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30 April 2017

Submission to the Review on the Future of Tax

Review overview

I see taxes as collective action to fund our social goals as a community. Parliamentary democracy is how we decide how to spend our own tax revenue – with occasional public consultation. I dislike the ‘four capitals’ framework which looks society with an economist’s eye, as if it were just the sum of individual ‘investments’. I prefer a framework that starts from our values, identifies social goals and then looks for ways to fund them.

My top picks for New Zealand values are equality and love of our environment. As at 2017-18, that has put poverty and climate change at the top of the agenda. How will our tax system best fund effective policy action on these?

The present government is committed to a greener economy, action on inequality (minimum wage, pay equity negotiations, benefits review) and affordable housing. These will all require upfront expenditure, though some will also raise tax revenue and benefit the economy (and society). I feel Labour and the Greens shot themselves in the foot with the Budget Responsibility rules. However, I attended a pre-election meeting at which they promised to look at taxing wealth as well as income. I welcome that, although it will affect me personally.

In the next term of government I *expect* that there will be new and perhaps higher taxes. New Zealand needs leadership on some serious issues, and we’ll need to pay the piper.

Terms of Reference

Of the objectives set out in the Terms of Reference, two points appeal to me particularly. The first is that wealth as well as income should be treated fairly for taxation purposes. The second is our tax system should be not only efficient, fair and simple, but also *collected*. It is shocking that so many people should be prosecuted for overpayments of benefits while so few companies are prosecuted for much greater underpayments of tax.[1]

I am also concerned about money leaving the country untaxed through various brand royalty or interest loopholes manipulated by overseas companies or private equity funds. It has become a norm of global accounting for money to spiral through whatever country/ies offer opportunities to reduce tax or regulation or provide anonymity.[2] When 50% of 2Degrees can be acquired by a company created the week before and registered at an Amsterdam airport address with 760-odd others[3], something is wrong. Signing the Multilateral Convention to prevent Base Erosion and Profit Shifting is a great step forward, but I am unclear what New Zealand is doing on that as it is excluded from the Review.

[1] Marriott, L, and Sim, D, ‘Tax Evasion and Welfare Fraud: Do punishments fit the crime or the perception of the crime?’ *Pacific Accounting Review,* (2017), 29, 4, pp. 573-589; Marriott, L, ‘An Investigation of Attitudes towards Tax Evasion and Welfare Fraud in New Zealand’, *The Australian New Zealand Journal of Criminology,* (2017), 50, 1, pp. 123-145.

[2] BBC (2013) The Tax Free Tour 2013. https://topdocumentaryfilm.com

[3] Cafca, OIO Decisions, June 2017. http://www.canterbury.cyberplace.co.nz/community/CAFCA/cafca17/fi-2017-06.html

Also excluded is the interaction of the tax system with ‘transfers’, as if income support was not a major social purpose and part of the equity and fairness objective of taxation. Tax rate codes, child benefits and credits like Working for Families are as much part of the tax system as they are part of the benefit system. I agree strongly with the Background Paper at p.20 that ‘it is best to think of the tax and transfer system overall, rather than individual taxes’. Particularly given the current government’s stated aim to reduce poverty. The government also needs to reconsider the wider context of economic policy settings and labour relations deregulation over the past three decades that have increased the need for transfers and redistributive taxes.

Impact analysis by gender, ethnicity, socio-economics

I expect a Review of the tax system to analysis the impact of proposed tax strategies by gender and ethnicity as well as socio-economics. Gender budgeting, i.e. analysing fiscal policy to promote gender equality, is supported by the OECD, UN, ILO and IMF and undertaken in over 80 countries. The way forward is shown by a paper recently published by Treasury that reviewed the 2016 Tax Expenditure Statement, which lacking any gender specific analysis but included a number of expenditures with potentially negative impact on gender equality.[4] An area of major expenditure for the government over the next year or three will be the outcomes of a series of pay equity claims being negotiated across the state sector. A Tax Review Report that includes gender analysis will be relevant and timely.

It does appear likely that such an impacts analysis will be carried out with regard to Māori. The fact sheet highlights what ‘the Māori economy’ can do for the tax system. Chapter 2 of the Background Paper does also acknowledge on-going inequalities (p.11) – but sees disparities in educational, employment and income as a risk to funding superannuation (p.10), rather than as a risk to Māori themselves. I expect the Tax Review Report will suggest tax policies that might help remedy current inequalities for Māori and Pacifika communities.

Principles for assessment and fairness

- Enough revenue to fund health, education, income support and superannuation services that work for everyone.
- Everyone contributes their share at progressive rates on income, together with taxes on wealth (capital gains, inheritance, gifts).
- All companies operating in NZ pay at least 30% tax on profits, whether they are local, global or cyberspace companies.
- Review and analysis of taxation impacts by gender, ethnicity and socio-economics.
- A tax to GDP rate within the range of other OECD countries.
- Serious international action to coordinate tax rates, and prevent base erosion, profit shifting and tax havens.

[4] S. Morrissey (2018) Gender Budgeting: A useful approach for Aotearoa New Zealand. NZ Treasury Working Paper 18/02.

Taxing wealth as well as income

New Zealand has one of the oldest publicly-funded education, health and income support systems in the world. Earlier generations built our welfare state and labour policies for a more equal society. But this has been eroded over the past 40 years by two main factors:

- Unemployment, casualised employment, labour relations deregulation, falling real wages and gender pay gaps, which impact on some sectors of society more than others; [5]
- Financial speculation and wealth accumulation without taxation, which benefits some sectors of society more than others, including intergenerational benefits.[6]

I support the need to tax wealth as well as income (and other policies) to reduce inequality.. This can be done through the following three forms of tax, working together and treating all investments equally. The Terms of Reference exclude inheritance tax, but the intergenerational inequalities of wealth accumulation cannot be reduced without it.

- ***A capital gains tax on sale of assets***
  This should be at a high rate if assets are sold within 2 years, a lower rate if sold within 2-5 years, then none. Its purpose is to slow speculation (see below) but not longer term investment/ownership. It should apply to housing; land (including farms and forests); commercial property; shares and other financial assets; and other defined assets such as gold, art etc. It should exclude sales of cars and boats below, say, $100,000. It can be implemented at the time of sale via lawyers/real estate and other agents/brokers, etc.

  Housing includes owner-occupied 'family homes'. These could be taxed at a lower rate than other housing assets, especially initially. However, they should continue to attract asset tax beyond 5 years if sold for more than, say, double the median national house price. This is to prevent distortions and avoidance of asset tax ('super' houses as wealth sinks). House sale taxes will slow speculation in Auckland housing market in particular, supporting regional development goals.

  Sale means changes of ownership of the asset and also changes of ownership/major shareholding of any company holding the assets (based on information from NZX and the Overseas Investment Office). This will encourage longer term investment in the productive economy, rather than speculation by (overseas) owners of land/commercial property/ business assets.

  ***Not an annual ownership tax on assets*.** This would administratively difficult, values would be 'market' guesswork, whereas sale established a real current price. It would irritate people on an annual basis. Most people will not have the money to pay the tax until the asset is sold, anyway.

  ***No compensation for losses on asset sales*.** The government should *certainly not* pay compensation or allow a tax credit. If the value of assets goes down, that is no different from a car devaluing as it ages. The government does not compensate employees if their current job pays less than their last one. The purpose is to tax incoming money whether it is from earnings or assets.

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[5] M. Rashbrooke (ed) (2013) *Inequality: A New Zealand crisis*. BWB; S. Groot et al. (2017) *Precarity; Uncertain, insecure and unequal lives in Aotearoa NZ*. Massey. The Background Paper notes difficulty collecting income tax in the precariat economy.

[6] T. Picketty (2014) *Capital in the 21st Century.* Harvard.

- ***Inheritance tax, including on the family home*** (death duty/estate tax).
  This is a transfer of ownership similar to an asset sale. It could be at a very low rate initially, then more at progressive rates.
  Most countries have some form of inherence tax. Its purpose is to slow growing inequality through intergenerational transfer of wealth, and widen the tax base. Low and progressive rates will allow the average family to still leave the kids a house deposit. Lawyers applying for probate can be required to send information to IRD. It will provide an ongoing source of data about the distribution of wealth in New Zealand.

- ***Gift tax on money or assets***. This will need to be reintroduced to avoid assets being gifted rather than taxed as inheritance or asset sales. The rate will need to be similar.
  Gift tax was only removed in 2011 (for party political reasons, I believe, following the Brethren/BRT/racing industry electoral spending scandal). At that time it was 12% on sums over $27,000 a year. Perhaps it did not generate much revenue at that time, because it was cheaper to the kids wait till you died, or perhaps sell them assets for $1, with no tax.

I have owned, then sold a few homes over the years, and accumulated capital in this way (mainly because I paid off mortgages asap). I intend to leave my house and any remaining financial assets to younger family members. I would consider the above tax regime to be fair. Tax on both income and wealth accumulation is a fair way of funding our shared social goals, including greater equality.

Capital Gains Tax to slow speculative bubbles

Taxation can be an important tool to discourage speculation, not merely 'balance' the productive and financial economies. The Auckland housing crisis is more than a social problem or 'supply and demand'. It is a speculative bubble waiting to burst. The Global Financial Crisis was the crash of financial speculation in mortgage and other financial asset. The productive economy gives us jobs, tax revenue and export earnings or savings on imports. Speculation gives wealth to those who have it already or can borrow-and-leverage, and gives us little tax, relatively few jobs, and a financial crisis every 10 years.

The financial services sector should support the productive economy, not replace it in driving the economy. The government should support to the productive economy, and use regulation and taxation to reduce the booms and busts of speculation. Capital gains tax, on all assets including houses as suggested above, is an important way to slow speculation, and encourage long term investment in home ownership and in the productive economy.

A capital gains tax on housing would, if anything, increase the supply of houses, as developers (including non-residents and overseas investment companies) would focus on building new houses, with a price and a profit, but no capital gain to be taxed.

Capital gains on land and business assets that can be remitted offshore by overseas investors ought to attract a higher tax rate of capital gains tax. The existing OIO system and requirements can provide the information base for this, including proportion of overseas ownership. If New Zealand residents pay a higher rate of tax on foreign investments, shouldn't non-resident investors in New Zealand pay a higher rate of tax on income from shares? Do they? (There must be an 'equal treatment' argument here somewhere.)

Taxing Kiwis an annual tax on assets in New Zealand if they go overseas is a really bad idea – then they'll never come home! But if they sell their New Zealand assets, they should be liable for capital gains tax – but perhaps not at the higher rate I just suggested for non-citizens/overseas companies.

Crypto currencies may have started as an alternative to a corrupt banking system but they are now just another speculative market, subject to crashes. Crypto-capital gains should be taxed, if you can work out how. In real New Zealand dollars.

Not a land tax

I strongly support an asset tax at the time of the sale of property, rather than an annual tax on land. We already pay a form of 'land rent' to local governments[7], which are increasingly under the direction of national government, so I think there is already enough land tax.

Land tax is proposed by some as the basis of an entire alternative tax system, not an additional tax as here. Interesting, but I've seen no suggestions on how Māori land would be treated.

The Background Paper suggests a land tax 'excluding land under the family home' – how does that work for collectively-owned turangawaewae land under Māori homes? Historically, land taxes/rates have been a way of commercialising Māori land and separating them from it for Pakeha settlement. A government announcement of a land tax would be a political disaster.

Company taxes

The company tax rate should be returned from 28% to 33%. For any appearance of fairness, company tax should be at least equal to the top personal tax. Businesses benefit from state-funded infrastructure (roads, comms, legal system, educated workforce, etc.), at least as much as their employees rely on state-funded education, health care and welfare that subsidises low wages and casualisation. Businesses are then able to set their costs off against tax, and pass on most of their GST, whereas we 'end users' living on wages and salaries can't. Figure 5 of the Background Paper makes it very clear who is contributing most.

If New Zealand's company tax rate is higher than the OECD average, or even the highest, that's fine. We should not bid for the bottom, to be a temporary tax haven.

That said, progressive company rates above the personal tax rate seem worth exploring. The rates should be based on total revenue/turnover, then applied to the profit after costs. A lower rate for small companies may help them invest more in establishment and growth, whereas companies with larger turnover are past that point. Big companies or subsidiaries with small profits should be investigated, not rewarded. I expect new rules about the Base Erosion and Profit Shifting will help..

The tax system should be simple and efficient, but it should not be Inland Revenue's business to worry about 'minimising costs for business'. They have IT systems and accountants. As noted above, it is Inland Revenue's business to worry more about tax enforcement.

I very strongly support all efforts to ensure that offshore and cyberspace companies operating in New Zealand pay their fair share of taxes in New Zealand. I look forward to hearing more about Inland Revenue's work under the BEPS Convention and other international work.

[7] Historically and theoretically, charges for local government services to properties (roading, drains, rubbish) but now based on assessed capital values of land and improvements.

Finance sector must pay GST

I only recently realised that banks and other financial services get away with not paying GST like the rest of us – just because they can take fees straight out of our account instead of invoicing us? That needs fixing right now. I don't see it as at all administratively complex for IRD to require a GST payment of 15% on their turnover less costs. Unless the banks themselves devise a better way.

Low value imported goods: Collecting GST on internet purchases from overseas may be less cost-effective than asking the banks for theirs, but still possible and important. Low value imported goods is how US-based Amazon makes billions without paying GST or company tax in any other country, while undercutting their local businesses. If just asking Amazon doesn't work, there might be an IT solution for GST on low value imported good via our banks. New Zealand banks charge percentages and small fees on all overseas credit card transactions in foreign currency. IRD could require banks to add GST on small overseas transactions by New Zealand residents who are not currently out of the country. Banks could add GST automatically to all small overseas transactions unless we inform them of the dates we'll be away. Like court fines, only in reverse. Perhaps it's a question for the government's Data Integration Project.

'Nudge' behaviour or regulate?

Tax and the environment

A tax on carbon would have been more effective than the present emissions trading scheme, which was designed to fail – both here and in the EU. I regret that we didn't go for a carbon tax in 2005 as a broad base way of reducing emissions across industry and agriculture, with the proceeds perhaps ring-fenced for public transport, etc.

As currently with emissions trading, a carbon tax could still allow polluters to buy their way of the problem, not fix it. The issue is too important. The government has strong public support for action on all forms of environmental pollution. We need to back up emissions trading or tax with stricter regulation and greater investment in enforcement, and recoop costs through really hefty fines that concentrate minds.

Increases in tax on specific products may not work well to change company behaviour; they can pass them on to consumers. Tax/price increases can work to shift consumer behaviour, though, by changing the environment in which they make small decisions. Alcohol research has shown tax to be one of the most effective policies to reduce alcohol-related harm; young people and heavy drinkers are particularly sensitive to price.[8]

A ***tax on sugary drinks*** would work in a similar way[9], and could be administered in much the same way as excise tax – through the small number of drinks ***producers or importers***. The companies might like to look socially responsible, if offered a combination of sugar reduction, tax or regulation with fines. Similarly, a tax on plastic bottles and cans raising the price of drinks might discourage consumers and reduce bottle waste by, say, 10%. Or, for 100%, you could regulate the companies to

[8] Babor et al. (2005) *Alcohol: No ordinary commodity*. OUP. The other effective policies are restrictions on availability (including age) and on marketing.

[9] World Health Organization (2016) Fiscal policies for diet and the prevention of noncommunicable diseases. http://www.who.int/dietphysicalactivity/publications/fiscal-policies-diet-prevention/en/

go back to using glass/recycled glass within five years… if the global drink industries didn't have more influence and money than small governments.

No GST on fresh fruit and vegetables only

Reductions in tax/price can also influence consumer behaviour. Removing GST on locally grown fresh fruit and vegetables would have real health benefits[10], particularly among low socio-economic groups including children and young people. There should continue to be GST on packaged fruit and vegetable products (tomato sauce, frozen peas, chips).

This could work through ***retailers*** of fresh fruit and vegetables (not importing or manufacturing companies) and the existing GST system, which is built into bookkeeping software. Supermarkets and fruit and vegetable venders (only) would not be the 'end users' paying GATl. Instead, they would report the GST they pay to suppliers and receive a tax credit from IRD.

Universal superannuation, not tax perks

Taxation should not be used to subsidise individualised retirement savings or savings scheme, which compete against the tax-funded one. Those with capital or with wages high enough to save or invest should not therefore be asked to pay less tax. That would produce still greater inequality than at present, and eventually a 'poor house' pension. Our taxes now should be used to support people in their old age now – the way it has always been done in New Zealand. My father used to wax apoplectic about past individualised retirement funds that failed him (both state and private).

Collective responsibility and university entitlement for health, education and welfare services is what works. We should value and maintain the collectively-funded universal system we've got.

What undermines it at present is a low wage economy with an increasingly casualised workforce, where companies pay low taxes and global multinationals none at all - so that is what need to change. With a bit more than a nudge. Of course, funding superannuation and income support is a also matter of Budget priorities – e.g. we could avoid 20 year programmes of military spending.

Future of tax and income

National superannuation is the successful working model for a universal basic income. If we really believe that the 'gig economy' (i.e. casualisation) and the world's work done by robots is inevitable, then the government needs to include a universal basic income among its tools to prevent an ever-diminishing spiral in tax revenue.

We can't leave the future to individual savings or living in cardboard boxes.

Linda Hill

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[10] WHO (2010) The effect of fiscal policy on diet, obesity and chronic disease: a systematic review.*Bulletin* 88(8). http://www.who.int/bulletin/volumes/88/8/BLT-09-070987-table-T1.html