Tax Working Group Public Submissions Information Release

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Submission on TWG Interim Report

[1] 21/9/18

Constrained excellence.

It is unfortunate that the TWG's terms of reference have constrained this excellent report and that these constraints have been repeated in the letter from Hon Grant Robertson to Hon Sir Michael Cullen dated 20th September 2018.

I note, with appreciation, that the TWG will liaise with the Welfare Expert Advisory Group (WEAG). I believe this to be of the utmost importance because the analysis in this report is almost entirely limited to the financial effects of various options while the WEAG is charged with considering social and medical effects etc. The two matters are closely intertwined. For example, poverty begets stress, mental health problems, depression, physical violence and the like. There are then intergenerational effects.

I, and many others, advocate Universal Basic Incomes as a way of ameliorating these problems. I have shown that there is at least one way of funding useful levels of UBI using an Asset Tax as an example of how to fund them. I will not elaborate here as my earlier submission has done so.

However you have asked, on page 20 in number 3, to be told whether you had missed any important issues. Accordingly, I will give you my view on these. Also I suggest that, as an independent group, you are obliged in your final report to point out the contradiction between these constraints and the requirement in your terms of reference to report on a fair, balanced and equitable system of taxation.

I made a submission on 3 April covering a number of these important, and other, issues. For convenience I will now append slightly modified remarks on some of these important issues.

Taxation of Family Homes

The idea of exempting family homes from various taxes, such as capital gains taxes, has an attractive emotional connotation but fails every test enumerated in the Submissions Background Paper - simplicity and efficiency, vertical equity, horizontal equity and fairness.

Defining a family home for tax purposes is far from simple. Particularly with the evolving modern, complex, multiple marriages and associations. Witness the reports appendix B.

This very complexity will be likely to lead to evasion, avoidance and inefficiency. It will be subject to many amendments and never-ending legal argument - particularly when dealing with family rearrangements, estates and bitter dissolutions.

A tax dispensation for family homes will greatly reduce the tax base and result in reduced Government revenue. For any desired level of such revenue the burden will then fall on the homes that are not owned by the resident family. The burden will fall on the many who rent their homes. **Those who have more get a dispensation which is not available to the less well off. Equity, both horizontal and vertical, is violated. Is this fair?**

Again, the value of properties varies enormously so any dispensation based on whether or not family homes are exempted has enormously different financial effects. There are said to be “family homes” valued at some $20,000,000. For others their ‘family home” may be an old van. Vertical equity is violated by any taxation dispensation based on ownership of a family home. **Is this fair?**

Anyone considering renting-out a property as a business investment rather than a speculation for capital gain will want to see a return on the investment. So taxes will have to be taken into account as part of the business plan. **Taxes on housing will therefore affect rents or the maintenance and quality of the rental stock. This impacts the increasing proportion of those who rent and who may never be able to buy a home of their own.**

Retirement Savings.
In my view there should be no discrimination between savings of various kinds. Why should calling something a retirement saving justify its being taxed differently from saving for a house or some unspecified purpose.? Especially as having one’s own house is so important for comfortable retirement? And if, as in the case of Kiwisaver, the retirement saving can be drawn upon to buy a house.

Difficulties always arise from attempting to give something preference because it has a more, or less, appealing name but is predominately the same item or the same action. We are drowning in complexities and regulations attempting to target ever smaller manifestations of what are considered to be desirable or undesirable. There are many legal and taxation differences based on gender, marital or partnership arrangements, ethnicity, location, employment etc when the actions or events are, of themselves, identical. The results of this kind of differentiation can hardly be considered to be fair.

Personal Tax System.
There seems to me to be a great deal of confusion about our personal tax system.

The letter referenced above reaffirms, on page 1, “...areas that are out of scope of the review …….increasing any income tax rate……….The adequacy of the personal tax system...” and, on page 2, “ We would like the Group to consider…..effective tax rates of individuals particular (sic) those in the top decile.”

On page 7 of your interim report you say:

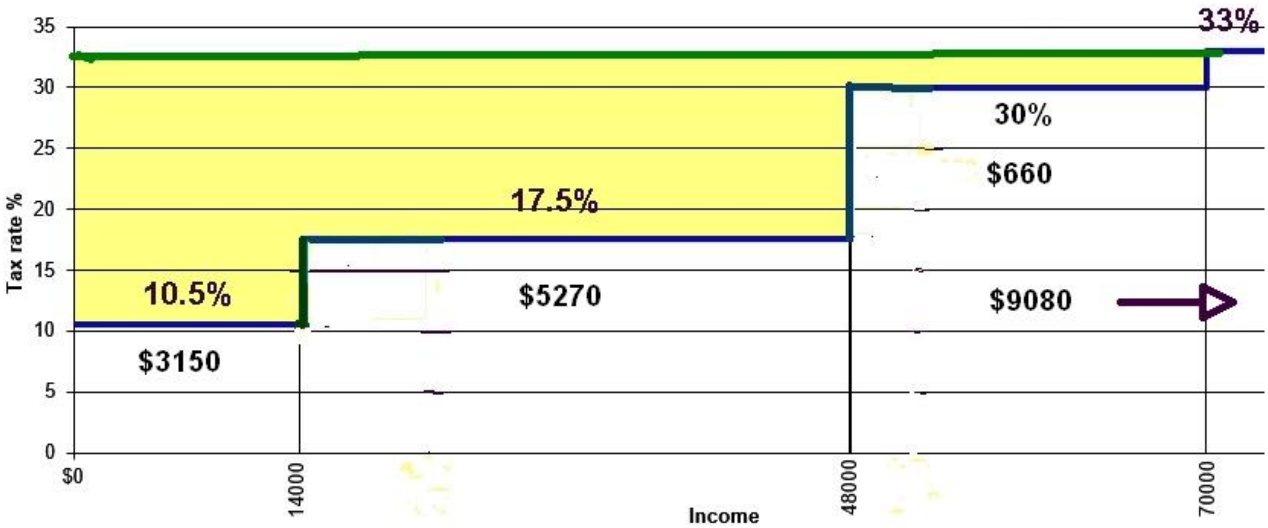
- *The best mechanism to improve incomes for very low income households, for example, will be to increase welfare transfers.*
- *If the intention is to improve incomes for certain groups of low-to-middle-income earners (such as full-time workers on the minimum wage), then changes to the personal income rates and/ or thresholds will be more effective.*

So far as the first bullet point is concerned a better mechanism may be to simply make the benefits tax free.

Applying the concepts of the second bullet point would further exacerbate inequality. In order to explain this I will here extract a part of the section "Why are the Poor poor?" of my main paper at https://perce.harpham.nz.

<u>Personal Income Tax</u>

A graph may help to understand what is a fairly complicated situation.



<u>Tax Rate versus Income</u>

On the left of the graph we have the percentage tax rate which applies for incomes as shown at the bottom. Thus, one can see that below 14,000 per year of income the tax rate is 10.5%. Between 14,000 and 48,000 it is 17.5%. Then another bracket with a rate of 30% and, finally, 33% applies regardless of how high the income may be.

At first sight it is good to have lower rates for lower incomes. They are effectively exemptions from the top rate of 33%. But to get all the exemptions available one must have an income of $70,000/yr or above. Thus, I have shown on the graph above that if you only have an income of $14,000/yr then by paying 10.5% instead of the top rate of 33% you are better off by $3150/yr. And the reduction in the 17.5% bracket saves you a further $5270 per year with another $660/yr if you have an income of $70,000/yr or above. So, all the people on the top tax rate get a discount of a total of $9080/yr!

What is demonstrated here is that with this sort of structure the more you have the more you get in the way of exemptions. The Poor get relatively poorer as in so many other ways. All the low tax exemptions that are given to the less well-off accrue to the better off also.

I then go on to extoll the virtue of Universal Basic Incomes as a solution to this problem of a stepped level of Income Tax disadvantaging the poor in comparison to the wealthy. I also propose steps in the tax rate for higher incomes which apply to the whole income at each step so that the advantages at lower incomes do not propagate to the higher incomes.

But whether or not my suggestions are thought to have merit for solutions to the problems of having a stepped Income tax rate the problem should not now be magnified further.

Options for extending the taxation of capital income

The discussion in the Interim Report and Appendix B is very valuable. Many of the matters discussed in Appendix B would be ameliorated by the risk-free rate of return approach. Largely for this reason that would be my choice. Always, as I note above, with the same treatment of all property – no exemptions for family homes. In this case risk- free is approaching my (informed but inexpert) choice of an Asset Tax for my example of how to pay for Universal Basic Incomes.

This Asset Tax would initially be based only on the improved value of property and collected with local body rates. I envisage no deduction for mortgages unless there is the complication of having the mortgagor pay their share – and, no doubt, recovering from the mortgagee. Otherwise there will be huge avoidance with owners possibly making investments in tax –havens or other entities which provide the mortgages. Moreover, the owner of the property is the user of the environmental resources that have gone into it.

An advantage of the risk free system as enunciated is that the deemed income is treated as income so that those on a lower rate of income tax pay less. However, if my UBI ideas for most people to be on the same rate of income tax were to be adopted then their UBI would cover the same issue.

This raises a more general matter. **One person's tax or other exemption is anothers tax or penalty.** I believe that a principle for a fair tax system must be that - **When Government makes payments to people they must be the same for ALL people of the same age and taxes must be proportional to both the income and the wealth of individuals.**

Company Tax

The report does not address one of the major reasons for increasing inequality. This is the difference in taxation for companies and individuals. Those who are sufficiently well-off or sufficiently knowledgable get the benefit of companies being taxed on profit whereas individuals are taxed on income.

Apart from numerous smaller matters companies can deduct the costs of fulfilling their function and continuing to do so but ordinary workers cannot. To be on a comparable footing the worker should be able to deduct the "living wage" from their income for tax purposes. This is clearly financially impractical with conventional thinking but a Universal Basic Income can be afforded at a level to make a significant move in this direction.

Greater Transparency and Accountability for Government.

At 17.6 there is a call for " Greater transparency and accountability on

the part of the Government."

And in Appendix B, no 2 we have:

"The Government's objective is to have a tax system that:……….

• supports a sustainable revenue base to fund government operating expenditure around its historical level of 30% of GDP;"

These two things seem to me to be in conflict because the practical relevance of the objective in the second statement is obscure. This statement deserves comment or explanation in order to maintain trust in the tax system and Government itself.

My reasons for this disquiet are:

- The recent historical level has been shown to lead to the run down and near collapse of many Government services.
- GDP is itself a hotch-potch of many kinds of expenditure.
- Countries, such as Denmark, run successfully with over 50% of GDP as Government expenditure.
- The measure of Government expenditure is the collection of many items known as the OBEGAL. Capital expenditures or recoveries (as by selling Housing Corporation or other assets) and SOEs are excluded.

- The OBEGAL also includes superannuation and other benefits totalling over 20% of the total. These Government costs are fundamentally different from the expenditures needed to run the Government administration and services. In order to pay benefits money is collected from some people and given to others to spend as they need or see fit. The spending of benefit monies is not under the control of Government departments but of the individual beneficiaries.
- One of the consequences of mistakenly including benefit costs in the OBEGAL is that one way to give the appearance of good management by meeting the chosen measure is to reduce the payments to beneficiaries either overtly or covertly.

It would be a simple matter to separate the cost of benefits from the OBEGAL and to report these separately as a percentage of GDP. To the extent that such percentages are meaningful transparency and accountability would be greatly improved.