Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

[1]

1 April 2017

Tax Working Group Secretariat
PO Box 3724
Wellington

Dear Sir/Madam

This submission to the Tax Working Group draws on a range of experience involving tax, business, and investment matters including –

- 1960-61 Inland Revenue Department - Assessment Officer
- 1963-64 Richardson McKissock Cartwright (Tax Consultants) – Tax Accountant
- 1975-79 New Zealand Dairy Board – Chief Financial Officer
- 1979-83 New Zealand Dairy Board (London) – Regional Director Europe
- 1985-92 New Zealand Dairy Board – Chief Executive
- 1992-2015 Professional Director/Chairman (public and private companies, including AMP NZ Ltd and investment company Rangatira Ltd)
- 1992-2018 Management of personal retirement investment fund

I am happy to be available to discuss the points raised.

Yours faithfully

[1]

R M (Murray) Gough OBE

SUBMISSION TO THE TAX WORKING GROUP

from Murray Gough

10 April 2018

Introduction

The fundamental aim of this submission is to highlight the practical difficulties of designing and implementing a Capital Gains Tax that could be accepted as fair by most New Zealanders.

As the Working Group has identified, New Zealand enjoys a tax system that is broad-based and widely supported - as well as being coherent and efficient. It is, in fact, remarkable how few issues of real concern are identified in the Background Paper.

Maintaining the existing level of acceptance is important. Any changes to the current tax system should be for clear reasons, and implemented in a manner that has wide public endorsement. This submission considers what such reasons might be, and comments on options for addressing them.

Reasons for Change

The Background Paper, explicitly or implicitly, indicates the following main reasons for significant change –

1. Additional tax revenue may be needed
2. Fairness requires a Capital Gains Tax
3. Wealth inequality is too great, and can be reduced by a suitable tax.

Comments

1. Additional tax revenue may be needed –

   The broad numbers (Table 1, Page 10) suggest that over coming decades New Zealand will need to either reduce Government Expenditure as a proportion of GDP, or increase taxes. The changes required are not particularly substantial and do not appear to be urgent.

   Both alternatives can be reasonably easily accommodated –

   a) Reduce Government Expenditure - obviously there are many ways to reduce expenditure, but the least disruptive way to make a significant difference is a progressive extension of the qualifying age for National Superannuation. Life expectancy is increasing by 3 months or so every year, and rather than an increased period of old age and ill health this is resulting in an extended healthy life. There is accordingly an increasing ability (and indeed, for many people, desire) to work longer. Pushing out the qualifying age for National Superannuation will almost certainly become increasingly acceptable.

b) Increase Taxes – if future governments find it impossible to curtail expenditure, the best way to increase revenue will be to increase expenditure-linked taxes, particularly GST. GST is widely regarded by New Zealanders as unobjectionable, and the VAT table (Figure 9, Page 30) shows that our rate is well below that of most other developed countries. The main concern with GST is regressivity, but that can be largely addressed by transfer payments. Expenditure-linked taxes also have the desirable outcome of causing tourists to contribute to tax revenue.

Any proposal to introduce new taxes, or increase income tax rates, should have merits that are clearly greater than these relatively straightforward alternatives.

2. Fairness requires a Capital Gains Tax –

The Background Paper makes the point that "What is fair to one person might not seem fair to another". It may accordingly be seen to be just as fair to tax Capital Gains as to tax income and expenditure. To gain widespread acceptance, however, a Capital Gains Tax (CGT) would need to be seen as unquestionably fair. The experiences of other countries, and previous reviews of our own tax system, highlight just how difficult – if not impossible - that is to achieve.

To be fair, a Capital Gains Tax would have to include the following provisions -

1) inflation would need to be allowed for when measuring gains and losses – otherwise CGT would be applied to partially fictitious value movements;

2) a carry-forward CGT credit would be needed for losses (asset values go down as well as up, and it would be unfair to apply CGT only to gains);

3) CGT would need to apply to *all* sales and transfers of assets - including gifts to family members and trusts, and assets transferred or sold from a deceased estate;

4) both realised and unrealised gains would need to be taxed because –

   a. it would be unfair that a taxpayer was subject to CGT because he had to (or decided to) sell, while his neighbour avoided CGT by continuing to hold;

   b. taxing only realised gains would result in substantial economic inefficiency by discouraging sales that would otherwise be made – such as a farmer selling to move to a larger property, or a particular share being replaced with a better investment in an investment portfolio; allowing a non-taxable rollover for reinvestment in similar assets may appear a simple solution, but would greatly reduce the CGT tax base (and unless gifts and transfer on death were treated as sales - or Gift and Estate Duties reintroduced - rollover would result in increasingly valuable portfolios being passed on with no CGT being paid);

however, taxing unrealised gains raises complex and difficult issues, such as how to value assets without a public market (shares in unlisted companies, small businesses, professional and other partnerships) and how to manage the cash impact on taxpayers with substantial assets but restricted cashflow.

A fair Capital Gains Tax system would also need to have found satisfactory solutions to the following issues -

1) while a New Zealand-domiciled investment fund would (presumably) be subject to CGT when any of the fund's investments were sold, overseas-domiciled funds in non-CGT jurisdictions would not (including ones investing in New Zealand shares and property); owning units or shares in such overseas funds would need to be prohibited as taxpayers would otherwise simply move their investments into them (avoiding CGT, and reducing New Zealand's CGT tax base);

2) funds that support final-salary-related pensions would be underfunded if CGT applied to sales of their investments, yet it would be inequitable for such funds not to be subject to CGT while defined-contribution plans (and private investment accumulations) were; it would also be inequitable if superannuitants whose payments were not drawn from an identified fund retained existing benefits while the funds supporting others became subject to CGT;

3) there would be a strong temptation to fail to report the existence of (and gains on) offshore assets, particularly non-income-producing assets;

4) significant valuation difficulties would arise (for gifts and estate transfers) for assets without a public market such as small businesses, professional and other partnerships, and shares in unlisted companies;

5) severe cash flow difficulties would arise for taxpayers selling one investment to reinvest in another (unless a rollover is permitted for reinvestment of funds into a replacement asset).

In summary, designing a fair Capital Gains Tax is a hugely daunting task. And if family homes are largely or wholly exempt, offset is allowed for capital losses, allowance is made for inflation, and reinvestment rollover is permitted, net tax raised is unlikely to be substantial.

3. Wealth inequality is too great, and can be reduced by a suitable tax –

   There is only limited data on wealth inequality in the Background Paper and it is difficult to know to what degree this is a problem – and importantly, how rapidly wealth inequality has been/still is growing. If the political judgement is that wealth inequality needs to be addressed, it is unlikely (given the concerns set out above) that a Capital Gains Tax will have much effect. While a Wealth Tax may be considered, the experiences of countries that have experimented with this are not encouraging. The valuation and cash flow issues with a Capital Gains Tax, as well as many of the other difficulties, also apply to a Wealth Tax.

   If it is considered that wealth inequality needs to be addressed, the simplest and most effective way to do so is likely to be reintroduction of Estate and Gift Duties.

Response to Appendix 2 Questions on CGT Design Issues

- *Should CGT be a separate tax?*
  Yes. Otherwise the huge swings that can occur in asset values (such as the 1987 and 2008 share market falls) would result in a substantial drop in income tax receipts as CGT losses offset taxable income.

- *Accrual or realised basis?*
  Accrual – for the reasons outlined in the submission above.

- *Matrimonial settlements and disposal of assets on death?*
  There is no obvious reason why these should be treated any differently from when an asset is sold. The question does not arise if the accrual option is used.

- *What assets should be covered?*
  Assets of an enduring investment nature should be covered; for administrative simplicity defined assets that have a limited life and declining value (such as ordinary cars and household goods) should be excluded.

- *Should assets held by Kiwisaver and other savings schemes be taxed?*
  Yes. To do otherwise will distort investment decisions.

- *Should assets held offshore be subject to tax?*
  Yes. Excluding such assets will distort investment decisions (please also note the comments in the submission above).

- *How would CGT integrate with current tax laws?*
  CGT paid by a company should be able to be passed down to its shareholders as a CGT imputation credit, able to be used by each shareholder to offset any CGT the shareholder becomes liable for. Otherwise a capital gain is likely to be taxed twice.

- *When should non-residents be subject to tax?*
  All property owned by non-residents but physically located in New Zealand should be subject to CGT. To do otherwise would give residents in non-CGT jurisdictions a greater financial return than that available to local residents – with obvious implications for foreign ownership of houses and farms.

- *Should capital losses be ring fenced?*
  Yes (per comments against the first question above).

- *Should there be a rollover relief?*
  Yes. This isn't an issue if CGT is applied on an accrual basis – which, for the reasons in the submission above, is the fairest basis for such a tax.

- *How should death, emigration, and immigration be handled?*

There is no reason why death should be treated any differently from when an asset is sold. Emigration and immigration are essentially questions of when a person becomes (or ceases to be) a New Zealand resident – assets should be valued as at the relevant dates, with CGT payable for emigrants based on asset values at the date the person ceases to be a resident. The question does not arise if the accrual option is used.

- *How should gifts and gambling winnings be taxed?*
  Gifts and gambling winnings (and prizes) should be treated as having been purchased by the recipient at market value, and disposed of by the giver at the same value.

- *Rate of CGT?*
  There is no strong pointer to any particular rate.

- *Should there be an allowance for inflation?*
  Yes. Gains and losses can only be measured fairly after making an allowance for inflation.

- *Should there be a de minimis rule?*
  Yes.

- *What administrative implications?*
  Some of the more difficult implications are how to ensure all gains are properly reported (particularly overseas assets); and how to value assets without a public market (shares in unlisted companies, small businesses, professional and other partnerships).

- *Transition rules?*
  Opening values for assets should be their value at the date of formal commitment to CGT introduction. It would be extremely unfair to retrospectively tax past gains - taxpayers may well have made different acquisition or sale decisions if they had known that CGT would be payable. It would also be unfair if existing assets were never subject to CGT. The accrual approach makes this issue irrelevant – assets would simply be valued at a CGT commencement date with CGT applicable to annually updated values from then on.

- *Family trusts?*
  Assets held in family trusts should be subject to CGT on exactly the same basis as assets owned by individuals and companies. Gifts to (and from) a trust should be valued at market value at the date of gift.