.

The commissioner did raise some tax policy issues, the main ones being the issue of form and substance and the issue of legal privilege. In both cases, however, the analysis in the report is loose and confusing.

New Zealand law is essentially based on the form of transactions, subject to their not being a sham or a means of tax evasion. The form versus substance

debate is generating some strange mystique. The principle is fundamental to our legal system, not just to our tax system. A corporate may raise money by discounting bills or by borrowing. The transactions are different, but the result is the same. It is a matter of fact as to which transaction actually took place. Tax law actually softens the normal legal approach by means of the anti-avoidance provisions contained in our taxation legislation. But, subject to these anti-avoidance provisions, why should tax law not recognise and respect the transactions that actually took place? Confused analysis in this area should not lead us to move away from the basic principle that parliament should determine the law and a citizen should be able to rely on the words of a statute as they stand, not be subject to the whims of judges imposing their own interpretations on policy. Who would want an even freer rein on judicial activism than we have had in recent years?

Similarly, legal privilege in our system is an ancient right attaching to clients, not to lawyers. Sir Ronald's comments on legal privilege are far too wide – no one could reasonably suggest the wholesale removal of such a protection. There may be grounds for relaxing the existing rules on both privilege and form and substance, but it is hard to see why the tax area should be singled out. Should privilege also be removed for murder or paedophilia, and should the 'form' of, say, marriages to obtain higher student allowances be disregarded in favour of their 'substance'? Regrettably, Sir Ronald Davison's report made no recommendations for review of the most flagrant abuse of privilege in the winebox context, the abuse of parliamentary privilege by Winston Peters.

Having said all that, it is still reasonable to hold serious misgivings about some aspects of the winebox. For its part, business should be prepared to take its text from Kipling:

Let us admit it freely, as a business people should –

We have had no end of a lesson: it will do us no end of good.

There were useful lessons from the winebox just as there were from the 1987 crash. The crash demonstrated that ultimately businesses can only survive if

they add real value. The winebox demonstrated the pitfalls of letting tax considerations, and not core business strategies, dominate decision making.

Both were the product of pre-1984 bad policies and bad laws. Our focus should be on not repeating the pre-1984 policy mistakes, rather than on castigating those who lost their way in a freer environment – like students on the binge after years of boarding school – or who acted on the incentives that bad policies created. A specific lesson for business is that it should be the first to advocate changes to bad policies and laws that can only store up trouble for business in the long run. I am pleased to say the Business Roundtable and some tax professionals supported the tax reforms Roger Douglas introduced as part of a programme of creating a far more coherent overall business environment, and businesses, tax lawyers and tax accountants who resisted them at the time should heed this particular lesson.

The business community should also be a supporter of high quality tax administration. Just as with any other areas of the law, tax law must be effectively administered so that lawbreakers don't prosper at the expense of those who abide by it. This means IRD must be able to attract and retain specialists who are the equal of those in companies and law firms. Many of New Zealand's commercial sector difficulties in recent years have been due not to poor law but to poor enforcement. I do not think we have in the IRD an organisation anywhere near as good as it should be. This is not a criticism of IRD management. It is simply that despite years of public sector reform, IRD is subject to constraints and provides levels of service in its core areas that the internationally competitive parts of the private sector could not tolerate. What business but the IRD could fail to answer 25 percent of its telephone calls and survive? The fact is that in New Zealand, public sector reform has stalled and gone backwards.

Another lesson for business is that standards change, and practices that might have been acceptable at one time no longer apply at another. Ten or 15 years ago, for example, the term 'due diligence' was seldom used. Now far deeper inquiries are routine before transactions are entered into. There are also higher expectations of corporate governance – many control systems were stretched during the 1980s. Businesses need to think not just about whether decisions

will stand up in court but whether they will pass the '6 o'clock news test' – although this should not mean giving in to every politically correct lobby group. As a result of the winebox, boundary lines have been redrawn in different places. In general, business today must be conscious of managing all forms of risk, including the risk of losing public support for the legitimacy of business endeavours.

But the lessons for business are not the only or even the main lessons to come out of the winebox inquiry.

The most specific lesson should be for Mr Peters and other politicians. His grossly overstated campaign damaged the careers of two senior public servants, and the standing of several New Zealand businesses and leading business people. It pandered to the anti-business prejudices of the significant element in the community who do not understand that the country depends on business enterprise for its incomes, jobs, health services and general material welfare. It is highly improbable that any outstanding legal action will change the fundamental conclusions of the inquiry. Mr Peters should drop the idea and apologise to those concerned, and his fellow politicians should insist that he does so. Cynics would say "don't hold your breath", but we should surely have the right to insist on higher political standards.

Another lesson concerns the media. One of the roles of the fourth estate is to expose wrongdoing and, beyond that, to denounce morally wrong but lawful conduct. However, it is also the responsibility of the media to dispassionately examine evidence and maintain objectivity and balance. Some journalists failed in this regard; they did not do their job of scrutiny and analysis and they joined in the witch hunt. They too should have the integrity to acknowledge their mistakes. And has anything changed? Another leader of a small party, Peter Dunne, has recently been seeking publicity by accusing the Business Roundtable of seeking to manipulate the Fire Service, but not one journalist has even been interested in exposing his baseless allegations.

For those who reflect with some justification about instances of doubtful business conduct a decade ago, there must be some duty to wonder about our current parallels. What does it mean for our concepts of right and wrong when

we tolerate 'perforating' in the police force; teacher unions defending their indefensible interests by preventing parents from exercising a free choice of schools; politicians who increase minimum wages knowing that they destroy jobs while professing to care about unemployment; Employment Court judges who reinstate dishonest or bad employees detested by their fellow workers; the fact that elderly women are attacked or raped in their homes and the young thugs responsible wind up on 'Police Youth Aid'; the moral corruption of a welfare system which draws no distinction between those in genuine need of help and those who could and should be looking after themselves; privacy laws which block legitimate enquiries about people's records and reputations; and a Treaty claims industry which has moved far beyond a mechanism for righting serious wrongs and become an engine for creating new bastions of privilege?

Morality is nothing if it is not seamless. We must root out reprehensible conduct in all its guises. At the Business Roundtable we have a record of attacking privilege wherever it appears. In other countries similar bodies have shied away from advocacy which might damage the interests of their members. It is time those who claim to be appalled by the winebox are forced to focus on these manifestations of double standards.

There is a final lesson from the winebox which I think it behoves all New Zealanders to absorb. How was it that a large section of the community took leave of its senses over extravagant claims made on the flimsiest of evidence?

People are particularly vulnerable to opportunist populism at times of great social change or national threat. President Harry Truman once reflected on the period of McCarthyism in the United States in a lecture entitled 'On hysteria and witch-hunting.' He spoke of the terrible consequences for a democracy and its political institutions "when some demagogue starts playing on the fears of the people and stirring them up for his own welfare and aggrandizement." Winston Peters was able to exploit New Zealanders' ambivalence towards wealth creation. So many wanted to buy into the fantasies, to protest against changes they regarded as having been imposed on them, to lash out, and to ignore the consequences of doing so. New Zealanders thought they were punishing politicians by voting for MMP, but in reality they shot themselves in

the foot. They thought they were punishing business by supporting the winebox crusade, but by damaging responsible business activities they damaged themselves.

Mike Moore pointed out that if our politicians, editors, talkback hosts and citizens do not show more maturity, integrity and commitment to the legal process and basic principles of justice in the future, we will become a banana republic, without the bananas. We seem to be heading in that direction. We now we have a weak and ineffectual government, a struggling economy, an unemployment rate that is rising again, and renewed social stress. The achievements of the post-1984 period are slip-sliding away.

The lesson of that period was that as a small, isolated country, New Zealand has to be stellar in everything it does to be internationally competitive, attract investment and enjoy economic success. We have to have the community understanding and will to pursue first best policies on a sustained basis if we want first world living standards. There is still enormous scope to get tax rates down further, reduce regulatory burdens and modernise the economy in ways which would shift the focus of business further away from unproductive activities and reduce the risk of a repetition of the winebox. But the winebox episode and recent trends have cast doubt on whether we have that understanding and that will. Mike Moore's banana republic warning is one that I don't believe the country has yet heeded.