

Tax Working Group Public Submissions Information Release

Release Document

September 2018

taxworkinggroup.govt.nz/key-documents

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Dear Tax Working Group (TWG)

Personal preamble:

I'm a little bit peeved to be writing this because I am currently in Buenos Aires, it is a lovely day outside and I'm sure there is something better I could be doing with my time. However, I want to make sure these views are expressed. My submission is entirely personal and does not represent the views of The Opportunities Party nor Dr Gareth Morgan. I am pretty sure he would say similar things in terms of substance, though the tone would no doubt be a bit less polite than mine. Last time I spoke to Gareth he wasn't making a submission because he is pissed off about the Terms of Reference. I've decided to make a submission anyway, because I realise that isn't your fault.

And yes, you can contact me if you want to discuss any of the points raised.

Summary of Key Points and Recommendations

1. The future of tax is reducing the tax on labour and paying for it by increasing the taxes on capital, resources (environmental taxation) and bads (alcohol, junk food and other legalised and regulated drugs).
2. The purpose of tax is to collect the money we need to pay for a civilised society in the most *efficient and fair* way possible.
3. We aren't taxing the right things – see 1 above and 5 below.
4. Tax can make housing more affordable. However, the exemption on owner occupied housing is complete tosh.
5. What matters to me is both fairness and efficiency. We can't have both with an exemption on owner occupied housing. Instead I am suggesting a form of asset taxation with a tax free threshold high enough to exclude most Kiwi families (and therefore their homes). This tax-free threshold must also apply to Kiwisaver, and ideally include shares and bank deposits.

Submission

First up, I think we all agree that the purpose of a tax system is to gather the revenue required to pay for a civilised society;

- I. in the most efficient (least distortionary) manner possible; and
- II. in the fairest way possible – meaning people with similar means are treated equally and people with more means pay more.

Our current tax system is failing on both these counts, as [this analysis](#) shows. There is a growing gap between rich and poor, and our tax system has a massive distortion towards housing and away from productive investment. How can we solve these problems?

A Capital Gains Tax is Not the Answer

Let's get this out of the way. Simply put, a Capital Gains Tax (CGT) applied on a realised (cash rather than accrued) basis is distortionary. It discourages selling of assets in order to avoid the tax. This reduces turnover of assets, resulting in sub-optimal allocation of assets in the economy. Houses would get held on to by baby boomers even longer. Succession of family businesses would get delayed even more. This is before we even start to contemplate the distortions added by an [exemption on owner occupied housing](#). This really makes a CGT a total waste of time because it encourages all sort of gaming of the system, as Morgan Foundation found in our review of what works in [taxing wealth and property](#).

Less distortionary alternatives include a Land Tax and the Comprehensive Capital Income Tax (CCIT) as designed by the [Morgan Foundation](#) and advanced by [The Opportunities Party](#) at the last election. A Land Tax is no doubt simpler than the CCIT. However, realistically a Land Tax will result in (accurate) cries from farmers about double taxation. After all, they are already paying income tax on their profits (if they make a profit). In my view the result of this process would be a Land Tax that looks surprisingly like the CCIT.

Of course, this quickly takes us to the issue of how to deal with the exemption on owner occupied housing.

A Fair Tax System. An Efficient Tax System. An Exemption on Owner Occupied Housing. Choose Two.

First up, let's be clear: one simply can't achieve fairness and efficiency with an exemption on owner-occupied housing as per the Tax Working Group's Terms of Reference. Let's put to one side the difficulty of even applying such an exemption in reality, as I have discussed [previously](#). The central problem is that you can't have all three of these things: a fair tax system, an efficient tax system and an exemption on owner occupied housing. You have to choose two. I realise this issue is outside the Terms of Reference of the Tax Working Group (TWG) but I believe the Number One finding of the TWG should be to reiterate this point, at the very least to help educate Kiwis.

As Bernard Hickey [pointed out](#) (with the Tax Working Group's own analysis) the tax break on owner occupied housing is the largest distortion in the New Zealand tax system, both in relative and absolute terms. Much maligned 'speculators' are merely capitalising on this addiction at the fringes.

By ignoring this distortion in the tax system, it means that any money raised by a tax change has to be spent either reducing the resulting inequality or improving efficiency of the tax system. You can't do both.

Reducing inequality requires money to make the tax system more progressive, either by reducing GST or dropping the tax rates applied to lower incomes. The alternative is to reform the welfare system, which also costs money and is sadly also outside the Terms of Reference of the TWG.

Assuming the distortion on owner-occupied housing remains, improving the efficiency of the tax system could also be achieved by reducing the tax applied to other investments. This happens in some European countries, such as tax-free savings accounts or tax exemptions on [retirement savings](#). This would not improve equity one iota, because such exemptions benefit the rich most. Dr Cullen knows about all this, it is why he designed the Kiwisaver incentives the way he did; on a dollar for dollar basis up to a cap.

The trouble is that there would not be enough money from a tax reform to pay for both a fair and efficient tax system. We see this in those countries with exemptions on owner occupied housing and incentives on other forms of investing. They don't have fair tax systems, resulting in a growing gap between rich and poor. Those that act to reduce inequality generally do so through steeply progressive income tax systems which reduce inequality in income – not wealth – but also the harm the efficiency of the tax system.

A CCIT or land tax (including the family home) would remove the key distortion in the tax system, allowing the money raised to be pumped into reducing inequality. It is a win/win solution.

On a personal note, if the exemption on owner occupied housing is applied, my intention is to pour all my wealth into buying a really really big house. Maybe the one next door too, and knock through. Then I will live in it, allow my friends to live there too rent free in return for in-kind services such as maintenance, buying and cooking food, paying the electricity bills and rates. This seems like the rational way to minimise the tax bill on my wealth going forward, as well as appealing to my slightly hippy dippy tendencies toward communal living.

Managing the Politics of Taxing the Family Home

How do we manage the politics of taxing the family home or family farm? In my view the best way to do this is not by excluding the family home, but by implementing the CCIT and putting in place a tax-free threshold. The level of such a threshold is a political question, although the higher the level means less tax is gathered.

A tax free threshold is less distortionary because it is blind to which assets an individual invests in. If they want to invest their tax free assets in a lifestyle business or farm, so be it. The money need not go into the family home. To make the system truly neutral the money raised could be applied to making sure people have a similar exemption threshold on the earnings from bank accounts and shares. At the very least any earnings from investments in Kiwisaver should be included in the exemption threshold.

The average Kiwi family would probably not balk at an individual threshold of \$500,000. Aucklanders might, but we care about regional development now, right? Such a threshold might finally give people like my parents a reason to cash up and leave central Auckland, freeing up housing for people that actually work there (sorry Mum and Dad). If you really want to be politically safe, have a

personal threshold of \$1m – that would be \$2m for a couple. Most Auckland houses would still be exempt, except maybe in Epsom. Beyond that level, the CCIT would apply.

Of course, this does nothing to help the 40% of New Zealanders that have no assets at all. That is why any exemption - including the family home - is ultimately middle class welfare.

In my view it is vital that we have an efficient and fair tax system. I have only been in Argentina a matter of days but the gap between rich and poor is stark, and it seems to feed into the massive political instability the country suffers from. Attempts to reduce inequality by populist governments are usually poorly implemented and end up damaging the economy, fuelling neoliberal reforms which favour the rich (and so the cycle repeats). New Zealand must avoid this fate, and tax reform is central to doing so.

Environmental Taxation

A final thought on environmental taxation. The usual economist view is that the double dividend from environmental taxation is only possible if it can reduce distortions in the tax system. New Zealand is generally seen as having a non-distortionary tax system (apart from housing as discussed above), hence the double dividend isn't possible.

I disagree. There is a [new school of thought](#) on this which points out that any taxation on labour favours the linear economy over the circular economy. The circular economy is labour intensive, and the linear economy is capital intensive, and our current tax system incentivises people to replace labour with capital.

To incentivise people to reduce, reuse and recycle we need to shift the basis of taxation to environmental or resource taxes and use the revenue to reduce taxes on labour. This will encourage the use of labour for reusing and recycling resources.

So should we have environmental taxes? Hell yeah. If I were boss, there would be a carbon price of at least [\\$50 per tonne of CO₂](#), and a [price on water](#) for commercial users. All commercial ocean users would pay a [resource rental](#) too. All money would either go into either improving the environment or lowering the tax burden on labour.

The Golden Thread

The golden thread to all of this is the need to future proof our tax system. The economic changes starting to take place are large and rapid. Jobs are being replaced by robots and artificial intelligence. The need to retrain is increasing. Technology is not only taking the jobs from the poor, but also the middle class.

To keep up with these changes we need to shift of taxation from labour to taxing capital, environmental taxes/ resource taxes and taxing “bads” including [alcohol](#),

[junk food](#) and other [legalised drugs](#). I have not discussed the last concept in this submission but it is at least as important in terms of improving wellbeing in the long term.