Tax Working Group Public Submissions Information Release

Release Document

September 2018

taxworkingroup.govt.nz/key-documents

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[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.

Property Institute of New Zealand Inc
Level 3, 69 The Terrace
Wellington 6011
PO Box 5304, Lambton Quay
Wellington 6145
T: 0800 698 258
[1]
www. propertyinstitute.nz

Submission to the Tax Working Group

27 April, 2018

The Property Institute of New Zealand (PINZ) welcomes the opportunity to provide a submission to the Tax Working Group.

The Institute is a not-for-profit member-based organisation, representing more than 2,000 valuers, property managers, consultants, advisors and a range of other property professionals, with members throughout New Zealand and the world.

PINZ is a leading contributor to public debate on the property market, drawing on specialist industry sourced data, publicly available data, and member input.

Executive Summary

The Property Institute of New Zealand is opposed to new property-related taxes, including land taxes, stamp duty, ring fencing losses, and a more comprehensive Capital Gains Tax.

In general, PINZ does not support the claim that further taxes will make housing more affordable, nor does it subscribe to the view that new taxes will make houses more available.

In fact, the Institute is of the view, that we are already seeing significant flight from the market of responsible property investors, which is leading to a new rental crisis, with fewer houses available and rising rents.

The Institute is of the view that rather than forcing responsible landlords to exit the property market, they should be encouraged to expand their activity, build more new homes, and therefore increase supply.

What is clear in 2018, is that the recent house price boom is over, and today we are seeing a flat/muted market, so much so, that the Reserve Bank and trading banks have been reviewing their macro-prudential and lending policies in order to stimulate market activity.

There are no longer the same sorts of pressures for policy makers to place additional handbrakes on the market, and as we are witnessing, a cyclical slowing in house price inflation is now well underway. Recent figures are also showing promising growth in first home buyer activity.

Further, other measures by the Government are already being introduced, such as the Overseas Investment Amendment Bill 2017, which are sending clear signals to foreign investors who may have previously looked to New Zealand property for a return.

In summary, it is the Institute view that further Government intervention in the property market through taxation at this time is unnecessary and will, in all likelihood, further damage an already finely balanced rental market.

Capital Gains Tax

It is clear from the directions given to the 2017 Tax Working Group and policy statements made by the current Government that some form of Capital Gains Tax extension is likely to be one of the recommendations.

The Property Institute opposes this. A CGT is administratively complex, does not generate large revenue, will not reduce house prices or increase supply, will deter investment from productive enterprises, will exacerbate the rental crisis, and will almost certainly lead to significant other unintended consequences.

Further, a Capital Gains Tax is not just about housing, it will also deter many other forms of capital investment, including investment in productive businesses such as farms and other enterprises which generate jobs and growth. There is a great deal of public uncertainty about what other forms of capital may be subject to a CGT – with suggestions of exemptions for some things and not others. It is usually in this area that gross distortions can occur.

Reviews

The possible introduction of a comprehensive capital gains tax has been reviewed extensively in New Zealand dating back 50 years. There are many examples, including:

- The 1967 Ross Committee which recommended a moderate CGT, but noted its potential for discouraging savings, risk-taking and investment for growth.
- The 1982 McCaw Committee recommended against a CGT stressing the substantial complexity of the tax for little revenue.
- The 1987 Brash Committee Report was ambivalent citing " real, theoretical, practical and political difficulties."
- The 1988 Royal Commission on Social Policy favoured a CGT on equity grounds and for social purposes
- The 1988 Valabh Committee was in favour of a CGT but inside the narrow context of international tax reform
- The 1988 Planning Council Report concluded it would be difficult to design a CGT that did not channel resources away from income producing activities.
- The 2001 Tax Review Commissioned by Finance Minister Michael Cullen who said: "The thinking is that it would increase the complexity and cost of the tax system. The government agrees with this analysis."

- The 2009 Tax Working Group Review led by Professor Bob Buckle who warned exempting the family home could lead to the "mansion effect", through overinvestment in a primary house.

The research papers and reports on the practical effect of a CGT in New Zealand are too numerous to list in full, but they often share common conclusions, particularly if the family home and other personal assets are subject to exemptions.

Perhaps most worrying is the almost universal observation that a Capital Gains Tax channels resources & investment away from productive enterprises through share ownership and entrepreneurial endeavour.

Does CGT arrest house price rises?

No. Countries (including those in the OECD often cited by CGT supporters) where a CGT is in place have experienced the same cyclical spikes in property prices that New Zealand has recently experienced. Furthermore, New Zealand is already implementing a strengthened test for investment property (the bright line test), proposing to ring-fence losses, ban letting fees, and enforce new healthy homes standards, which PINZ believes should be allowed to properly bed in before further changes are contemplated.

How much revenue does CGT generate?

Not much. Economic forecasting conducted by BERL on Labour's 2011 15% CGT policy (which did not feature inflation indexation) suggested it would raise $78 million in the first year, rising to $2.27 billion by year 10. That estimate was made in a rising market, not a flat one as we have now. And, the whole proposition becomes even less attractive when/if people start realising capital losses in significant numbers. Also, in the Institute's view, the absence of inflation indexation would be a significant issue, and its inclusion should be part of any CGT proposal – otherwise those targeted by a CGT will be forced to pay extra taxes on simple cost of living increases.

Practical considerations

- Impact on residential rents: Even in its own 2011 Capital Gains Tax policy, Labour admitted the impact of a CGT on rents was "unclear". Logic suggests however, that if such a policy were ever successfully implemented, it would further discourage the buying and selling of homes (including new ones) for rental/investment purposes. Rents are already on the way up according to numerous reports, including from TradeMe and the Property Institute/Valocity's own statistics, which warn of a 'perfect storm' looming for those seeking rentals.

- Retail/Commercial/Industrial: Of course, rental increases are not confined to the residential market either. Retail, Industrial, and Commercial property value gains would all be targeted with the addition of a CGT - and that too will be an extra cost on business as it is passed on. That has the potential to further slow employment and economic growth. At a time when our retailers (in particular) are facing huge competition from online providers without bricks and mortar infrastructure (often based overseas), the Institute does not see this as a useful addition to the tax toolbox.

- Farms & Horticulture: Farms & the animals upon them would undoubtedly be subject to some form of CGT even if the primary residence is excluded. This would be a new tax on farmers/horticulturalists and their families who often rely on capital gains to fund retirements/diversification/security.
- Inheritance tax by another name: Previous CGT proposals suggest “the asset will automatically be rolled over to the new heir. But if you decide to sell the asset, CGT will apply to the gain made since valuation day.” Any consideration of this policy proposal needs to be measured against the promise of no new inheritance taxes, as laid out in the Tax Working Group mandate.
- Exemptions: This is where Capital Gains Taxes generally become unwieldy, complex and subject to avoidance & legal challenge. The more exemptions that are added, the more susceptible the system is to manipulation. While the Institute does not support a CGT, international experience suggests the most effective implementation includes ALL classes of asset including a family home.

Valuation Day

Of particular interest to the Property Institute and its members is the method of valuation deployed during implementation, administration, and dispute processes of any CGT.

The Property Institute membership includes the New Zealand Institute of Valuers (a legislated and approved professional body) and the only structured Plant, Machinery and Infrastructure Valuation professional community in New Zealand.

In its 2011 paper, Labour suggests: ‘the implementation and operation of a valuation day system, including issues such as pragmatic valuation methods for assets not easily valued. The final approach adopted will need to be practical and flexible, such as the South African approach where taxpayers were provided with a choice of methods for valuations, some of which were relatively simple proxies for full market valuation’.

The Institute views this as an area of significant concern and administrative uncertainty.

Indeed, there are many ‘simple proxies’ for ‘full market valuation’, but research shows wild fluctuations between the values offered by ‘simple proxies’ and a proper valuation by a registered property professional.

These can vary between a vast overestimate of the value, and significant underestimates by the ‘simple proxies’, which may not require the same full disclosure and/or an in-person inspection like Registered Valuers.

Council and Government Valuations usually done via algorithms and sales history statistics are notoriously unreliable, as are the other online calculations.

And the public also distrust these other ‘simple proxy’ means of valuation.

A recent poll by the Property Institute focused on, ‘who people trust for an accurate market valuation’.

The result was clear. People least trust online appraisals (3%), only 7% believe Government or council valuations, only one in five trust their real estate agent, yet an overwhelming 62% of people trust a registered valuer to give them an accurate estimate of a property’s market valuation.

Predictably, errors in calculations on Valuation Day will inevitably lead to dispute in the event of an asset’s sale/realisation. For example: Is Inland Revenue going to accept online valuations as a true and accurate reflection of an asset’s value on V-Day, or will they seek independent assessment/review? What form should the valuation take?

Our best guess is that in cases of dispute, Inland Revenue and/or the asset owner will seek a review and/or closer examination from independent third parties. The Institute argues those should be respected property professionals, with rules, ethics and standards, disputes processes and a comprehensive Continuing Professional Development programme.

Those would be our members, and while this may generate significant new business for our professional membership, it will certainly add complexity to the enforcement and administrative overheads of both the Crown and the individuals concerned.

While the Institute sees some benefit in accurate market valuations of all assets held in New Zealand, the overall complexity is one of the reasons why, on balance, the Institute opposes the application of a Capital Gains Tax, despite the added workflows that some of our members may realise both in the short, and long term.

Conclusion

Like many popular OECD countries, the New Zealand property market has been through a period of rapid house price inflation.

However, measures including the Reserve Bank’s macro-prudential tools, trading bank capitalisation rules, bans on foreign capital and other measures have already had a considerable dampening effect on the housing market.

The Institute is of the view that further taxes targeting property investors and developers will lead to a further slowing of housing supply, and with a large state house building programme in the wings, there is also a considerable risk that the private sector will be crowded out.

The Institute believes we need a good balance of private and public housing, but one should not be at the expense of the other. New Zealand has a housing supply problem, and putting up new barriers will only exacerbate that situation.

But for the Institute the opposition to the Capital Gains Tax and Land Tax runs deeper than just housing.

New Zealand is a nation of risk takers, where it is already hard to source capital for business start-ups – new taxes on Capital Gains will only make it even harder for entrepreneurs to source the private investment they need for start-ups and expansion.

A CGT is complex and cumbersome to administer, it does not generate significant revenue and it runs the risk of further slowing growth at a time when our OECD counterparts are ramping up economic growth.

For these reasons the Property Institute of New Zealand would prefer to maintain the status quo with property taxes. They have served the country well in recent tough times.

The Institute believes the raft of other changes made to the property market need time to bed in.

PINZ would be more than happy to answer any questions the Tax Working Group may have, and/or appear in-person during any public hearing process.