Tax Working Group Public Submissions Information Release

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Submission to the Tax Working Group

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General Remarks

New Zealand's tax system exists to raise revenue, which is used to fund the government's activities. We all rely on the state to legislate in the public interest, to support those who are unable to support themselves, and to provide a variety of goods and services. In this way, tax is the price we pay for a civilised society, as Oliver Wendell Holmes Jr famously said.

The tax system also exists to promote desirable outcomes directly. For instance, the excise tax on alcohol reflects the fact that the price that consumers pay for liquor does not reflect the cost that society bears as a result of its consumption. Taxes of this sort can discourage harmful behaviour and raise revenue, which can be used to mitigate the worst effects of the activity. Desirable outcomes can also be promoted through the design of the tax system: the progressivity of the income tax rates ensures that those who have higher incomes pay more in tax. In this way, the two objectives of a good tax system can be complementary.

In my view, politicians and tax officials in the last thirty years have predominantly focused on raising revenue in such a way that minimises distortions and promotes coherence. These were appropriate priorities at a time when New Zealand was rapidly liberalising its economy, but today, the context is different. While we know that the level of taxation and government intervention under Muldoon was costly and ineffective, we also know that successive governments have failed to remedy the negative social effects of the subsequent economic transition. Further, New Zealand faces a number of challenges in the years ahead, including water management, climate change, an aging population and the changing nature of work.

Tax can and should be part of our response to these challenges. I do not call for the Tax Working Group to abandon the principles that have guided tax policy developments in the past: efficiency, revenue integrity and practical concerns are just as important today as they were in the 1980s. I merely call for a richer understanding of two principles that are sometimes sidelined in tax policy thinking: fairness and responsiveness.

Fairness

I have heard it said that when the 'established criteria' for assessing tax policy proposals are applied, fairness tends not to get the same attention as the other principles. I do not necessarily agree, because the emphasis on minimising distortions is simply one way of speaking about a particular type of fairness. This is frequently captured by the idea that '*taxation should not affect people's investment choices; different investments should be taxed as similarly as possible*.'

However, this conception of fairness is deficient in a number of respects. For a start, its very language obscures that fact that there are a large number of New Zealanders who simply do not have the means to '*make investment choices*.' In his 2017 paper for the Ministry of Social Development, Brian Perry found that –after housing costs and inflation had been taken into account– the poorest 10% of New Zealanders have seen no improvement in their incomes since 1982, while the incomes of the wealthiest 10% of New Zealanders have doubled in that period. A growing body of scholarship clearly shows the harm caused, to economies and societies, by such wide differences between rich and poor. Taxation is not divorced from politics; it was a substantial contributor to the disparities we see today, and I believe that that tax could be used more effectively to promote equality of opportunity.

Secondly, for all the talk about BBLR, successive governments have failed to eliminate the largest distortion in our tax system: our lack of a comprehensive capital gains tax (CGT). Multiple tax reviews have considered CGT and none have come out in favour, which suggests the evidence for such a tax might not be as strong as its proponents claim.

However, I urge this Tax Working Group to seriously consider the idea once again; not from the perspective of whether it will take the heat out of the housing market, but simply as a base-broadening measure that is desirable in the interests of fairness. It is important to get the details right, but I urge the Group not to lose sight of the bigger picture. New Zealand's income tax, in particular, has developed over the course of many years. It was not perfect when it was introduced, and neither should we expect a CGT to perform to an unrealistically high standard.

On the subject of details, it seems to me that:

- Taxing capital gains on realisation, rather than accrual, is more practical.
- There should be as few exceptions to the tax as possible, in keeping with the BBLR philosophy; it is for this reason that I prefer a CGT to a land tax.
- There should be no exceptions for 'like kind' transfers, such as where a cryptocurrency trader sells one digital currency and invests in another.
- The tax rates should be the same as those on personal income.

Of course, if you find that a CGT is not worth pursuing, then I encourage the Group to recommend other options for taxing wealth, although I acknowledge that the Group is unable to recommend any form of inheritance tax.

Responsiveness

I also urge the Tax Working Group not to be unnecessarily constrained by the BBLR principle. Having a large, stable tax base is a wonderful thing for revenue integrity, but restricting ourselves to taxing broad bases can result in missed opportunities.

For example, there is significant public concern about water bottling plants, and there have been calls to impose a specific tax on businesses that engage in this activity. Tax purists would be aghast at the idea of singling out a particular industry, and would argue that the coherence of the tax system would be undermined if such a tax were to be pursued. Respectfully, I disagree: the tax system should be responsive to communities and their concerns. There is a value in demonstrating that people's opinions matter, and in more cases than at present, this should outweigh the loss of coherence, equality or certainty.

Similarly, the BBLR principle should not prevent us from using tax as a policy lever where there is strong evidence suggesting that quantifiable negative outcomes could be avoided by imposing a tax. Other submitters will speak to the effectiveness (or otherwise) of increasing the tax on alcohol, taxing sugar-sweetened beverages, or using tax to promote environmental sustainability. If some of these proposals stack up and are implemented (as I hope they will), the rest of the tax system will not be substantially affected.

Conclusion

New Zealand has one of the better tax systems in the world, and I do not see any need to make radical changes to it. However, I urge the Tax Working Group to investigate proposals that could promote fairness, understood in a richer and more consistent sense than at present. I ask the Group to be responsive to public concerns, even if this means that the overall coherence of the tax system is undermined to some extent. In this way, I believe that tax can be more than simply plucking the goose for its feathers, but can be a force for good in our nation.