Tax Working Group Public Submissions Information Release

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Submission
by

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On the

Future of Tax

To the

Tax Working Group

April 2018

Introduction

Thank you for the opportunity provided to complete submission. There are a number of different matters that I wish to comment upon under the following headings.

- Capital Gains Taxation
- Previous Tax Review Outcomes – Including an Appendix containing extracts from those earlier reviews
- Kiwisaver and Taxation of Savings

The submission content follows.

Capital Gains Taxation

One expects that the question as to whether there should be a capital gains tax will continue to be asked ad nauseum until a capital gains tax is introduced.

Accepting without reservation all of the theoretical reasons that justify the introduction of a capital gains tax, I am yet to see anyone, including numerous previous tax review groups, come up with a practical capital gains tax that meets the theoretical requirement. That, surely, is the fundamental reason why New Zealand has not previously introduced such a tax and, I am sure, remains the fundamental reason why New Zealand should continue not to do so.

For the record, I note yet again that such a tax fails to meet the theoretical requirements because:

- There must be exemptions to gain political acceptance (e.g. the family residence, which will simply continue to exacerbate over-investment in housing)
- The tax can only be applied on asset realisation, as an accruals basis is simply not practical on large value assets without forcing sale to meet the accrual tax
- Roll over relief may be required for some assets
- Taxation is generally (and inappropriately) applied to gains unadjusted for inflation
- Assets may have to be periodically valued, increasing costs
- Tax returns become more complicated, reducing the benefits of simplification already achieved in New Zealand

Previous tax review outcomes

Referring to the Appendix attached, including extracts from two previous tax reviews (2001 & 2010), the following questions are relevant for the tax working group to consider:

1. Unless the latest government tax working group can identify something that has changed since the conclusions reached in the 2001 review report (provided to the

then Hon Dr Michael Cullen, Minister of Finance), what justification can there now be for supporting narrowing the GST base or for taxing some goods or services at lower GST rates, or for introducing:

a. a general realisations-based capital gains tax
b. a general wealth tax
c. a cash-flow tax
d. a Tobin Tax
e. national eco-taxation?

2. While the 2010 tax review supported the introduction of a low-rate land tax, does the government directive (presumably to address the political sustainability issue) to exclude owner-occupied property from such a land tax mean that a recommendation to consider such a tax proposal can still be regarded as appropriate or useful?

One can also note that exclusion of all owner-occupied property from many of the proposed taxes effectively results in an increased impost on rental residential properties at a time of recognised rental accommodation shortage. Is this appropriate?

Ironically, the exemption for owner-occupied residences also potentially provides for legally allowable mechanisms to minimise or remove the impact of such taxes from those individuals or entities investing in property that any such proposal is meant to be targeting. Reduction or avoidance of the taxes can be achieved by an individual or entity wanting to invest in property simply providing a non-recourse loan to someone else to buy and live in a property where the loan repayment amount is set at a percentage of the eventual sale value of the property, the percentage being anything up to 100% of such sale value. Interest payments on the loan can be set at any amount from 0% upwards.

Interestingly, Brian Fallow, an economic journalist for the NZ Herald, outlined a similar lending concept in a Herald article dated 15 December 2017, albeit he proposed a much smaller equity sharing loan component, focused upon a risk-sharing alternative to traditional mortgage debt to reduce systemic financial risks in an economy.

Further, while I make no claim to be an expert on sharia law, I understand that this concept can be structured to be sharia compliant, via a profit sharing contract known as “murabaha” that might be used to provide a mortgage on a property. The property is registered to the buyer from the start.

While owner-occupied property is exempted, such a legally allowable loan structure also avoids the recently introduced bright line test as well as any proposed capital gains tax, wealth tax, or land tax, even while all of the benefit is effectively being passed to the loan provider under the structure envisaged. However, I acknowledge that any profit achieved on repayment of the loan will likely be taxable but note also then that any loss on repayment of the loan would likely be tax deductible, against all income, not ring fenced.

In case you might think it appropriate to introduce anti-avoidance measures, I strongly suggest that anything that allows a New Zealander to borrow to buy a home and potentially to also live in it, even while giving up some of or all the potential growth in value, must be acceptable and should not be precluded or disadvantaged.

Such a structure may be even more beneficial for overseas parties providing the financing. Not only does it potentially minimise or avoid tax, but it also provides a simple legal mechanism to still obtain economic exposure to NZ residential property while avoiding the proposal currently being considered under the Overseas Investment Amendment Bill to ban foreigners from buying residential land, provided a New Zealander is the recipient of the loan, which is then applied by the New Zealander to purchasing a property for the New Zealander to occupy.

I emphasise that these comments do not imply that I am supporting removal of the exemption for owner-occupied homes, rather that these comments simply help highlight the impracticality of any attempt to introduce such taxes, as recognised by both the 2001 & 2010 tax reviews.

KiwiSaver and Taxation of Savings

The government tax working group background paper acknowledges the differential rates of taxation applied to various forms of savings or investment options, including KiwiSaver. Clearly, while one answer to fix this is to increase tax on the tax favoured savings or investment options, don't lose sight of the other answer available, namely to reduce tax on the savings and investment options regarded as being tax disadvantaged.

This is a topic that previous reviews have focused upon. The combined IRD & Treasury paper titled "Taxation of Savings and Investment Income" and dated 27 September 2012 is also worth referencing again.

Focusing now on retirement savings, retirement savers always fall into one of three categories:

- Those who can afford to save and already do
- Those who can afford to save and don't
- Those who can't afford to save and don't

To the extent that KiwiSaver results in the final two groups undertaking retirement savings that would otherwise not occur, there may be some small incremental increase in retirement savings. I understand that research suggests that this is the outcome being achieved by KiwiSaver, but with much of KiwiSaver monies otherwise being savings diverted from alternative savings. The latter is certainly the case in my KiwiSaver account, undertaken at the minimum possible level as a self-employed person, solely to obtain the incentive provided in the form of a government credit.

Noting that KiwiSaver includes incentives in the form of a government credit, alternative incentives might also be considered by the tax working group, whether as a direct deduction of contributions from taxable income, or as some form of relief from tax on fund earnings.

However, as history has proven time and time again when incentives are provided, most of the benefit goes to the first category of savers, and/or to the fund managers. It is therefore unsurprising that the Chair of the tax working group has publicly lamented the obvious and entirely foreseeable outcome that KiwiSaver increases inequity. This was always going to be a given outcome of the scheme as designed.

The Chair of the working group has also been publicly reported as suggesting compulsory membership of KiwiSaver be considered to assist in overcoming this inequity. Noting that compulsion is pointless for the first group, one can conclude that compulsion might only ever assist people in the last two categories to achieve retirement savings that otherwise would not occur. However, for the last group, it is at the expense of their ability to meet their basic living requirements. Hence, if compulsion is introduced, to ensure that the living standards of this final group are not adversely impacted, government has no choice but to either enhance the income of this latter group to cover the contributions required to be made to KiwiSaver, or alternatively for the government to make some or all of the payments direct to KiwiSaver that such individuals would otherwise be required to make,.

It is at this point that one can ask, in the face of a universal NZ Superannuation payment and minimal poverty reported amongst the aged population, what the point of KiwiSaver is?

Acknowledging that KiwiSaver has had some benefit towards enhancing financial capability in the form of financial literacy, outside of this benefit, it only has a point if it is believed that NZ Superannuation is insufficient in itself to provide an adequate retirement income, or if there is an as yet unstated intent to replace NZ Superannuation with KiwiSaver or make NZ Superannuation means tested again.

Unless the financial literacy benefit achieved via KiwiSaver is sufficient unto itself, I suggest that the inequity that the Chair of the tax working group is concerned about might best be addressed by abolishing KiwiSaver and reverting to the pure voluntary savings structure that previously existed, supported by an ongoing universal NZ Superannuation benefit at a level that obviates poverty in old age.

Retirement saving is simply about having enough money when one wants to retire to enjoy the lifestyle that one aspires to at that time. It does not need to be in a specialised "retirement" fund. Providing incentives, introducing compulsion and locking money away until a specified age simply introduces unnecessary distortion, increases inequity, and reduces personal financial flexibility. Even without compulsion, KiwiSaver does all of this, with the restrictions on financial flexibility specifically recognised in the circumstances allowing withdrawal of funds in the case of hardship and buying a first home. KiwiSaver fails to recognise the other costs that the lack of flexibility within the scheme imposes.

Appendix

Extracts from the Overview of the Final Report of the 2001 Tax Review

"We do not consider that New Zealand should adopt a general realisations-based capital gains tax. We do not believe that such a tax would make our tax system fairer and more efficient, nor do we believe that it would lower tax avoidance or raise substantial revenue that could be used to reduce rates. Instead, such a tax would increase the complexity and costs of our system."

"We do not support implementing a general wealth tax in New Zealand, nor reintroducing an estate duty. We conclude that neither of these taxes would fill a gap in the income tax base. We recommend that the Government not implement a cash-flow tax, given the severe transitional problems that would arise."

"In the Issues Paper, we indicated our support of the overall design of GST and did not propose any significant changes. In particular, we did not believe that a strong case could be made for either narrowing the GST base or for taxing some goods or services at lower rates. We have not altered our view of GST, and do not recommend any material reform."

"We do not support the introduction of a financial transaction tax, first, because of harmful cascading effects, and secondly, because we do not consider it a superior substitute for GST. We do not support the introduction of a tax on short-term foreign exchange flows popularly known as a Tobin Tax, as we believe that the goal of reducing exchange rate volatility by means of a Tobin-type tax is misguided. We are also unconvinced that a Tobin tax imposed by a single country would be effective in furthering such a goal."

"The Review was unable to identify instances where new eco-taxes at the national level could be considered an effective means of addressing environmental concerns facing New Zealand. It follows that we do not favour proposals to target and move towards predetermined levels of tax revenue from national eco-taxation. For similar reasons, we do not consider that national quotas or similar regimes are appropriate to New Zealand circumstances. Such measures also fail to satisfy the criteria noted earlier for a nationally applied eco-tax. Where, on the other hand, environmental concerns are highly localised, as they currently appear to be in New Zealand, measures such as carefully designed eco-charges applied at the local level can be appropriate."

Extracts from the Overview of the 2010 Report of the Victoria University of Wellington Tax Working Group titled, "A Tax System for New Zealand's Future"

"Most members of the TWG support the introduction of a low-rate land tax as a means of funding tax rate reductions and improving the overall efficiency of the tax system. However, there are concerns over the political sustainability of such a tax."