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## Submission to the Tax Working Group on The Future of Tax

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### About the New Zealand Centre for Sustainable Cities

1 The New Zealand Centre for Sustainable Cities is an interdisciplinary research centre dedicated to providing the research base for innovative solutions to the economic, social, environmental and cultural challenges facing our urban centres. We undertake a range of research, published as journal articles, policy papers working papers, and blogs, as well as making submissions from time to time to central government and councils on a range of issues relevant to cities, from climate change policy to compact development. See <http://sustainablecities.org.nz/> and <http://resilienturbanfutures.org.nz/>

### Introduction

2 This submission is largely focused on environmentally related taxes and taxes which are likely to affect housing and urban development.

The Working group report is an important opportunity to promote the idea of **‘ecological tax reform’** (or a ‘green tax switch’), not because New Zealand is a (natural) ‘resource based economy’ (p. 40)<sup>6</sup> but because our natural capital base needs protection for our wellbeing and for its own sake. Moreover, taxes on extractive or polluting activities can contribute to this protection goal

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<sup>6</sup> E.g. agriculture, forestry and fisheries together constituted only around 6% of GDP in 2005 (Statistics NZ).

while either reducing distortions in other parts of the tax system, or raising much needed additional revenue.

### Main points

**3** These points are arranged more or less in (descending) order of importance to environmental protection and urban sustainability.

- i. **Carbon pricing.** Given the critical urgency of climate change mitigation, no tax working group can afford to ignore the present and future issue of carbon pricing, even if hints from the Government suggest substantive policy change in this area will be for the yet-to-be-appointed Climate Change Commission.
- ii. There is a huge economic and social distortion caused by not sufficiently pricing carbon (or other GHGs<sup>7</sup>), together with the demonstrated inadequacy of the ETS as presently configured. In terms of its contribution to pricing GHG externalities, the most important element in ecological tax reform is a floor on the carbon price, attained either with a **minimum tax on carbon** alongside the ETS, or a minimum floor price on carbon inside the ETS. Our view is that emissions trading is ‘riddled with daunting problems’ in practice, to quote economist Robert Shapiro (Shapiro, 2009) and to echo many others. In any case, a consistent price signal is critical for incentivising investment and behaviour change. For revenue reasons, the notion of a minimum tax on carbon has strong attractions.
- iii. **Nitrogen tax.** For both water quality and climate change mitigation reasons, there is a strong case for a tax on use of nitrogenous fertilisers, a type of pollution tax. New Zealand has a very high level of application of such fertiliser, by global standards. The OECD (2017) noted that between 1998 and 2009, the ‘nitrogen balance has worsened in New Zealand more than in any other OECD member country, primarily due to expansion and intensification of farming.’(pp. 159-160); this has led to growth of nitrogen pollution in soils and rivers, especially in key farming regions, and especially where dairying has been intensifying. The OECD also notes that ‘the polluter pays principle should be the first line of defence in securing water quality (e.g. water pollution charges).’(p.179).
- iv. **Air pollution tax.** On air quality (as well as carbon) grounds, there is a case for a (revenue neutral) **feebate** vehicle tax system, in which the tax paid increases steeply from low levels for clean (e.g. electric) vehicles with small engine size to high levels for large engine vehicles (Barton & Schutte, 2015, pp., p.31). A feebate would apply the first time a vehicle was registered in New Zealand; and would send a useful signal to importers. It is particularly important in the absence of NZ fuel efficiency standards. The newly released Draft Government Policy Statement on Land Transport 2018 (MoT, 2018) mentions feebates as a policy option at paragraph 122.<sup>8</sup>

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<sup>7</sup> The major omission is the lack of price on the major long-lived GHGs, carbon dioxide and nitrous oxide. However, short lived climate pollutants such as methane must also be reduced.

<sup>8</sup> ‘122. Initial actions outside of the GPS for reducing greenhouse gas emissions in transport could include regulatory initiatives such as exploring vehicle fuel efficiency standards and the potential for a vehicle purchase feebate scheme.

- v. **Diesel excise.** There is a good case for reform of the fuel excise to **introduce a diesel tax**, so as not to create an artificial incentive favouring use of diesel vehicles, the operation of which creates emissions, which lower air quality and cause environmental health problems. The recent OECD (2017) report on NZ's environmental performance pointed out that NZ is alone in the OECD in its approach, which looks increasingly outdated as the dangerously negative effects of diesel fuel use become more evident. The current tax arrangement, 'does not encourage behaviours that would reduce fuel use (e.g. avoiding high-speed driving that uses up more fuel). The tax and charge rates are set based on investment needs, with no consideration for environmental externalities.'(p.31).
- vi. **RUC exemption.** While electric vehicles have environmental advantages, there is no good case for exempting them from the RUC. This is designed (to date) to run until 30 June 2020. Electric vehicles, like other vehicles, cause congestion and contribute to negative effects in the urban environment, such as road wear and urban sprawl. A charge on them should reflect these impacts and externalities to the maximum feasible extent. To the extent that there are carbon (climate change) advantages to EVs, these will be recognised and rewarded through the lower impost they would pay *relative to* internal combustion engine vehicles running on fossil fuels, assuming there is an adequately stringent carbon tax/price.
- vii. **Company cars.** Tax treatment of company cars also has deleterious environmental effects. The OECD noted in its 2017 report that 'New Zealand applies a favourable tax treatment to company cars and parking lots, which is a cost for the public budget and tends to encourage private car use, long-distance commuting and urban sprawl.'(OECD, 2017, p.31).
- viii. **Land tax.** One key resource is land, and there is a case for a land tax. A land tax on *unimproved* value of land would create desirable incentives for land to be more efficiently utilised (e.g. a given parcel with two dwellings on it would pay no more land tax than the parcel with one dwelling on it), thus leaning against urban sprawl. There is some evidence it might reduce wealth inequality slightly, which seems desirable (Franks, Klenert, Schultes, Lessmann, & Edenhofer, 2018). Current urban rating systems, where based on unimproved value, do already provide similar incentives, but patchily. A nationally consistent land tax would provide uniformly beneficial incentives.
- ix. **Taxing housing value gains.** Two major distortions in the NZ economy are the lack of tax on **imputed rental income** of owner-occupied dwellings, and the **absence of a capital gains tax (CGT) on residential property**. These distortions have led to significant overinvestment in property and the bidding up of house prices, the unnecessary expansion of urban areas and adverse environmental consequences arising from this – from carbon emissions, to adverse impacts on air and water quality, to loss of habitat.
- x. **A tax on imputed rental income.** Such a change could be progressive, depending on whether it is accompanied by a tax rate reduction for all taxpayers or a tax exemption

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'123. GPS 2018 will support this result through encouraging: - a whole-of-system approach to reducing greenhouse gas emissions from transport, including considering the cumulative effects over time;- investment in lower emission modes of transport or transport systems...'

increase. Figari et al. found that a tax exemption increase reduces inequality, with gainers mostly situated in the middle of the income distribution (Figari et al., 2017). It may be impracticable currently to introduce a tax on imputed rental income, but such a tax is not unheard of in developed economies – one did exist in the UK until 1963 – and this option should be kept on the table for the medium term.

- xi. **Capital gains tax (CGT).** In our view, it is desirable that a CGT be introduced, even if the family home remains exempt, and even if the administration and compliance costs of a CGT are substantial. Other developed countries have successfully managed these transaction costs, in the pursuit of a fairer and more comprehensive tax system. The signal a CGT's introduction would send, in terms of both efficiency and equity, and both domestically and internationally, are important. Not to introduce one would be to countenance a continuation of the distortions identified.
- xii. **Water rents.** Given the comparatively large resource rents currently being extracted in parts of the economy, the application of a **resource rent tax** e.g. on **water** rents, would be highly desirable.

#### **Tax expenditures**

- xiii. **Tax subsidies.** For consistency in terms of enhancing its tax base and making the tax system more efficient, equitable and environmentally sustainable, New Zealand should be minimising undesirable tax expenditures. A valuable step would be to eliminate tax subsidies for fossil fuel exploration, particularly as there is an overwhelming case against further fossil fuel prospecting for extraction. In its 2017 report, the OECD noted that 'the OECD (2016b) estimates... that some of these [fossil fuel subsidy] measures cost the New Zealand government about NZD 60 million in tax breaks and budgetary transfers in 2014.' (OECD, 2017, p.32). However, it is acknowledged that with recent policy changes in regard to oil and gas block offers, this matter is not paramount.

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