Tax Working Group Public Submissions Information Release

Release Document

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

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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.

Submission to tax working group on tax system

There are problems the tax system could address

There is rising wealth inequality which is helped along by the tax system. The tax system does favour investment in housing over putting money in the bank and other forms of investment – because of the fact real estate can be highly leveraged and the fact there is no adjustment for inflation in the tax system (which may well be a nightmare to implement).

Higher income tax rates are counter-productive

While it may equitable to tax higher income earners more, higher income tax rates over the current top rate of 33% tend to raise very little revenue because they encourage tax avoidance and there are relatively few of the so called high income earners, which nowadays might be people earning over $120,000 a year. Furthermore many of the wealthiest people earn income that is non-taxable in their hands such as capital gains, superannuation and trust distributions.

Capital gains taxes don't work

Putting aside short term speculation which is already caught under the current tax system, taxing capital gains that might not happen until 20 years or more in the future would likely cause more problems than it solves.

For a start, the gain due to inflation over a 20 year period will be considerable so a house rising only at the rate of inflation would have a considerable capital gain. For example if inflation was 2% a year after 20 years a house purchased for $100,000 would be worth $148, 595 if it appreciated only at the rate of inflation – giving a potential taxable gain of $48, 595! To tax this gain would be a huge impost and unfair.

Secondly the prospect of the tax far away in the future is unlikely to impact human behaviour. Property investors currently are clearly investing for the capital gain in many instances because the investment otherwise does not stand up -it is often not earning sufficient cashflow to even cover costs and financing. I have had Auckland property investors telling me their rental properties are a cash drain but they are prepared to accept that because the good location means in the end they will get a great capital gain. Telling them the big gain might be taxed 20 years down the track is unlikely to discourage them. The tax system is always being changed so there is no certainty a tax imposed now will even be around in 20 years, and who knows what rate might apply then! This probably explains why capital gains taxes appear to have had virtually no effect on slowing down runaway housing markets.

Financing arrangements should not affect tax liability

How an investment is financed should not affect the taxes imposed on it. Why should a person borrowing a large amount to buy a business pay less tax than one who saved up and didn't borrow anything? Allowing interest payments to be deductible is a distortion that also allows various tax rorts that can stop multi-nationals with related party loans from paying company tax in New Zealand.

Stopping interest from being deductible would level the playing field between putting money in the bank and investing in real estate. Savers putting money in the bank would get taxed on their interest income and property investors would pay tax on their net rental income after taking into account normal property expenses but not the interest on any loan taken to buy the property because they didn't have sufficient of their own money to buy it.

Stopping interest deductibility for tax purposes is something that has been advocated by the Economist magazine:

https://www.economist.com/news/briefing/21651220-most-western-economies-sweeten-cost-borrowing-bad-idea-senseless-subsidy

https://www.economist.com/news/finance-and-economics/21716050-would-be-risky-time-fiddle-tax-code-what-if-interest-expenses

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