

Tax Working Group Public Submissions Information Release

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Submission to the Taxation Working Group

by

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[1]

1 Introduction

I welcome the formation of the Taxation Working Group, and the opportunity to make this personal submission. The views expressed in this submission are mine and are not submitted as the policy of any political party or lobby group, although there may be some similarities.

My qualifications include holding an MBA degree, but mostly having spent a working lifetime as a taxpayer mainly in New Zealand, but also in other jurisdictions (Canada and United Kingdom). Although various numerical figures are noted in this submission, these are not the result of any quantitative analysis. Rather these are estimates based on my general understanding of the topic in NZ.

If requested I would be happy to present this submission and answer any questions in person (or via video link).

2 Purpose of the tax system

In my view the taxation system has an important role as the revenue collecting "pillar" of our society, which supports the range of services and welfare distribution that make our society decent. Since the 1980's I have observed a marked increase in inequality and decline in the cohesiveness of our society. I am seriously concerned that if this issue is not properly addressed, it will pose an existential threat to the society we aspire to. I do not gain any pleasure from the degree of selfish ruthlessness that has gained a foothold at the upper levels of our society, nor its most obvious manifestation – the extreme inequality now prevalent.

I agree with commentators (eg Robert Reich, author of "Fixing Capitalism") who suggest that the prevailing degree of inequality is deeply embedded within our economy and bureaucratic systems, and will require a comprehensive effort to reform. A comprehensive review of the tax system is an important aspect of such reform. Obviously the causes of severe societal and generational inequality is not just the tax system, but the tax system can and should play a major part in addressing it. To this end I believe that a significant reform of the principles underpinning our tax system is required, but also our welfare support system requires substantial changes.

NZ adopted a range of neo-liberal economic policies in the 1980's, which stimulated the increase in inequality we see today. This has been exacerbated by laissez faire economics in the past decade. One of the tenets of neo-liberalism was that the "trickle-down" effect would improve the fortunes of the lower strata. After more than 30 years, trickle-down has been exposed as a hoax. In my view therefore, it is time to adopt more explicit measures to reduce the inequality in our society. We ignore this at our peril: in the longer term even the selfish interests of the upper echelons of society are not served by exploiting the poor.

In addition to historic injustices, the future of work (and therefore personal income) has significant uncertainty especially to the poorer members of our society. Many commentators predict that over the coming decade, technology will cause significant disruption of employment. The outcome of this disruption is expected to be a general reduction in the total number of jobs within the manufacturing and service sectors as well as a shift to different types of work. I foresee increasing polarisation of work opportunities – to both more intellectual (eg software development) and to

more menial (eg old-aged care). There is likely to be a "hollowing-out" of middle-tier jobs, which will tend to force people towards the two extremes, and make it increasingly difficult for individuals to transition between them.

The disruption seems likely to occur within a single generation, and it is therefore likely that there will be a significant number of people stranded by their current skill set and educational attainment. This will challenge our current views of employment and employability. It does not seem possible that large numbers of, for example newly unemployed truck drivers, will be able to retrain as software developers. It is much more likely that they could retrain for new, but less fulfilling work at the more menial end of the spectrum.

One key outcome of this transition is that the current linkage between welfare support and employment will not be sustainable. It seems to me likely that there will be more people who are unable to find suitable employment. This may well combine with known demographic changes to create an impossible burden on those people who do remain employed.

Under this future scenario tax revenue will need to move away from employment income tax towards other economic activity – especially income earned as a result of speculation and non-productive investment.

I also have serious concerns for the younger generation. The baby-boomer generation of which I am a member has benefitted in the past from their parents and will also extract benefits in future from their children. It is wrong for my "boomer" generation to imagine that NZ society can sustain the heavy burden we now and will place upon it. We have comprehensively failed in our responsibility to leave the world a better place for our descendants. I think it is time we redressed the inter-generational balance.

The tax system serves many important purposes, linked to core government policies, which in turn reflect societal aspirations. In my view the tax system should operate to foster advancement of all parts of our society – not just the wealthy. The tax system can and should encourage better choices of education and investment by citizens, while generating the revenue to pay for core services and support those who, often through no fault or lack of initiative of their own, require some assistance. Ideally, the tax system should operate in a simple and straightforward manner with a minimum of compliance effort by all concerned.

3 Making income tax more progressive

The changes to tax and other fiscal policies introduced into NZ in the mid-1980's (ie Rogernomics), reinforced and compounded by successive governments (ie GST, user-charges for a range of government services, student-paid education) have had a disproportionately negative effect on the lower socio-economic strata of New Zealand.

While income tax *per se* is moderately progressive, the overall effect of other taxes (eg GST) and systemic disadvantages make the overall system much too regressive. Currently a new wave of "special purpose" taxes (eg fuel tax) are being considered, which will aggravate this situation.

In my view there are measures available that would improve progressivity of the tax regime including:

- Tax-free income allowance
- Changing the tax treatment of tertiary education fees
- Supertax on extremely high incomes

As noted in the Working Group background paper, there are proposals to reduce the regressivity of GST by introducing multiple rates of GST for different types of goods, as is done in other countries. I do not support multiple GST rates. My experience in UK suggests this creates compliance problems, and disputes at the boundaries between categories. I believe the current simplicity and near-universality of the GST regime should be retained, but other measures adopted to address the regressive nature of GST – principally a tax-free personal allowance (see below).

3.1 Tax Free Personal Allowance

One simple mechanism that would improve income tax progressivity, would be a tax free allowance, such as in UK. In the UK, the tax free allowance is currently £11,500 (NZ\$22,500pa) which is very significant compared to the median UK income of £27,200 pa. Historically, NZ had a tax-free threshold, and also personal tax rebates, but these were set at low levels with minimal impact, and understandably were simplified out of existence. A tax-free allowance of UK proportions however, would make the tax system significantly more progressive.

I suggest the NZ tax-free allowance level be set equivalent to the 25th percentile gross income. In this way lower income earners would effectively get a full refund of GST and other indirect taxes and charges. As in the UK, the tax-free allowance would apply to all individual tax payers, but this would be recovered from the upper end of the income scale by changes to the current tax-tier thresholds.

This approach would directly address the regressive nature of GST, which retaining the desirable simplicity of the current GST system.

3.2 Tax-deductible Tertiary Education

The charging of full-tuition costs to students (ironically a policy imposed by the "boomer" generation who received substantially free university education) has systematically disadvantaged the lower strata of our society – who are generally unable to afford to participate in tertiary education.

I support the aim of the current government to reduce the cost of tertiary education – in due course back to the levels prevalent in the 1970s.

To assist those former students with outstanding loan balances, I suggest that repayment of the fees portion only (ie not living allowances) of existing student loans should be deductible against post-graduate income at a rate commensurate with annual tuition fees historically incurred.

Since tertiary education is considered a "private-good", it is entirely reasonable that the investment required to acquire it be tax deductible. Unlike physical assets, the earning power of tertiary education typically depreciates very rapidly after graduation.

Allowing tax-deductibility would encourage faster repayment of student loans than the current claw-back arrangements, releasing funds for other purposes. The relevant information to administer this proposal should already be on file at IRD.

3.3 Supertax on extremely high incomes

One feature of the increasing income inequality observed over the past few decades has been the significant increase in very high incomes. Research and my own work experience suggests that personal performance alone cannot justify these very high income levels, and they are therefore undeserved. Rather, these excessive remuneration levels arise out of self-serving distortions in the salary setting process of major enterprises (including government departments). I see no moral obstacle to part of this vicarious benefit being shared with society as a whole.

I propose that a supertax be introduced at a level of 50% of gross incomes (including all kinds of remuneration or benefits) exceeding \$1M pa. The additional tax revenue gained from this measure is likely to compensate for the tax free allowance for the lower 30-percentile of income earners.

This measure may make NZ a less desirable country for individuals with excessive salary expectations, but I consider this would be to the benefit of our society in general.

4 Tax impacts on housing

Housing affordability is a significant issue for our society. There are many factors at work in housing costs; one of them is the tax treatment of housing investment. Therefore the tax system should be amended to the extent it is able to influence this issue.

It seems obvious that one of the factors contributing to our current housing situation has been the favourable tax treatment of property ownership compared to other types of investment. Although housing-ownership is a largely non-productive investment, it has perversely enjoyed tax advantages over more productive investments. I consider this imbalance highly undesirable.

I am embarrassed that the baby-boomer generation (of which I am a member) now enjoy benefits of housing investment, at significant cost to younger generations. Not only is this not sustainable in future (especially when combined with retirement pension burden), I believe it requires reversal.

The distortionary effect of the current tax regime on investment is obvious when considering the return on rental property. The financial returns are typically only about 3% - similar to bank term deposits. It is only the prospect of untaxed capital gain that incentivises the current level of investment in property, with investors/speculators benefitting vicariously from all of the various other pressures on housing. The fact that foreign investor/speculators are prepared to ignore currency risk is further testament to the perverse attractiveness of NZ housing as an investment.

The increase in the house-price-to-earnings ratio from around 3 historically to now more than 8 is a stark indicator of the degree to which my 'boomer' generation has trampled over the reasonable aspirations of younger generations. Past governments have failed to respond adequately to house-price inflation – preferring to feed the myopic illusion of increased wealth. Succeeding generations have a legitimate grievance, which their elders should address.

In my view the Government should have explicit responsibility to manage house price escalation – to ensure escalation never again reaches recent levels. The tax system is one of the main tools to achieve this, but also urban planning, immigration and other policies have a role to play.

The tax-treatment of housing investment should be changed to remove features that cause speculative pressure so that housing reverts to simply the means to achieve physical shelter. I support investment in property being subject to the same tax treatment as any other capital investment – ie tax should payable on both the cash returns and the increase in capital value over time. It seems sensible to me that the tax become due when the capital gain is realised, ie upon sale of the taxable asset. While regular property valuations could provide a basis for provisional capital gains tax, published valuations only provide a very general guide to actual selling prices.

Negative-gearing for housing investment should be disallowed as an income offset. Negative gearing indicates the basic investment is unsustainable as a profit-making enterprise, and this should be reflected in the tax treatment.

A sudden significant change in tax treatment for property will be disruptive for many, but at the same time significant disruption will be required to achieve the desirable situation where younger kiwis can again readily access housing ownership. The change in tax treatment of property should be clearly signalled, and be applicable to any purchase made after a specified date. The grandfathering of historic tax treatment should be progressively eliminated over say 10 years, but at a rate aimed to reduce severe drops in the house prices.

The most difficult problem is how to protect the modest equity of younger home-owners who have been forced to purchase in the currently hyper-inflated housing market. Obviously, driving out speculation is likely to cause a significant fall in property values, which will wipe out small equity holdings, and leave an over-priced liability to mortgagees. Policy levers aimed at addressing housing speculation should thus be operated with care.

5 Retirement savings

At present retirement benefits are paid from current tax revenue, with some support in due course from the "Cullen Fund". Due to the different populations in the age cohorts paying retirement benefits from current tax income will place a heavy burden on future tax payers. This is yet another example of the poor regard which "boomers" have for their children's generation. The contemporary beneficiary group always fall back on the justification that "we have paid taxes all our lives, and now it's our turn to be supported" – inferring a mistaken belief that there has been some historic "setting aside" for this purpose.

I believe that retirement benefits should primarily be funded out of historic savings by retirees. This could be from a combination of government and private savings. Compulsory contributions to NZ Superannuation were introduced by the Kirk government in the early 1970's, but venally reversed by Muldoon. The Cullen fund is the latter-day successor, and will ultimately bail-out the very generation who opposed Kirk's initiative.

Until a full transition can be made (it is unreasonable to expect the coming generation of taxpayers to fund both their parents' and their own pensions) I support payment of retirement pensions (but at a level much lower than currently) from current tax revenue to provide a safety net for those who require it – as part of a universal basic income.

To top-up this basic income Kiwis will need to dramatically increase their personal retirement savings which is very unlikely to occur under the current system.

The present taxation arrangements incentivise purchase of property rather than retirement savings. Perversely the tax system incentivises speculative property investment even above owner-occupied housing. In contrast there are few incentives to save cash (which can then be invested in productive assets) as part of retirement preparedness. Current poor saving performance is therefore not at all surprising.

Many people (although the proportion is rapidly shrinking) regard their investment in a home as their retirement savings pot. Many baby-boomers have also invested/speculated in additional (rental) property, which has contributed significantly to house price inflation, as investment money chases a slow-moving stock of properties which are also subject to other pressures such as population growth.

To counter-balance the tax changes noted above to property investment, I advocate greater incentives for true retirement savings. In my view NZ should adopt an EET (exempt, exempt, taxable) regime for retirement savings – similar to other jurisdictions. I suggest a pre-tax contribution limit of \$25,000 pa, up to a maximum lifetime contribution of \$750,000 (these limits

being adjusted over time). The current Kiwisaver regime could be easily modified to accommodate this. The current fairly trivial government Kiwisaver contribution of \$512pa would stop, being replaced by the tax-free contribution regime. I support the current "lock-in" that applies to Kiwisaver savings.

The EET regime operated by many other jurisdictions appears to be much better at incentivising retirement savings.

6 Environmental taxes

Along with many others I am concerned about climate change and the lack of definitive corrective action by recent governments. While a cap-and-trade regime may be the most efficient way to address climate change, the track record has been to do nothing at all.

Until a cap-and-trade framework is developed and implemented, I suggest that a simple carbon tax be introduced immediately on all NZ fossil fuel consumption. Different tax rates can be calculated for coal, fuel and diesel oils, motor spirit, avgas etc, and applied at the point of purchase. The fund thus created must be ring-fenced for climate change initiatives, in particular research into reducing the carbon footprint of NZ pastoral farming, and energy efficiency measures in the housing sector.

I am reminded of historic initiatives following the energy crises of the 1970's which provided a stimulus for alternative technology development. Clearly we need to avoid the mistakes such as massive (Think-Big) investments in white-elephant projects, and failure to follow through when short-term prospects improved. If some of the ideas of that time had been implemented then, we would have less of a climate change problem today.

7 Summary of proposals:

1. Income tax should be made much more progressive, reversing the steady regression of the past 3 decades. The main measures I propose to address this are:
 - a. Establishing a significant tax-free personal allowance (at about the 25th percentile income level), sufficient to offset GST and other costs incurred by low income earners.
 - b. Allowing tertiary tuition fees (not living allowances) to be fully deductible for income tax purposes in the first years of postgraduate employment.
 - c. Introducing a supertax of 50% on personal income (from all sources) in excess of \$1Mpa
2. GST should remain as it is currently, ie largely universal and at a single rate.
3. Tax treatment of housing investment should be brought in line with other forms of investment, to make it less attractive for speculation.
 - a. To the degree possible, tax policy on housing should aim to remove speculative pressure from investors, and prevent a repeat of recent rampant house-price escalation.
 - b. This will require introduction of a capital gains tax on residential property investment. This tax should apply to all non-occupier purchases after a specified date. Tax exemption for earlier purchases would be grandfathered, but only for say 10 years.
 - c. CGT should be payable at the time of sale rather than annual accrual – thus obviating final adjustment based on the actual selling price.
 - d. Negative gearing for housing investment should be disallowed
 - e. In the battle against speculation, the policy levers must be operated with care to preserve as much as possible the equity of recent owner-occupied home buyers.

4. Retirement benefits and funding require a major overhaul to achieve sustainability and generational equity. Over the long term, retirement benefits should be funded out of previous savings (both Government and private), rather than current tax revenue. The transition should begin with the current baby-boomer retirees, who are excessively rewarded relative to earlier or later generations.
 - a. The retirement benefit should be reduced to the same level as other state benefits.
 - b. Retirement savings should be incentivised by adopting an EET regime. I propose an annual tax-free contribution of \$25,000, up to a lifetime amount of \$750,000.
5. Although a cap-and-trade emissions policy may be economically preferable, the fact is that it has not been implemented and will be some time yet. In the interim a carbon tax of \$10/T_{CO2} should be applied to all fossil fuel use, with the resulting fund allocated to climate change initiatives, principally in the pastoral farming research and energy efficiency in the housing sector.

8 Response to on-line submission questions:

1. I believe that major changes are required, which may reach the point of being a complete overhaul. NB tax is only the revenue pillar of state activity. I believe that a complete overhaul is also required to the welfare and benefit system.
2. I consider that the purpose of tax is all of the options offered, ie to encourage better choices, encourage/discourage investment in certain types of business, and to support those who need help, as well as core services.
3. To me, the tax system is generally taxing the right things – with the notable exception of investment in residential housing. However I think the tax system is overall far too regressive.
4. I am strongly of the opinion that tax is able to contribute to housing affordability, mainly by discouraging speculation. Housing is a multi-factor problem, but tax has an important role to play in its solution.
5. Of those tax issues listed, I believe those that matter most are retirement, environment and capital gains. A tax-free personal allowance would assist in making the tax system more progressive at the low income end of the scale, and a very high earner supertax would address the very high income end of the scale.