Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax policy report: Further information on TWG issues raised

Date:	5 February 2019	**Priority:**	Medium
Security level:	Sensitive	**Report number:**	IR2019/031 T2019/175

Action sought

	Action sought	Deadline
Minister of Finance	**Note** the contents of this report	None
Minister of Revenue	**Note** the contents of this report	None

Contact for telephone discussion (if required)

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5 February 2019

Minister of Finance
Minister of Revenue

Further information on TWG issues raised

Purpose

1. This report responds to four issues raised by the Minister of Revenue at a meeting with officials:

   - What sort of economic effects have been experienced in other jurisdictions when capital gains taxes have been introduced.
   - Should a capital gains tax (CGT) rate be lower than other income tax rates to account for the fact that some capital gains represent a return to taking risk?
   - How the extension of taxation of capital gains recommended by the Tax Working Group compares with CGTs in other jurisdictions.
   - s9(2)(f)(iv) [redacted]

2. The Minister of Revenue also raised questions relating to the number of individuals who would be likely to report particular capital gains, among other distributional questions. Those questions will be addressed in a later report.

What sort of economic effects have been experienced in other jurisdictions when capital gains taxes have been introduced?

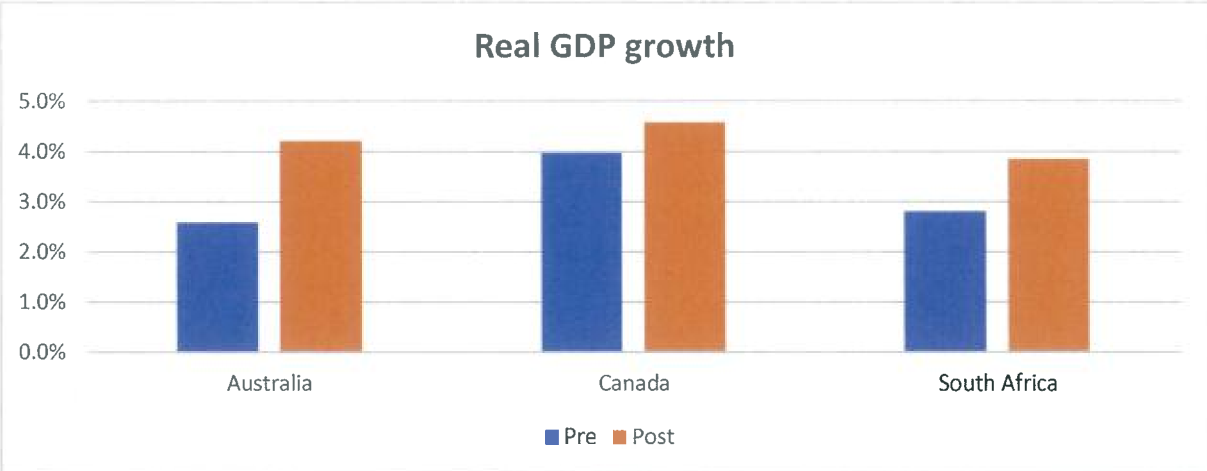
3. Officials' full discussion of the likely impacts of the capital gains tax is in a paper prepared for the Tax Working Group. That paper is appended to this note.

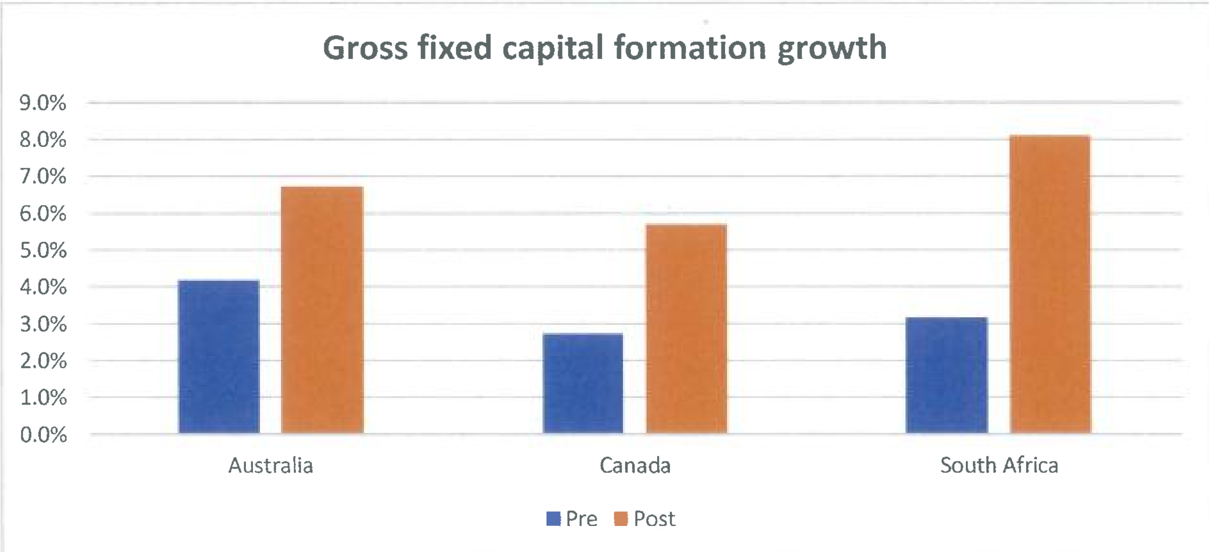
4. There is no comprehensive academic literature that compares economic performance based on the introduction of capital gains taxes. There are academic papers on the effects of changes in capital gains tax rates, and on the theoretical effects of capital gains taxes, but these are often focussed on questions like the extent of "lock-in" rather than aggregate economic performance.

5. The Minister of Revenue asked whether there have been any large effects on aggregate economic performance (in terms of GDP etc.) from the introduction of capital gains taxes. We have carried out a simple exercise comparing two measures of economic activity before and after the introduction of capital gains taxes. For Australia, Canada, and South Africa, we provide averages of annual gross fixed capital formation (GFCF) growth, and annual gross domestic product (GDP) growth, for five years prior to, and five years after (including the year of) introduction of a capital gains tax. Canada introduced its capital gains tax in 1972. Australia's CGT applies to gains from 20 September 1985, and South Africa introduced its CGT in 2001.

6. We do not recommend using this sort of analysis as evidence of a capital gains tax, but at the very least the high-level data show no outright reductions in gross fixed capital formation or GDP growth rates. Gross fixed capital formation was higher after the introduction of a CGT in Canada, South Africa, and Australia. Per capita GDP growth was higher in the five years after introduction in all three countries. We

emphasise that this is not a sophisticated analysis – it merely compares high-level averages in three countries. Further, we are not of the view that the fact that gross fixed capital formation and GDP were higher provides any evidence that the capital gains tax *stimulated* investment and growth. Rather it reflects the fact that there will have been other confounding factors that make any simple relationship impossible to disentangle. Other factors in the economy, such as the business cycle, are likely to dominate any effect from extending the taxation of capital gains. At the same time, some critics of extending the taxation of capital gains have at times seemed to suggest that doing so would do catastrophic things to the economy. That is not at all apparent from looking at headline numbers. Ultimately, the costs and benefits of taxing more capital gains will obviously depend on how the revenue is spent and the productivity gains that this provides.





Source: OECD

7. The fact that there is limited academic literature on the effects on national economic performance before and after the introduction of a CGT probably reflects the difficulty in disentangling any effects from a CGT from other national and international trends that are likely to have a larger impact.

8. With regard to New Zealand, officials are of the view that a capital gains tax is unlikely to have any large impact on aggregate economic performance that would be of a magnitude to show up in aggregate data, but it could be significant for some sectors. We also point to the forecast revenue that a CGT is expected to raise, relative to the size of the total economy. After ten years, extending the taxation of

capital gains is expected to raise 1.2% of GDP in tax revenue per annum. Our full discussion is in the attached paper.

Should a CGT rate be lower to compensate for the fact that some capital gains represent returns to risk?

9. Provided that the tax system treats positive outcomes and negative outcomes symmetrically, no part of the tax will "tax risk".

10. As an example, assume a risky venture can result in a capital gain of +$100 50% of the time, and a capital loss of ($100) the other 50% of the time. Such a venture would have a 1:1 risk-to-reward ratio.

11. Now assume that capital gains and losses are brought within the tax system. If the tax rate is 33% and the tax system allows losses to be offset against other income, then provided there is other income against which to use the loss, the post-tax positive outcome would be +$67, and the post-tax negative outcome would be ($67). The risk-to reward ratio is still 1:1.

12. The same is true for risks that are expected to return more than the possible loss. If the capital gain from a positive outcome is $1000, and the capital loss from a negative outcome is ($100), the risk-to-reward ratio is 1:10. With a 33% tax rate, the positive outcome after tax is +$670, and the negative outcome after tax is ($67). The risk-to-reward ratio is still 1:10.

13. In their submission to the Tax Working Group, the Angel Association New Zealand (which represents start-up investors) concluded that:

> a well-designed capital gains tax policy, which includes property, together with a carefully defined and described high growth start-up ecosystem and its ventures, would see resources channelled more efficiently and purposefully to support the success of these high risk, but high impact ventures. A capital gains tax, and a corresponding offset for capital losses, would allow early stage investors some respite from the inevitable failure of early stage investment.

14. We do not consider that by itself risk provides a case against taxing realised gains. However, it does provide a reason to be wary of extensive loss ringfencing. Extensive loss ringfencing will increase the chance that losses are not able to be used for tax purposes, or at least delay their use. In that case the loss ringfencing will have changed the risk-to-reward ratio.

How does the extension of the taxation of capital gains outlined by the TWG compare with CGTs in other jurisdictions?

15. An appendix attached to this report sets out how the extension of taxation of capital gains outlined by the TWG compares with CGTs in other jurisdictions on some of the major dimensions.

16. For capital gains earned in companies and distributed to individuals, New Zealand would be at the low end of effective tax rates due to imputation which relieves double taxation of income earned through companies. For capital gains earned directly by individuals, New Zealand would be at the higher end of tax rates, but a significant number of countries have rates in the range of 25 to 30%[1], and some countries such as Germany and Italy (except for shares and real estate held for a certain period), Ireland, and Denmark, tax capital gains at 33% or higher.

17. On capital loss ringfencing, the TWG are recommending as little of this as feasible, which would put New Zealand on the more liberal end of the spectrum, and (as discussed above) would treat risk more neutrally.

[1] Harding, M. and M. Marten (2018), "Statutory tax rates on dividends, interest and capital gains: The debt equity bias at the personal level", OECD Taxation Working Papers, No. 34, OECD Publishing, Paris.

18. The rollover reliefs recommended are very similar to most other countries that have rollover reliefs.

19. The types of assets to be excluded are similar to most other countries, with perhaps the exception of collectibles, which many other countries include.

20. Many countries have no small business concessions, and for those that do, it is often to be consistent with the way these countries tax retirement savings, which in turn is influenced by their restriction of superannuation payments. That is, countries that do not provide universal superannuation often tax retirement savings in a concessionary way, and to be consistent with this retirement treatment any capital gains taxed on the sale of a small business to fund retirement is treated similarly. New Zealand is different from many of these countries in that it has a universal superannuation scheme that is not means tested, and does not have large retirement savings concessions.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

[redacted]

Recommended action

We recommend that you **note** the contents of this report.

Noted | Noted

s9(2)(k)

[redacted]

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Hon Grant Robertson
Minister of Finance
/ /2019

Hon Stuart Nash
Minister of Revenue
/ /2019

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
TWG recommendations for NZ	33%	33%	28%	Not generally only for listed shares and other easily traded assets	Death Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt Rollover for small businesses (less than $5m of turnover) that reinvest in active assets	Main home Cars Personal use items and collectibles Trading stock	Retirement concession: lower KiwiSaver tax rates apply to the first $500,000 of capital gains made by business owners who sell a closely held active business they have owned for a certain period of time (e.g. 15 years) in order to retire once they reach retirement age (e.g. 60 years or older) or younger business owners if the capital gain is reinvested into a KiwiSaver scheme. Rollover for small businesses (less than $5m of turnover) that reinvest in active assets
Australia	47% (2% is medicare levy which applies to all income including capital gains)	23.5% (50% discount if held for 1 year by individuals or trusts)	30% large companies 27.5% medium companies 13.75% if applying 50% discount for small business assets owned for 1 year 15% rate for superannuation funds or 10% if the shares held for 1 year (33% discount)	Yes	Death Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt Rollover for small businesses that reinvest in active assets within two years	Main home Cars Personal use items acquired for less than AUD$10k (NZD $10.5k) Collectibles acquired for less than AUD$500 (NZD $525) Depreciating assets and trading stock (taxed under income tax rules at full rates) Pre-CTG assets acquired prior to 20 Sept 1985	4 types of small business concession. To qualify less than AUD$2m (NZD $2.1m) of annual turnover or less than AUD$6m (NZD $6.3m) of net CGT assets: Exemption if owner is aged over 55 has owned asset for at least 15 years and is retiring Exemption if funds put into the owner's superannuation scheme ($500k lifetime cap (NZD $525k)) 50% discount for small business assets owned for 1 year (can be combined with individual discount so taxed on only 25% of gain) Rollover for small businesses that reinvest in active assets within two years

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
Canada	53.5% (Average combined federal and state tax. 33% is federal tax. State personal tax is applied on same basis as federal)	26.75% (50% discount for Canadian residents)	13.4% (50% discount for Canadian residents including corporates. Based on an average combined federal and state rate of 26.8% of which 15% is federal)	Yes	Death (only to spouse or farm, forestry or fishing property to children) Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt Like-kind exchanges of tangible business assets	Main home Personal use items if market value is less than CAD$1,000 (NZD $1,107)	Exemption for capital gains realised by an individual from sale of shares in a closely held corporation up to a lifetime limit of CAD$848,252 (NZD $940k) in 2018, indexed to inflation A CAD$1 million (NZD $1.11m) lifetime exemption applies to farm and fishing property
Denmark[3]	55.8%	42% The first DKK52,900 ($11,825 NZD) of gains from shares (per spouse) is taxed at lower rate of 27%	22% Unlisted shares held by corporates are tax exempt	Yes Real estate capital losses are also ring-fenced to capital gains on real estate	[Unknown – no information could be found in English]	Private house that the owner has lived in Cars Private personal use items Inheritance tax applies to inheritances (not CGT)	None
France	53.9%	30% standard rate on shares. Reduced to 15% for shares if held for 2-7 years, 10.5% for shares held for 8+ years or 4.5% if SME shares are held for 8+ years 19% on real estate	28% on income up to €500k (NZD $834k), and 31% on income exceeding that amount	Yes	Divorce[4] Sole trader incorporates Transfers between wholly-owned companies in same group	Main home Gifts to close member of family under certain condition and under a certain threshold Gains derived from the sale of moveable assets under a threshold and subject to conditions Inheritance tax applies to inheritances (not CGT)	4.5% tax rate on capital gains tax on shares in SMEs held for at least eight years, provided the shares were acquired within 10 years of the creation of the SME.

[3] Denmark, France, Germany, Ireland, Italy, Japan, Spain, UK and US apply an inheritance tax on death (instead of the CGT).

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
Germany	47.5%	25% on shares 47.5% on other assets **NB:** real estate / housing is exempt if held for at least 10 years	30%	Yes for individuals	Divorce Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt Exchanges of tangible business assets (no like-kind restriction)	Main home Other real estate / housing owned for at least 10 years Other private assets owned for at least 1 year Collectibles held for at least 1 year (still taxed if sold as part of a business – e.g. of dealing collectibles) Inheritance tax applies to inheritances (not CGT)	None
Ireland	48%	33% (CGT rate is lower than top personal rate)	33% (CGT rate is higher than company rate of 12.5%) 12.5% or 15% CGT rates for Venture Capital funds	Yes	Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt	Main home Private motor cars and other wasting chattels Annual exempt amount of first €1,270 (NZD $2,119) of gains is exempt from CGT. Moveable property, where the gain is less than €2,540 (NZD $4,238) Animals Certain shareholdings by corporate shareholders No CGT on death and inherit at market value (but inheritance tax may apply)	Retirement exemptions for business assets (including farms) held for at least 10 years and transferred by a person aged over 55 Capped at €750k (NZD $1.25m) of consideration unless transferred to the person's child. Lower limits apply for persons aged over 66 (€500k (NZD $834k) limit or €3m (NZD $5m) limit if transferred to your child). Entrepreneur relief: 10% rate on shares (minimum 5% shareholding) and business assets held by individuals for at least 3 years and who spent at least 50% of their work time working in the business. Limited to a lifetime cap of €1m (NZD $1.67m) of gains.

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
Israel	50% (3% is surtax which applies to income from all sources)	20% on real estate (but inflationary component of gain is exempt from tax) 25% on domestic listed shares (but inflationary component is exempt from tax) Offshore listed shares are taxed at 20% or 25% tax rates	23% (but inflationary component of gain is exempt from tax)	Yes	Death Gifts Transfers between wholly-owned companies in same group Reinvest insurance proceeds 50% reduction in tax if compulsory acquisition by Govt	Main home (exemption can only be used once every 18 months and only applies to the extent the home sells for less than NIS 4.5m (NZD $1.8m))	None
Italy	43%	43% generally 26% rate on portfolio shares **NB:** real property is exempt if held for at least 5 years (or inherited)	24%	Yes for individuals	No rollover relief	Main home Other real property held for at least 5 years (or inherited) by individuals Inheritances and gifts are subject to Inheritance tax and Gift tax (not CGT)	None
Japan	55.8%	20% on shares 20% on long-term gains on real property (39% if short-term gains)	30%	Not generally only for shares owned by individuals	Reinvest insurance proceeds or compulsory acquisition by Govt Transfers between wholly-owned companies in same group Like-kind exchanges of tangible assets	Personal property for daily living (such as furniture and clothes) Inheritances and gifts are subject to Inheritance tax and Gift tax (not CGT)	None

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
Mexico	35%	35% 10% on listed shares	30%	Not generally only for shares	Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt	Main home Inheritances are not subject to tax Gifts, but limited to MXN$88k ($6,777 NZD) of gifts unless gifted to your spouse, parent or children	None
Norway	38.2%	22% 31.68% on gains from shares	22% Exemption for shares held in another company	No	Death Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt	Main home (if owned for at least one year) Vacation home (if owned for at least five years)	None
South Africa	45%	18% (60% discount for individuals)	22.4% (20% discount compared to 28% company tax rate)	No	Death (only transfers to spouse) Divorce Reinvest insurance proceeds or compulsory acquisition by Govt Transfers between wholly-owned companies in same group	Main home exempt up to R$2m (NZD $210k) Personal use assets of an individual not used mainly for purposes of trade, subject to exclusions Annual exempt amount where the first R40k (NZD $4,298) is exempt from capital gains tax	Retirement concession: A small lifetime exemption of R1.8m (NZD $190k) of capital gains from active assets of small businesses that have less than R10m (NZD $1.07m) of total assets. The exemption applies upon death or retirement (aged over 55 or sick) of the small business owner / operator

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
Spain	43.5%	23% top rate Spain has special tax rates for investment income (including capital gains) which are: 19% for first €6k (NZD $10k) of investment income 21% for €6k to €50k 23% above €50k (NZD $83.5k)	25%	Yes	Divorce Sole trader incorporates Transfers between wholly-owned companies in same group	Main home (but only if sale proceeds used to pay off mortgage or reinvested into another main home) Inheritances and gifts that are subject to the Inheritance tax and Gift tax (not income tax)	None
Sweden	60.1%	30% generally 22% on main home 25% for individuals with unlisted shares	22% Exemption for shares held in another company (if the company owns at least 5% of the other company)	Yes	Death Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds	Main home taxed at reduced rates (approx. 22%) Gifts and family law related acquisitions Annual exempt amount of SEK $50,000 (NZD $8,084) gains on personal assets by individuals	None
Switzerland	36.1% (Average combined federal and canton tax. 11.5% is federal tax)	11.5% on business assets 6.25% on shares if shareholding is at least 10% and held for 1 year Gains on real property are taxed at various rates at canton level rather than federal level	8.5% Exemption for shares held in another company (if the company owns at least 10% of the other company) Gains on real property are taxed at various rates at the canton level rather than federal level	No	Death Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Exchanges of tangible business assets (no like-kind restriction)	An individual's non-business assets (but gains on real property are taxed at canton level rather than federal level)	None

Country	Top personal tax rate	Top personal CGT rate after applying discount	CGT rate for companies	Capital loss ringfencing	Rollover relief (main types)	Excluded assets (not subject to CGT)	Small business CGT concessions
UK	45%	20% generally (top CGT rate is lower than top personal rate) 28% on residential property and carried interest (8% surcharge) 10% rate on the first £10m (NZD $19.3m) of gains (lifetime cap) on shares held for at least 3 years in companies (excludes listed companies unless the shares were issued before the company was listed) or held for at least 1 year if person holds more than 5% of the shares in a company (which can be a listed company).	19% Exemption for shares held in another company (if the company owns at least 10% of the other company) 20% if the company sells UK residential property	Yes	Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt Exchanges of business assets (including goodwill and no like-kind restriction)	Main home Cars and passenger vehicles Wasting chattels except plant and machinery Annual exempt amount of £11,700 (NZD $22,578) of gains by individuals No CGT on death and inherit at market value (but inheritance tax may apply)	10% rate on the first £10m (NZD $19.3m) of gains (lifetime cap) on shares held for at least 3 years in companies (excludes listed companies unless the shares were issued before the company was listed) or held for at least 1 year if person holds more than 5% of the shares in a company (which can be a listed company). Exemption for gains on shares held for at least 3 years that qualify under the enterprise investment scheme. The investor has to hold less than 30% of the shares in the company. At time the shares were issued the company must be less than 7 years old, not have assets greater than £15m ($29m NZD) and fewer than 250 employees and has raised less than £15m of equity. Excludes the following industries: coal and steel production, farming, leasing, financial services or property development.
USA	46.3% (Average combined federal and state tax, 37% is federal tax)	20% rate for individuals who hold assets for 1 year 7.5% or 10% rates for shares in small companies (less than $50m of assets (NZD $73.2m) held for at least 5 years (limited to $10m (NZD $14.6m) or 10 times the cost of the shares)	26% (Average combined federal and state tax, 21% is federal tax)	Yes	Divorce Sole trader incorporates Transfers between wholly-owned companies in same group Reinvest insurance proceeds or compulsory acquisition by Govt Like-kind exchanges of real property (including residential property) or small business shares in companies	Main home (capped at US$250k (NZD $366k) of gains every 2 years) Gifts and bequests No CGT on death and inherit at market value (but inheritance tax may apply) 0% capital gains tax rate for long-term gains made by lower-income individuals / married couples	7.5% or 10% rates for shares in small companies (less than US$50m of assets (NZD $73.2m) held for at least 5 years (limited to $10m (NZD $14.6m) or 10 times the cost of the shares) Like-kind exchanges of real property (including residential property) or small business shares in companies