Tax Working Group Public Submissions Information Release

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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.

From: Stephen Minto [1]
Sent: Monday, 30 April 2018 2:43 PM
To: TWG Submissions
Subject: Submission
Attachments: Submission on tax working group.pages

Hi, This is my submission to the tax working group.

I attach it as I did it in IMac 'pages' format (not as easy as 'word')

But I also cut and paste it into the e-mail in case you don't accept 'pages' format.

If you need me to drop it off or post it let me know.

Plugging the income tax cullender

Executive Summary

Income tax resembles a colander more than a tax collection bowl. The consequence is an out of control tax avoidance industry that is undermining civil society and the ability to do business in it. As importantly, destructive economic signals on competition and the use of resources are currently being sent to business about expenses and this is undermining innovation in the economy.

It is now overdue to reconsider the fundamental assumptions that underpin the income tax regime and make changes so it will work better for the economy and society. These proposals see tax not as a cost to business to be avoided but as payment of a 'society dividend' for the laws and structures that enable the business to function in safety.

For income tax to recover its primary purpose and role of funding the needs of society, and to drive efficient economic decisions for the better of society and business, it must be simplified. By:

Three main proposals (there are 3 more subsidary)

1. Remove deductibility for all expenses except for domestic (NZ) salary and wage payments.
2. No capital revenue distinction for non-individuals with a wider definition of income for all, (variation for private homes in trusts or other entities).
3. Imputation and other related memorandum accounts should be ceased.

Why?

1. The tax avoidance industry can almost be stopped or at least deeply and seriously hindered by these two proposals.
    - More revenue comes to the govt.
    - a greater sense of fairness and therefore cooperation on compliance.
    - more financial capital can be freed up for investment elsewhere in the economy.
2. Economic efficiency is being seriously undermined by the ability to deduct expenses and re-characterise revenue income as capital gain. For example,

Proposal one - deductibility of expenses as current.

(i) Current rules of deductible expenses for two companies producing the same good/service
earns
expenses Tax income
28% tax residual to invest
Efficient company A
$150 $50
$100 $28
$72
Lazy inefficient B
$150 $100
$50 $14
$36

As a question of economic policy, why should efficient Company A pay more tax than Inefficient Lazy Company B when they earned the same gross income?

(ii) Proposed changes - no deductibility of expenses (no employees)

earns
expenses Tax income
28% tax residual to invest
Efficient company A
$150 $50
$150 $42
$58
Lazy inefficient B
$150 $100
$150 $42
$8

With no deductibility of expenses Efficient Company A's competitive advantage is properly rewarded and the economy gets either cheaper goods and services from the business or there is financial capital accumulated and available for investment in the wider economy.

When expenses are deducted Inefficient Lazy Company B gets a massive handout of $28 (28%) on their expenses for no benefit to the economy or society. The money it spends on being wasteful and inefficient (thought it has some benefit for those who get the expenditure) could be taken up elsewhere in the economy to stimulate the production of needed goods and services, or even exports. There is less waste.

If the company was already efficient then it will remain so.

No deductibility of expenses rewards and helps drive innovation because you have to be efficient, to earn the income to drive your return on capital. The focus for a return on capital gives a better focus not only on exports, but value add. You have to make every item count. There is less resource/financial capital waste with no deductibility of expenses.

No deductibility for expenses will also significantly free up financial capital for other investments in the economy without the risk of targeting one business type and creating a victim culture, e.g. by targeting rental properties.

If for example you ring fenced losses then this opens it for some big businesses being built around renting and capital gains. Just ordinary NZ'ers would be shut out of the current tax gains. Or if you removed expense deductibility for small businesses the same would happen, large companies come in and there would be no freeing up of financial capital to fund new business ventures outside of property.

Proposal two - no capital revenue distinction for non-individuals
A non-individual entity is recognised and supported by the laws and processes of society which defend its rights and entitlements. As a consequence of that recognition and protection, all income (not donations) that may be generated through that non individual entity should pay a 'society dividend' to the society that supports that entity. (There is no free ride).

These are mechanical entities designed to achieve a purpose in society and that means managing itself financially, so a part of that purpose is to pay a 'society dividend' back to society. By their mechanical nature luck and good fortune do not belong to them but to the owners. For example if an owner buys a lotto ticket and wins in the name of the entity, or deposits it through the entities bank account, then that is taxable income to the non-individual entity. (Perhaps the owner has a child support obligation?)

Thus all revenue that accrues to a non individual entity is taxable, including windfall or capital gains. (Some of these entities only accrue these sort of gains). The risks of the distinction being used for tax avoidance are real if we don't. Ill focused business accountants may drive more and more of the income (using the colander techniques) away from revenue and into capital to avoid tax. NZ society is no better off if this happens.

Proposal three - Imputation and other related memorandum accounts should be ceased.
Imputation was introduced to avoid the idea of double taxation. However, ordinary NZ's pay tax on their income and then that income is used to pay GST . It is said not to be double tax but a switch in how tax is paid but the regressive nature of GST means it is. Financial capital may stay in the companies to finance further development and only withdrawn when revenue maximised.

Summary
The economy is greatly improved by removing the deductibility of business expenses, and the capital revenue distinction for non-individuals. Positive signals are sent to business about economic efficiency and competitive advantages so both are correctly rewarded. Opportunities will open up for many more smaller low capital intensive businesses.

The economy will be healthier and more stable as the debt level of NZ'ers will decrease, the money leaving the economy to overseas will have tax paid on it, the incentive to debt finance is gone improving our international credit rating and reducing risk to our economy when recession bites. Financial help may need to be given to assist transition.

It is quite possible new taxes are not really necessary if the existing foundation income tax is made to work more efficiently. Because:

- Removing the capital revenue distinction is like a wealth or capital gain tax only simpler.
- Removing imputation is simple and low cost and is like a well targeted progressive tax rate charge on those who can afford to pay because it is on income coming to them.
- removing expense deductibility is again a targeted progressive tax rate increase with essential and highly desirable economic behaviour outcomes. The economic reasons are paramount.

Overall tax rates could be reduced, or debt repaid, or govt services given the chance to catch on capital expenditure, if these are applied in full.

Introduction
The purpose of a tax regime is to quickly and cheaply raise funds for the work of supplying societies needs as identified through the elected government. But the current income tax regime collection bowl more resembles a colander poked full of holes to serve the special interests of those with the ear of a politician. Holes are about a clarification needed or a situation being amended to 'be fair'. The rules and exceptions can become a way of dispensing the largess of government (benefit handouts) without the inconvenient transparency on how they drag on the crown accounts.

Thus the ability to deduct expenses from gross income, and make capital revenue distinctions within income tax have been stretched over many years; as part of a world wide phenomenon. We now have the situation of multi nationals barely paying tax combined with the ability of wealthy individuals to shift money at will around the world to avoid tax.

As importantly, inefficiency in the economy is being encouraged by the deduction of expenses and the tax system is less efficient and fair when the bigger players can more easily re-charactise their income as capital and therefore non taxable. The current income tax assumptions inadvertently encourage a focus on tax avoidance as an easy low capital intensive path to profit. Tax being seen as a cost that an entity has the right to avoid that and they should do so, (everyone else is) for profitability and shareholder value.

It is now overdue to reconsider the fundamental assumptions that underpin the income tax regime and make changes to the understanding, calculation, and administration of this tax so it will work better for the economy and society.

We need change that will have a long term benefit to the economy with a shift to more efficient use of the Financial Capital resources of New Zealand, and in turn that shift will better protect our natural, our human and our social capital.

Change is not only justified by the values of 'fairness' about paying tax but also the desperate need to raise funds to meet the needs of our society. Too little tax is currently collected to sustain society, hence the crisis in health, education, water quality, the environment, and social environment. At times of high society stress, as previously in wars, taxes are high.

There is no suggestion here to raise income tax rates, in fact the suggested changes may over time make it possible to reduce tax rates. These suggestions should not be dismissed on a false pretext they raise taxes, though one outcome I expect is that tax revenue rises.

Now is the time to move from tax being seen as a cost that can be morally and legally avoided to a recognition that all business benefits from contributing back to the society that underpins the economy in which a business runs. The proposals here move from the denigrated label 'income tax', to the payment of a 'society dividend', payable on whatever income is generated.

Income tax simplification six proposals

For income tax to recover its primary purpose and role of funding the needs of society, and to drive efficient economic decisions for the better of society and business, it must be simplified. By:

1. Remove deductibility for all expenses except for domestic salary and wage payments.
2. No capital revenue distinction for non-individuals. (variation for private home in trusts or other entities).
3. Imputation and other related memorandum accounts should be ceased.
4. Introduce some restrictions on charitable status, and donations.
5. Remove GST as a tax (alternative taxes could be considered to replace if needed).
6. Tax evasion (tax avoidance is dealt with by the above proposals) is the one of the most serious threats to the health of our society and therefore to our democracy. (The current growth of populist leaders could be linked to the instability created by inequality which is in part driven by tax avoidance and evasion). Tax evasion must be made an act of treason in our laws and the powers of the GCSB made available to help tackle it.

Some of these proposals links to the theorists on Turnover Tax, but this is a wider more systemic approach which is why it is much stronger.

Why these six proposals?

Proposal One - Remove deductibility for all expenses (except for domestic salary and wage payments)

1. The deduction of expenses along with the capital revenue distinction have helped facilitate the massive growth of the destructive tax avoidance industry. It's that industry that pushes the drive for nations to have the lowest company tax rates to try and draw investment capital back into their nations economy. But lower tax rates just set up a cycle that further strips money out of societies and economies. It is redistributed tax revenue that can help stimulate a demand driven growth economy. The tax avoidance industry can be easily stopped or at least deeply and seriously hindered by these proposals.

Economic efficiency

2. Deductibility of expenses means a company pays 72% of the cost of an input to business as they can offset the expense against their gross income which means for each dollar of expense they don't have to pay the 28% 'cost' of tax . If tax is a cost of business no other 'cost' can be subsidised like this.

3. Because the expenses come off the gross income, tax payable is reduced. The people of NZ in effect become a subsidiser of the company or entity because less tax is paid on income earned. There is an opportunity cost to ordinary NZer's to allow less revenue to be collected.

4. There is no consideration of the efficiency or effectiveness of the expenditure as these are private decisions by the owners. So the risk in these private decisions should sit with the entrepreneurs who make those decisions.

5. The consequences of those decisions should be felt in full by the entrepreneur so the right economic signal is sent about the use of the resources. There is no compelling reason why other NZer's should subsidise those decisions.

6. The subsidy effect is sending damaging economic signals to the economy about the efficient use of the financial capital of NZ, which is what expenses represent. See the Table A example below.

Current deductibility of expenses and its impacts

Table A - two companies producing the same product

Entity	Gross income	Expenses	Net income	28% tax	Residual to invest
Efficient Company A	$150	$50	$100	$28	$72

Inefficient Lazy Company B	$150	$100	$50	$14	$36

- Efficient Company A earns gross income of $150, less expenses of $50 = gross income of $100 so it pays tax of $28 and it now has $72 to develop new business.
- Inefficient Lazy Company B earns gross income of $150, less expenses of $100 = gross income of $50 so it pay's tax of $14, leaving it with $36 to grow new business.

7. As a question of economic policy, why under Table A should efficient Company A pay more tax than Inefficient Lazy Company B when they earned the same gross income?

Proposed highly limited deductibility of expenses and its impacts

Table B - same two companies

Entity	Gross income	Tax at 28%	Expenses	Residual to invest
Efficient Company A	$150	$42	$50	$58
Inefficient Lazy Company B	$150	$42	$100	$8

With the proposed change to 'no deductibility of expenses', each company would pay $42 tax (28% tax) on their $150.

- Company A would have ($150 less $50, less $42 =) $58 to grow new business.
- Company B would have ($150 less $100, less $42 =) $8 to grow new business.*

*Company B in Table B does spend money in the economy with the wasteful expenditure but that waste could be freed up to produce needed goods or services, even exports.

8. Table A shows deductibility of expenses has narrowed the competitive advantage between the two companies (as measured by the 'residual to invest' figures) with no benefit to the economy. Table B with no deductibility of expenses shows the competitive advantage being properly rewarded.

Allowing the deductibility of expenses is sending the wrong economic signals around both the wasteful use of resources in the economy and the efficient use of financial capital.

9. Comparison of Table A and B shows Inefficient Lazy Company B gets a huge subsidy of $28 dollars when they deduct expenses. The effective subsidy means, not only more money in hand for their next business choices but also the choices they have already made have been supported more than the company that was efficient and did not need to incur extra expenses.

10. Business expenditure can be about anticompetitive behaviour to drive competitors out and reduce competition. This does not produce better goods and services for society or our social capital. If companies want to do that they should not be able to deduct those costs.

Economic benefits of removing expense deductibility from Gross income

11. Table B shows the removal of deducibility of expenses gives a strikingly strong economic signal toward the efficient use of resources. Both companies remain viable but Company B has to really pick itself up as its return on its capital is lower and consequently its ability to reward investors is lower. This is as it should be in a competitive world.

12. Deductibility of expenses is sloping the economic playing field towards inefficient and high cost business structures. The existing old boys club of businesses is being favoured by this. To remove deducibility of expenses would slope the economy back to smaller scale , low cost, innovative, service industry businesses. This would promote and favour what our economy has left after the gutting of our manufacturing and industrial base by the failed neoliberal market reforms.

13. Removal of deductibility does not remove the ability of a future government to directly fund what businesses it wishes. e.g. R&D research development tax credits could still occur, if desired.

14. More financial capital will be available for new low cost structure businesses as the clear tax signal is you have to earn money to deliver a return on capital. (See Table B)

- Some of this new financial capital will come from expenses being reined in.
- the removal of interest deductibility as an expense will drive down demand for borrowing as a mechanism for financing capital growth. There will be a shift in how assets are held and NZ's level of indebtedness will reduce. This improves the nations credit rating and overall access to financial capital.
- Financial accounts would reflect positive investments rather than creating debts and structures to hide income
- over time there will be a diversion of money from investment in property because no tax advantages would exist. This will free up capital for the wider economy - without singling out property and creating a victim culture.
- Banks will also be directly impacted by no deductibility of expenses so they will have the push to attract and earn business. Also they can't coast along with residential property as a safe strong investment. There would be an incentive for them to look for economic development opportunities.

- With the removal of the strong incentives to invest in property some financial capital may over time come back into the NZ share market. Though the problem that has ruined it, too open an economy that has allowed our companies to be stripped out, is still not dealt with.

Further economic benefits from the removal of deductibility of expenses.

15. Vastly reduced opportunities for tax avoidance. e.g.
    - Thin Capitalisation is removed as a device to pay less tax as interest is no longer deductible, including by multi-nationals.
    - The ability of multi-nationals to do Transfer Pricing is significantly reduced in scope, e,g, no deduction for management fee charges. (Valuation of goods sold between related entities is still an issue).
    - no benefit in re-characterising capital expenditure to revenue expenditure as expenditure is not deductible.
    - no ability to generate losses, which currently shelter profitable business activities.
    - Entertaining clients is done at full cost to the company and not subsidised by a reduced tax take for ordinary NZer's, giving a visible sense of fairness.

16. Easier collection of revenue
    - Gross income could be paid into a bank account and an automatic tax deduction made and sent to IR. No worry about due dates, late payment penalties or shortfall penalties; unless fraud is involved.
    - Where credits of income are involved the existing or new rules about paying tax would apply. Less risk of tax dispute or the need to check lots of business accounts.
    - Payment of the society dividend could become procedural.

17. Less red tape and industry specific rules
- Rental property would be treated like any other business with tax paid on the gross rent received. The tax advantages to invest in property would disappear but there is nothing making it inequitably treated compared to other businesses.
- Over time houses prices may decrease or not rise as steeply as there is less investor demand for property.
- The two major and sizeable NZ tax acts would plummet in size.
- With a lot of complexity stripped out the administration needed to support income tax would reduce.

18. *Reallocation of investment*
    - Another implication is that if high cost business models were more difficult to start up there would be more money in the economy for other initiatives. This is a similar idea to the old concept of Government expenditure crowding out funding for the private sector within the economy. Here it is businesses with high cost structures that are sucking in the investment money which restricts the ability of the economy to provide other goods and services.
    - Another current example in the NZ economy is money being sucked into real estate leaving under investment in NZ businesses, especially as most of that mortgage investment is borrowed money. Real estate has been the only reliable investment in NZ, especially considering the repeat stock failures and every 10 years a significant shake up of finance companies, 1988, 1998, 2008.
    - It would be good for the NZ economy to target all high cost structure businesses equally and without resentment at being targeted, as amendments such as ring fencing losses does.
    - Tax exceptions can still be made for research and development expenditure but it would be better if tax money went to Govt research institutes and research was then picked up by companies or others.

Proposal Two - Remove capital revenue distinction for non individuals and define 'income' widely within the Act

19. Creative accounting has abused it.
    - The distinction has been abused through creative accounting to re-characterise income as capital and not subject to tax. The distinction is a major driver of the tax avoidance industry.

20. Negative practises are encouraged within the NZ economy.
    - Entrepreneurs and investors are lured by the quick wins of a non taxable sale to a third party, usually overseas. Time and again our NZ income earning assets are lost to the NZ economy and with it the sources of financial capital growth.
    - The benefits of trade appear based on the foundation of ownership. Once owned overseas the gains are lost from NZ to other markets even when they sell the assets.

21. Overseas entities with bases in NZ will pay tax in NZ.
    - The removal of expenses and the capital revenue distinction would mean overseas entities are sourcing income within NZ and subject to tax on all that is sourced from NZ.
    - And all income, as defined by NZ laws, that is sourced from NZ should be subject to NZ tax.

22. Historical precedent of capital revenue distinction is no longer relevant.
    - The original intent was to separate gains from income but has become a tool to avoid tax.
    - Most countries now have wealth or capital gain taxes so removal of the distinction of capital and revenue makes for a simpler introduction of such a tax.
    - The calculation of gains will be a battleground that should be decided with an emphasis on simplicity and ease of collection, and ability to generate revenue (that is its purpose), without an overriding input by those with a vested interest, i.e. business. It should have a wide range of academic input.

Why can't a non individual get a chance windfall gain?

23. A non-individual entity is protected by the laws of society.

- As a consequence of legal recognition and protection, all income that may be generated through that entity should contribute to the welfare of the society that supports that entity.
- All actions, windfall gains, and capital gains , sale of assets are used towards the purposes it was set up for and so by nature they are gross income to the entity.
- Its mechanical nature means there is no 'luck' for the entity. If a company director buys a winning lotto ticket in the name of the company or cashes it through a company account, it is taxable income to the company. (Possibly done to avoid child support?) The director has the luck, the company has the income.
- For syndicates of people who buy lotto tickets it is not taxable though it often is overseas. For a Trust to manage the old family home, or current home, it is not taxable unless it is conducted as a rental. If the house is owned by the family that lives in it, then the sale of the home is not a capital gain, same as if it was held in the name of an individual living in the home .

24. Holiday homes.
    - Are subject to the capital gains bright line test. Gain from the sale of these holiday homes would remain as taxable income. Rules about the gain would have to be developed to prevent sales to related parties at below market rates to avoid taxation.

25. There would be no capital loss allowed from the sale or loss of an asset.
    - These are risks carried by the decision makers. It is not appropriate for rest of society to carry the consequences for individuals decisions.
    - Society carries the obligation to support the person through our social welfare system, health, education and superannuation policy, etc. i.e the fabric of society carries the person.

26. It is appropriate for society to share in the benefit of private decisions.
    - Because society has protected the business assets and provided the context in which positive decisions can be made. Even if it sometimes feels to the entrepreneur that they have achieved despite all the nay sayers and 'society' has tried to hold them back. Society has still provided the context to enable the success.
    - The struggle to succeed is inherently a competition of ideas and the success of that struggle for the individual should not perversely be used as an excuse to petulantly tear society down.

<u>Impacts of proposal One and Two</u>

27. *The transition period will be difficult for some. But …*
    - The tax is on gross income so no business will go under but the return on capital may be significantly reduced and some businesses may decide they are not profitable enough. This will create opportunities for new low cost structure businesses.
    - Some businesses are in loss and will pay tax on the little they earn. They will have to budget for the 'society dividend' just as they would if any other expense rises in price. The need to make profit does not change, and the entrepreneur must budget for it but not in some imagined future.
    - Many businesses in loss have some quite lucrative income streams, these would now pay a 'society dividend'. The loss making activities can be about anticompetitive behaviours so the business would have to decide whether they want to continue these or not. Opportunities for low cost businesses could again open up.

High cost business structures
(See Appendix B for a list and brief discussion of market segment impacts)

Themes on impacts

28. **Competition** - Overseas firms are able to deduct expenses but our firms can't so NZ products will be more expensive.
    - This can be said about other costs, like transport and distance to market. Businesses factor this in and overcome these or it just isn't viable. Economic activity must return a 'society dividend' or it is not worth it for society and the economy. This is the same argument for any shareholder so it is valid for society and govt - expectations of the return on capital must change in the short term.
    - A struggle to compete overseas will refocus on the need to get the value add for exports. e.g. instead of a business strategy allowing whole milk powder to be sold wholesale and then marketed by dozens of dubious middle men who may damage the NZ brand in the process, the incentive is for NZ to build that value add.
    - NZ has few manufacturing or industrial jobs left after the neo-liberal experiment so the risks to NZ are low from supposedly being less competitive. If competitive means society has to subsidise the business then it is not economic for society to support the business or allow the use of resources to support that business when there are other business opportunities.
    - NZ is now very focused on those items where it has a comparative advantage and our comparative advantage for tourism is not impacted. This is our biggest economic activity and it is growing.

29. **Inflation** - it will be argued it will inevitably increase.
    - The removal of the regressive GST tax would minimise that.
    - The same forces of demand and supply would apply.
    - Sharp rises in price would instantly provide a stronger signal for smaller local low cost businesses to enter the market. There would be a damaging lag that may need some fiscal stimulus, like how GST was supported by govt when introduced.
    - Govt co-operation with some key local businesses could ensure price inflation is kept under control. e.g. The Warehouse (just guessing here) has retail and supermarket activities and they could be supported by the govt to ensure it has low prices. This would make sure other competitors do not act as a de-facto oligopoly and hike prices to undermine the changes. Self interest reactions of high cost structure businesses will be extreme.

30. **Low cost technology remains** - innovation?

- e.g. clothing manufacturers using old sewing machines. If they can make things and run a business that complies with health and safety, environmental and labour laws, all with no deductions from tax (except for domestic salary and wages), then this shows their business is truly viable.
- New technologies have to be truly efficient or we are wasting money on the new without it being better for society. For the new to be effective it must prove that by being able to price compete. The new must prove its value, not just be different.
- innovation is not just high cost technology. Laws should encourage local enterprise and decentralised. Centralised wealth is a bureaucracy that tends to be inefficient, and risk adverse.

31. **Automation** - must prove itself by being price competitive
    - It is the future and will bring great benefits. But unless the people in society have enough money to pay for the things that machines produce, then automation could collapse.
    - Automation could open the way for costs of production to be extremely low and therefore prices to be extremely low.
    - Automation is a signal that employment in our economy will become even more focused on service related industries and that is often best delivered local and small scale. These proposals are a step that supports our economy's transition purely by making sure high cost structures are not being favoured as currently. We don't need to subsidise the trend. Automation has to prove itself by being price competitive (or will that die too?).

32. **Domestic employees** - pay tax in NZ
    - Salary and wages are deductible because they pay tax independently of the entity they are employed by and they have background costs that are not deductible expenses (training, health and safety, etc). These are just the cost of doing business.
    - Private contractors do not carry all the costs of employees. The privilege of undertaking this employment practise is that the cost becomes like any other contract cost and it is not deductible.
    - This means employment agencies contracts are not deductible. These people may be employee's of the agencies.
    - Employment must not be a negative to a business otherwise nobody would earn income to pay for the items automation produces and all businesses go under.

<u>Proposal Three - Imputation and other related memorandum accounts should be ceased</u>

33. <u>Times have changed</u>
    - This was a tax cut in disguise when introduced and tax rates were higher than they are now. Tax rates are now lower and the need for this type of reduction is less.
    - NZ's tax rates for investors due to imputation are one of the lowest in the OECD but NZ is a small economy where the govt plays a much bigger part in role in providing services. Therefore it should not have some of the lowest tax rates in the world as govt has to do more here.

34. <u>The justification for imputation is not consistent</u>, i.e. to prevent double taxation.
    - Ordinary NZ's pay tax on their income and then pay tax again for GST. (The argument went ,it is just a switch of how to pay so it isn't double tax. But the proportional impact means that is not the case). Income tax rates are now below 15% .

35. <u>Progressive tax structure</u>
    - Taxing income, such as dividends, rather than wealth taxes is easier to administer and identify, and it is properly targeted to those who can afford to pay.
    - Removing imputation can be likened to the input of a more progressive tax structure.

36. <u>More financial capital could be available to business.</u>
    - Taxation of investors encourages them to consider leaving money in the company for development and growth so the revenue is maximised before investors decide to take the return and pay tax.
    - There could be reductions in taxes from extra revenue collected, e.g. to align the top rate or attempt a flat tax tax(?).

<u>Proposal Four - Introduce some restrictions on charitable status, and donations.</u>

37. <u>The advancement of religion</u>
    - We can no longer determine the direct value of religion as in times past. It is different to how it used to be. It is far more fragmented and open to sects which can have dubious value for the individuals involved in them, or to society.
    - The positive and targeted outcomes of religion, e.g. relief of poverty, advancement of education are tangible and of clear benefit to society. Those objectives can be covered under the other charitable grounds.
    - The idea that a business can be run to fully support a religion without it paying a 'society dividend' seems incongruous with the religion sharing and directly contributing to the society it is part of. None of this affects the rules about religious people getting small stipends.

Religion as a grounds to gain charitable status should be removed.

38. <u>Donations</u>
    - The current ability to turn all your taxation on income to a donation to charity undermines the need for every society member to contribute to society and to what makes it safe for the charity to function in.
    - Several millionaires have said they pay no tax as they can divert all tax to the causes or choices they prefer. Those who like cats may not agree with that sort of choice and would rather the contribution by the society dividend was to a wider cause where they can influence their democratically elected representative.
    - The ability to channel all tax to your personal choice undermines the need to contribute to society and the ability of elected representative to represent some peoples interests.

Tax deductible donations should be restricted to $500 or something small.

39. <u>The advancement of education</u>
    - Is too wide as NZ already tries to provide free education. The grounds arose in the day's when there was not universal education.

- This ground is also from memory allowed to be a little more targeted which can favour the privileged.

This ground should be modified to apply openly (i.e. to the general public and not defined groups or schools) to those who are economically disadvantaged or to the provision of assets where there are socially deprived people who can use those assets.

Proposal Five - Remove GST as a tax (alternative taxes could be considered to replace if needed).

40. GST damages the demand driven economy
    - Keyes showed demand drives the economy more effectively. GST is helping to suck the life blood out of the services industries that our economy has come to heavily rely on.
    - The need is to put more money back into consumers pockets to help drive business.
    - Removing GST will make NZ businesses more competitive with overseas online providers.
    - Cost of imports will rise due to expenses not being deductible. That will send a signal to local suppliers or innovators that there is a market opportunity. Franchises, often overseas chains, that supply overseas product and have high cost structures will struggle more, see appendix B, but local owned businesses should finally thrive.
    - GST is stifling business because even though they don't pay it, their customers do.

41. Inflation
    - GST removal combined with the removal of deductibility of expense would see less risk to the economy from inflation.
    - Combined with govt co-operation with some key local businesses could ensure price inflation is kept under control. e.g. The Warehouse (just guessing here) has retail and supermarket activities and they could be supported by the govt to ensure it has low prices. This would make sure other competitors do not act as a de-facto oligopoly and hike prices to undermine the changes.
    - The object of this is to make sure Inflation is not just an expectation of other price rises or is fear driven.

42. GST is a regressive tax

Proposal Six - Tax evasion must be made an act of treason in our laws and the powers of the GCSB made available to help tackle it

43. The most significant threats to NZ are not from terrorists but the bleeding of the NZ economy from tax avoidance and evasion.
    - Tax avoidance is largely dealt with in these proposals.
    - Evasion is much more difficult as it involves illegal activity.
    - White collar crimes needs to be dealt with because of the serious and long term harm it can cause for ordinary NZ'ers. A more robust co-operation between IR and GCSB will go a long way to making tax more effectively policed and shutting down big crime.
    - The willingness to voluntarily comply will be increased as people will have more confidence that competitors are complying and not getting a tax advantage by not paying the 'society dividend'.
    - The legal privilege extended to accountants for advice given to business on tax should be removed as the advice could be illegal. A business has an obligation to the society that it works within just as citizens do. Advice about evading paying the 'society dividend' is illegal and must be stopped. Just as crime or terrorist organisations are followed.

Summary

In this model business entities work in a context where tax is much hard to avoid and must shift their mindset (a shake up is good as things aren't working great) as these proposals would mean:

- business will receive strong and immediate economic signals about efficiency in cost structure.
- Those firms that are more cost efficient will get the full benefit of their comparative advantage
- No losses available to shelter profitable business from taxation.
- Reduced scope for multi nationals on transfer pricing.
- The elimination of Thin Capitalisation.
- The removal of opportunities to re-characterise capital as income.
- No tax benefits from the grouping of companies, which links to the ability to use losses.
- No tax subsidy to inefficient business or wasteful/high cost business practises,
- Entrepreneurs would carry the full risks of their business or investment decisions.
- No tax subsidy to polluters.
- Business getting back to running their business, with a full focus on efficiency.
- Changes in society being truly based on the more efficient and effective low cost options.
- As cost structures lower, more funds remain within business entities to drive investment.
- More potential opportunity for smaller low cost business to arise and succeed.
- A level tax playing field for all those in business.
- Tax is paid according to earning power, (not cost structure) which is the intention of income tax.
- A lot less regulation and red tape, making for a cheaper more streamlined tax administration

These changes do not mean that govt can't directly assist business, such as with Research and Development grants or tax credits.

These changes do not mean the ruin of business but there would be adjustment and rationalisation away from top heavy large bureaucratic structures that now dominate much of our business

Appendix A

Principles guiding structural reform of Income Tax.

- tax should not be costly to calculate or collect

- have a strong argument for being fair. (You can never convince everybody or fit all situations).
- Send positive signals to the economy promoting efficiency and effectiveness in economic behaviour.
- Remove distortions in the financial capital market and free up more capital for investment.

Assumptions in the proposed Income Tax system
- The government/Inland Revenue should not inadvertently encourage certain behaviours or types of businesses. There should be a level playing field that does not favour inefficient or high cost structures.
- Business people should be focused on making their business work, not calculating tax.
- Tax is like a cost of business and accountancy is ancillary to business (not an income stream in itself).
- Each company or legal entity or economic activity needs to stand or fall on its own merits.
- Entrepreneurs and business risk takers should carry the risk in their ventures.
- Tax should be paid according to the ability to earn money and not be influenced by how inefficient or costly their business structure is.

Appendix B

1. Franchises - will become less profitable.
   - Revenue is often taken overseas by these structures and out of the NZ economy. Now they will pay more tax and their structure is not subsidised. This will really open up opportunities for small local businesses, e.g clothing, fashion, food. Retail could become more local.
   - These places will not disappear as the infrastructure will remain physically in place but they will have to carry their full cost structure into their prices making other low cost producers more competitive. The current deductibility rules favour the big existing players that push franchises.

2. Supermarkets - are now palaces to extract maximum revenue.
   - NZ already has a price vulnerability from just two main players in the market.
   - A rise in the price of the goods in these currently subsidised palaces would make other options more price competitive and bring back more local retail opportunities, e.g. farmers markets, online retail, community co-operatives, dairies.
   - (a confession - it is currently cheaper for me to go to the dairy for milk and bread despite it being double the price of the supermarket because of the money I spend on 'addiction needs' when I go to a supermarket).

3. Steel or aluminium firms in NZ - are they viable?
   - They should be. They still return gross income.
   - The infrastructure is in place but would the return on capital be sufficient. There is plenty of spare capacity in the world if it is not. If these firms decide to close the assets, NZ *could* take them and offer them to see if there is a willing party to take over the running. This action would only be to prevent petulant behaviour to undermine the changes.
   - However, my own opinion is every business must live or die on its own merits and that is its ability to earn income.

4. Overseas film production companies in NZ - do these overseas firms pay tax in NZ?
   - The firms based in NZ and who support these productions presumably return tax to NZ.
   - If NZ wants to fund these firms/films then it should do so directly and we have a film fund to do so, it cold be expanded.
   - There is no need for deductions. If it is essential to have deductions of expenses then it can't be a viable business model. It's just a business like any other that has to pay its way.

5. Luxury shipbuilding - The input costs not deductible
   - There is still gross income so the business must be viable. The 'society dividend' impact would be passed onto the purchaser just like any other cost.
   - If the business is less competitive then it may have to change its return on capital expectations.

6. Fishing industry - costs would go up?
   - This is already a high cost structure business so a 'society dividend' is just another essential cost.
   - Fishing quota to NZ businesses only would help offset the disadvantage.
   - In all cases there can be specific things done to assist a business if the govt decides.
   - But the economic principles should remain consistent and the same and not seriously distorted by tax which is what currently happens.

7. Housing - will build costs go up?
   - The market is currently dysfunctional as it does not build enough houses to meet demand. Significant work needs to be done in this area, so impacts could be modified.
   - Most inputs are local so all businesses are in the same boat.
   - The net income a builder takes home has no need to change but some will be tempted to use the change to increase it.

8. Rental property - will rent go up?
   - Clearly many will see any change, ring fencing etc as the opportunity to raise rents to recover costs. This problem is not confined to this suggestion. Those who own property can get guaranteed social welfare payments of rent as well as making deductions from their other income. The current situation is unsustainable and damaging the NZ economy.
   - Property needs some measures to directly address the reaction problems that any tax changes will make.
   - I suggest, govt invites rental property owners (those interested) upon the new tax law taking effect, to transfer their property to the Government (at an agreed value depending on condition and compliance with a building warrant of fitness), but the money is held in a govt bond for up to 5 years or more (because property is a long term investment for an invesor). Options to roll these forward could exist. Govt could then raise money by selling the property back to first home buyers (at an affordable price with the rest to be held to be paid back later either as income increase or when the property is sold) or those on low incomes through rent to buy schemes. This would pull demand out of

the housing market and increase supply of the existing houses - there is less chance then for some rental properties to be left empty. No matter what option we still have to build more capacity.

- If these properties bought are close together (a caveat could be held over the properties) then opportunities for medium density housing builds could open up, with the existing residences have guarantees of accomodation in them.
- Overall this could reduce the social welfare liability of paying markets rents to owners. It would also spread the cost over many years.

9. Petrol retail - the existing big business would struggle?

- Opportunities for small simpler operators to start up and break away should be encouraged by law changes. Current practises by companies are deliberately punitive to discourage this. With more smaller operators the opportunity to collude on price is reduced.

10. Employee's overseas - become more costly?

- For example, some businesses run overseas call centres and the cost is deductible from gross income and those people employed do not pay tax to NZ.
- Where to have the call centre is the business's choice but it should not be at the expense of the NZ taxpayer having our tax base undermined.

11. Public transport - public utility

- Trains are such big costs such that they can't viably be run in NZ privately. Privatisation did not work.
- Little benefit has been gained from privatising local bus services as costs of using public transport are very high and priced to match alternative transport options. This maximises revenue rather than public utility and the environment. The cost of making a return to shareholders is an extra cost that did not exist before.
- The return to shareholders will be lower and the likelihood of public transport buses being like trains is high. This is not the end of the world.

12. Oil/mineral exploration -

- Special rules already exist for these. If the govt wanted some special rules it could easily allow it. It could even be directly funded. Otherwise they would have to pay their own way. The choices and risks sit with them.
- The current depression in world prices means it is not hugely likely they will be successful. The current environmental crisis and accompanying mass extinction means this is not a bad thing.
- Many many years in the future our retained reserves have some exceptional value.