Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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Submission to the Tax Working Group

20th April 2018

Submitter: Lee Short
[1]

I welcome the Government setting up a Tax Working Group to review current and future taxation revenue and its sources and thank you for the invitation to make a submission.

I would like to comment on several of the sources of taxation by separate headings.

Goods and Services Tax

New Zealand's GST is one of the simplest and most comprehensive in the world. There are two main exemptions – for financial services, and for low value imported goods. These exemptions reflect past judgements that it would be too administratively complex to include financial services and low-value imported goods in the tax.

I am opposed to any further exemptions as it is a very simple tax to collect and reflects costs on the consumer without any exemptions. It is far better to target welfare directly to those who demonstrate the need. Circumstances change and so can the targeted welfare. If there are GST exemptions then those who do not need welfare benefit when it is not required. Our simple GST system requiring very little bureaucracy, administration, and compliance monitoring, must be the envy of many other countries.

Land Tax

I oppose the introduction of a land tax as it is unfair. It taxes one component of wealth. The impact on land values would be borne only by those who are unfortunate enough to hold wealth in one particular form. Retirees, farmers would be particularly affected. Tax bases that use broader measures of wealth, income or consumption better meet social conceptions of horizontal equity.

A land tax would also be expected to cause an immediate fall in the value of land by the net present value of the future land tax liabilities (and so constitutes a lump-sum tax on those who own land at the date of its introduction). An calculation suggests that the introduction of a 1% land tax should result in a 16.7% fall in land values. But greater falls are likely if there is some ongoing real increase in land rents.

The expected fall in land values is very sensitive to the rate of tax introduced and to assumptions made in modelling. In particular, it will tend to be larger the greater is the expected real rate of growth in land rents. A deductible land tax of 1% in conjunction with a 1% annual growth in rents, a 30% marginal tax rate for investors but other assumptions modelled by Inland Revenue, produces a 26.4% drop in land values. Such falls in land values would have significant effect on existing land owners and others, such as investors and lenders. It might mean that people who currently have heavily geared land end up with negative net equity. This could in turn impact on the balance sheets of mortgage lenders, particularly banks.

It would cause cash flow issues In its simplest form, land tax would be payable on an annual basis. However, land tax does not relate to a flow of income (e.g. income tax) or a transaction (GST). Consequently, payment of land tax may give rise to cash flow issues for some landowners, particularly those who have significant land holdings but lower income levels, such as retired people.

Progressive company tax

I am opposed to the introduction of a progressive company tax. Progressive tax systems make you pay more as you earn more, and such systems punish success, which leads to undesirable consequences. For instance progressive taxes can create a disincentive to grow the business and look to relocate to more tax friendly environments. It also reduces the investment in productivity initiatives. Punishing success also has the potential to hurt innovation, since people are less likely to take risks on new ideas if the government takes larger amounts of new profits.

Growing companies are vital to the economy because they create the businesses and make the investments necessary to create jobs. Taxing companies at high rates leaves them with less cash left over to put into their businesses and other investments, so they create fewer jobs. Fewer jobs means there are fewer workers earning income that the government can collect taxes from, which ultimately reduces tax revenue. A common argument is that reducing taxes will increase hiring and economic growth, creating more income that the government can tax, which makes up for the revenue lost by lowering tax rates in the first place.

Capital gains tax

I am opposed to the introduction of a capital gains tax. Capital gains taxes reduce the return that entrepreneurs and investors receive from the sale of a business. This diminishes the reward for entrepreneurial risk-taking and reduces the number of entrepreneurs and the investors that support them. The result is lower levels of economic growth and job creation.

Capital gains are taxed on a realization basis. This means that the tax is only imposed when an investor opts to withdraw his or her investment from the market and realize the capital gain. One of the most significant economic effects is the incentive this creates for owners of capital to retain their current investments even if more profitable and productive opportunities are available. Economists refer to this result as the "lock-in" effect. Capital that is locked into suboptimal investments and not reallocated to more profitable opportunities hinders economic output.

Loss ring-fencing

I support the removal of the ability to offset investment losses against other income earnings tax. If a loss ring-fencing policy was introduced , a property investor will no longer be able to use tax losses on rental properties to offset their tax on other income. This is in my opinion one of the contributing reasons for the rapid increase in house prices over the past few years.

Multinational companies operating in New Zealand

I support the New Zealand authorities implementing a suite of measures – developed in cooperation with other OECD countries – that will further strengthen the rules for taxing income from investment and commercial activities in New Zealand. I agree that Multinational Corporations should be paying the appropriate level of tax for any commercial activity. I would

support legislation to satisfy commercial competitors and the public concerns about the tax practices of some multinational corporations, which exploit inconsistencies and mismatches in domestic tax rules in order pay little or no tax anywhere in the world.

The digital economy

The companies who derive income and profits in New Zealand from the digital economy need to pay tax on the same basis as other New Zealand based companies. Internet-based firms can trade with customers over the internet without having a physical presence here in New Zealand and can get away with paying no income tax under present rules. This issue is will become increasingly important as the digital economy accounts for a greater proportion of business activity

Maori and the tax system.

You ask How could tikanga Māori (in particular manaakitanga, whanaungatanga, and kaitiakitanga) help create a more future-focussed tax system? **Quite simply by treating them the same as all other tax paying citizens.** This is a great Segway into my next submission point.

Charitable trusts tax exemptions on commercial activities

I am opposed to the current legislation that allows charities to set up structures to achieve a lower rate of tax (or in some cases an effectively no tax) exemption for income and profits derived from commercial operations, compared to other companies carrying out similar businesses. It does not meet the test of equity and fairness:

The current legislation allowing these exemptions:

- Allows a competitive advantage to the entity in that less tax or no tax is paid.
- Provides significant cash flow advantages to the entity, so allowing a reduced cost of funding.
- Means the entity is effectively subsidised by all other tax payers, as it is able to make use of the infrastructure and other assets and benefits provided by those paying full tax.
- Allows the entity the opportunity to grow its business base, knowing the lower taxes and cost of capital can be factored in to any new business start-up or acquisition purchase price.
- Means the entity does not have to use the funds from its commercial activity and lower taxation advantage to provide charitable services for everyone in the community.
- Results in the Government having reduced taxation income and the foregone opportunity to provide services and assets for the wider community.

"[I]f a business was being taxed at a lower rate on profits that it had retained, ***[or not at all]****, it had a competitive advantage in being able to invest more money in the future. It paid a lower tax on profits,* ***had more money to invest****, and therefore was at a competitive advantage."*

- - Dr the Hon Lockwood Smith
- *Hansard* 27 February 2003
- 606:3891

A discussion on charitable organisations undertaking commercial activity would not be complete without mentioning Maori/iwi based commercial organisations. They have organised themselves under the Charities Act 2005[1] and its recognition of blood relationships, making it unique in the

[1] Charities Act 2005, (20 April 2005) No. 39.

world of charity law. Section 5 (2) Meaning of charitable purposes states that the public benefit requirement will apply in the situation where "the beneficiaries of the trust, or members of the society or institution, are related by blood." Such a provision rectified the consequences arising from *Arawa Maori Trust Board v CIR*[2] in 1961 in which Donne SM had ruled that "[t]he trust failed the public benefit test because it was for the benefit of a group of people determined by their bloodline or whakapapa,"[3] and the narrow concept of public benefit applied in *Oppenheim v Tobacco Securities Trust Co Ltd*[4] "that the beneficiaries of a charitable trust must not be linked by blood in order to satisfy the public benefit requirement."[5]

All charitable entities whether they be religious or iwi based, should be taxed equitably with all other commercial enterprises, and I am asking the Tax Working Group to recommend the removal of the competitive advantage they currently enjoy.

During the debates in Parliament in 2003 prior the Charities act legislation in 2005, members of the opposition were against such a proposal for Maori Authorities as is evident in the comments by Dr the Hon Lockwood Smith that:[6]

> *"…………this will be very divisive. It is not good for New Zealand's future. It will result in disharmony. It does confirm privilege under our tax laws, purely on the basis of race. We reject that, and I think most sensible, right-thinking New Zealanders will reject that. The Government should go back to the drawing board and remedy the problem around the taxation of Maori authorities with new legislation that does not confer privilege on the basis of race. It is morally wrong to do that."*

And the Hon David Carter was also concerned:[7]

> *"……….about the special rate that has been created for Maori organisations. It does mean that there is a competitive advantage. People in business will now have the ability, if they are a Maori authority, to pay tax at a lower rate than a business operating right next door that is carrying out exactly the same business activity."*

Thank you for the opportunity to submit on the taxation issues.

Regards

Lee Short

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[2] *Arawa Maori Trust Board v Commissioner of Inland Revenue* (1961) 10 MCD 391. See also Audrey Sharp, "The taxation treatment of charities in New Zealand with specific reference to Maori Authorities including marae" (June 2010) 16 New Zealand Journal of Taxation Law and Policy 177-216 at 182.

[3] Inland Revenue, Public Ruling BR Pub 08/02: Maori Trust Boards: Declaration of trust for charitable purposes made under section 24B of the Maori Trust Boards Act 1955 – income tax consequences (31 July 2008) at 32.

[4] [1951] AC 297; [1951] All ER 31 (HL).

[5] Sharp, above n 2, at 204.

[6] NZPD, above 27 February 2003, at 3891.

[7] NZPD, above n 27 February 2003 at 3891.