Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

1 November 2018

The Chair
Tax Working Group

By email: secretariat@taxworkinggroup.govt.nz

Dear Sir Michael

The following is my submission on the Tax Working Group's (the Group's) very well written Interim Report. The Report covers an impressively wide range of tax matters.

In general, the Group's recommendations are good and are to be applauded. However, a CGT is only worth having if the associated compliance costs are acceptable. As proposed this is not the case. The implementation costs, which arise from the proposed valuation day approach, are extremely high. At v-day:

- All businesses will have to ascertain whether they have goodwill, and, if so, it has to be valued;

- The vast majority (95% plus) of companies in New Zealand will have to have their shares valued;

- Land and buildings will have to be valued (government or rateable values are meaningless in this context); and

- Other fixed assets will have to be considered to ascertain if their market value is above cost, and if so they will have to be valued at v-day.

This is, in my opinion, is an unacceptable imposition – not only of compliance costs, but also because of the uncertainty inherent in valuation. Third party market transactions are the only accurate determination of real value.

My other major concern at this stage is that the Group's good and coherent work to date has the potential to be undone by compromise. For example, a new decision to tax capital gains at a concessionary tax rate will significantly reduce the integrity of the CGT and will increase compliance costs.

This attachment to this letter discusses my brief analysis of some of the proposals and outlines some issues:

- Compliance costs generally;
- Capital gains tax generally;
- Collecting PAYE;
- Contractors; and
- Environmental tax issues.

I would like the opportunity to discuss the major points I make with the Group.

Yours sincerely,

Jim Gordon
Jim Gordon Tax Ltd

Attachment

Compliance costs

New Zealand's tax compliance costs are low by international standards. In particular our GST is world leading because its "no compromises" approach makes it simple and certain. I am very pleased that the Group has seen fit to endorse without amendment New Zealand's core income tax, imputation and GST settings. In particular I agree with the decision not to have a lower SME company tax rate – this would have been compliance cost intensive. This endorsement of the core settings will help to keep compliance costs low.

I will comment more specifically on compliance costs under the various headings below.

Capital gains tax

If New Zealand is going to have a capital gains tax then the Group's Interim Report discussion represents an excellent start, with a couple of exceptions. Any stepping back from these positive features has the potential to reduce the integrity of the CGT proposals and increase compliance costs. In particular I endorse:

- The proposed integration with income tax – this is essential to prevent boundary issues and debates, and to reduce compliance costs.

- Determining the assets involved by inclusion – this successfully deals with all the marginal issues such as collectibles and the question of when does my old car, which I still regularly use, stop being a cost center and starting being a collectable.

- The proposed family roll-over reliefs. Spouse to spouse and matrimonial property should just be automatic and the relief should apply to all CGT assets (as it already does to income tax assets). The more interesting issue is when assets pass through generations. I accept the point that this could be more than one generation, but if you follow the pattern of the Tax Act which often regards associated persons as one economic entity an inter-generational roll-over relief is sensible. If there is real concern about this perhaps there should only be one inter-generational roll-over per substantial asset. Also, it could perhaps only apply to non-liquid assets such as land and shares in family companies (remembering that the underlying assets of such companies will also be subject to CGT).

- Roll-over relief for replacement assets. The Paper helpfully uses stepping stone farms as an example. Another example is highlighted by the single-asset (e.g. a cool store) company and replacement insurance. If the asset is munted (as actually happened in the Canterbury earthquake) it is, under current tax law, deemed to be sold at the value of the insurance proceeds received (which is in practice always higher than cost). Presently depreciation is recovered – meaning that unless new funds are injected the asset can't be replaced like for like (a roll-over was given for depreciation recovered from assets munted by the Canterbury earthquakes). A CGT will exacerbate this as the whole difference between tax book value and replacement value will be taxable. At the least roll-over relief for both depreciation recovered and CGT for assets that are munted that are insured for replacement value seems appropriate. Preferable would be a generic CGT roll-over for assets that are replaced.

However, I have real concerns about:

- The proposed valuation day approach. This will be compliance cost intensive. The particular concerns I have in this area include:

    - Valuation:

        - The need to value all shares in non-listed companies – this will be onerous and subjective;
        - The need to value all land and buildings that is in the CGT base– while there are suggestions to reduce compliance costs and subjectivity I do not believe that these will be properly effective; and
        - The need to value all other business assets (including goodwill) except for those assets whose valuation is obvious (e.g. cash and listed securities), and those items of depreciable property whose market value is clearly below cost, will be onerous and subjective.

      These issues can be addressed by applying the CGT to assets acquired after the CGT introduction date – the advantages being an elimination of the valuation requirement with a consequent significant decrease in compliance costs and an elimination of the subjectivity that valuation causes – a 3rd party transaction always provides hard evidence of valuation.

- The compliance costs associated with having to record the v-day value, perhaps for years, do not seem to have been fully considered. It the CGT asset belongs to a business and that business prepares financial statements those financial statements should be required to schedule v-day CGT assets and the v-day values. However, if there are depreciable assets whose market value is above cost an extra column in the depreciation schedule will be needed to record this valuation. On a whole-of-New Zealand basis this will be expensive as the programs for fixed asset schedules will need to be amended. In fact, this could get very complicated as there may be depreciation recovered on the sale of a CGT depreciable asset as well as a capital loss!

  Again, where financial statements are prepared, the adoption of "an assets acquired from" approach solves this as there will be one common cost base established by the 3rd party transaction. However, I acknowledge that this does not resolve the issue of recording the values of CGT assets which not in the tax base or which are not included in financial statements (see below).

  Where there are CGT assets not in the tax base or which are not included in financial statements I accept that there will be issues with recording the CGT cost base. I agree that the requirement for this to be notified annually to Inland Revenue is by far the best way around this. An issue will be identifying the value of enhancements/improvements after acquisition (or the valuation date if that approach is not changed), especially to the extent this includes work contributed by the owner. This may deserve further thought.

- Herd scheme livestock. The herd scheme clearly cannot continue in its present form as the Herd schemes' policy presumption is not compatible with a CGT. This policy presumption is that the whole herd is the equivalent to one fixed asset and that asset value changes should be regarded as being on capital account and therefore tax-free. There are a variety of issues here that need to be considered potentially including both fiscal and compliance costs. Expert advice will be needed.

- Farm improvements other than depreciable assets. This includes fencing and orchards, including their infra-structure and the vines or trees themselves. Currently, a new owner of these assets may amortise these improvements, presuming that they are listed in the appropriate Schedule of the Tax Act, based on the original owner's original cost, and not, for subsequent owners, their acquisition values. A CGT will cause this to be reconsidered. At least in early years, the fiscal cost of amortisation based on a valuation or acquisition values is likely to exceed the tax made on any capital gains assessed to the vendor. This fiscal cost might simply be part of the cost of introducing a capital gains tax.

- Where companies own CGT assets there is a potential issue with double tax of the one gain (or double losses), especially where the company is land-rich. For listed land-rich companies such as Property for Industries it seems reasonable to presume that, over time, all shareholder gains or losses are reflected in the net assets of the company, which will be recorded at valuation. This may provide an opportunity to address this.

  For non-listed companies the issue is equally acute, although family companies may be able to structure around any double tax – however, at the least this will incur compliance costs and is yet another item that could trip over small business accountants. An inter-generational roll-over relief might help in this area.

  However, considerable thought is clearly needed.

Collecting PAYE

The Paper correctly identifies that there is a problem with collecting PAYE in some circumstances. I agree that PAYE and other compulsory deductions from wages should be regarded as being held in trust by the employer for employees and accordingly should not be regarded as being part of the working capital of the employer. The single best way of achieving this would be to require such deductions to be forwarded to Inland Revenue or other agency at the same time as employees are paid. In practice this would be when the payroll information is forwarded to Inland Revenue. However, this may not be achievable.

I wonder if in the past Inland Revenue has not pursued outstanding PAYE etc. with sufficient vigor – if so this might be part of the problem and should be part of any solution.

The Paper proposes a “directors’ liability” based on a notice to directors. While I can understand why such a suggestion is made, its scope is too wide. Non-executive directors should not be subject to such obligations. Often, they don’t have access to the detailed books and records of the company. Sometimes they have been brought in to assist in trying to resolve a company’s poor trading position.

However, I am totally comfortable that executive directors, and especially executive directors that are associated with the shareholders, should be personally liable for PAYE etc. short-falls. Perhaps this should be as if they have personally guaranteed that the payments will be made, i.e. without any notice regime applying. This should address the concern that the private sector has raised concerning this proposal while still allowing Inland Revenue to pursue the relevant offenders.

Contractors

I strongly endorse the Group's work in this area. Contractors are a significant portion of the SME sector and it is in this sector that the vast majority of tax evasion occurs. Third party reporting of contractor's income to Inland Revenue to Inland Revenue will increase compliance and decrease evasion in this area.[1]

The corresponding increase in "employers'" compliance costs is a small price to pay for this.

Environmental tax issues

I endorse the Group's work to date in coming up with a framework approach, however, I strongly believe that the framework should be a whole-of-government framework. This is to ensure that in respect of environmental matters Government and its agencies has one coordinated approach. For example, it is conceivable that one government agency might be considering a penalty on farmer's excessive nitrogen outputs and another agency might be considering a nitrogen tax on fertiliser, both with the same objective of reducing the use of nitrogen. A whole-of-government approach to environmental issues seems to be essential. A tax approach to the environment in isolation is not appropriate.

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[1] See the August 2009 OECG paper *"Withholding & Information Reporting Regimes for Small/Medium-sized Businesses & Self-employed Taxpayers"* and various papers authored by Joel Slemrod, an internationally noted expert in tax administration.