Tax Working Group Information Release

Release Document

September 2018

taxworkingroup.govt.nz/key-documents

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TWG vision where all 4 capitals are sustainably increased. What this would look like:

- The partnership with Māori expressed in te Tiriti o Waitangi is respected and embedded in our society and culture, and Māori economic and social disadvantage has ended. [All 4 capitals]

- Our society and economy is built on a relationship with our natural environment which ensures that our use of natural resources is sustainable over our own and future generations.[Natural and social capital]

- The economy is high value, high wage, with productivity similar to other high income countries and real rewards to labour similarly comparable to those countries; productivity growth is strong and real wages and salaries grow proportionally to labour productivity; and we have employment in jobs that provide dignity, respect and liveable incomes for all who are willing and able to work. [Social, human and financial capital]

- Productive, innovative firms have access to the: capital they need to grow and develop; the markets that desire their products; and the connections to service the markets from New Zealand. [Financial, Physical capital, social capital]

- Inequality in the distribution of income and wealth for individuals and households is among the lowest in the OECD, regional inequality is reduced, and there is no income or wealth discrimination by gender or ethnicity. [Social capital]

- Democracy is thriving, shown in wide and effective participation in the decisions that affect our lives, and people have confidence in the decisions and actions of their government. [social capital]

- Long-term thinking is valued and encouraged through our institutions and culture. [social capital]

- The government has sufficient revenue to provide the public services that are supported by the electorate, are not commercially provided or are more effectively provided by government, and the transfers needed for redistribution of income. [social, human and possibly financial capital]

- People and whanau have the security in their lives that allows their children to thrive as they grow, gives them the confidence to invest in their homes, education and businesses, allows them to participate in society, helps them through personal misfortune in their lives without undue personal or economic harm, and to have a secure and adequate income in retirement. [social and human capital]

- In particular, we recognise that the transition to a better future may be difficult at times, and that change is continuous, so we have systems in place that support our people through change, ensuring that individuals and whanau do not disproportionately bear the cost of changes that will benefit society. [social capital]

Current issues facing New Zealand

- While the Māori economy valued at 50 Billion and growing, 44% of those eligible for social housing are Māori. Younger than average demographic but poorer than average educational/employment outcomes. [Human, financial and social capital]

- Natural capital severely run down. Parts of our environment are at or beyond their sustainable limits and some damage may take decades or more to recover, if it can recover at all. [insert some stats] [Natural and social capital]

- Low wage, low productivity economy with long tail of low productivity firms who don't either expand or exit. Overvalued exchange rate reflected in long term current account deficits. However high rates of employment and labour participation. [Human, social and financial capital]

- Insufficient domestic capital for innovative high productivity firms to grow and develop. [Financial, human and social capital]

- Land price inflation has brought housing to unaffordable levels and creates both deep-seated social problems and systemic risks to our financial system through our high household debt levels. There may be similar risks with some farmland. However this may support for comfortable retirements for some home owners than would otherwise be the case. [Human, social and financial capital]

- Compared to OECD higher than average income inequality (gini) but lower than average redistribution through the tax and transfer system. 75% of non-housing wealth owned by 20% of the population. [Social and human capital]

- Lack of competition in services sector [Financial and social capital]

Developing risks facing New Zealand

- Demographic – more elderly population and lower percentage in the workforce likely to put pressure on fiscal position.
- Changing nature of work – likely to make work less structured and could result in growing income disparities.
- Increasing community concern that the wealthy and the foreign owned companies are not paying enough tax aka 'their fair share'.
- Increasing globalisation of the economy – creates possibility that New Zealand becomes a branch economy with low level output and poor opportunities for New Zealanders. There seems to be a pattern of successful New Zealand start-ups being sold to overseas buyers before they reach their potential with jobs and IP then being taken out of the country. The result is a loss of IP, jobs and skills.

- IT revolution is going to have large as yet unpredictable effects. Seeing it in growth of MNEs that generate significant income from New Zealand but with little physical presence – Google, Facebook etc. Also results in less structured workplace but could also result in undermining of other structures such as corporate form.

While all the above have risks, they also represent opportunities.

- Demographic change provides more opportunities for the elderly to participate more in the economy and historically a lower percentage of the population in the workforce has been associated with higher wages.

- The changing nature of work can provide more flexibility for people in managing life/work balance.

- Globalisation and IT revolution should provide greater new opportunities. It makes it more possible to have a global MNE run from New Zealand and while globalisation may increase risks for the more vulnerable in society it can make life more exciting for many.

- Environmental challenges provide opportunities for new ways of living and new industries.

- The growth of the Maori economy provides some exciting opportunities for the next generation.

What can tax do to help?

1) First and foremost tax provides revenue to government to provide funds for:

- transfer payments (human and social capital)
- health and education (human and social capital)
- (inadequate) treaty redress (human, social, and financial capital)
- Environmental protection or clean up.(Natural and social capital)

On that basis the key objective in using the tax system to mitigate the current and developing risks on a pathway to the desired future where all four capitals have been increased is to **first do no harm** to the tax system and its ability to regularly and reliably collect revenue for government.

To me this then weakens the case for an explicit tax concessions unless the underlying behaviour change it caused is desired. For example a tax concession for saving has merit if it changes behaviour from spending to saving or from one tax preferred form of saving – owner occupier housing – to the new tax preferred method[1]. However if it simply involves moving from a tax paid form to the preferred one – not so much.

[1] At its core this is what the Andrew Coleman work seems to be saying. When one form of tax preferred saving was removed – superannuation savings – it moved to larger owner occupied housing.

An easier and more topical example involves tax credits for research and development. If more R&D is done following the credit that is a worthwhile use of the concession but if all it does is encourage existing expenditure to be reclassified as R&D this then just effectively becomes a cut in the corporate tax base with no associated benefit.

On the flip side it also means that if we were to recommend a removal of a tax benefit we will need to be comfortable about where the capital might move to if it continued to seek a tax preference. 2

2) Extending the taxation of capital

While this would improve social capital as it would reduce the options of those with wealth to minimise tax; it is an open question as to what else happens. Is existing investment unchanged and simply more tax paid? Does the removal of the tax benefit mean investment moves into different taxed sources?;or is there greater direct investment in active businesses in low tax countries or the owner occupied home?

Depending on the outcome physical and financial capital might also increase if investment moved to high productivity firms but it is also possible that natural capital is further harmed if larger family homes are built. This could be mitigated by using some/all the revenue raised to support less or reapportioned tax on retirement savings. Discussed below.

Alternatively any money raised could be targeted at investment recommended by Māori to narrow the disparities between Pakēha and Māori. This is particularly the case as Māori are younger on average than Pakēha and so disproportionately will be required support the ageing Pakēha population.

Regardless an extension of the taxation of capital income should be accompanied by a reconsideration of the treatment of capital expenses that are currently neither deductible or depreciable as this exclusion only makes sense in a world where capital gains aren't subject to tax. This would support financial and physical capital.

3) Environmental, ecological or pollution taxes in situations where taxation more useful than regulation; there are political constraints on regulation; or work in conjunction with regulation. This would have natural capital benefits as well as social capital ones as increasingly vocal section of the community that is advocating against the decline of the environment. There could be physical and financial capital costs of this as the associated asset would decline in value unless there was associated governmental support to move into less polluting activities.

Such taxes would not be part of the tax system per se as their primary objective would be behaviour change or raising targeted revenue to support targeted expenditure.

[2] For this reason maybe we have to – in absence of regulation on the size of housing and contrary to our ToR – suggest some sort of cap on the exclusion from taxation of gains from the family home.

4) implement a targeted land tax on land – other than Maori freehold land[3] - that is undeveloped and either zoned residential or close to urban areas. This would have the effect of reducing the price of this land by the NPV of the land tax and would provide an incentive to release the land for housing.

This would improve social and human capital through making housing more affordable. It could also help financial and physical capital as the consumer base had more free income and possibly over time businesses faced proportionately lower rental costs. It would however deplete natural capital as undeveloped land became developed.

5) Reduce tax advantages for closely held businesses

Treasury's narrative says that there is a long tail of low productivity firms in New Zealand that face no incentive to move up or out. While on the face of it the same tax rules apply to small firms as large firms; there are benefits from the tax system not available to shareholders of widely held firms[4]. Interest apportionment over personal and business assets as well as increased IR review of family member employment and business expenditure would be necessary to limit or offset these 'benefits'.

6) Reduce or realign the taxation of retirement savings

This could involve a move from TTE to tTE or ttt and could involve additional tax credits for Kiwisaver, spreading the PIE/top tax rate discount down the scale and/or a possible small tax (5%?) on withdrawal. Even if there were a final tax, unlike other options such a move would be revenue negative at least in the early years. Such an approach could have merit as a counterweight to the increased taxation of capital income where the owner occupied house remained untaxed.

Such tax benefits could also be specifically aligned with investment in cleaner industries if desired. This would support natural capital.

Even if such a move did cause a switching out of higher taxed savings it could still increase financial capital as the capital was locked in until retirement. If this supported higher incomes on retirement then this would improve human and social capital.

7) Traditional tax options I have not included

These include raising the rate of GST – yes a negative incentive for saving but regressive and in my view the past compensating adjustments to transfer system have been unwound. (Benefit cuts or more recently stringent administration that has made receiving all benefits extremely difficult). Harm to social capital

Cuts in the corporate tax rate. IRD analysis has not shown an increase in FDI or improvement in labour productivity through increased capital investment. Harm to social capital.

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[3] The reason for this exclusion is that Māori freehold land is held in perpetuity for the benefit of the iwi; not for economic income as a landbanker.

[4] These include the ability to structure debt as business and not personal; income split and deduct personal expenditure (home office but wider if prepared to play the audit lottery).

Tax incentives for training and development. Such costs are already tax deductible and I am nervous that any incentives will be captured through a recharacterisation of other expenditure.

Lower rate for social enterprises. This may be worth considering as part of the group's review of charitable businesses but a zero rate is currently possible if a charity.

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19 April 2018