Tax Working Group
Te Awheawhe Tāke

**Tax Working Group Information Release**

**Release Document**

**April 2019**

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**1 February 2019**

Hon Grant Robertson, Minister of Finance
Hon Stuart Nash, Minister of Revenue

Dear Ministers,

It is with great pleasure that I present the *Final Report* of the Tax Working Group. The *Final Report* is a result of further consultation and engagement with various sectors of society but particularly focuses on furthering the technical work involved with an extension of the taxation of capital gains as well as the outcomes from further engagement on environmental taxation.

The report seeks to present new areas of thought by the Group since the *Interim Report* but includes the recommendations from both reports in summarised form. The Group has endeavoured to address the points you raised in your letter to me on 20 September 2018 and this letter seeks to highlight our responses.

**General observations**

The Terms of Reference noted that the New Zealand tax system has been justifiably commended internationally for being a simple and efficient system. This does not mean, however, that there is not room for significant improvement in the structure, fairness and balance of the New Zealand tax system particularly in the areas of the taxation of capital gains and environmental taxation.

There were differing views within the Group as to the appropriate level of extension of capital gains. The clear majority favoured the broad approach outlined in Volume 2 while the minority's view was that there was only a case to extend taxation to capital gains from residential rental investment properties. The preference of the Group was that any extension of the taxation of capital gains be through a taxation of gains on realisation, rather than a form of risk free rate of return or deemed rate of return methods. The merits of a deemed rate of return method are, however, discussed in the report.

The Group has also noted the need for the Government to enhance its institutional technical capability and capacity in the area of tax. This includes the tax technical capability of Inland Revenue's investigation function, Treasury's strategic capacity; and also capability across Government to design and implement environment taxation. For the Government's tax policy function this involves an improvement in its policy processes as well as the understanding of a Te Ao Māori worldview.

**Packages**

The Group has considered four illustrative packages for revenue to be recycled within the tax system. They are all predicated on a broad extension of the taxation of capital gains. If a narrower approach was taken to the extension of such taxation the packages would need to be scaled back to maintain revenue neutrality.

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The Group's view is all the potential components have merit and the Government could choose any of them or elements of them depending on its priorities. Further the options are merely possibilities within the tax system and there may be other options, such as increasing benefits or Working for Families Tax Credits that may better advance the Government's objective to reduce inequality.

In terms of the specific points you raise:

**Capital, wealth and savings**

The Group considered whether there were better approaches to understand the wealth, capital income, and effective tax rates of individuals particularly in the top decile. Our recommendations are that the Government:

a. Funds oversampling of the wealthy in existing wealth surveys.

b. Includes a question on wealth in the census.

c. Requests Inland Revenue regularly repeat its analysis of the tax paid by high wealth individuals.

d. Commissions research on using a variety of sources of data on capital income, including administrative data, to estimate the wealth of individuals.

We also considered whether a threshold would be appropriate where any capital gains on the sale of businesses were not taxed. Our view is that there should be a deferral of taxation through rollover relief where a small active business reinvests the proceeds from sale into other active business assets.

The Group also understands that many business owners fund their retirement by selling their business. Another major form of retirement savings is KiwiSaver schemes. As referenced below, if the Government were to lower the prescribed investor rates for KiwiSaver schemes to five percentage points below the savers' marginal tax rate (so the KiwiSaver tax rates would be 5.5%, 12.5% and 28%), this should be extended in some form to business owners selling their businesses to fund their retirement.

The Group recommends providing a one-off concession by extending these lower KiwiSaver tax rates to the first $500,000 of capital gains made by business owners who sell a closely held active business to retire. This measure could also potentially apply to younger business owners to the extent that the capital gain they made from selling their business is reinvested into a KiwiSaver scheme.

To promote a more balanced savings culture and deeper capital markets, the Group considered a range of possibilities to encourage low-income earners to save. Within the tax system, an illustrative set of options could include:

a. *A refund of the employer's superannuation contribution tax (ESCT).* Inland Revenue would refund ESCT for KiwiSaver members earning up to $48,000 *per annum*. The ESCT would be refunded to the taxpayer's KiwiSaver account. The refund would be progressively clawed back for employees earning more than $48,000 *per annum*, so that employees earning over $70,000 would receive no benefit. This is a modification of the capped ESCT exemption that was discussed in the *Interim Report.*

b. *Parental benefit.* A KiwiSaver member on parental leave would receive the maximum member tax credit, even if they did not make the full $1,024 of contributions.

**c.** *Member tax credit.* An increase in the member tax credit from $0.50 per $1 of contribution to $0.75 per $1 of contribution. The contribution cap would remain unchanged at $1,024.

d. *Portfolio investment entity (PIE) rate reductions.* A five percentage point reduction in the lower PIE rates for KiwiSaver funds (i.e. the 10.5% and 17.5% rates).

**Taxation of business and future of work**

The Group has investigated and recommended a number of tax measures that could enhance productivity. These include changes to the loss continuity rules, expanding deductions for 'black-hole' expenditure, and concessions for nationally significant infrastructure projects. Some or all of these measures could form part of a package of tax reform.

We have also assessed the merits of restoring building depreciation deductions. Subject to fiscal constraints, the Government could consider restoring depreciation deductions if capital gains taxation is extended.

As requested the Group has expanded its consideration of what compliance cost reductions would be beneficial. These are:

*For immediate action:*

a. Increasing the threshold for provisional tax from $2,500 to $5,000 of residual income tax.

b. Increasing the closing stock adjustment from $10,000 to $20,000-$30,000.

c. Increasing the $10,000 automatic deduction for legal fees, and a potential expansion of the automatic deduction to other types of professional fees.

d. Reducing the number of depreciation rates, and a simplification of the process for using default rates.

*Subject to fiscal constraints:*

e. Simplifying the fringe benefit tax, and simplify (or even removing) the entertainment adjustment.

f. Removing resident withholding tax on close company related party interest and dividend payments, subject to integrity concerns.

g. Removing the requirement for taxpayers to seek the Commissioner's approval to issue GST Buyer Created Tax Invoices.

h. Allowing special rate certificates and certificates of exemption to be granted retrospectively.

i. Increasing the period of validity for a certificate of exemption or special rate certificate.

j. Removing the requirement to file a change of imputation ratio notice with Inland Revenue.

k. Extending the threshold of 'cash basis person' in the financial arrangement rules, which would better allow for the current levels of personal debt.

l. Increasing the threshold for not requiring a GST change of use adjustment.

*The Government should also review and explore opportunities to:*

m. Adjust the thresholds for unexpired expenditure, and for the write-off of low value assets.

n. Help small businesses reduce compliance costs through the use of cloud-based accounting software.

o. Consider compensation for withholding agents if additional withholding tax obligations are imposed.

p. Review the taxation of non-resident employees.

q. Review whether the rules for hybrid mismatches should apply to small businesses or simple business transactions.

The Group continues to be of the view that there are a number of measures required to ensure that the tax system is able to accommodate likely changes in the future of work.

**International income tax**

The Group supports the Government's direction to officials to consider options, including an equalisation tax, for the taxation of multinationals. It recommends that the Government stand ready to implement a digital services tax if a critical mass of other countries move in that direction, and it is reasonably certain New Zealand's export industries will not be materially impacted by any retaliatory measures.

**Environmental and ecological outcomes**

The Group has designed a framework for taxing negative environmental externalities and recommends that the Government adopt it.

The Group looked at environmental and ecological outcomes from a short, medium and long term perspective. You have particularly asked about the medium and long term.

In the medium term, environmental tax revenue should be used to help fund a transition to a more sustainable, circular economy.

In the longer term, environmental taxes could extend New Zealand's tax base in a regenerative economy. This could be enabled by the consideration and design of innovative new tools like an environmental footprint tax or a natural capital enhancement tax.

**Other issues**

The Group continues to be supportive of a tax advocate service and is the view that this could be the first step in the development of a truncated disputes process for small taxpayers.

The Group supports the development of a framework for the application of corrective taxes similar to the one the Group has designed for environmental and ecological outcomes.

The Group continues to be of the view that the settings for the taxation of charities and in particular charitable business should be reviewed. This is to ensure that the tax benefits provided by the Government ultimately flow to the enhancement of the wellbeing of New Zealanders.

The Group has looked at tax depreciation for buildings in various ways. The Group considers that including seismic strengthening has merit and that there be consideration of further extension of tax depreciation for commercial and industrial buildings in light of fiscal circumstances.

**Concluding comments**

While the Group has achieved much in its time together, there is still much more to be done. Many of the recommendations require further analysis and engagement with affected and interested parties.

It is important to stress that the Government does not face a binary choice regarding whether or not to extend capital gains taxation. There is a spectrum of choices for the coverage of assets, and the inclusion of each asset class will come with its own costs and benefits.

For this reason, the Government could choose to extend the taxation of capital gains to some asset classes only. The Government also has options around how to stage the timing of introduction and whether to phase in the inclusion of asset classes.

Regardless of their position on the merits of extending the taxation of capital gains, all members agree that the introduction of a system for taxing capital gains would be a significant endeavour requiring the full attention of the Government.

If the Government decides to proceed, it is crucial that Inland Revenue is fully resourced and has the capability to develop and implement the new tax. The policy and legislative processes must also include thorough consultation with a diverse range of voices using both formal and informal channels.

The Group also notes that the Government's stated timeframes for implementing tax reform will be challenging. The Government will need to ensure additional resources are available for implementation if these timeframes are to be achieved.

If the Government decides not to extend the taxation of capital gains to all asset classes, Inland Revenue will need to fully enforce the existing capital/revenue boundary. This includes the taking of test cases, as well as giving policy and investigative attention to existing areas of concern.

Yours sincerely
Michael Cullen KNZM
**Chair, Tax Working Group**