Tax Working Group Public Submissions Information Release

Release Document

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Tax Working Group Submission

April 2018

Executive Summary

New Zealand currently has a well established, fair and progressive tax system. The more you earn the more tax you pay. Approximately 35% of current NZ tax is paid by the highest 10% of taxpayers. The more you tax these same high earning taxpayers, the more you will alienate them. Tax avoidance will increase, or worse case high earning taxpayers will vote with their feet and leave NZ altogether, as has happened in the past.

Any new taxes need to be introduced in a fair and equitable manner and apply equally to all. To apply tax due to ideology or a tax grab does not make for good enduring tax law and will inevitably have unintended consequences.

The solution is not to complicate and skew the New Zealand tax system with further exemptions and taxes. The tax system is not broken and does not require new taxes.

The solution for property, is to solve the supply imbalances for property and not to penalise and complicate it for those with the entrepreneurial spirit that make this country great.

How does the tax system affect housing affordability?

Frankly I don't believe this. The recent property boom quite simply has been driven by a long lasting under supply of property, mainly in Auckland. This is well documented. Latterly the under supply has been compounded even more by a tightening of bank credit and LVRs, making it more difficult to build new homes and purchase property just at the critical time when more are needed.

The other main driver of property has been the constant, almost daily, media frenzy focused on property. Count the housing related articles and it will reveal the love affair of reporting on property by the media. The media sells entire sections of the newspaper and its websites on the subject and has a big vested interest in the property market, the same as banks and real estate agents do.

There has been much noise and distortion of the facts when it comes to blaming the tax system for supporting housing affordability. And if it did, the most recent changes if anything have tipped the playing field adversely and unfairly against property.

The government recently increased the bright-line test to 5 years to target speculators. Whilst I believe the increase to 5 years was unwarranted (the previous 2 year test was sufficient to prevent speculation in the property market) this serves to address the demand side of property speculation.

The government has also claimed that the 'loss offset' (negative gearing) of property losses against other income distorts the property market. However, this has existed for decades, long before the current property boom and therefore can't be argued as to the cause of the current property problem. Furthermore, the loss offset rules apply not just to property. It is a basic long lasting principle across the tax system that income tax losses from all sources (including property) can be offset. The effect of this recent change, has been to unfairly target property as the only exemption from this principle, which is not fair and equitable. However, this change won't just target property speculators (who typically only hold property short term). Ring fencing property losses will more adversely target landlords who intend to rent property for a number of years and who in their first initial years may make a loss. Making a loss starting out in a new business is common in all industries which is why the loss offset of all income sources exists.

It is no longer an even playing field. The recent changes to target property has skewed the property market adversely for those who own property for investment. To suggest that the tax system still favours property over other forms of investment is not correct.

PIE and Investment Income unfair tax advantage

PIE income is taxed at a lower marginal income tax rate for individuals. Examples are unit trusts, kiwi saver and interest income. This concession was introduced a number of years ago to promote the share market and retirement income sources. The fund management industry has conveniently forgotten that they have an unfair tax advantage and they are very quick to allege that property has a tax advantage over other investment sources, however the reverse is actually true.

Capital Gains Tax (CGT) is not a silver bullet

NZ is often stated as the only country in the world not to have a CGT. And for this very reason, it should have one! However this is a baseless argument. Why should we have one just because everyone else has? Have you considered that NZ may be the only smart country not to have a CGT? CGT exists in other countries, correct. But CGT has not prevented significant property and share market booms over decades in those same countries. This is counter intuitive to the NZ argument we should have one.

NZ already has a number of CGTs in its tax law for property, shares and foreign exchange to name a few. Labour has just introduced further change, increasing the property bright-line test to 5 years, to target so called property speculators. So why is there a need to introduce a new CGT as well?

Long lasting sections of the income tax act already tax capital gains, relating to property and shares, if brought for the intention of sale and a wide range of other property development scenarios.

Labour has suggested the family home would be exempt from a CGT. However, it is difficult to understand the justification for exempting the greatest holders (approx 60%) of residential property from a CGT. What about the family home which is held in Trusts or other entities? What about the inheritance of the family home, should that be taxable? Exempting the family home will have a lot of unintended consequences. It will have limited impact if it only targets the minority of housing, which is not fair and equitable.

If a CGT were to be introduced, like GST, it would only be effective if it had the minimum of exemptions and the widest possible base. A CGT would need to apply to everything ie. all investments, sale of businesses, shares, art, and gold. Not just property. Property is only a subset of investment choice and should not be singled out for a CGT simply because property has had a recent boom. What about shares which have similarly enjoyed significant growth? Why is the IRD not targeting share speculators who are blatantly trade shares for a profit?

Other reasons for no CGT:

- Introducing a CGT will distort decision making, entrepreneurship and growth
- A CGT would drive negative 'lock in effect' behaviours to avoid paying CGT. Less property would be sold
- Higher compliance costs would arise including greater use of lawyers and accountants
- A CGT is complicated and difficult to administer and will likely require millions to administer

Wealth Tax

A wealth or inheritance tax has been suggested as another possible source of tax. Which would be an envy tax. It would be a disincentive for those with aspiration and entrepreneurial spirit to setup business in NZ and succeed. Introducing a wealth tax will risk driving aspirational individuals from NZ, as they likely have the means and inclination to live in any progressive country that welcomes them.

As stated previously the top 10% of taxpayers are already paying 35% of NZ tax. Loading them with a further wealth tax is inequitable.

Land Tax already exists

NZ already has a land tax, it is called rates. This is an out of control tax, welded by councils, which are spending well beyond their means. They increase rates every year with limited accountability.

Introducing a land tax, possibly levied on artificial rateable values has questionable merit, other than a blatant tax grab.

The reason touted for introducing a land tax is to act as a disincentive and further holding cost for vacant land. However there are already disincentives called rates and interest. A holder of land cannot avoid rates and if they financed the purchase they have to pay interest, with the likelihood of no offsetting income stream.

Exempting the family home from a land tax, which comprises the majority (approx 60%) of residential housing on land is ridiculous. Exemptions cause imbalances. This will discourage subdivision of existing large sections and infill housing in the cities, which are desperately needed to for building sites to build new homes. Accordingly, exempting the family home is not well thought out and will cause unintended consequences.

The other main owners of land are businesses, farmers and government. Land tax will merely add another burden to NZ businesses and farmers who are trying to make ends meet in a competitive environment. Inevitably businesses would have to pass the higher costs of the land tax on to their customers.

GST works well leave it alone

The NZ GST system is often hailed as the best indirect tax system in the world. It is a simple tax, with very few exceptions and therefore hard to avoid. It is a consumption based tax, the more you spend the more GST you pay. Accordingly high net wealth taxpayers will pay more GST as they spend more.

The argument to remove GST from vegetables, or other basic necessities, because it impacts the poor more is baseless. GST applies to everyone, it cannot be avoided easily, which is at the heart of its strength and why it should not be changed and complicated.

Simply put GST is not broke, don't stuff it up, or the Labour government will never live it down.

Progressive Company Tax

Why would you wish to penalise successful businesses with progressive rates? Most company tax regimes in other countries have a flat tax rate, as far as I'm aware, which is fair. Why should larger businesses pay a higher rate of tax? As it stands a company pays 28c tax on each and every dollar earnt. The more it earns the more it's taxed, at the same rate, which is fair and equitable. Don't unnecessarily complicate NZ tax and discourage business and entrepreneurial effort setting up in NZ.

Income Tax

Several anomalies still exist within NZ's current income tax system, which have not been addressed for some time. Namely:

- The income tax thresholds have not been adjusted for many years and lag wage growth and inflation
- The bottom income tax thresholds are far too low and should be higher

Perhaps Instead of increasing the minimum wage, the government should be lowering the lowest income tax rate, to encourage and reward those who work and reduce benefit dependency.

I leave you with my considered comments. I'm obviously a tax practitioner that works with the tax laws of the day and I have a strong understanding of the property market as a result. There is no unfair tax advantage granted to property. And in fact, the recent proposals of the current government have significantly skewed the playing field adversely against property.

The solution is to solve the supply imbalances for property and not to penalise those with the entrepreneurial spirit that makes this country great.

Tania Gullery
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