Tax Working Group Public Submissions Information Release

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1 November 2018

Tax Working Group
Submitted via email: submissions@taxworkinggroup.govt.nz

Dear Tax Working Group,

FUTURE OF TAX: INTERIM REPORT

Deloitte is writing to provide comment on the Interim Report of the Tax Working Group.

Our feedback focuses on practical, process-oriented and resourcing issues that may arise from implementing an extension of taxation of capital income, or the risk-free rate of return, on assets. We underscore that our feedback does not support or contend with any of the policy considerations and recommendations described in the Interim Report relating to capital income. Overall, we agree with the comments in the Interim Report that the effectiveness of any policy for the taxation of capital income "will be dependent on its design."

The Generic Tax Policy Process ("GTPP")

1. At [80], Appendix B, of the Interim Report, the Tax Working Group asserts that:

   "Implicit in the Group's approach is that the income brought into the tax base by taxing more realised capital gains should be taxed in the same way as any other income, unless there is some reason to do otherwise. The rules taxing more capital gains ***can be seen as no more than expanding the definition of what is a revenue account asset****, albeit in a reasonably far-reaching manner"* ***[emphasis added]****.*

2. The Tax Working Group therefore describes the policy considerations on imposing tax obligations on capital income as an "extension of the taxation of capital income" throughout the Interim Report – not a new tax for which new, separate tax legislation is required.

3. While we generally agree that many "supporting provisions and mechanisms" do already exist in the current tax framework to enable the implementation of rules that tax capital income, we question the conclusion that the changes proposed are merely an expansion of the 'revenue account asset' definition. Instead, we consider that any choice to tax capital income in a more complete manner is a fundamental change in our tax framework. Such policy considerations will have a significant impact on taxpayers as it demarks a distinct and significant conceptual change in the obligations taxpayers have to Inland Revenue.

4. In summarising the interactions between a potential tax on capital income and other tax regimes, at [74] to [76], Chapter 6, the Tax working Group identifies that "these issues are complex and will require industry and stakeholder consultation." Further, at [244] and [245], Appendix B, the Tax Working Group acknowledges that "there are a number of other issues largely relating to how the new rules would integrate with existing tax rules" and "we expect that there will also be other

issues that will arise as a result of industry and stakeholder consultation and of course through the Generic Tax Policy Process."

5. At the same time, members of the Tax Working Group and associated Ministers of Parliament have indicated an appetite to make legislative changes to effect these policy recommendations before the 2020 general election – which, at latest, must be held by 21 November 2020.

6. With the Final Report expected from the Tax Working Group in February 2019, we question whether there will be sufficient time before the general election to completely and effectively work through the GTPP on a reasonable and sustainable timeline. We submit that the best tax policy will be developed where the GTPP is fully worked through over a realistic timeframe.

7. We would find it useful to understand where in the GTPP the Tax Working Group imagines Officials will begin the process of developing policy recommendations in to draft legislation – i.e. the strategic, tactical or operational phase?

8. If the policy recommendations are intended to launch Officials into the operational phase, beginning with detailed policy design, does the Tax Working Group imagine that Officials will still undertake to consult with the public and industry through green and white papers? We submit that supporting a robust and on-going public discussion will be fundamental to the success of any new tax policy for capital income.

9. Depending where responsibilities start and finish, we also submit that the Tax Working Group should either set out a concrete plan for the development of any proposed changes to the taxation of capital income from the issue of the Final Report through to the implementation phase; or encourage Ministers to have a clear plan which is articulated to the New Zealand public once the Final Report is delivered.

A staged approach

10. At [45] to [52], Chapter 6, the Tax working Group explores policy ideas on "how far to extend the existing [capital income] tax net" – considering a targeted versus broad-based approach. The Tax Working Group acknowledges, at [50] that the design principles in Appendix B largely focus on a targeted approach which, when taken together, "the outcome will be a broad-based taxing of nearly all capital gains."

11. We submit that the Tax Working group may wish to consider a targeted approach which phases additional asset classes in *over time* until the treatment of capital income is as broad-base as is considered appropriate once the potential effects and compliance costs of each expansion of the tax are fully worked through. For example, Officials could initially implement tax policy for capital income from land and land interests.

12. Implementing policy using a targeted approach over time, but building a broad-base approach to capital income, may be more effective in ensuring that the Government, Officials and taxpayers have sufficient time and resources to properly develop proposals through the GTPP, consulting with industry and public stakeholders on specific technical and administrative issues for each asset class.

13. However, we also accept that any approach to policy development which singles out specific asset classes for taxation, even for a short period, is likely to have important and complex impacts on the overall horizontal equity of the tax system in New Zealand. We appreciate the inherent complexity involved in these policy considerations, acknowledging the trade-offs between compliance costs, horizontal equity and the overall integrity of the tax base

Deloitte.

Taxpayers' compliance and administration burden

14. We concur with the Tax Working group's comments at [34] to [36], Chapter 6, that "the extension of capital income taxation will significantly increase compliance and administration costs"; specifically that "unlike most other complex areas of tax law, the capital gains rules must be interpreted and applied by 'ordinary' taxpayers."

15. We are concerned about the significant additional costs of compliance and administration that will fall to taxpayers for the foreseeable future if all the policy changes contemplated are implemented. While we acknowledge that some proposed design principles will limit or minimise compliance costs in some respects, we think there is a high level of risk that many taxpayers will find it hard to adapt to the fundamental conceptual changes imagined – many will have to reform their internal systems and seek professional support.

16. Specifically, we are concerned that the policy considerations described in Chapter 6, and the design principles in Appendix B, will be hard to reconcile with the Business Transformation project.

17. We concur with the Tax Working Group's assessment at [241], Appendix B, that taxing capital income broadly will be hard to reconcile with changes made through the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill to "automatically assess an individual's tax refund or tax to pay." This is because "any taxpayer may have made a capital gain in any tax year, [so] the number of cases in which Inland Revenue would be confident to automatically assess based on reportable income would reduce."

18. We submit that the Tax Working Group should include final recommendations on how the Government can properly reconcile proposed changes to the taxation of capital income with the technical details and overall policy intentions of the Business Transformation project – specifically, mechanisms to ensure many taxpayers are not automatically assessed when certain capital income is earned. It will be best for the overall development of the tax framework if the two regimes fit together seamlessly.

19. Further, it is worthwhile to note that there are multiple design principles which may be effective in limiting taxpayers' compliance burden. While we support the Tax Working Group's exploration of these principles, we consider that there are risks to horizontal and vertical equity if concessions are made (e.g. providing rules of thumb for simple valuations, or using withholding tax processes).

Resourcing – Officials

20. Finally, in [36], Chapter 6, the Tax Working Group identifies that they "expect the extension of the taxation of capital income to put additional demands on Inland Revenue in terms of tax assessment, advice, collection and enforcement." We concur with this assessment and consider that the resourcing of Inland Revenue needs to be strongly considered in making conclusions about the appropriate time frames for developing and implementing any changes to the taxation of capital income.

We welcome the opportunity to discuss our submission points with the Tax Working Group.

Yours sincerely
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for Deloitte Limited (as trustee for the Deloitte Trading Trust)