Tax Working Group
Te Awheawhe Tāke

**Tax Working Group Information Release**

**Release Document**

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**taxworkinggroup.govt.nz/key-documents**

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*The advice represents the preliminary views of the Independent Advisor and does not necessarily represent the views of the whole Group or the Government.*

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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.

Below is a note I prepared for the Māori advisory group. It predates the officials paper for this meeting on Māori collectively held assets. I am tabling this as a background note for the Group's information.

It was prepared following a meeting of the CGT subgroup where there was a request to see how the approach of 'coming home' could apply to Māori collectively held assets. Feedback I received following this note was that it was interesting but there were queries as to how it would work. There were also queries as to whether it was necessary and if it was fully grounded it was was actually happening.

I then put this work on hold and have been assisting officials in their work.

## Extension of taxation of capital income and Māori interface

The note attempts to apply a te ao Maori interface to the issues associated with an extension of the taxation of capital income.

It argues that the family home exemption in the terms of reference for the Tax Working Group is directly analogous to freehold land held under the jurisdiction of *Te Ture Whenua Māori Act* 1993. For that reason this note argues that any family home exemption should equally apply to this land.

The note further considers assets and rights received under a deed of settlement for past wrongs of the Crown. It considers that these assets do not have the nature of assets that are generally covered by taxation of gains. That is these assets were often not particularly chosen by iwi. Rather they were assets that were available to the Crown at the time of settlement such as closed rural schools. For this reason the note argues that such assets should receive rollover relief as any gain on sale was incidental to iwi repackaging and reorganising their assets into ones that are more productive and culturally significant.

This will require settlement assets to be tracked by asset and by value – similar to available subscribed capital – to remain eligible for rollover relief.

The quid pro quo for the exemption for freehold land and rollover relief for settlement assets would be that the ability to pass out capital tax free would be removed from the Māori Authority rules. The distribution rules would become aligned with the dividend rules for companies.[ Need to think some more about this. Feels right to me but may not be necessary as when capital passed out this would be a crystallisation for tax purposes.]

Other assets held by Māori authorities namely ones purchased from borrowing or from the retained earnings of settlement assets would be subject to taxation under the prevailing rules at the time. This would be consistent with existing Māori authority taxation where the prevailing rules apply.

**What is being considered?**

Currently the TWG is considering whether there should be increased taxation on income that arises from capital. This is because there are efficiency and fairness issues with taxing some income like labour, interest and rent but not taxing other types of income like gains on sale of shares, land, or a business.

There are already a number of gains from the returns from capital that are subject to income tax. These include the taxation of:

- Discounted bonds – Financial Arrangement rules
- Foreign shares – Fair dividend rules
- Residential property – Brightline test
- Some land sales – land rules

It is unlikely there will be changes to those rules although the land rules may become redundant and so able to be repealed.

**Why is it being considered?**

Inherent in the taxation of the gains from sale on capital item is the idea that a taxpayer has chosen the ownership of an asset with a view to making a gain on it. This gain, if it arises on sale, increases the net wealth or consumption potential of the taxpayer in the same way that labour income does which is fully taxed.

With this in mind it is interesting to note that the family home and the land underneath it has been carved out from the terms of reference. While a gain on a family home – realised or not – does increase a person's wealth, generally speaking it does not increase the person's consumption potential as it simply represents a place to live and connect their family. That is it is their *turangawaewae*.

**What does that mean?**

What that means is that gains on assets that are currently not taxed – gains from sales of land, shares or businesses - would become taxable from a certain date. The government has indicated that any new legislation would apply from 1 April 2021. This means that assets that are currently not subject to tax on their gains would be valued at 1 April 2021 and then when subsequently sold the difference between the sales price and the value at 1 April 2021 would be subject to tax.

For example

Ross bought land in 1990 for $200,000 just outside Auckland. On 1 April 2021 it has a value of $2 million. On December 2023 he sells it for $2.1 million.

The taxable gain would be $100,000 as being the difference between the sale price and the value on 1 April 2021. That gain would be taxable in the 2023/24 income year.

**Rollover relief**

Rollover relief is a feature of capital gains taxes internationally. The effect of rollover relief is that tax is not levied on the sale if the funds are reinvested in an 'approved' way. Tax is effectively deferred until the subsequent assets are sold and not reinvested.

For example – continuing from above.

Ross sells the land on December 2023 but invests it in other land costing $3 million that entitles him to rollover relief. Without rollover relief the cost base of the new land would be $3 million and Ross would be taxed as above. With rollover relief Ross is not taxed on the gain of $100,000 but the cost base of the new land is $2.9 million. $2 million from original land plus extra cost of $900,000. This means that if the new land is sold – and there is no further rollover – tax is levied on the sale price less $2.9 million as the cost base. Thereby taxing the gain on the original sale as tax is on $100,000 more than would otherwise be the case.

**Family Home exemption**

The terms of reference specifically exclude the family home and the land under it from the scope of any potential capital gains tax.

Family home in the Pākehā sense of the term is the house that is the centre of family connections for the individuals who live there. While the nuclear family – parents and young dependent children - is the most common representation of family in New Zealand; even for Pākehā family is increasingly taking on broader connotations involving blended families; grandparents raising grandchildren; and significant delay for adult children leaving to set up their own households.

For Māori the concept of home is even broader. This was discussed in a recent report on Māori housing[1]

> The Productivity Commission and other researchers over this time have found that home for Māori starts with the ancestral home-place: important to Māori cultural identity. Home-place links are reinforced by physical associations with land, whakapapa, proximity to extended family, experience of te reo, and the importance of the marae. Home is about whānau, whenua and whakapapa. (Emphasis added)

[1] http://www.buildingbetter.nz/publications/SRA5/Maori_and_indigenous_housing_annotated_biblography.pdf

In fact it is also possible that the specific place for living can be created on this land in the form of *Papakainga* housing[2].

**Application to assets held by Maori authorities**

Currently Maori Authorities are broadly subject to the same tax rules as all other taxpayers. This means that all interest, dividends, rent and business income is subject to tax. Gains from sales of land, shares, fishing quota or businesses are not currently subject to tax as is the case for all other taxpayers.

Assets are held by Māori Authorities for the collective benefit of its members to support *tino rangatiratanga*. Their investment approach is one of *kaitiakitanga* to grow the assets base for current and future generations. This means that the nature of the investment structure is that members cannot transfer their ownership except on death. Unlike pākehā structures involving companies there is no market value for their rights in the Māori Authority.

That is value can only 'come home' to members when it is distributed to them.

Without any specific carveouts and with an extension to the taxation of capital income; Māori Authorities would pay tax on any gains earned from 1 April 2021 on land, shares, property or fishing quota consistent with all other taxpayers.

There issue though is whether this a fair approach bearing in mind the differing characteristics of Māori collectively owned property.

There can be considered to be three types of assets or capital held by Māori Authorities:

1) Māori freehold (and customary) land.
2) Settlement assets and assets purchased from rights in settlement deeds ie rights of first refusal for culturally significant land.
3) Assets purchased or 'created' from borrowings or retained earnings.

***Māori freehold (or customary) land***

This is land subject to *Te Ture Whenua Māori Act* 1993. Its objective is to show that:

> it is desirable to recognise that land is a taonga tuku iho of special significance to Maori people and, for that reason, to promote the retention of that land in the hands of its owners, their whanau, and their hapu, and to protect wahi tapu: and to facilitate the occupation, development, and utilisation of that land for the benefit of its owners, their whanau, and their hapu…

As discussed previously this is analogous to the Pākehā concept of family home. And like the family home gains on sale are generally notional. In most cases they do not expand the

[2] https://www.tpk.govt.nz/documents/download/3201/tpk-guide-papak%C4%81inga-housing-2017.pdf

owners consumption opportunities as another family home/freehold land needs to be purchased from the funds released from sale.

For these reasons my view is that it is appropriate to incorporate land subject to *Te Ture Whenua Maori Act* 1993 within the family home exemption of any proposed extension of taxation of capital income.

***Settlement Assets***

Settlement assets are assets received by iwi for past wrongs by the Crown. They reflect a tiny proportion of the actual compensation due and settlement redress usually involves an apology, some cash and possibly some land. The land given is generally the land that is available to the Crown at the time of settlement which may or may not have a commercial or cultural value to the iwi concerned. For example a closed rural school could be part of the redress.

Alongside these assets is often the *Right of First Refusal* for iwi to buy Crown assets that may come up in the future which may have much greater commercial or cultural value than the land or assets that were available at the time of settlement. Cash from the settlement or sales of other settlement assets will be used to fund subsequent assets purchased under a *right of first refusal.*

Such assets may still not be optimal as far as the iwi is concerned but part of the progress towards developing the portfolio of assets that best supports it commercially and culturally.

Thus there is a disconnect between the realities of settlement assets and the underlying assumptions of taxation of the gains from these kinds of assets. That is these assets did not arise by choice; they are a fraction of the value there should be; and that they are often not the ones iwi ultimately want.

For these reasons I would argue that rollover relief is appropriate for settlement assets and assets purchased under rights in settlements. The options for putting this into practice could be either:

1) When a settlement asset – or asset purchased under a right arising from a settlement  - is sold; if the proceeds are reinvested in 'similar' assets – there is rollover relief[3]; or

2) Settlement assets and assets purchased as a result of rights under a settlement are 'ring fenced' and tracked. Rollover relief is available to those assets when sold to buy 'other assets'.

When any of these assets are sold to make a distribution to a member; a gain is crystallised and tax payable.

[3] The new asset would become a 'settlement asset' and have rollover relief available.

***Other assets from borrowing or retained earnings***

Consistent with the general approach to taxation of capital income; when assets are purchased from borrowing or from retained earnings from settlement assets; iwi have an unconstrained ability to buy whatever asset they feel is most appropriate.

For this reason I would argue that the prevailing rules that apply generally to any increase in the taxation of capital income should apply here too.

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28 June 2018