

Tax Working Group Public Submissions Information Release

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Submission to the Tax Working Group Secretariat

Response to Interim Report

Abstract

The interim report indicates that the idea of a Financial Transaction Tax appears to be not well understood by the Tax Working Group. So that it can be considered before the final report, I intend to explain why a type of FTT should be considered as a far simpler, more practical and fairer type of tax than we currently have. Many of the best ideas are the simplest ones. New Zealand likes to think of itself as innovative and pioneering so it should be willing to consider a radical shake up to its taxation system.

The mention of the Financial Transaction Tax was an improvement on the last one a decade or so ago which failed to mention FTT apart from a brief reference to a Tobin tax. However, it's still only a fleeting reference and made no reference to the various forms of FTT, referring to only one form which, I agree, would not be worth consideration in New Zealand. The form of FTT I propose is the Automated Payment Transaction tax (APT). No investigation into the tax system is complete without showing why an APT should be dismissed.

Automated Payment Transaction tax explained

To understand how APT would work, a good starting place is the New York Times article *ON THE CONTRARY; Dreaming Out Loud: One Tiny Little Tax*¹ by Daniel Akst from 2003. It describes what was proposed as a simple and fair tax suggested by Edgar L. Feige, a retired economist from the University of Wisconsin.

The article is copyright and thus it's not appropriate for me to include it in this submission, but it will still be available either directly from the New York Times website, or via a library service.

Form of APT for New Zealand environment

That article describes a USA environment and so not every detail is applicable to a New Zealand environment. I would suggest some small changes to what Dr Feige proposed:

1. The tax would eliminate GST in addition to income and corporate tax.
2. Dr Feige suggests that 0.6% would be sufficient to cover what is now covered by other taxes. It would be levied equally on the payer and the payee. I suggest levying it all on the payer as explained in paragraph 4 of the section *Some of the benefits of an APT* below.
 - (a) To compensate for the loss of tax on cash transactions Dr Feige also suggests levying a higher tax rate on cash withdrawals and deposits. I suggest that wouldn't be necessary given the huge decrease in the number of cash transactions in the last decade, and there's no indication that would reverse.

¹<https://www.nytimes.com/2003/02/02/business/on-the-contrary-dreaming-out-loud-one-tiny-little-tax.html>

The current incentive to avoid GST is far greater. It would be preferable to keep the system as simple as possible. However, if cash again became more common, a specific higher rate could be introduced in response. Were that to happen, in that case, it **would** be appropriate to charge it on deposits as well as withdrawals.

3. The APT would not eliminate excise duties. There is good reason to levy specific taxes on activity that involves undesirable consequences but are impractical to outlaw, such as alcohol, nicotine, sugar and cannabis. Just how those would be levied are separate discussions.

How it would work

For the purposes of explaining the principle, say the APT rate is 1% and an account holder makes a purchase of \$100.

1. The payer's bank pays \$100 to the payee, and an additional payment of \$1 to IRD.
2. The payee's account receives a deposit of \$100 where it can earn interest until it is spent. It would incur an APT of \$1 at that time.
3. Tax would be levied on every transaction that passes through a bank, or entity that acts in the manner of a bank servicing payments. The only way to avoid it would be to use cash or attempt to set up a payment system outside the New Zealand banking system.
4. Banks make payments to IRD at intervals to be decided according to the size of the individual accounts and could be as frequently as daily for large ones or even in real time. There is a view that banks should be recompensed for their tax-collecting tasks. Those are minimal in the computerised system that is well-developed already, and banks already have access to substantial over-night short-term interest-free loans. That's not likely to change, but if it does, banks can be compensated by adjusting the size of the payment intervals.
5. Inequities brought about would be alleviated or eliminated by specific payments such as the present housing allowance payable to beneficiaries.
 - (a) For example, donations to registered charities would also incur tax which would be considered unfair. That can be offset simply by IRD paying the amount of tax (simply calculated) to the charity. The net result is that the charity receives the amount that the donor's account has deducted from it. To make it more like the net result of the present system in which IRD effectively subsidises the charity by the amount of the tax deduction, IRD could pay a multiple of the APT it collects from donors. That multiple could be calculated, using simple arithmetic, to have a similar net result.

Some of the benefits of an APT

Using a system as radically different from what tax experts are familiar with could appear daunting. It would be necessary to phase in the change over a number of years, beginning with a very low rate of APT while lowering and eventually eliminating GST, income tax, etc. When the change is complete a large number of benefits would arise.

1. Very simple to set up and cheap to administer. Banks are already set up to do nearly everything necessary so scarcely any new investment will be required. Whatever is required will be several orders of magnitude less complicated than what is required with the way tax is structured at present.
 - (a) Tax law would become immeasurably simpler. I could envision it getting to the stage whereby it would all fit into a single volume. Businesses could get on with business instead of being concerned about whether it is structured to make best use of tax laws.
2. GST has become popular with governments as a form of revenue-raising because it is relatively simple to arrange, and not easy to avoid. APT is even simpler and fairer than GST – to the extent of eliminating the need for a return to be filled in. Hence the term “automated”. An APT would also constitute a much lower rate than GST and so there would be less incentive to attempt to avoid or evade it.
3. Gone will be the incentive to invest in housing that has no capital gains tax in preference to services or products that benefit the economy. The result will be less investment speculating in the housing market and more in productive industries.
 - (a) A CGT is not effective at reducing that speculation and resulting instability. Trying to devise a fair form of CGT is fraught with problems as can be seen by the complicated regulations in Australia. Even professional accountants cannot tell how the Australian Tax Office will rule on rather simple cases. The ATO even reserves the right to change its ruling at a later date.
4. Payments for purchases abroad would incur the same tax as those made in New Zealand. As well as eliminating unfair competition for NZ businesses, it would eliminate the need for offshore supplier registration, and also collect tax on purchases less than \$400. Levying all the tax on the payer instead of splitting it with the payee eliminates the problem that would otherwise arise collecting tax from an offshore supplier. That might be considered unfair but it would affect everyone equally and is an insignificant price to pay for the simplicity it provides.
5. Because everyone spending money will be paying tax, and at the same rate, there will be less inequality. The more money spent by a taxable entity, the more tax it will pay. Dr Feige has been quoted² as describing an APT as “. . . a public brokerage fee accessed by the government to pay for the provision of the monetary, legal and political institutions that protect private property rights and facilitate market trade and commerce.” Whether or not the attribution to Dr Feige is correct, I consider it to be an apt description.

²<http://blog.heartland.org/2014/05/rethinking-taxation-the-automated-payment-transaction-tax/>

6. Though not (yet) an issue in New Zealand, high-frequency trading of financial instruments would never get started. That's to be applauded since it would mean that New Zealand would not get into the legal wrangling over the question as to whether high-frequency trading constitutes insider trading.

There are others with large amounts of initial capital who don't require ultra fast network cabling and computer algorithms designed to change market positions at millisecond or even microsecond intervals. It is still possible to "make" money by exploiting arbitrage margins that are available on forex and futures markets. But it requires what is considered "work" which can result in money for the trader but produces no benefit to the economy.

If APT were charged on those trades, there would be no profit, so the market would cease.

- (a) People who make money from that type of business produce no benefit to the tax-payer yet they're able to consume large amounts of what is produced by the "real" businesses. That is part of the reason why there is insufficient money to pay aged-care and other low-paid workers an income that is able to keep pace with inflation.
- (b) In a recent discussion about daylight saving on BBC World Service radio, a view was expressed that because of the disruption to body clocks when the clocks are changed, millions of dollars are "lost" on the financial markets. By a "loss", it was meant a potential profit that was not taken advantage of, though nothing was actually lost. Removing such a distortion from the economy would have a not insignificant benefit.

7. Trans-national corporations which currently avoid income tax by shifting profits to their low-tax country affiliates through an accounting fiction would be paying APT on those transfers. The benefit to them would be substantially reduced or eliminated, while IRD would receive an APT as well as on each transfer within New Zealand. It would not be receiving income tax on the salaries of staff, but those are small in magnitude compared with the turnover of the businesses.
8. An APR would be very difficult to avoid. Using cash would avoid the APT but that would be a very small proportion of the transactions. Cash has to pass through the banking system at some stage, at which point, measures can be taken if it becomes necessary to respond to large amounts of tax evasion through the use of cash. Such measures were described in paragraph 2 (a) of the section *Form of APT for New Zealand environment* above.

The Pushback

A small but influential number of people who are doing well out of the current system will resist the idea of an APT tax. They will have substantial resources of finance and skilled staff or consultants who would make strenuous measures to avoid it.

Trans-national Corporations

In recent years, attention has been drawn to the fact that large trans-national businesses typically pay minimal tax by virtue of the accounting practice of charging internal

“fees” resulting in movements of money from high tax countries to low tax countries. Fictitiously high profits are made in low tax countries and fictitiously low ones in high tax countries. It’s completely legal but it’s unfair competition for local businesses.

1. Expect such businesses to resist the introduction of an APT since they would be less profitable. They would prefer the current system partly because it is difficult to make rules that can be adopted internationally that can curtail those practices.
 - (a) Expect them to lobby against a change to an APT tax. They already have supporters such as Ireland which even disagreed with a European Union Commission decision that Apple had under-paid its tax to the tune of €13.2 billion.
 - (b) Expect them to devise new methods of transferring money within their organisations that are separate from the banking system, such as block chain technology.

Taxation Consultants

Businesses in New Zealand that make their income by advising tax-payers how to avoid tax are operating entirely legally. So too, are those who structure their business to incorporate that advice. It’s important for them to limit expenditure wherever legally possible or at least keep abreast of what techniques their competitors use. While tax consultants benefit their clients’ profitability, the tax avoidance industry does not actually produce anything for the economy.

1. Expect them also to be opposed to an APT. IRD staff are also not likely to be in favour of making the tax system so simple it will require far fewer people to run it.
 - (a) It is very difficult to make a radical change such as an APT when a substantial industry has the ear of government.

Conclusion

An APT would not be a perfect solution to every problem encountered in devising a fair tax system, but it obviates many of them and comes close to a fair resolution for nearly all of the rest of them. Though there would be a very strong lobby against the idea of APT, that’s no reason not to consider it. There was strong opposition to women’s suffrage, same-sex marriage and even MMP, yet change did happen. No change will happen if the subject isn’t discussed. I make this submission with the aim of starting that discussion.

Patrick Connolly
[1]

22nd October 2018