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;

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Chris Kelly: Submission to tax working group

I am a lawyer who has for some years specialised in the law concerning wills, estates, trust and elder law.[1] I wish to put forward some ideas for the reform of tax on trusts. I also want to make some comments about how to broaden the tax base generally.

Taxing trusts and trustees

Trusts are usually assumed by most people to be primarily used to avoid tax. This is not entirely true. Trust are set up for many reasons. The main tax advantage – income splitting to take advantage of lower rates for lower income tax payers - was addressed in part by the "minor beneficiary rule" some years ago. There remains, however, some ability to reduce tax by allocating income to family members over the age of 16 who are not yet working.

This ability to allocate income is mainly of benefit to those with high levels of family income. For such families, the cost of employing accountants to file both trustees' and beneficiaries' tax returns is relatively minor comparted to the tax savings. For those on middle to low incomes, it is often not worthwhile going through the process. In my experience tax savings through use of trusts are mainly of benefit to high income families or those with quite substantial assets.

It would simplify the tax system if all trust income were simply taxed as trustees' income. Distributions to beneficiaries would thus be tax free (because tax had already been paid on that income stream). This should reduce the scope for trustees to play games with distribution to whoever is on the lowest tax rate irrespective of who actually gets to spend the money in reality. Trustees' income should all be taxed at the top rate for income tax. Currently this is 33% but, as I explain below, I consider there is scope for higher tax rates to be imposed on those on higher incomes. Thus trustees' income should potentially be taxed at 35% or even 39%.

There may be some need to retain the present system (taxing income distributed to beneficiaries at the individual beneficiary's own rate) for trusts arising in estates.[2] Trusts set up solely for the support and welfare of handicapped people may also need to be able to continue under the current system, but I would think these should be the only exceptions. Of course, there would be no need to change the current rules applicable to charitable trusts, superannuation schemes, unit trusts etc.

Income tax and medicare surcharge

The current income tax bands have not been adjusted in line with inflation for some years now. This has had the effect of compressing the bands. People on quite modest incomes find themselves taxed at a higher band than previously. The bands need to be recalibrated in line with inflation.

There is also scope to tax those on high incomes at a higher rate. 33% is very low for the top rate. For example the rate for incomes over $120,000 could be 35% and incomes over $180,000 could be taxed at 39%. This would put the emphasis on taxing those who can afford to pay. Government also needs to increase the total tax revenue to allow increased spending on such things as housing,

[1] I am co-author of recognised authoritative legal texts, including Garrow and Kelly's Law of Trusts and Trustees. I have also present a number of papers for legal conferences and contributed articles to several legal journals.
[2] That is trusts arising under the will of a deceased person or on an intestacy.

schools and hospitals. I propose this in the full knowledge I am likely, as a consequence, to pay more income tax, because I am in a higher income bracket, but I accept that as a necessary contribution to society.

It would also be worthwhile considering a surcharge to cover the health system, similar to what is done in Australia. The money from the surcharge should be completely devoted to the public health system – private medical insurance should not be subsidised in any way. The tax rates could be reduced somewhat for those on lower incomes so that the medical care surcharge would not impose too much of a burden. Thus, instead of a 33% tax rate, the rate might be 30% with the surcharge taking the effective rate to about 34%.

Company tax

There is always a risk that companies will disguise returns to their owners as expenses, so as to reduce tax. This problem has been addressed in relation to larger overseas companies but my experience suggests it remains an issue with some local companies also. My suggestion would be:

- Smaller companies, with no significant overseas ownership, would be taxed much as partnerships are at present – the income would be attributed direct to the shareholders;
- All other companies, including any with overseas ownership of any significance, would be taxed on their total turnover, not on net profit – for example a tax of 9% or 10% on total turnover might equate to 33% of net profit but would leave less room for avoidance.

It would be necessary to define what are "small" companies. Inland Revenue should be able to provide statistical basis for such a definition. Possibly companies with total capital less than $5 million and no less than 10% of ownership held outside NZ.

Farms

The taxation of farms is also quite complex. Again there is wide scope for personal expenditure to be disguised as business expenses. To most farmers, income is what is left in the bank account at the end of the season.

One solution might be for farms to be taxed on the capital value of the property. There would then be no point trying to manipulate expenses to create a notional loss or small profit. Farms could be exempt from income tax and GST provided they pay a tax on the capital value of the land and buildings.

GST and other direct taxes

I have read proposals that GST should be reduced back to 10%, as it was originally, and other environmental taxes and charges used to make up the difference. I strongly agree with this approach. As is widely recognised, GST is a regressive tax and a heavier burden is placed on lower income people who have less ability to pay.

Alternative taxes that I believe need to be introduced, include:

- A sugar tax – the rate of tax should increase according to the level of sugar in each product;

- Continue to increase the tax on tobacco;
- Increased tax on alcohol, especially drinks likely to be attractivd to teenagers (who need to be discouraged from early heavy alcohol consumption) – for example ready to drink mixes;
- Taxes on plastic bags, bottles and packaging, with higher tax rate for plastic which is not recyclable or is not recycled.

Transaction tax

A transaction tax or Tobin tax of some kind should also be introduced. This would help fund the reduction in the GST rate as above. At the least a small charge each time someone sells NZ dollars – or moves money out of the country - would be a simple and easy tax to collect through the banking system.

Contact

The working group is welcome to contact me if you wish to discuss any of this further or require further explanation. I can be reached on:

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Chris Kelly

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