Tax Working Group Information Release

Release Document

September 2018

taxworkingroup.govt.nz/key-documents

This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group of the Government.

After this paper was received by the Tax Working Group, an error was found in the fiscal estimates contained in this paper. This error was later corrected, and a new version of the fiscal estimate is contained in the appendix in the Secretariat paper "Tax and Housing II".

Coversheet: **RFRM and Land Taxes**

Discussion Paper for Session 11 of the Tax Working Group
June 2018

Purpose of discussion

This paper seeks the Group's views on the merits of introducing land taxes or RFRM taxes in New Zealand. The paper outlines the main features of land taxes and RFRM taxes, provides a summary assessment of their advantages and disadvantages, and compares their features to narrow and broad-based capital gains taxes.

Key points for discussion

- What does the Group see as the main advantages and disadvantages of land taxes and RFRM taxes?
- Is there are a case to consider the introduction of land taxes or RFRM taxes in New Zealand?
- Is there a need for any further analysis to inform the Group's views on land taxes or RFRM taxes?

Recommended actions

We recommend that you:

a **indicate** whether the Group wishes to pursue any further consideration of land taxes or RFRM taxes; and

b **indicate** whether any further analysis is necessary to inform the Group's views on land taxes or RFRM taxes.

RFRM and Land Taxes

Discussion Paper for Session 11
of the Tax Working Group

June 2018

Prepared by Inland Revenue and the Treasury

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Executive Summary

Purpose

This paper seeks the Group's views on the merits of introducing land taxes or RFRM taxes in New Zealand. The paper outlines the main features of land taxes and RFRM taxes, provides a summary assessment of their advantages and disadvantages, and compares their features to narrow and broad-based capital gains taxes.

Land taxes

A land tax imposes an annual tax liability on the unimproved value of land. Broad-based land taxes are highly efficient, simple to administer, and difficult to avoid. The exclusion of owner-occupied homes, however, will reduce the efficiency of the tax.

Land taxes can be criticised on horizontal equity grounds because they apply to only one type of asset. For a perfectly broad land tax, the tax will also fall entirely on the owners of land at the time of introduction, irrespective of their actual levels of net wealth. For a land tax that excludes owner-occupied housing, land prices would fall, but by less than the perfectly broad land tax, and some of the tax will be paid through higher rents for non-owner occupied uses of land.

Public submissions have exposed significant Māori opposition to land taxes. Submitters are concerned that land taxes would have a disproportionate impact on Māori and could alienate Māori from their land.

RFRM taxes

RFRM is an *ex ante* method of taxing economic income. Under RFRM, the total income generated by an asset is calculated by applying a risk-free rate to the equity held by the owner in the asset; the result is then taxed at the taxpayer's marginal rate.

RFRM can potentially be applied to any asset for which a verifiable and independent estimate of the net equity held in the asset is available each year.

RFRM may not be appropriate in cases where labour income can be bundled into the return, where there are economic rents that are not capitalised into asset prices, or where an asset is difficult to value.

Next steps

Due to timing and resourcing constraints, this paper has drawn extensively upon the previous work of the Tax Review 2001 and the 2009 Victoria University of Wellington Tax Working Group. The Group may wish to consider whether it is ready to make a decision on these issues, or whether any further analysis or information would be helpful.

1. Introduction

1.1 Purpose

1. This paper seeks the Group's views on the merits of introducing land taxes or RFRM taxes in New Zealand. The paper outlines the main features of land taxes and RFRM taxes, provides a summary assessment of their advantages and disadvantages, and compares their features to narrow and broad-based capital gains taxes.

1.2 Context

2. At the discussion on Friday 4 May, the Group commissioned detailed work on the design of a capital gains tax, for comparison against RFRM and land taxes. Due to timing and resourcing constraints, this paper provides only a high-level, conceptual assessment of land taxes and RFRM taxes. In writing the paper, the Secretariat has drawn heavily on the work of the Tax Review 2001 and the 2009 Victoria University of Wellington Tax Working Group.

1.3 Structure

3. The paper is structured as follows:

   - Chapter 2 provides a description and assessment of land taxes.
   - Chapter 3 provides a description and assessment of RFRM taxes.
   - Chapter 4 outlines some of the distributional considerations that will influence the design of these taxes.
   - Chapter 5 provides a summary assessment of land taxes and RFRM taxes against narrow and broad-based capital gains taxes.

1.4 Assessment frameworks

4. The paper assesses the efficiency, fairness, integrity, administration and compliance, coherence, and revenue impacts of the options. Efficiency impacts link directly to physical and financial capital, while fairness and integrity impacts provide an insight into impacts on social capital.

5. The paper also notes impacts on natural capital and Māori interests.

2. Land taxes

6. This chapter outlines some of the main features of a land tax, and offers a high-level assessment against the established criteria of tax policy design.

2.1 Definitions

7. A land tax imposes an annual tax liability on the unimproved value of land. A land tax therefore represents a uniform increase in taxation on landowners based on the value of their land, rather than an increase based on expected capital gains.[1]

2.2 Some key design issues

2.2.1 Coverage of assets

8. A comprehensive tax on the value of all land is sometimes advocated on the basis that it is a perfectly efficient tax. Land is in fixed supply, so a comprehensive land tax will not affect the quantity of land supplied and will not bias decisions on land use.

9. From an efficiency perspective, then, the base of a land tax should be as broad as possible. If certain types of land are exempted from the tax, or subject to lower rates, there will be an incentive for taxed landowners to convert their land to tax-favoured land types. There will also be a disincentive for tax-exempt owners to convert their land to certain uses that might actually generate higher value in the absence of the tax.

10. Notwithstanding the efficiency costs, a narrower land tax could be used to pursue other goals by favouring certain land uses over others. Examples may include taxes on unoccupied land (in order to incentivise housing development) or lower taxes on land that provides certain ecosystem services.

11. Such options are not discussed further in this paper, but the Secretariat's Discussion Paper on *Tax and the Environment* suggested a framework for deciding when to apply environmental taxes. A forthcoming Secretariat paper on *Housing Affordability* will also explore other options for promoting housing affordability through the tax system.

2.2.2 Māori interests

12. Māori interests in land are influenced by a range of values that may include manaakitanga (the care of land and of each other), whanaungatanga (wider kinship ties), and kaitiakitanga (guardianship and sustainability). Land may be the only asset held by some Māori communities. It can be important as a taonga asset to be sustained for future generations.

13. The Tax Working Group received nine submissions opposing the application of a land tax to Māori land. These submitters cited the following reasons for their opposition:

[1] Land taxes are a form of wealth taxes. Wealth taxes were discussed in the Secretariat's Background Paper on the *Taxation of Capital Income and Wealth*.

- Māori would be disproportionately affected by a land tax.

- A land tax has the potential to destroy Māori wealth and alienate Māori from their land. It will increase the cost of holding whenua in trust for future generations and cut across Māori land-owners' rangatiratanga and mana whakahaere.

- Land returned as redress from settlement was negotiated in good faith in the context of there being no land tax. A land tax would reduce the level of redress received and potentially require a revisiting of settlements.

14. There are a number of options for responding to these concerns:

- Exempting Māori freehold land altogether from the land tax.

- Applying a discount to the valuation of Māori freehold land to reflect the constraints associated with this type of land ownership.[2]

- Applying a *de minimis* threshold (based on value per hectare) to land covered by the tax, which would have the effect of excluding much – if not all – Māori freehold land due to its generally low monetary value per hectare.

2.2.3 Deductibility

15. One question to consider is whether a land tax should be deductible if it otherwise meets the 'nexus' test for determining eligibility for deduction.[3] It would be consistent with general tax policy principles for land tax payments to be deductible when the nexus test is met. Deductibility will have a negative revenue impact.

2.3 Assessment

16. For the purposes of assessment, the following analysis assumes a deductible land tax that covers all types of land, except for conservation and public land, and the land under owner-occupied homes.

2.3.1 Equity and fairness

17. Land taxes are open to criticism on horizontal equity grounds in the following respects:

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[2] Local authorities are already required to adjust the value of Māori freehold land for rating purposes, in light of the constraints imposed on the land by the Te Ture Whenua Māori Act 1993. The Valuer General has issued guidance to assist local authorities to value Mäori freehold land. The guidance suggests that valuers apply deductions of up to 10% for the number of owners, and up to 5% for sites of significance. The valuer must still consider each valuation individually, and other influences not listed in the guidance should also be considered.

[3] Under the nexus test, deductions may be granted for expenditure incurred in deriving assessable income, or in the course of carrying on a business for the purposes of deriving assessable income.

- A land tax taxes only one type of asset. It will have a disproportionate impact on certain groups and industries – such as Māori, farmers, and land-based industries – that hold a greater proportion of their wealth in land.

- A land tax will be capitalised into current land prices and paid by all current owners. Some of these owners will be wealthy, but others will not be; a land tax does not distinguish between levels of wealth. A land tax may be viewed as particularly unfair because it is not dependent on traditional measures of economic welfare (i.e. income, consumption, or wealth).

- A land tax does not account for the fact that some landowners will have purchased their land with debt. As a consequence, a land tax may leave some landowners in negative equity.

18. A land tax also raises questions of social acceptability:

    - There is strong opposition to a land tax from Māori stakeholders.

    - Asset owners will face tax obligations even if their assets generate a loss during the tax year.

    - The tax will create cash flow pressures for the owners of assets that do not generate regular streams of cash income. Some owners may even have to dispose of assets to meet their tax liabilities.

2.3.2 Efficiency

19. Land taxes are generally considered to be an efficient means to raise revenue: the supply of land is fixed and therefore unaffected by economic incentives such as taxation. The exclusion of owner-occupied homes, however, will reduce the efficiency of the tax. This is because land tenure will be able to change in response to the tax. In that case, the tax will encourage the conversion of land (including land currently used for rental housing) to owner-occupied housing.

20. The introduction – or even announcement – of a land tax will cause land values to fall. In principle, land values will fall by the net present value of the future land tax liabilities if the tax is perfectly broad. (The tax therefore constitutes a lump sum tax on those who own land at the time of implementation.) Significant falls in land value may have broader impacts on the stability of the financial system.

2.3.3 Integrity

21. It is difficult to conceal the ownership of land, so a land tax should be able to achieve a high level of revenue integrity. The exemption for the principal residence will create some integrity issues, but these will exist with any tax system that differentiates between the primary residence and other residential land.

2.3.4 Compliance and administration

22. A land tax could be operated with fairly low compliance and administration costs, at least relative to, say, a capital gains tax. Local authorities already value property for rating purposes. If local rating valuations are also to be used for the land tax, however, it will be necessary to ensure that a separate land value is calculated for all properties.

2.3.5 Coherence

23. A land tax is a new tax base. It is not a substitute for an income tax, such as a capital gains tax or an RFRM tax. It could apply in addition to those taxes if it has merit.

24. In a static sense, a broad land tax would be efficient and would impose a one-off tax on those with wealth in one particular form. But a land tax could have unsettling effects if people have no clear idea of how the rates will change in the future. It may cause people to be concerned about holding land because of the possibility of future rate rises. This could affect both social capital and efficiency. The effects on social capital and efficiency could also arise for a land tax which exempts primary residences.

2.3.6 Revenue

25. A land tax will provide the Government with a less volatile revenue stream than, say, a realisation-based capital gains tax on real property. Tax will still be collected in years when asset values fall and actual economic income is negative. From a long-term revenue perspective, land is also a desirable tax base because it is immobile.

26. In advice to the 2009 Tax Working Group, officials calculated the revenue potential of a non-deductible land tax that was levied at a 1% rate on all land (except public, conservation, and Māori authority land). The tax was estimated to generate gross revenue of $3.8 billion *per annum*. A deductible land tax was estimated to generate almost a fifth less revenue than a non-deductible land tax.

27. The amount of revenue generated will be affected by any change in land values arising from the imposition of the tax. The 2009 estimate assumed that land values would fall by 16.7% in response to the imposition of the tax; a greater fall in land values would lead to a lower amount of tax revenue.

28. These numbers should be seen in context. A land tax of 1% would raise much more revenue than a capital gains tax would raise from land only, and would be far less volatile. A lower rate is likely to be desirable if a land tax is contemplated.

29. The Secretariat can prepare updated revenue estimates if the Group wishes to explore the option of a land tax further.

3. RFRM taxes

30. This chapter outlines some of the main features of an RFRM tax, and offers a high-level assessment of the tax against the established criteria of tax policy design.

3.1 Definitions

31. RFRM is an *ex ante* method of taxing economic income. Under RFRM, the total income generated by an asset is calculated by applying a risk-free rate to the equity held by the owner in the asset; the result is then taxed at the taxpayer's marginal rate. RFRM was first suggested in the Tax Review 2001 as a means of dealing with the non-taxation of imputed income and the inconsistent treatment of capital gains.

32. The tax base under RFRM is the amount that would have been earned if the funds invested in an asset subject to the regime had instead been invested in a risk-free government bond. A real risk-free interest rate (which exempts the part of interest that is compensation for inflation) would be chosen if the aim is to do the equivalent of only taxing real economic income.

33. The income that is *actually* earned from the asset, and the expenses associated with earning that income, are both ignored for tax purposes. Thus, in relation to residential property investments, for example, rental revenue would not be taxable income – but interest, repairs, and maintenance would not be tax deductible either.

3.2 Some key design issues

3.2.1 Coverage of assets

34. RFRM can potentially be applied to any asset for which a verifiable and independent estimate of the net equity held in the asset is available each year. RFRM is unlikely to be appropriate in cases where labour income can be bundled into the return, where there are economic rents that are not capitalised into asset prices, or where an asset is difficult to value.

35. RFRM applies most cleanly to simple portfolio investments. Since the idea of an RFRM tax was first proposed, however, there has been considerable progress in addressing the areas of concern originally highlighted by the Tax Review 2001. For example, interests in listed foreign entities are now taxed by the FDR method, and domestic saving vehicles are taxed by the PIE regime, which has reduced disparities in how domestic shares were taxed to individuals and funds. The benefit of replacing these regimes with an RFRM tax is unclear; applying RFRM to interests in domestic shares is likely to be complicated because of interactions with the imputation system.

36. That leaves real property. An RFRM tax is unlikely to be attractive for commercial, industrial, or farm property. When those assets are owned by a business, the tax will face the problems that arise from the bundling of the owner's labour income and the existence of economic rents. It is likely preferable to tax these businesses on their income instead, in which case it would be unnecessarily complex to apply an RFRM tax on those classes of land if they are rented out. If gains on commercial, industrial, and farm property are seen as a hole in the tax system, a more neutral way of taxing these gains is likely to be through a tax on realised capital gains.

37. If this is the case, there is a question as to whether it would make sense to have an RFRM on residential property other than a principal residence.[4] One efficiency advantage of doing so is that it would include second homes and baches in the base. A disadvantage is that a considerable part of the income on a rental property investment may, at times, be a return on the owner's labour. An RFRM would not tax this component of income. For this reason, the Secretariat considers that the disadvantages of having an RFRM here are likely to outweigh its advantages. A tax on realised gains is likely to be preferable.

3.2.2 Treatment of inflation

38. RFRM provides a simple means to index (part of) the tax system for inflation, because a real rate of return can be used for the RFRM calculation. At present, however, the rest of the tax system is not indexed for inflation. A real rate of return would therefore create a new distortion by taxing assets within the regime more favourably than assets outside the regime. Unless the rest of the tax system is indexed for inflation, it would be preferable to use a nominal risk-free rate for the RFRM calculation.[5]

3.2.3 Māori interests

39. The Group did not receive any submissions relating to Māori interests in the design of an RFRM tax. The extent of Māori concerns about RFRM will likely depend on the type of assets covered by an RFRM tax.

3.3 Assessment

40. For the purposes of assessment, the following analysis assumes that the RFRM tax covers residential property investments only.

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[4] The Tax Review 2001 consulted on a proposal to tax owner-occupied homes on an RFRM basis, and stated that the RFRM tax should also apply to residential property investments if it applied to owner-occupied homes.

[5] The current one-year government bond rate is 1.78%, so that would be about the nominal risk-free rate.

3.3.1 Equity and fairness

41. RFRM taxes an *ex ante* conception of economic income, rather than cash income. This may not correspond closely with public perceptions of what constitutes income. The tax will also create cash flow pressure for the owners of assets that do not generate regular streams of cash income. Some owners may have to dispose of assets to meet their tax liabilities.

3.3.2 Efficiency

42. In principle, RFRM is an efficient and relatively non-distortionary tax. It does not discourage risk-taking, because only the risk-free return is taxed. It removes the tax bias towards investing in assets that produce capital gains, because it taxes a proxy of economic income, rather than applying a distinction between taxed income and untaxed capital gains. It also avoids the lock-in effect associated with a realisation-based tax, because it is calculated and applied each year.

43. One caveat is that the efficiency of the tax will be affected by whether the 'correct' value for the rate of return is used. An 'incorrect' value may result in some under- or over-taxation of the assets that are subject to the tax.

44. The Secretariat is not aware of any recent studies that attempt to quantify the housing market impacts of RFRM on residential property investments in New Zealand. However, the impacts are likely to be immaterial if the rate is set at the average nominal interest rate of the last ten years (3.5%).

3.3.3 Integrity

45. It is difficult to conceal the ownership of real property, so the tax should be able to achieve a high level of revenue integrity.

3.3.4 Compliance and administration

46. RFRM is conceptually simple. It avoids the complexities associated with defining and measuring income. Ideally, the tax should be based on an up-to-date market value of the asset, and the equity stake of the owner. There could be substantial compliance cost in doing this each year; adopting 3-yearly rating valuations could simplify the task, albeit at the cost of less accuracy.

3.3.5 Coherence

47. An RFRM tax on residential property investments will replace the existing taxation of income from residential property investments (including loss ring-fencing and the five year bright-line test).

3.3.6 Revenue

48. As with a land tax, an RFRM tax will provide the Government with a less volatile revenue stream than, say, a realisation-based capital gains tax on real property. Tax will still be collected in years when asset values fall and actual economic income is negative.

49. Revenue estimates for RFRM taxes are heavily assumptions-driven. The Secretariat has calculated the indicative revenue impacts of an RFRM tax on residential property investments:

    - An RFRM tax is estimated to have a net negative impact on forecast revenue, relative to the existing taxation of rental property, if the average nominal interest rate over the last ten years (3.5%) is used as the risk-free rate of return. Such a tax is estimated to reduce revenue by approximately $100 million *per annum*.

    - An RFRM tax on residential property investments is estimated have a net positive impact on forecast revenue if a rate of 5% is used. Such a tax is estimated to generate additional revenue of approximately $400 million *per annum*.

50. These estimates are preliminary and subject to further quality assurance.

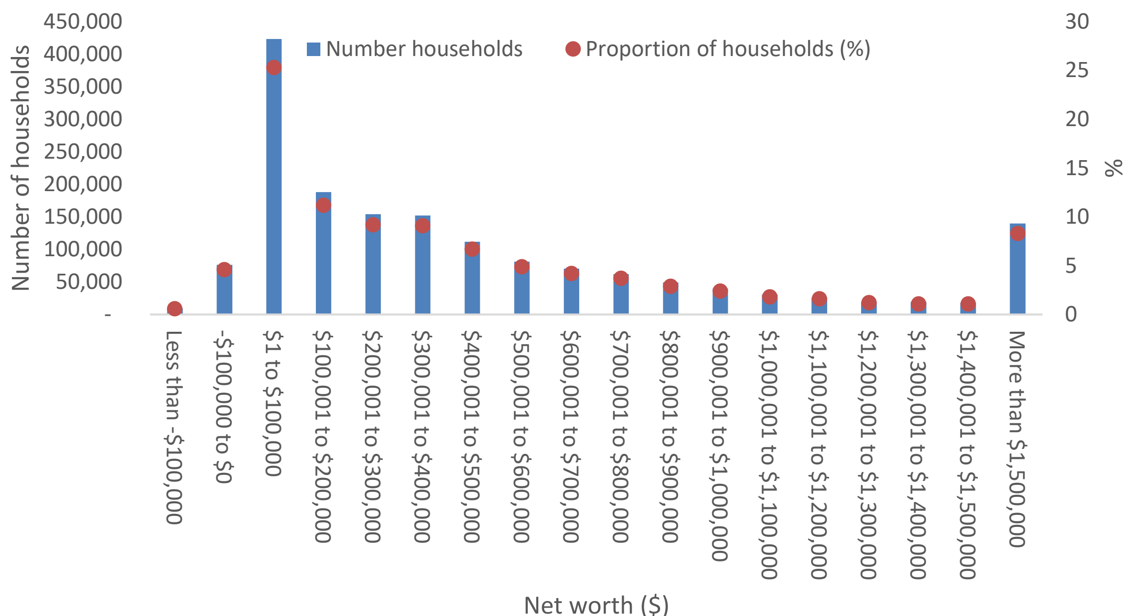
4. Distributional considerations

52. This chapter describes the distribution of wealth across New Zealand households. It draws upon material previously presented in the Secretariat's Background Paper on *Distributional Analysis*. The distribution of wealth will provide an insight into the legal incidence of the costs of taxation of particular types of assets.

53. The Secretariat has used data from the Household Economic Survey (HES) to illustrate the distribution of wealth in New Zealand. Estimates using HES are based on sample survey data and are subject to sampling and non-sampling error. Care should be taken when interpreting wealth estimates because the confidence intervals around any point estimates may be wide.[6]

54. Figure 1 illustrates the distribution of net worth across households. Household net worth is concentrated in the top twenty percent of households, which hold about seventy percent of total household net worth. Out of a total of 1.67 million households, thirty per cent of households hold net worth of less than $100,000.

Figure 1: Distribution of household net worth by net worth band, 2015

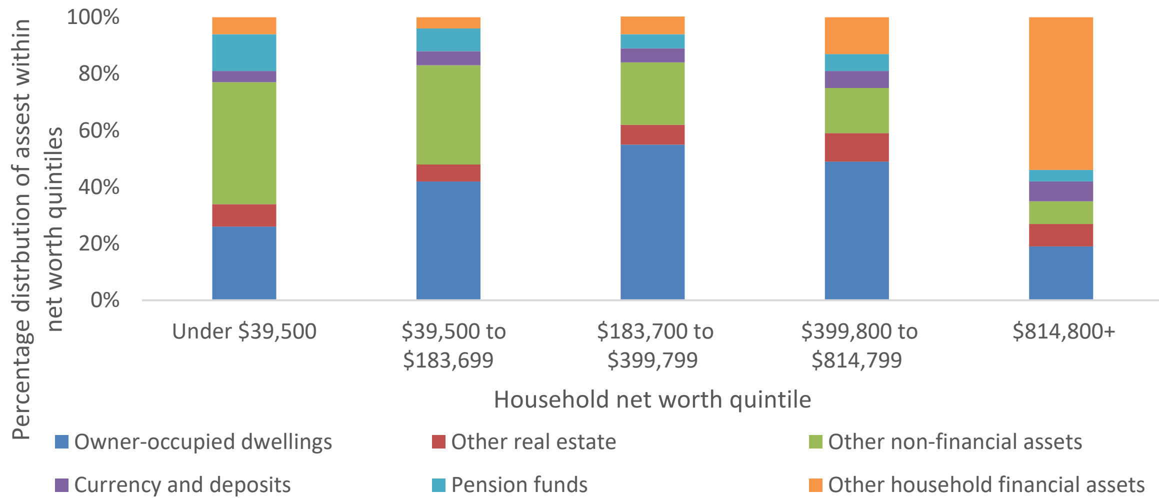


Source: Statistics New Zealand

55. Figure 2 illustrates the distribution of household assets across each net worth quintile. The composition of assets varies over the net worth distribution. Real estate is a higher proportion of assets of low and middle net worth households. The wealthiest twenty percent of households hold mostly financial assets, although this will include real property that is held in businesses and trusts.

[6] SNZ (2016) provides more information about the interpretation of wealth measures estimated from HES. Statistics New Zealand provided access to the HES data under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975.

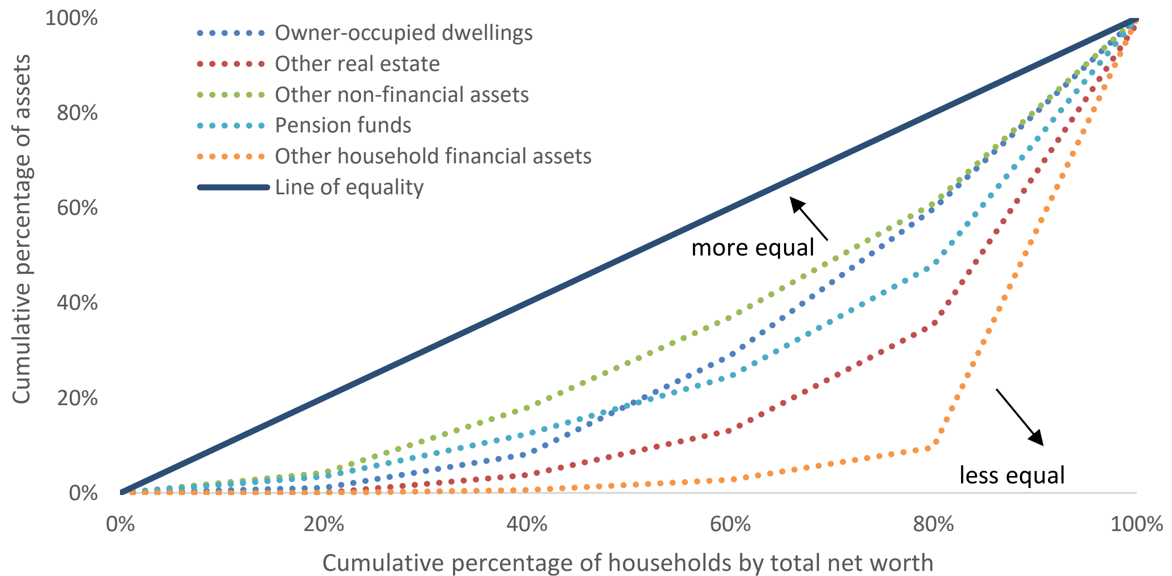
Figure 2: Distribution of household assets for each net worth quintile, 2015[7]



Source: Statistics NZ

56. Figure 3 illustrates the concentration curves for a range of assets.[8] 'Other real estate' and 'other financial assets' are the least equally distributed household assets.

Figure 3: Concentration curves for household assets, 2015



Source: The Treasury, Statistics NZ

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[7] *Other household non-financial assets* include consumer durables and valuables. *Other household financial assets* include bonds and other debt securities, equity in own unincorporated enterprises, shares and other equity, mutual funds and other investment funds, life insurance funds and annuities, and other household financial assets.

[8] A concentration curve represents the cumulative percentage of assets held by the population by level of net worth. The 45° line indicates the line of perfect equality (where 10% of the population would hold 10% of the wealth). Curves that are further away from the 45° line indicate greater inequality of the distribution.

57. Further work is necessary to form a view on the economic incidence of taxes when certain types of assets – notably owner-occupied homes – are exempt from the tax. The Secretariat has commissioned economic modelling to estimate the housing market impacts of land taxes and capital gains taxes. The economic model is currently undergoing calibration and testing. Results should be available by July.

5. Summary assessment

58. The table in this chapter provides a summary assessment of land taxes and RFRM taxes against narrow and broad-based capital gains taxes (at marginal rates).

59. The options presented in the table are indicative only. The table is intended to allow for a conceptual assessment of the relative merits of the options; the options do not necessarily represent officials' preferences for the design of any of the taxes. Nor are the options intended to pre-empt or replace the work of the Sub-Group, which is currently forming a view on the preferred design of a capital gains tax.

60. There are four indicative options:

- A broad-based land tax that applies to all land, except public and conservation land, and the land under the family home.

- An RFRM tax that applies to residential property investments.

- A narrow capital gains tax that applies to the gains from all real property, except public and conservation land, and owner-occupied homes.

- A broad-based capital gains tax that applies to a wide set of gains (e.g. all real property, except public and conservation land, and owner-occupied homes; depreciable business assets; intangible property; and domestic shares).

61. The following table provides a conceptual assessment against the established principles of tax policy design, and notes impacts on Māori interests and natural capital.

Summary Table: Initial Views on the Relative Assessment of Options

	Land tax	RFRM tax	Narrow CGT	Broad-based CGT
Coverage for purposes of analysis	- All land except: ➢ Land under the family home. ➢ Public and conservation land.	- Residential property investments.	- All real property except: ➢ Owner-occupied homes. ➢ Public and conservation land.	- All real property except: ➢ Owner-occupied homes. ➢ Public and conservation land. - Depreciable business assets. - Intangible property. - Domestic shares.
Equity and fairness				
Horizontal equity	- Targets one type of wealth.	- Depends on rate selected. Public may view it as inequitable as unrelated to *ex post* returns.	- Reduces differences in treatment of types of income and types of assets.	- Reduces differences in treatment of types of income and types of assets.
Vertical equity	- Those with greater wealth are likely to pay more tax – as will some who do *not* have much wealth, but happen to hold it in land.	- Depends on rate selected.	- Increase in progressivity.	- Largest increase in progressivity.
Risk of cash flow pressure	- Yes.	- Yes.	- No.	- No.
Māori interests	- Public submissions demonstrate strong Māori opposition to land tax.	- Few public submissions on RFRM, but strong Māori opposition to inclusion of certain types of real property is likely.	- Public submissions demonstrate strong Māori opposition to taxation of gains from certain types of real property.	
Efficiency and growth				
Distortions to investment	- The broader the base, the fewer the distortions.	- The broader the base, the fewer the distortions.	- The broader the base, the fewer the distortions.	- Minimises differences in treatment of types of income and types of assets.
Entrepreneurship / risk-taking	- Probably no impact.	- Probably no impact.	- Small, if any.	- Depends on treatment of losses.
Risk of lock-in	- No.	- No.	- Yes.	- Yes.
Housing market impacts	- Fall in land prices. Extent of fall will depend on rate of tax. - Modelling forthcoming.	- Immaterial impact if the rate is set at the average nominal interest rate of the last ten years (3.5%).	- Fall in land prices. - Modelling forthcoming.	- Fall in land prices. - Modelling forthcoming.
Integrity				
Opportunities for tax avoidance	- Low.	- Low.	- Low.	- Higher.
Compliance and administration				
Complexity of administration	- Least complex.	- Less complex.	- More complex.	- Most complex.
Compliance costs	- Lowest.	- Lower.	- Higher.	- Highest.
Revenue				
Revenue estimate	- Updated estimates not available.	- Depends on rate.	- Approximately 1.0% of GDP p.a. (after 10 years).	- Approximately 1.3% of GDP p.a. (after 10 years).
Revenue volatility	- Less volatile revenue stream.	- Less volatile revenue stream.	- More volatile revenue stream.	- More volatile revenue stream.
Living Standards considerations				
Natural capital	Generally, broad-based taxes on land or property will not affect incentives for the efficient use of that land. The exclusion of owner-occupied homes will, however, reduce efficiency.			

6. Conclusion

62. This paper seeks the Group's views on the merits of introducing land taxes or RFRM taxes in New Zealand. The paper outlines the main features of land taxes and RFRM taxes, provides a summary assessment of their advantages and disadvantages, and compares their features to narrow and broad-based capital gains taxes.

63. Due to timing and resourcing constraints, this paper has drawn extensively upon the previous work of the Tax Review 2001 and the 2009 Victoria University of Wellington Tax Working Group.

64. The Group may wish to consider whether it is ready to make a decision on these issues, or whether any further analysis or information would be helpful. To this end, the Secretariat suggests that the Group discuss the following issues at the meeting on Friday 15 June:

- What does the Group see as the main advantages and disadvantages of land taxes and RFRM taxes?
- Is there are a case to consider the introduction of land taxes or RFRM taxes in New Zealand?
- Is there a need for any further analysis to inform the Group's views on land taxes or RFRM taxes?

Glossary

Deduction. Losses or outgoings incurred in producing income or running a business that can be used to reduce taxable income.

Economic incidence. The individual or entity which bears the final burden of a tax (or receives the benefit of a transfer), after response effects, such as price and wage changes, are taken into account. This is distinct from the legal incidence of the tax or transfer.

Fair dividend rate (FDR) method. The FDR method is used to tax portfolio investment in foreign shares. FDR is a form of accrual-based taxation of income, inclusive of capital gains and dividends. Shares are generally taxed on a 5% deemed return, based on the opening value of the shares in each year. Actual dividends and sale proceeds are not taxed. However, in any given year, individuals and family trusts can pay tax on the actual return from their foreign share portfolio (including accruing gains and losses) if it is lower than the deemed return.

Horizontal equity. Horizontal equity refers to people in similar circumstances being treated in a similar way. For instance, by paying a similar amount of tax in the context of the tax system, or receiving a similar level of benefit in the transfer system.

Legal incidence. The individual or entity legally liable to pay a tax or receive a transfer bears the legal incidence of the tax or transfer. The legal incidence often differs from the economic incidence.

Māori freehold land. Māori Freehold Land is land that: has been investigated by the Māori Land Court and a freehold order has been issued; or was set aside by the Crown as Māori freehold land and awarded by Crown Grants to specific individuals; or has had its status determined as Māori Freehold Land by order of the Māori Land Court. Māori Freehold Land is held by individuals who have shares together as tenants in common.

PIEs. A portfolio investment entity (PIE) is a type of entity, such as a managed fund, that invests the contributions from investors in different types of investments. Eligible entities that elect to become a PIE will generally pay tax on investment income based on the prescribed investor rate of their investors, rather than the entity's tax rate.

Vertical equity. Vertical equity is the principle that people with low means should receive greater assistance than those with higher means, and that those with greater economic capacity should have a higher tax burden.

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