Tax Working Group Public Submissions Information Release

Release Document

September 2018

taxworkinggroup.govt.nz/key-documents

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

axiome
CONSULTANTS LTD

30 April 2018

Tax Working Group Secretariat
PO Box 3724
Wellington 6140

By email: submissions@taxworkinggroup.govt.nz

SUBMISSION

I am a chartered accountant in public practice working primarily with private clients, trustees and small business enterprises. I also advise clients on investment portfolio matters most commonly encompassing diversified PIE and FIF fund assets as an Authorised Financial Adviser.

There are several matters that one might wish to focus on in preparing a submission for the tax working group's consideration, but the matter that I feel motivated to comment on relates to the complexity of a potential for a capital gains tax (CGT) and if recommended the promised carve out for the family home. This is because I have not heard any detail in the public debate that allays my concern of distortions that the definition of 'family home' may create at the margins of a CGT.

Capital Gains Tax (CGT)

I note that New Zealand already has a range of mechanisms to tax capital appreciation in many circumstances including:

- The bright line test now capturing up to a 5-year ownership period on property
- The FDR and CV calculation of tax on FIF assets
- The accrual rules for financial arrangements
- Habitual or frequent trading in any asset

I am in principle averse to the introduction of a broadly-based CGT for the same reasons referenced in the conclusion of the Victoria University of Wellington Tax Working Group (TWG) report of January 2010.

Their conclusions expressed in chapter 4 include the following on page 67 include the excerpts below:

"…most members of the TWG are concerned about the practical challenges and efficiency implications of introducing a CGT. These issues include the lock-in effects that can result from a realised CGT and the inherent complexity of a CGT."

"A key concern with a CGT is the treatment of owner-occupied housing. If comprehensive base broadening is pursued through the introduction of a CGT, then in principle owner-occupied housing should be within the CGT base. However, the Group recognises that this is unlikely to be the case as evidenced by the exemptions which operate in other jurisdictions. Introducing a CGT that excludes owner-occupied housing would create a new bias in the tax system."

CGT and the family home…

I note that the government has already ruled out the application of any CGT to the 'family home'. If CGT continues to be advanced as a policy consideration I raise the concern of what constitutes the family home and how this can be fairly defined today.

One concern is that this policy lacks symmetry with the fact that we do not calculate income tax based on a family unit. In fact, attempts to change income tax policy to value the work of stay at home parents by permitting income splitting have been ruled out by successive governments. I am not fully aware of all the reasons that income splitting based on a family unit have been rejected historically, but the notion of ruling capital gains in or out of the tax net based on an arbitrary expression of 'family' will in my view have unintended consequences.

If CGT is advanced as a recommendation in some form, I believe the family home exemption needs to be simplified to the concept of one nominated residential property per individual adult taxpayer. This would also remove the need to link the property to where those individuals reside.

This nominated property that sits outside the CGT net should look through the legal ownership structure, be it held in individual names, joint names or in a family trust.

A range of circumstances come to mind where an individually based nominated property outside the CGT net creates a fairer and more practical working outcome than a single 'family home' concept. For example:

- A couple jointly own a primary residence and a second holiday home that has been in the family for three generations. I.e. these personal family property assets can fall outside the CGT net if one is nominated to each person.
- A couple that jointly own two residential properties, one in which they live and one rental property. Again, two people will permit nominating one property each to be held outside the CGT net, recognising and avoiding penalising the small-scale rental property investment of Mum and Dad investors.
- A family trust that owns three residential properties for the benefit of beneficiaries, where three adult beneficiaries can be nominated as having the primary non-CGT beneficial interest. With the current cost of housing relative to incomes, this is an increasing means whereby trustees assist younger generation beneficiaries into property ownership. E.g. parents might live in one property and their two adult children and grandchildren might live each of the other residences.
- A couple entering a second relationship may wish to protect their separate interests and to preserve some distinct financial security for their separate children from previous marriages. Accordingly, they enter a pre-nuptial agreement to recognise the financial stating point of the new relationship. This includes houses that served their family homes before meeting. They decide to rent their individual houses and to jointly rent a larger 5-bedroom family home to accommodate the larger blended family. Each separate property owned before entering the new relationship can continue to be recognised as the nominated residential property outside the CGT net for each partner.

- For couples partnering later in life bringing two existing properties to the relationship, but retaining them as separate property, electing to live under one roof would unequally penalise one partner's security if the CGT only recognises one house as the new family home. The adverse impact of one property failing the 'family home' test is even more unfair if the new relationship is not enduring and one partner needs to return to their previous housing asset but during the intervening period it has been caught in the CGT net.

I believe this concept of personal residential property defined on an individual basis as outside any potential CGT calculation is a valid clarification to the concept of family home. It is small scale, as it is naturally limited to one asset per individual taxpayer. Further, it maintains symmetry with the approach of basing income tax on individual income rather than family units.

In circumstances where multiple properties might feasibly be in common ownership of a family trust, the designation of different properties to individual beneficiaries is consistent with the option trustees currently have to allocate trust income to beneficiaries and for such beneficiaries to be taxed on that income rather than it being retained and taxed as trustee income.

Conclusion

I am concerned at the distortions a broadly-based CGT will introduce to the tax system and therefore am against such a CGT in principle.

However, if a CGT is advanced as a policy recommendation and If the 'family home' is not the target of a possible CGT, then I believe the refinement recommended within this submission more validly reflects the complexity today's relationships and modern family life. Otherwise tax policy will create potential distortions at the margins of the family home concept and may even be an unhelpful driving factor in relationship decisions.

Yours faithfully

[1]

Philip de Lisle
Axiome Consultants Ltd
[1]