Tax Working Group Public Submissions Information Release

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April 2018

Tax Working Group : Submission

I submit to the Tax Working Group my thoughts on the future of tax in New Zealand, with a view that it will benefit the many and not the few, through a fairer, simpler, and more efficient tax system.

Attached please find:

- **The future of Tax in New Zealand – Submission (pages 2-5)**
- **Questions & Answers (Future of Tax – Submissions Background Paper)**
  - **Appendix 2 Design Issues with a capital gains tax (pages 6-7)**
  - **Appendix 3 (Questions for Submitters) (pages 8-11)**
- **Additional Appendices – various articles and reports referred to in my submission**

By way of background, I am a Sharebroker with 32 years' experience, with prior experience as a qualified accountant working in public practice. I have started up, invested in, closed down and sold out of and continue to run private companies (in New Zealand and offshore) in a range of sectors including IT, biotech, seafood, importing, sharebroking and investments. As a result, I have dealt with the tax system at many levels.

Throughout my career, I have always thought:

- *How can New Zealand operate a tax system that is more efficient, fair and simple - with no room for error?*

- *How can New Zealand operate a system that frees up the time of business owners, investors, individuals and trustees, to focus on the business and not on massive amounts of paperwork?*

As you outline in the background paper: 'tax is not just for "experts"'. We all have a stake in the design of our tax system.

I have no axes to grind, am not a member of any political party, and have no vested interest apart from being a New Zealand tax payer with a desire for a better and simpler system for the many. These views are my own and are not representative of my employer.

You will see from the various appendices in my submission that I have a long-standing interest in tax reform. Relevant sections of these appendices are highlighted to reduce your reading.

I accept that major tax reform will take courage to implement and a stomach for heights. I encourage you to be brave for the good of the many, not the few and create a better NZ (the few will be the loudest to say 'no' and the many will praise you for common sense and a simpler life).

I am happy for the Group and the Secretariat to contact me to discuss the points raised in my submission.

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F J Gargiulo ACA, AFA

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The future of Tax in New Zealand

I believe New Zealand can operate a tax system that is fairer, more efficient and simple, cuts down on paperwork and minimises room for error.

I have observed that issues such as capital gains tax, reducing compliance, and tax leakage repeat over the years, with little having been done to solve them other than "add ons" or trimming around the edges of the existing tax system instead of tackling the issues head on (Appendices 8, 9, 20 and 21 (A20 page 6 onwards – history from 1967 to 1988 on GST).

My proposal is for New Zealand to adopt a **Turnover Tax System**.

> *"… a single point-of-sale tax between companies and companies, companies and individuals, and individuals and individuals. Such a low, fair and consistent method of funding government could easily replace the cacophony of taxes that are stifling trade and commerce in this country today. Let's just tax the dollar traded, not who or what entity traded it, not why it is traded. Why should companies (groups of individuals) and individuals be taxed at different rates?"* (Appendix 1).

The rationale behind a **Turnover Tax System** is as follows:

- Tax ALL financial (bank) deposit transactions *(Turnover Tax, Appendices 0, 1, 9, and 30 on page 3)*. To enable this, the government would need to remove all cash from the monetary system (go cashless) so all payments/receipts are processed via a bank (Appendices 2, 3, 4, 5, 6, 7 and 46). Tax would be applied at a rate to be determined when Treasury works out the total cash flow within NZ and amount of FX coming in and going out of NZ (Appendix 36).

*A **Turnover Tax System** would:*

- cut the IRD to a very small unit;
- allow accountants and lawyers who specialise in the tax field to apply their expertise to other, more productive sectors;
- eliminate tax errors, tax avoidance and tax evasion (Appendices 43 and 45);
- eliminate the issues of unpaid taxes (Appendix 22);
- get rid of the cash economy and all that goes with it, seal up the leakage;
- do away with tax losses carried forward;
- help with Anti-Money Laundering (AML) (Appendices 24,25,26,27,28,28A,29,30);
- reduce government spending on bank notes and coins;
- reduce bank size in terms of space and number of people employed (you will be aware that banks do not wish to have customers in their branches and focus instead on online transactions as is the IRD);
- pass all the points of purpose and principals of a good tax system: efficiency, equity and fairness, revenue integrity, fiscal adequacy, confidence and administration costs, as outlined in the background paper;
- "… be sufficiently robust to deal with future challenges and sufficiently nimble to take advantage of opportunities", a requirement outlined in the background paper;
- having no exemptions and a single tax rate creates a relatively simple system (simpler than GST which has a few exceptions);
- actually collect tax as it's on a cash flow basis (you wouldn't be able to avoid paying tax through evasion or an avoidance arrangement);
- ensure households and businesses have appropriate incentives to work, save, innovate and invest;

- have a high level of compliance (self-compliance once the system is in place);
- being cashless eliminates armed robberies, burglaries, break-ins etc which is a saving in both cost, stress and police time;
- deal with cash flow (which is fact) versus profit/loss (which is an opinion);
- shows movement of funds via the banking system whereas cash can be untraceable;
- would reduce the cost of tax compliance (Appendix 21). It deals with tax on a real time basis as opposed to assessing what people did last year and what they might do this year.

Further, I propose a Turnover Tax System which would have a single tax rate which avoids splitting income between family members, trusts and company structures. Everyone would be on a single tax rate which saves both time and money (Appendix 33).

It should be noted that South Africa has a Turnover Tax System in place. Its system has thresholds and different tax scales whereas my proposal is for a single rate tax paid monthly.

As with any system, there will always be pitfalls. I am sure the Working Group will be able to identify and address these.

To elaborate on the case for a Turnover Tax System further:

- Under a **Turnover Tax System**, banks and financial institutions end up being the tax collectors as they currently are with RWT on gross interest. This system would do away with ALL the other various taxes we currently have and would eliminate tax returns – PAYE, GST, FBT, Provisional Tax etc. It removes all other tax related paperwork, and the compliance that goes with it, but would open the gates to taxing anything deposited which will expand the tax base (it would be a capital gains tax, estate tax, inheritance tax and the list goes on) (Appendices 8,9,10,11 and 48).

- The system would free up business owners to work on their business rather than tax related paperwork that they have no interest in, and which doesn't help them run a better or more profitable business. Furthermore, business owners often need to rely on tax professionals to help them with the tax component which adds additional business costs (Appendices 12, 13). The paperwork also deters people from starting their own business because it is complicated, onerous and time consuming (Appendix 8, page 3).

- The points that need to be considered with any change in tax rates are the flow on effects. Getting rid of all other taxes would reduce the prices of goods and services (15% GST) and flow on effects of inflation. Will businesses pass on wage increases as tax rates drop or keep it for themselves? If businesses' profits increase, will we get a boom period of spending etc?

- The current tax system does not create wealth for New Zealand, or for the tax payer, as no value is created from data collection and filling in forms (Appendix 14). However, it does provide a living for the sector of society that administers it. Under the Turnover Tax System, this sector would need to refocus its business model, or move on to other things that add value (Appendices 8, 9).

- We currently place a large burden on tax payers in a number of areas that are often subjective requiring them to engage with professionals which can prove costly and without guarantee the IRD may disagree with such advice at a later stage. Tax payers do not want to feel they need an honours degree in law and accounting to understand the rules of a tax system (Appendix 16). Further, the courts should be dealing with criminals, not ruling on who is right or wrong on a subjective matter (it adds no value). Why do we continue to do this to our people when it is clearly wrong? (Appendices 10, 15, 16, 17, 18 and 30).

- People have suffered personal health and financial issues which have ruined lives (and in some cases resulted in jail time). This results in a loss-loss situation for the person concerned, their family, their business and staff, and the wider community (Appendices 19, 23, 44 and 47). This reinforces my point that we need a simpler tax system that stops this from happening. Tax changes do alter people's behaviour and where the system is simpler, the result is better (Appendices 10, 28, 30, 31 and 32).

- Tax payers want certainty. The Government recently brought in laws that are very clear on property and include - no offsetting losses and the "5 years" rule. This is what Turnover Tax is all about – a clear and simple system. The government gets the tax paid monthly without the hassles, which helps its cash flow and therefore the country in general. (Appendices 34 and 35.)

- We need a simple system which gets away from tax schemes, and tax driven investments, which only encourages tax payers to invest in them as a way of avoiding paying higher rates of tax (Appendix 40). If the IRD decides to challenge the tax scheme this will amount to a cost to the rest of the community (less tax revenue) and more cost to the tax payer.

- Turnover Tax would remove the bad taste in the mouths of investors with imputation/franking related to Trans-Tasman investing that needs to be addressed. Trying to do business across the pond is very hard and most stop trying (I did!). (Appendix 41).

- If Turnover Tax can be implemented, it will encourage overseas companies to do business here because the tax system is simple, there are no tricks and the tax rate would be low. NZ could become the 'Switzerland of the Pacific'. Craig Heatley sums it up so well: "We are at the bottom of the world so we need to be better than everyone else to be considered by investors." (Appendix 42).

- I have spoken with people who have worked in the IRD's audit/investigation team in the past and they believe this type of system is what is required on so many levels. Some time ago when I presented my ideas to an economist, he commented as follows:

  "With regards to your simplified tax structure, while I feel has much to commend it – like getting rid of accountants – I think its two major shortcomings are:

  1. *The incentive to invest beyond NZ in order to avoid tax – this might reduce the tax base as much as the capture of the black economy would expand it.*
  2. *Tax is used not just to fund government but also to redistribute wealth/income – this is where progressivity of income tax comes from. Your tax would have no progressivity in it – although, of course, you can get it effectively by giving handouts to the less well off.*

  Apart from that I can see beauty in its simplicity."

- This was followed up with a further email:

  "I suspect the idea's a dead letter. Since I sent you that last email a third avoidance occurred to me – simply avoiding the banking system that is building up non-bank credits and debits at some non-banking intermediary. All you'd have to have is a deposit somewhere in trust to cover your net liabilities so I suspect across the three channels there'd be too big an undermining of the tax base."

  I believe the Economist's comments above can be made to work and are not deal breakers.

Observations on Tax Generally

- With R&D tax credits, cash rebates rather than tax offsets, smaller companies do not make a profit so there is no benefit from the offset and only benefits to profitable companies. If the government decides to help in this area that can be dealt with outside the tax system. As stated above, the new tax system would ignore tax losses and encourage businesses to become profitable immediately.

- The IRD (therefore NZ Inc) loses over $200m a year from liquidations. They close more businesses than anyone else because of unpaid taxes and manage billions of late tax payments (Appendix 22). A Turnover Tax System would eliminate this and the issue would be dealt with at the time, otherwise the doors get shut (you can't pay you don't play). I say pay now (PAYG) and not later. With the current tax system you do not know what is around the corner. With the Turnover Tax System you are up to date monthly (and any issues should be very small).

- AIM (accounting income method) has started for small businesses. This is a take-off from the Turnover Tax System, without all the features, and is all about cash flow. It goes only part of the way and should be implemented for all tax payers. While we can see the advantages of the system now, we have to think bigger and better.

- There is more than $1.35 billion laundered in New Zealand each year (Appendix 29). Under a Turnover Tax System all these transactions will be taxed; increase the tax take, along with cash jobs (which would be eliminated) as all transactions have to be via a bank account.

- The likes of the Amazon tax issue will be dealt with when funds are moved off shore via FX so retailers are on a level playing field under the Turnover Tax System (Appendix 38).

- Digital tax on turnover that Google, Facebook and Apple etc. will face, is the way of the future in my view, as sectors change. If we are to believe that the tech world will do away with our jobs then the tax system needs to be at the forefront of the changes to ensure the tax base is not eroded. Future government expenditure will only increase with the likes of health, pensions and unemployment. (Appendix 0).

- Another area of concern is how to address cryptocurrencies. There will be more of these types of products in the future (and products yet to be invented). Under Turnover Tax they will be taxed on the way out and when coming back in via bank accounts (if they do actually come back in to the system) (Appendix 37).

- The IRD manages social policy initiatives such as Student Loans, KiwiSaver and Working for Families. Are these initiatives merged with the Turnover Tax System or are they moved to another department?

- To round this all off, the penalties that will need to be put in place with a Turnover Tax System must be tough and not open to the courts' interpretation. They must be easy to understand by the many so the system is simple and clear to follow. There is no grey in a very black and white system.

My input to the questions you are seeking answers (Future of Tax –Submissions Background paper) are based on Turnover Tax System vs. current tax system.

APPENDIX 2 – Design issues with a capital gains tax

If you think the Group should design a capital gains tax (CGT) for Government consideration, we need your feedback now on a number of detailed design issues:

- Should the CGT be a separate tax or part of the income tax? Most countries tax capital gains as part of the income tax.

  Yes, CGT should be implemented as part of the overall Turnover Tax system as it is central to widening the tax base and lowering the tax rate. (Appendix 48).

- Should capital gains be taxed on an accrual basis or only when realised (i.e. only when the asset is sold)? Most countries tax on a realisation basis. How should matrimonial property settlements and disposal of assets on death be treated?

  Only when assets are sold and funds are banked as part of the overall system as I have outlined. Matrimonial settlements should be excluded, but any cash banked is taxed as is with winding up of an estate or trust.

- What assets should be covered given that the terms of reference exclude any tax on the family home? Should it include just rental properties, shares, collectibles, private assets such as cars?

  All assets should be covered no with exceptions. Exceptions cause a breakdown and tax payers know the rules which are plain and simple when assets are sold.

- Should assets held by KiwiSaver and other savings schemes be taxed?

  Yes. When funds are banked into the various schemes going in, and when funds are banked on their way out of the various schemes to the savers bank accounts in a lump sum or as pension etc. These should be taxed.

- Should assets held offshore be subject to tax?

  Only when the assets are sold and banked. Any funds moved offshore will be taxed when the FX transaction is done and if and when funds come back to NZ.

- How would a capital gains tax integrate with current tax laws, such as when land sales are already taxable, our company imputation system and our CFC/FDR rules?

  With the Turnover Tax System these taxes are no longer applicable.

- When should non-residents be subject to tax?

  When funds are banked into a NZ bank account and again when funds are transferred out of the country when a FX transaction is done.

- Should capital losses be ring-fenced to be offset only against capital gains income or should they be offset against any income? If capital gains are taxed on a realisation basis tax base maintenance considerations suggest that capital losses should be ring-fenced.

  No. Whatever is banked is taxed.

- Should there be roll-over relief allowing capital gains re-invested in similar assets to be treated as unrealised? If so, when should roll-over relief apply? For example, should a farmer selling a farm and buying a new farm be taxed on the increase in value of the old farm?

  No. Contra deals need to be accounted for and taxed as the Turnover Tax System I propose is all about the flow of funds.

- How should death, emigration and immigration be handled?

  All should be subject to tax.

- How should gifts and gambling winnings be taxed?

  Yes. Funds will be banked and will pass through a bank account and be subject to the Turnover Tax System.

- What should the rate of tax on tax on capital gains be – the normal income tax rates, or some other rate(s)?

  Under the Turnover Tax System, I propose a single tax rate (to be determined by Treasury).

- Should any allowance be given for inflation in calculating capital gains?

  No. We are trying to make this a system that runs without input, is clear, simple and tax payers understand the rules. It should be black or white – no grey areas.

- Should there be a de minimis rule?

  No. It adds no value and exemptions create issues.

- What administrative implications would there be from a capital gains tax?

  None. The Turnover Tax Systems has no exemptions and is self-regulated.

- What rules should govern the transition into a capital gains tax? The options seem to be cost of the assets (retrospective taxation of past accrued gains), valuation at date of introduction or only assets acquired post introduction (the Australian rule).

  No rules apply. What is banked is taxed at the single tax rate.

- How should family trusts be integrated into the system?

  The same way as companies and individuals under the Turnover Tax System – a single tax rate which is standard for any funds banked.

APPENDIX 3 – Questions for submitters

Chapter 2: The future environment

What do you see as the main risks, challenges, and opportunities for the tax system over the medium- to long-term? Which of these are most important?

- *That the tax system becomes like all the other tax systems in the world, hard to follow, understand, subjective and unbalanced. We need to spread the tax base as wide as possible. In order to do this it needs to be simple and easy to administer, freeing up people's time to work in and on their businesses without them having to do all the paperwork (which does not add to the growth of NZ).*

How should the tax system change in response to the risks, challenges, and opportunities you have identified?

- *Yes. Implement the Turnover Tax System. One people, one tax system based on one rate of tax for all.*

How could tikanga Māori (in particular manaakitanga, whanaungatanga, and kaitiakitanga) help create a more future-focussed tax system?

- *By embracing a "one people, one tax system" where all New Zealanders are treated fairly and equally.*

Chapter 3: Purposes and principles of a good tax system

Principles for assessment

What principles would you use to assess the performance of the tax system?

- *Simple, easy to understand and follow, not subjective, as wide a tax base as possible, not time consuming for the tax payer, a system with no exemptions, a system that has no slippage, a system that is fair to all tax payers.*

Defining 'fairness'

How would you define 'fairness' in the context of the tax system? What would a fair tax system look like?

- *All members of society are paying their fair share of tax. This ensures NZ Inc operates as a decent and caring society with a tax base that is as wide as possible. Tax payers are incentivised to work hard knowing they are being treated fairly. They will be happy to contribute as they have a low tax rate and a tax system that manages itself without unnecessary and time-consuming paperwork. A system that caters for all in society.*

Chapter 4: The current New Zealand tax system

Frameworks

New Zealand's 'broad-based, low-rate' system, with few exemptions for GST and income tax, has been in place for over thirty years. Looking to the future, is it still the best approach for New Zealand? If not, what approach should replace it?

- *No. Our current system has been described as simple when comparing with systems around the world but I feel it can be even simpler if a Turnover Tax System was implemented.*

Taxes and behaviour

Should there be a greater role in the tax system for taxes that intentionally modify behaviour? If so, which behaviours and/or what type of taxes?

- *Yes. With the Turnover Tax System all business owners would be over the moon. With a simple and easily understood system there is no room for misunderstanding. Combined with a system that is not subjective, tax payers would feel in control and will not be worried about an future outcomes that may come back to bite them due to professional opinions they may or may not have received. Tax payers will spend more time doing what they are good at, ie running their businesses for profit and having more leisure time.*

Retirement savings

Should the tax system encourage saving for retirement as a goal in its own right? If so, what changes would you suggest to achieve this goal?

- *No. Vested interests will tell you otherwise, but the Turnover Tax System should encourage this itself. If you apply this to retirement I would suggest you need to open the gates to education and health. All of these need to stand on their own merit and having a tax system as outlined provides for this as part of an overall package. I am of the view that save as you go (SAYG), so you can pay as you go (PAYG) when the time comes. Tax is paid SAYG and when you PAYG the tax is again paid when those funds reach a bank account, however, this time they bear the tax whereas with SAYG you would bear the cost. Remember, tax is taken again when the funds reach a bank account.*

Chapter 5: The results of the current tax system

Fairness and balance

Does the tax system strike the right balance between supporting the productive economy and the speculative economy? If it does not, what would need to change to achieve a better balance?

- *No. The Turnover Tax System I have outlined will achieve this balance and remove the pitfalls of the current system.*

Tax and business

Does the tax system do enough to minimise costs on business?

- *No. The current system has only added to business expenditure in terms of cost plus wasted time for the tax payer. Further this could be even more expensive if they make an error.*

Does the tax system do enough to maintain natural capital?

- *No. But a wider tax base would increase revenue allowing the Government to implement policies in this area which in the past has been neglected.*

Are there types of businesses benefiting from low effective tax rates because of excessive deductions, timing of deductions or non-taxation of certain types of income?

- *Yes. High depreciation type companies, the IT sector, marine farms and property companies etc.*

- *With the Turnover Tax System this is all done away with as it is funds banked with no deductions that tax is applied to (saving costs and time). The tax payer can claim whatever cost they think they require to run a successful and profitable business, but under the Turnover Tax System who cares, as tax only applies to funds banked. This again takes away the subjective element and I would suggest there would be fewer costs as a result as there is no point in giving it a go to try and get a deduction and maybe argue it later (with this system there is no “argue later”). In the Turnover Tax System there are no tax losses carried forward and it’s in your best interests to get the business profitable as soon as possible as you are still paying taxes on funds banked.*

Chapter 6: Thinking outside the current system

What are the main inconsistencies in the current tax system? Which of these inconsistencies are most important to address?

- *Subjective decisions that are required to be made by the tax payer, Foreign Investment Funds (FIF) and Fair Dividend Rate (FDR).*

Is there a case to consider the introduction of any new taxes that are not currently levied? Should any taxes be reduced if new taxes are introduced?

- *Yes. One tax that covers all funds banked and funds transferred in and out of the country. Do away with all the taxes we currently have leaving this final tax so tax payers have no further liability apart from a contra deal that will need to be accounted for.*

Chapter 7: Specific challenges

Housing affordability

How, and to what extent, does the tax system affect housing affordability for owners and renters? Is there a case to change the tax system to promote greater housing affordability? If so, what changes would you recommend?

- *By changing to a Turnover Tax System the costs of goods and services would drop by 15% which will help with affordability at the same time widening the tax base to make it a fairer tax system.*

Capital gains tax

Should New Zealand introduce a capital gains tax (that excludes the family home)? If so, what features should it have?

Should NZ introduce a capital gains tax *– YES (as part of a Turnover Tax System) and based on there being no exemptions creating a fairer and simpler tax system.*

Should the capital gains tax exclude the family home *– NO (as part of a Turnover Tax System).*

- *We already have a capital gain tax with the new bright line test (the rules are simple if you sell before 5 years, its taxable, end of story). If the IRD proposals are adopted real estate investors will lose the tax loophole from April 2019, and their ability to offset losses on residential properties to reduce their tax on other income. The IRD's argument is those expenses in fact relate to the capital gain so those expenses should not be deductible unless the capital gain is taxed.*
- *The Turnover Tax System cuts through all this and believes that investors will change the way they invest in the future. We need to put fairness back into the system in my view. There is story in the media (Stuff 24/3/18 by tax expert Chris Wales – Appendix 39) that the Prime Minister will turn down a capital gains tax (but government has not seen what a new tax system would be able to do). To accept a capital gains tax on the current tax system would be for the government to be kicked to touch. Therefore we know the likely result of getting a capitals gains tax.*

Land tax

Should New Zealand introduce a land tax (that excludes the land under the family home)? If so, what features should it have?

- *No. As above, anything banked is taxed.*

Environmental taxation

What are the main opportunities for effective environmental taxation?

- *The Turnover Tax System is based on the flow of cash and makes no distinction across sectors or boarders which is the way it should be. (See Appendix A0 on digital tax on EU turnover.)*

Progressive company tax

Should the tax system do more to support small businesses? In particular, is there a case for a progressive company tax?

- *No, one tax for all tax payers, no difference - one tax, one people. Wealthy people and the biggest companies will pay the bulk of the tax as is the case now (all related to cash flow). A progressive company tax would not improve the tax system or business environment in my view. Tax is a business cost that must be allowed for and accounted for. In the Turnover Tax System it is simple, easy to understand and the tax rate will be lower than what is currently the case so would be no need for this.*

GST exemptions for particular goods

Should the tax system exclude some goods and services from GST? If so, what should be excluded? What else should be taxed to make up for the lost revenue?

- *No. As stated above I would eliminate all taxes. A Turnover Tax System is the same as GST without exemptions - simple, straight forward, easy to understand, and eliminates tax payers having to be involved in the calculation or payment of tax.*
- *Benefits to the tax payers are many, as are the benefits to the government. They get monthly payments, reduced compliance, a streamlined IRD, catch all cash flow in the system, reduce leakage, and it widens the tax base.*
- *Overseas companies would be keen to set up business in NZ as the tax system is simple, easy to understand and the tax rate would be low as a result of taxing all the cash flows.*
- *We would get all the bright people working in the tax sector taking on roles that would benefit from their huge brain power. This helps the country and business sectors as they are not playing the tax system (which only benefits the few at the cost of the many). It may put some people out of work but that work is costing NZ Inc a lot of money that could be better invested in making the bus go faster.*