# Tax Working Group Public Submissions Information Release

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## September 2018

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# Submission To The Tax Working Group:

# A Submission On The Potential Use Of Land Tax In New Zealand

By Dylan Hobbs

## Key points

- Any new land tax should be revenue focused. Despite 100 years of trying there is little to suggest it is an effective tool to improve housing affordability.

- Land tax exemptions narrow the potential land tax base, add to administrative complexity, encourage avoidance and introduce economic distortions. They should be limited as much as possible.

- A land tax with exemptions will not be paid by landlords, they will pass it on to tenants. If the family home is to be exempt from land tax, residential rental property should also be exempted to prevent further biasing the tax system towards homeownership and to limit adverse consequences to renters.

- Land tax levying taxation unconnected to income can lead to cash flow problems for taxpayers. This is worse in poor economic conditions which can lead to pressure for exemptions that risk undermining the tax.

- Land subject to land tax should be revalued annually.

- A broad based land tax with a low, flat rate should be introduced. However including exemptions will likely undermine its benefits.

## Introduction

I am a PhD student at Victoria University of Wellington, presently researching my thesis on the historical use of land taxation in New Zealand from 1891-1991. Based upon my work and findings I offer the following observations and recommendations as to the potential implementation of a new land tax for New Zealand.

I am happy for the Tax Working Group and the Secretariat to contact me about this submission.

## The Purpose Of Land Tax

Historically there have been two uses for land tax in New Zealand; as a social policy tool to discourage land aggregation and speculation while improving land affordability or as a revenue instrument to raise tax revenue. While there have been attempts to achieve both, these aims are somewhat contradictory and benefit from different approaches. A social policy orientated land tax aims to discourage land holding for speculative purposes or in excessive quantities, reducing land demand and therefore lowering prices. This can take the form of broad based taxation or a targeted approach where the tax falls more heavily upon those taxpayers who own the most valuable, or greatest amounts, of land. Regardless of the chosen base, the key element is tax rates high enough to encourage behavioural changes.

This social policy focus was the main driver of New Zealand's old land tax which adopted a targeted approach through the inclusion of high tax free value thresholds and graduated rates. There is little evidence that land tax in New Zealand was ever especially effective at reducing land prices or demand however. This may have been because the base was too narrow, historically the vast majority landowners were excluded, or the tax rates were insufficient.

Following the introduction of a new land tax a small fall in the price of any liable land would be expected as future tax payments are capitalised but there is some evidence to suggest that a land tax could achieve larger falls. In 1937 and 1988 land tax was predicted to lead to prices decreases of around 25%. Both cases occurred during poor economic conditions and saw high tax rates (2-2.5%) artificially inflated through the use of land value records that predated the most recent economic crash (the Great Depression and 1987 Share Market Crash respectively). In these cases the value changes were limited to a relatively small group of properties; estates worth more than £40,000 in 1938[1] and commercial property within the Wellington CBD in 1988.[2] This suggests that a land tax could result in a large falls in land prices but the required rates are very high and changes appear limited to land liable for the tax. That means that a land tax excluding the family home would probably not have a significant effect on housing affordability, regardless of the rate.

Historically attempts have been made in New Zealand to make the land tax burden more targeted to discourage particular types of landholding. In the past this has seen the addition of 50% higher rates for absentee landholders and unimproved land in an attempt to limit foreign ownership and land banking. In neither case was this especially effective. Additional taxation for unimproved land required additional assessment by the Tax Department who lacked both resources and expertise to

[1] MacLaclan, R J, The Effect Of Graduated Land Tax On Unimproved Value, 19 January 1939, (AAVI W3486 12/270 Box 32, Archives New Zealand)

[2] Central City Land Valuation Face 25% Fall In Tax Squeeze, National Business Review, 1 December 1988

actually do it, so it was seldom assessed.[3] The absentee tax had the potential to be a useful deterrent to absentee landholding but it was vulnerable to avoidance, with trust and company structures generally used to give landholdings a nominally New Zealand based owner. If the avoidance issues could be solved an absentee tax may be a useful tool the limit landowning by non-residents.

Aside from dubious evidence of effectiveness, a social policy focused land tax as has other weaknesses, primarily that it is not a sustainable revenue source. As land tax discourages non-exempt land holding, revenue falls. Should a social policy focused land tax be successful, new taxation will be required in the future to offset the revenue loss. More targeted approaches can also be vulnerable to avoidance through ownership splitting, potentially requiring new anti-avoidance rules to deal with it, and do not align with the broad based taxation generally embodied by the New Zealand tax system.

Conversely a land tax designed to optimise revenue is generally regarded as simpler. This land tax should be broad based, with few, if any, exemptions, and a low, flat rate. This expands the tax base to include a generally untaxed capital element while producing a relatively sustainable revenue source. This generally does not impose economic distortions and should have little to no effect on existing land holding behaviour, but this means it is ineffective as a tool to improve land affordability. This approach is less vulnerable to avoidance. It is also easier to administer, reducing the strain on Inland Revenue resources that marred land tax administration throughout the 1980s. A revenue focused land tax that does not include the family home is workable, it is the approach New Zealand's last land tax took from 1983. However this collects much less revenue; it previous peaked at 1.03% of total tax revenue,[4] and has historically been criticised as not worth effort and aggravation it causes.

The previous tax working group recommended the adoption of a land tax conforming to the revenue model.[5] This is generally recognised as best practice and what New Zealand land tax was moving towards before abolition in 1990. Land tax as a social policy tool, while sounding good, is undermined by limited evidence that it works, despite 100 years of New Zealand experience with it.

**Recommendation**: Any new land tax should be introduced with a revenue focus. The preferred model would be a broad based, low rate, flat tax applying to almost all land, including family home, but the current Tax Working Group's Terms of Reference mean that option will not be considered. Nonetheless exemptions should be as restricted as possible.

## The Burden of Land Tax

The 2010 Tax Working Group raised questions as to where the burden of land tax would fall. Theoretically a pure land tax should fall on land owners who, because it applies equally to all land,

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[3] Report Upon The Provisions And Operation Of The Land And Income Tax Act 1923 And Its Amendments, 1937, page 204

[4] Chapter 25. Public Sector Finance, New Zealand Yearbook 1992

[5] A Tax System For New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group, January 2010, page 11

would be unable to pass the tax on. This sees land tax as less favourable to those who hold more of their wealth in land.

The 2010 Tax Working Group identified Maori authorities and those with landholdings but limited incomes, such as retirees, as likely to be particularly affected. An exemption for the family home would likely limit the adverse effects for retirees but is less likely to help Maori authorities. The traditional solution to this has been to exempt Maori authorities. An exemption for communally owned Maori land was included within the old land tax from 1891 and lasted the tax's entire life. This was always a matter on administrative practically and as late as 1989 attempts to remove it were stalled when Treasury was unable to figure out how doing so would work.[6] While exemption does solve the problem, an exemption based on Maori ownership can be seen as discriminatory by the public.

The inclusion of exemptions within land tax sees its burden move further beyond landowners however. Once exemptions are included the theoretical inability to pass on land tax breaks down, creating a particularly bad situation for tenants. As land tax began to apply to more property over the 1980s and owner-occupied residential housing was exempted[7] Treasury observed that land tax does not fall on landlords who generally passed it onto their tenants, either directly or through increased rents.[8] This occurred for both residential and commercial tenancies and there is nothing to suggest that it would not reoccur if a new land tax was implemented. The increased rental cost, particularly for residential tenants, risks further biasing the New Zealand tax system in favour of home ownership and penalising the poorer and younger members of society who cannot afford to own their own home. Furthermore increasing rental costs is unlikely to help alleviate the rental shortage presently being experienced in some cities.[9]

The historical solution to this problem was to expand the exemption for owner-occupied residential property to any property used for the purpose of a residential home, whether owner-occupied or tenanted.[10] Including this in any new land tax would likely reduce the harm faced by residential renters but would exempt many investment properties, undercutting any intention to use land tax to discourage land speculation.

With exemptions for land used for the family home and residential tenancies the majority of land tax would be paid by businesses. This is broadly the same as how land tax operated in New Zealand from the 1960s.[11] While the cost is generally absorbed by the businesses, in the past greater land tax bills have led to concerns that the tax would be passed on to consumers through higher prices or that that businesses may reduce operations and employment as land tax costs increase.[12] Land dependent industries such as agriculture are generally worse effected and have usually been

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[6] Treasury, Review Of Exemptions From Land Taxation, 22 June 1989 (AALR W5427 873 Box 1862, Archives New Zealand)

[7] *Land Tax Amendment Act 1983, s3*

[8] Treasury, Budget Report 137, 27 April 1988 (AALR W5427 873 Box 1861, Archives New Zealand)

[9] Stuff.co.nz, 'Massive' demand for Wellington rentals and shortage won't ease soon, Trade Me says, 19/01/2017, https://www.stuff.co.nz/business/property/100675144/rentals-in-hot-demand-and-shortage-wont-ease-anytime-soon-trade-me

[10] *Land Tax Amendment Act (No 2) 1988, s2*

[11] Taxation In New Zealand: Report of the Taxation Review Committee, Appendix to the Journals of the House of Representatives, 1967, B-18, page 413

[12] Wellington Shopkeepers Seek Land Tax Review, National Business Review, 17 March 1988; Major Recession Seen For Capital Through Land Tax, Evening Post 23/3/88

exempted. This appears to have been based on the political influence of farmers rather than policy grounds however. As farmers are operating a business they should be liable for land tax.

**Recommendation**: If an exemption for the family home must be included within the land tax it should be expanded to any home used for residential purposes.

**Recommendation**: Despite historical precedent farmers should not be land tax exempt.

## Miscellaneous Issues

One major problem with implementing a new land tax would be its sustainability. Land tax levying a cost unconnected to an income flow is not ideal and has the potential to lead to cash flow problems in the best of circumstances but can put the system under serious pressure in poor economic climates. As taxpayers' normal income streams are lessened in poor economic conditions the largely fixed expense of land tax can be difficult to pay and when this affects large groups of people it leads to political pressure for exemptions and tax relief. This was seen following economic crashes in both 1929 and 1987. The problem is worsened by the existing exemptions in the system as they set a precedent and taxpayers will argue their liability is comparatively unfair. When economic conditions improve these exemptions are not fully rolled back gradually undermining the land tax's usefulness.

**Recommendation:** Land tax exemptions should be limited to make it more likely to be politically sustainable.

Valuations used for land tax purposes need to be revalued frequently and responsive to market changes. New Zealand land tax has been historically be plagued by slow revaluations. In good times as land prices rose land values quickly became understated, reducing potential tax revenue and, following revaluations, forcing taxpayers to deal with large tax increases they were often not expecting.[13] In those times when land prices actually fall slow revaluations see taxpayers paying tax on values that no longer exist, creating significant public hostility to the towards the land tax and further increasing political pressure for exemptions and tax relief. Past experience shows that set revaluation periods are required to prevent these problems but revaluations every five or three years were not quick enough. Annual revaluations have previously been considered by governments[14] but have a higher cost and have never be implemented. Nonetheless annual revaluation is likely the best approach.

**Recommendation**: Land subject to land tax should be revalued annually.

It is worth considering the degree to which any new land tax would bind the Crown. Traditionally land owned by the government, government departments and local government has been exempt from land tax. However in 1989, as part of an attempt to align the public sector with the principles of

[13] Following the 1988 and 1989 revaluations of Wellington and Auckland many taxpayers land their land tax liability increase by more than 600% compared to the previous year

[14] Butcher, D, Press Release: Land Tax Issue Linked To Unreal Property Values, 12 May 1989 (AALR W5427 873 Box 1862, Archives New Zealand)

the *State Sector Act 1988*,[15] land tax was amended to apply to most land owned by government departments and local government. It was hoped that forcing these entities to operate under the same cost environment as the private sector would encourage efficiency, accountability and transparency.

Expanding land tax to government departments essentially acts as a budget cut. In some cases this can be politically unpopular with the public, such as the taxation of schools or hospitals,[16] while the taxation of some other land, including that used for the road system and national parks, makes little sense. Upon local government this policy would impose significant costs.[17] Accordingly the original policy created hostility from local authorities, who saw it as an exercise in central government greed,[18] and any attempts to re-implement it likely face significant opposition.

**Recommendation:** A new land tax should exempt publicly owned land

## Conclusion

The usefulness of any potential land tax depends upon what those implementing it want to achieve; if the intention is to improve housing affordability other measures are likely to be more successful but it has promise if targeted solely as a revenue source. It has the potential to raise revenue while producing little economic distortion and diversify the existing tax base.

Any land tax will stand or fall based on its exemptions however. Exemptions do not just narrow the potential land tax base, they add to administrative complexity, encourage avoidance and introduce economic distortions which cause the tax burden to move. They establish a precedent and over time they will be widened, undermining the tax's usefulness. Ideally I would recommend introducing a land tax with very few exemptions that does tax the family home but this working group is not empowered to consider that. In light of this restriction I find it more difficult to recommend a land tax. In the short term it may produce some amount of revenue but I would not be surprised if it followed historical precedent and its usefulness was eroded over time. Other tax reforms would likely have greater benefit.

[15] Treasury, Budget Report 117, 29 June 1989 (AALR W5427 873 Box 1862, Archives New Zealand)
[16] Hospitals were made liable for land taxation the 1989 budget. Public backlash was so strong that were exempted again before the year's end.
[17] Treasury, Budget Report 129, 3 July 1989 (AALR W5427 873 Box 1862, Archives New Zealand)
[18] North Shore Raps Govt On Land Tax, New Zealand Herald, 9 May 1990