Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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SUBMISSION TO TAX WORKING GROUP

27 APRIL 2017

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[1]

Some Important Principles To Consider

1. In this submission I set out what I consider are some important principles to consider when looking at any tax. In this submission I use “tax” in a wider sense that includes user charges for public services, unless the context suggests otherwise.

2. Specific taxes I consider and comment on are income tax, wealth tax (including land tax), goods and services tax and taxing environmental externalities. I do not comment in any detail on company or trust tax as I am not familiar with the fine details of these. However the principles I identify in this submission can be applied to the consideration of company and trust taxes.

3. I do not consider local government taxes, although it is clear that there should be a degree of integration with central government taxation and, possibly, collection.

4. I also point to an important link between the social security system and the tax system.

Principle 1 – NZ is a monetarily sovereign nation

5. The first principle is that a country such as New Zealand does not need to depend on tax income, borrowing and other income to meet its expenses.[1] The New Zealand Government can always meet its financial obligations so long as those obligations are in $NZ.

6. The reason for this is that New Zealand is a monetarily sovereign nation, with the government issuing its own currency and operating a floating exchange rate.[2] This allows the government to meet its expenses by spending money into existence.

7. The significant limit on public spending thus changes from the commonly perceived need to balance spending against income[3] to ensuring that the money supply is sufficient for the economy to operate at a full employment of resources level[4].

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1 This statement applies to central government finances. Local government, not being a currency issuer, is still subject to the need for expenditure to be balanced against income. The same need to balance income and expenditure applies to countries using the Euro.

2 This proposition is fully developed in modern monetary theory. Modern monetary theory is based how monetary relations changed after most nations went off the gold standard and adopted floating exchange rate regimes.

3 Income being, broadly, taxes, borrowing and revenue from public enterprises.

8. An implication of this principle is that the purposes of tax become:

- to control the money supply and inflation;
- income redistribution; and
- discourage “bads” and/or encourage “goods”.[5]

9. Any central revenue gathering via borrowing from private sources is not an essential funding source to fund public activities, given the intrinsic capability of the government to issue $NZ. Government borrowing can however assist with control of inflation, as it removes currency from circulation.

10. Another consequence for the Tax Working Group should consider with respect to this principle is the inconsistency with the principles of responsible fiscal management set out in section 26G of the Public Finance Act.

Principle 2 – Fairness and Simplicity

11. Most people will agree that a tax system needs to be fair and simple.

12. Our current tax system is, especially the PAYE and GST systems, simple to understand and to comply with.[6] The IRD web site helps with this simplicity. Retaining that simplicity is important to public acceptance of taxes.

13. The perception that a tax system is fair is also importance. When a tax system is not seen as fair and simple there are compliance issues.

14. There is unfairness and inconsistency in the current tax system, especially with regard to the taxing of wealth and capital gains, a trend over the past few decades of increased regressiveness in the tax system, the different treatment of interest on savings v other investments, and in the treatment of trusts and companies compared to wage earners. This is discussed further later in this submission.

Principle 3 – Tax and Social Security Need to be Integrated

15. The government operates a social security system which relies on the income tax system to provide an element of targetting.

16. Working for Families is the prime current example of this. There are issues with abatement rates for this system which I leave to other submitters to address.

17. The important point is that any review of the tax system needs to include consideration of how the tax system, especially the income tax system, can be integrated with, and help achieve the intent of, our social security system in a simple and efficient manner.

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4 Full employment as used here includes no underemployment and no structural or cyclical unemployment, but does include frictional unemployment. The full employment level for natural resources is, for renewables, the sustainable maximum rate of use. For non-renewables it has to be a minimum level of use.

5 This can include explicitly linking a tax or charge to a particular spending programme (e.g. linking a fuel tax to transport spending) to help develop public acceptance of the tax.

6 I pick up this point further under the discussion of universal v targetted taxes.

18. Further comment is made on this under the discussion on universal v targetted taxes.

19. One example of the way social and security and income tax can be better integrated arises with superannuation. Superannuation is a universal payment to all aged 65 years or more. There is no means testing, which is a strength of this system. There is targetting of people who continue earning income and receive superannuation via the current income tax bands. This is significantly more efficient and simpler, administratively, than any means testing. There is a strong case to be made, however, for a special income tax code, with a higher abatement rate, for working people receiving superannuation. This would avoid the demeaning and bureaucratic means testing for superannuation, while taking advantage of the simple and efficient income tax collection system we have, in a way that integrates tax and social security.

Principle 4 – Income and Wealth

20. As stated earlier in this submission, one of the purposes of a tax system is income redistribution. A more equitable income distribution benefits society and the economy for several reasons, including social stability, reduced social security needs, a better fed, healthier, clothed and educated work force, reduced environmental impacts, and increased spending in the economy.

21. These social benefits do not arise only from more equitable income distribution. Less concentration of wealth is also important to a functioning society. Important socially-desirable results of less concentration of wealth is increased social mobility and more secure housing.

22. Currently the tax system does not, with some specific exceptions, tax either wealth or capital gain. The disincentive this causes for investment is well recorded.

23. What is needed is a consistent and universally applying system of taxing wealth as well as income to provide the income redistribution and investment benefits identified above.

24. The current income tax system, but more progressive, will achieve these benefits with respect to income.

25. There are main avenues for address the taxing wealth – a tax on capital gains, or a tax on wealth, or a land/resource tax.

26. The assumption behind a capital gains tax is that wealth increases through income which is already taxed, and from capital gains which, by and large, are not taxed. A capital gains tax would take at least a decade to have reasonably full effect as capital gains are episodic. It also introduces a significant financial record keeping complexity to which is presently a fairly simple overall tax system.

27. An annual tax on wealth has immediate effect, and provides a strong incentive to use wealth productively. There would be an initial major exercise for all taxpayers recording the current level of taxable wealth if a wealth tax is introduced. After that initial exercise, however, the administrative overhead can be expected to greatly reduce as only the annual changes in wealth would need to be recorded.

28. A tax on wealth could also take the form of death duties, a system that has been used in New Zealand previously. This is a tax that would apply randomly, may be perceived as an unfair tax, and does not act as a constant incentive in favour of investment in the same as an annual wealth tax.

29. The simplest wealth tax to administer would be a land tax, possibly extended to apply to other selected natural resources. The infrastructure to implement such a tax already exists with our land valuation system used in local government rating systems. It is based on the assumption that a land tax, coupled with an income/company tax system, is an effective proxy for all wealth.

30. Any wealth tax will need to consider the benefits and disbenefits of a progressive wealth tax, what would be included as taxable wealth (for example should a family home be excluded? a family home below some value?), whether a land tax should be set at a different rate for extensive land uses such as pastoral faming v intensive land uses, ensuring people cannot hide behind trust or company structures, whether a wealth tax based on land should include other natural resources, and, importantly, the relationship between income/company tax and a wealth tax, and whether the introduction of a wealth tax, of whatever form, should be roughly revenue neutral when considered in conjunction with current income and goods and services and company tax.

31. A wealth tax in the form of a progressive annual land tax based on unimproved land value, that is roughly revenue neutral when considered in conjunction with income and company tax, appears to be the most efficient and fair system which would help with the income redistribution and the encouraging goods (in this case productive investment) purposes of our tax system. The progressiveness of such a land tax provides the means to address the issues of cash poor-asset rich and to provide a level of exemption for a family home. Fairness considerations would also suggest that there should be several classes of land tax, reflecting the development potential of land as provided for in the relevant district plan[7] and in order to capture betterment. The administration is simpler because of it would be based on the same information as is used for local government rates, and it would be cover all landowners, whether individuals, trusts or companies.

32. Relying solely on a land tax to address wealth inequality is based on an assumption that it would serve as an adequate proxy for all wealth. If that assumption is not supported then further wealth taxes would need to be considered.

Principle 5 – Universal v Targetted

33. In general, a universal approach to taxes is to be preferred as it makes the tax system much simpler and reduces the opportunity for loopholes to be exploited.

34. Where targetting is considered necessary, a general principle to apply is to apply the targetting at the specific stage of the payment and tax process which is administratively simpler.[8]

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7 A classification could be, for example, to set different rates for rural, urban residential (low, medium and high density), urban commercial and mixed, urban industrial, based on the type and level of development provided for in the relevant district plan.

35. This includes considering the administrative impact on the taxpayer. A system that requires means testing can be, in my experience, very stressful and demeaning for a taxpayer.

36. I have discussed means testing of superannuation payments earlier in this submission, and concluded that the administratively simpler approach to this is to apply a universal payment principle to the payment of superannuation, and to introduce a specific individual tax code to abate superannuation payments at a greater rate where there is additional income. This avoids the need for an administratively complex means testing system while taking advantage of the universal and relatively simple nature of our income tax system.

Principle 6 – Regressive v Progressive

37. The fundamental principle to apply with respect to whether to apply a regressive or a progressive tax is that there should be a strong preference for progressiveness with any tax. This is an approach that is fair, and, in so far as it assists in reducing inequality, will have a beneficial approach to all of society.

38. The main tax that is regressive is goods and services tax. Goods and services tax does have the benefit that it is paid by all.[9]

39. My submission on this tax is that the rate of goods and services tax should be reduced (to its original 10% rate) in conjunction with a new wealth tax as part of a roughly revenue neutral exercise.

40. My submission is also that income tax should be more progressive than it is now. The benefits of a progressive income tax in terms of helping reduce inequality, increase if the income tax system is made more progressive.

41. Increased progression in the income tax system could occur by reducing the tax levels for lower income earners, or by increasing the tax levels for higher income earners.

42. Attention also needs to be given to how to overcome the practice of using trust and/or company structures income liable for income tax is understated. The same income and wealth tax rates applying to trusts would remove that loophole[10].

43. Whether income and wealth taxes should apply to company revenue is a more complicated consideration, discussed in the next section of this submission.

Principle 7 – Economy v Environment – Taxing Bads

44. The economy is a social construct that can only exist within, and which depends on, the wider natural environment. However environmental costs are, by and large, an externality which has lead to significant environmental impacts, including climate change.

8 Establishing the administratively simpler system where there is a targetting intention will require considering the payment and collection components of the revenue. This may mean deciding whether it is administratively simpler to have one government department undertaking a universal payment system, and a second government department applying some sirt of progressive targetting of that income.

9 Although taxpayers can and do use a company structure to avoid paying goods and services tax on their expenditure.

10 Coupled with public beneficial owner disclosure for trusts.

45. A further role of the tax system is to put a price on that externality, to encourage a shift from environmentally damaging behaviour.

46. My submission is that a shift to taxing environmental bads is to be encouraged. It would make sense to link this to some reduction in company taxation[11], and in income tax levels for lower income people so as to provide the means to shift away from environmentally adverse behaviour.

47. More design work is required on which bads can readily be taxed, the impacts of different rates of tax, and the extent to which any 'bads' tax should be set against reduced company and/or income tax, before it is possible to comment further

48. Conclusion -- Some Suggested Tax Changes

49. In my submission I discuss tax, particularly income and wealth tax, goods and services tax and taxing 'bads' using a framework of seven principles to apply:

- New Zealand is a monetarily sovereign;
- a tax system should be fair and simple;
- tax and social security need to be integrated;
- both income and wealth should be taxed;
- universally applied taxes are to be preferred over targetted taxes in most cases;
- the tax system should be progressive, not regressive; and
- environmental 'bads' should be taxed.

50. I suggest the following specific changes be considered to the tax system:

- keep superannuation as a universal payment, any targetting should be by a specific income tax code for superannuatants;
- introduce a wealth tax based on unimproved land value, with consideration to the tax being progressive and reflecting the level of development each property has under the relevant district plan;
- make income tax more progressive, and reduce it so that the combination of a new wealth tax and goods and services tax and income tax is roughly revenue neutral;
- reduce goods and services tax back to 10%; and
- agree in principle with a taxes on environmental 'bads' with the revenue raised in from this group of taxes used to reduce income tax for lower income people and to reduce company tax.

51. I am happy to discuss this submission further if the Tax Working Group wants to do so.

<u>Andrew Riddell</u>

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11 A radical approach would be to replace company taxation with environmental and betterment taxes.