Tax Working Group Public Submissions Information Release

Release Document

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New Zealand Tax Working Group Submission

I expect you will receive many submissions from people with their own vested interests. I offer my perspective with a focus on the long term intergenerational benefit that can be offered by tax changes, which are at times counter to my own personal interests.

Overall, I believe, the performance of the current tax system is good:

- Easy to understand
- Good horizontal equity (the same treatment for the same people in the same circumstances)
- Simple and low administration and compliance costs for tax payers and collection
- Revenue integrity: minimises opportunities for tax avoidance and arbitrage
- Fiscal adequacy: raises sufficient revenue for the Government's requirements
- Coherent

The areas where I believe performance can be improved are:

- Greater vertical equity (higher tax obligations on those with greater economic capacity to pay) and fairness
- Efficiency: the need to minimise impediments to economic growth and avoid biases to the use of resources

Changes recommended to address the most significant inconsistencies in the current tax system, ordered from highest urgency to lowest:

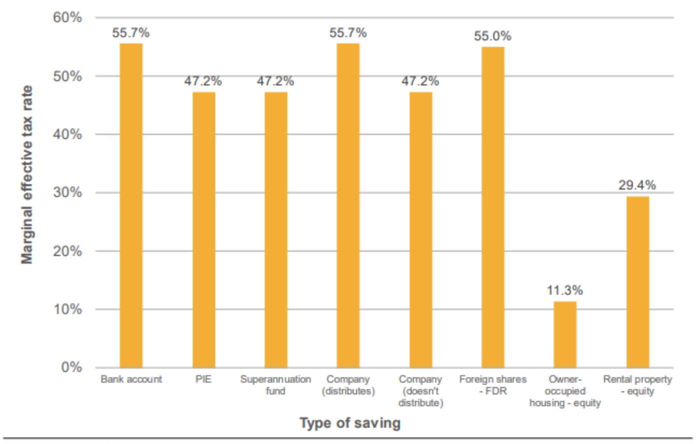
1. New Zealand currently has very high wealth inequality compared with other OECD countries. A Capital Gains Tax (CGT) would help address this. This may also have the added benefit of creating a level playing field for asset classes and thereby reducing house prices, making housing affordable for all New Zealanders, and reducing the amount of money borrowed from overseas to fund mortgages, with the attendant risks to the New Zealand economy. Feedback on the design issues for a CGT are discussed in the next section.
2. Long term, New Zealand should consider CGT on the family home, while allowing roll over relief. Exempting the family home from CGT will cause people to over invest in the family home, this is based on first-hand experience. We plan to down size the family home and invest in shares, however if a CGT is introduced with a family home exemption we will not do this. Figure 21 of the Future of Tax Submission Paper highlights that it is the family home with the greatest inconsistency in tax obligations, (figure included below). In conjunction with CGT for the family home, estate duty / inheritance tax and gift duty should also be introduced to limit tax avoidance behaviour and ensure everyone is taxed fairly and consistently.
3. Tax should be equal across all asset classes to avoid distortion of economic incentives:
    - Overseas shares should be taxed on the same basis as New Zealand shares. The FIF regime assumes a fixed income return and imposes costs that may require shares to be sold to be met, which is inconsistent with other asset classes.
    - Shares and ETFs should be taxed in the same way. Currently the tax treatment for Australian shares is the same as New Zealand shares, but Australian ETFs are treated as FIF income.
4. New Zealand should maintain a system where income earned on investment is taxed at the same rate as income from labour. Anything else would be unequitable.
5. There is a case to make greater use of environmental taxation to improve environmental outcomes, especially the use of water resources. This is needed to ensure biodiversity and

resources are available for future generations. Alternative non-tax measures, such as fines and targeted regulations could be introduced depending on the administration cost and practicalities.

6. The tax system should keep the same tax rate for companies regardless of size. To change the tax rate for small companies would be counter to the current horizontal equity and encourage tax avoidance.
7. Charities should have to pay tax on businesses owned for fairness to competing businesses.
8. The lack of GST on low value imported goods is a disadvantage for New Zealand retailers and should be addressed.
9. There should be better tax compliance for the sharing economy, for example income from Airbnb.
10. Rather than assisting low income people by GST exemptions, assistance can be more directly targeted, for example by changing the way benefits abate or reducing the lowest tax rate.
11. Fining people who pay ‘under the table’ (for services and rental properties etc.) may result in higher compliance and lower tax avoidance. ‘Under the table’ payments provide an unfair price advantage over a competitor who does pay tax.
12. There is a need to include the agriculture sector in emissions targets for economic neutrality. For example, some marginal farm land might better be forest. This parallels the need to put an economic cost on water (bullet point 5).
13. The maximum income tax threshold of $70,000 is too low and should be increased. To balance the books either the highest top tax rate could be increased, or a new step in tax brackets could be introduced. The challenge with this approach will be the current company tax rate at 28%, which can encourage tax sheltering. For comparison the highest income tax rate in Australia is 45%.
14. I am apprehensive about a sugar tax, due to the law of unintended consequences. How effectively has this been implemented overseas?
15. I endorse the introduction of a policy regarding the ‘ringfencing of losses’ for property investment.
16. Additional tax revenue from CGT could be targeted to a universal benefit for young people and / or the New Zealand Super Fund.

The figure below was referenced in bullet point 2 and is included here for completeness.

Figure 21: Marginal effective tax rates on savings



Source: Treasury/IRD analysis

Source Future of Tax: Submissions Background Paper

Design issues for a Capital Gains Tax

- If CGT is implemented it should:
    - be paid on realisation. In the instance of a start-up company this is important as cash flow is usually very limited during the initial years. Paying CGT on realisation will avoid the potential need for an annual valuation for unlisted companies and property (and the associated cottage industry).
    - have the same rate of tax as income tax to avoid distortions and tax avoidance behaviour
    - be equal across all asset classes to avoid distortion of economic incentives, including assets held by KiwiSaver and other savings schemes and offshore assets
    - be applied only to assets acquired post introduction of CGT
        - This will create a tax incentive for people to hold onto an asset acquired pre-CGT introduction rather than sell to an economically higher value owner.
        - The alternative approach is for CGT to be applied retrospectively or to the value of the assets at the date of introduction. This would financially penalise an individual who has made a purchase on the assumption of no CGT. Although applying CGT to assets acquired post introduction creates a tax advantage for those holding assets post introduction and an incentive to retain assets, it is not the intention of the tax system to be punitive, and therefore retrospective CGT should be avoided. Retrospective taxation could lift the risk premium attributed to New Zealand investment.
    - allow roll-over relief for capital gains re-invested in similar assets, by treating these gains as not yet realised. Otherwise there will be a financial incentive to hold assets longer than required.
    - allow rollover relief for property transferred as a result of a relationship property agreement. This means that any potential tax liability will be deferred until a subsequent sale.
- The family home CGT exemption will cause tax avoidance behaviour, such as the family bach being owned by one family member / partner and the family home being owned by another, is this fair? What can be done to reduce this avoidance?
- The system will need to ensure transactions of unlisted shares and property are at market value. The cost of providing an independent market valuation for transactions subject to CGT could be onerous. This impediment could be limited by only requiring independent market valuations for transactions between related parties. Rules around valuation methodologies would be beneficial.
- If gifts are not subject to tax, then could CGT be avoided by gifting assets to family members? What could be done to address this?
- If capital gains tax includes private assets, such as cars, would this would mean that an individual could claim a tax loss on the family car and may result in higher spend on private assets? As these private assets do not create economic growth for New Zealand, higher spend is unlikely to be in New Zealand’s best interest. Similarly, for collectible assets, however if collectibles are not included in CGT is there a risk that this will cause distortion and greater investment in the collectible asset class?
- If CGT is introduced the need to review FIF regime becomes more pressing. The 5% assumed fair dividend rate for overseas shares is higher than the historical average for U.S. shares (4%).

It is acceptable for the Group and the secretariat to contact me and discuss the points raised, if required.

Kind regards,

Kim Bannon