Tax Working Group Public Submissions Information Release

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Submission to the Tax Working Group

1 Introductory Comments

The political motivation for the review of the tax system is grounded in issues of fairness, income and wealth inequality and profound problems in the New Zealand housing market.

There are indeed major issues facing New Zealand which can be enumerated as follows:

1. Wage growth has failed to keep pace with the real cost of living.

2. House prices have increased at a rate that vastly exceeds inflation and wage growth.

3. Home ownership rates are falling.

4. Increasing numbers of New Zealanders are becoming trapped in the rental accommodation market and after paying rents are unable to save for a home of their own or indeed fund reasonable quality of life objectives (such as enjoying a healthy diet, good health care or having a stable home and strong community connections).

5. There is a major imbalance between the amount of money foreign investors extract from the New Zealand economy as profits (approximately $20 billion pa) versus the amount of money New Zealanders earn from their foreign investments (approximately $5 billion pa).

6. Societal infrastructure is not receiving the level of investment needed to sustain quality outcomes in core areas such as education, health care and transport.

7. There is significant under-investment in training of doctors and teachers and many critical public sector jobs are poorly paid.

8. Increasing incidence of mental health issues is attributable in part to the increased personal pressures faced by ordinary people in an economy that is not serving the common good or the interests of ordinary people.

9. There is insufficient funding available for research & development, innovation and business development. Few start-up companies of note remain in New Zealand ownership for long.

10. The working for families program is effectively a wage subsidy for businesses operating in the face of extreme competitive pressure; potential threats of off-shoring to lower cost jurisdictions; or in low margin industries. It is unlikely to be sustainable indefinitely.

11. There is evidence of growing levels of unfunded future liabilities in the welfare system due to changing demographics and in particular with respect to superannuation funding.

12. Rates of poverty and deprivation are at absolutely unacceptable levels and we appear to be breeding the foundation for future social problems, criminality and welfare costs through our collective failure to ensure children are well-cared for.

13. Free trade agreements are no longer about free trade but have become implements of social re-engineering that are attempting to drive common standards into economies. The investor state dispute resolution provisions are of particular concern in that they provide the right for investors to sue the State in the event government policies affect investment returns. This should be seen as a blatant attempt to constrain democratic freedom and create undeserved and biased protections for a privileged class of international investors by removal of risks that would otherwise be an intrinsic part of the investment landscape.

These issues cannot be solved through changes to the tax system alone.

Indeed, some of the changes proposed to the tax system by experts and commentators will in fact be highly counterproductive to solving these issues.

The issues require solutions defined in a much broader strategic framework.

Requirement to be Forward Looking

This framework must necessarily be forward looking and include consideration of the future pressures that New Zealand will face from major disruptive factors such as:

1. Climate change related damage to low altitude infrastructure and properties; impacts on agricultural outputs; impacts on job security; disruption to business and governmental revenue streams; and consequential financial market instability.

2. Climate change adaption costs and emission reduction costs.

3. Artificial intelligence and robotic automation which it is estimated by McKinsey will eliminate 800 million jobs globally by 2030. This will affect the fabric of society in a highly negative manner by reducing personal incomes, impacting the ability of many people to care for themselves or their families, reducing income tax and disrupting markets.

The required strategic framework requires politicians to abandon blind ideological nonsense and proceed based on verifiable fact-based analysis of problems, cause and effect, risks and solutions. This constraint cuts left and cuts right across the political spectrum.

Instead of just fighting about redistributing the scraps from an under-performing economy, we need to be concentrating on creating a larger economic pie as well as ensuring that all people in our society receive a respectful and decent social dividend to sustain their lives at more than a subsistence level.

Entitlement

Wealthy people are not worthier human beings.

Furthermore, they are not wealthy in isolation.

They are wealthy because of the opportunities existing in the society in which they live, education and healthcare, stable food supplies, stable legal systems and the markets the society creates through the needs of businesses and citizens <u>and</u> the ability of businesses and citizens to buy goods and services that meet their needs.

Usually wealthy people become so with as a result of simple good luck and they could in fact be replaced by any number of other equivalently capable people who would be similarly rich given the same fortunate breaks.

It is true that <u>some</u> wealthy people have a deluded sense of entitlement as a result of becoming rich.

There may well be fewer lucky breaks available in future.

The scale of disruption to employment from artificial intelligence and robotic automation will span all levels of society and will significantly erode the basis of the traditional conservative view that poor or unemployed people have made bad life choices and are responsible for their own demise.

It's certainly true that <u>some</u> people are responsible for their predicaments or act in ways that load unconscionable burdens on the State and have a false sense of irresponsible entitlement.

However, in future many ordinary hard-working people stand to be seriously affected by job losses from artificial intelligence and robotic automation leading to the need to consider what people are entitled to receive from the society in which they live and what constitutes sufficiency at both ends of the wealth spectrum.

Capitalism and Artificial Intelligence and Robotic Automation.

It is said that the capitalist desire to eliminate labour costs through automation is unstoppable.

In the absence of regulation, companies will seek to locally optimise their business operations using artificial intelligence and robotic automation, shedding jobs and relying on other actors, especially the State, to deal with the impacts of job losses.

Job losses on a major scale will affect market demand and diminish company profits.

Countries that have lost manufacturing jobs to low cost Asian countries have on balance been spectacularly unsuccessful in creating equivalent replacement jobs. Many former manufacturing workers in the American 'rust belt states' now have multiple low paid menial jobs instead of a single job supporting a middle-class lifestyle. There is no reason at all to believe that job losses to artificial intelligence and robotic automation will play out any differently.

Governments faced with falling income tax takes will need to increase tax from other sources, including companies. Therefore, a company having invested in automation may well find its markets are diminished and face increased taxes to fund welfare income for displaced employees.

One must ask whether the combination of capitalism and artificial intelligence and robotic automation will of necessity result in strong and active socialism becoming the entrenched political norm.

Equally, one must ask whether at a societal level, where all costs must be accounted for, it makes sense to invest in artificial intelligence and robotic automation technologies that will render human beings less valuable and less employable, if not redundant in large numbers.

Would it not be better to design society to meet human needs and avoid non-productive disruptions based in the desire of company owners to achieve self-centred local optimisation of company profits?

The Government must urgently consider the full picture in respect of artificial intelligence and robotic automation and ensure that the overall interests of society are identified and represented. Businesses do not exist independently of society and have a critical role to play within society.

Exclusion

We need to understand that the consequences of excluding people from achieving good outcomes in a society are profound. Apart from the direct human impacts, we erode the basis of civil society.

When a person does not get a good education; cannot get proper health care; cannot get a job; cannot buy a house; is trapped in rental accommodation or lives in the garage; is faced with grinding poverty and a subsistence income; or when they lose these benefits; or when they are threatened with the loss of their social position or standing then they question the value of their personal social contract.

When people do not feel they belong to a properly functioning society that works for them, they retreat to partisan identities to regain their lost sense of attachment and their beliefs can be become bound to those partisan identities.

Facts and rationality become less important in forming their opinions or determining their actions which are then most strongly influenced by partisan messaging. Exclusion, diminishing opportunity, loss or the threat of loss - these are the sources of the emerging post-truth society.

Accordingly, we see lies, dishonesty, denialism and fact aversion more and more commonly in political discourse despite the ready availability of information.

We have seen National Party leaders absurdly denying the reality of climate change and denying the existence of a housing crisis.

Shaping the Debate

It is likely that the debate around tax will become a contest of rich versus poor.

However, it is imperative that the framework for addressing the issues confronting New Zealand includes economic and competitive strategies that serve the common good of New Zealanders and faces the harsh realities head on.

This means we must both look after the interests of less well-off, less skilled and disadvantaged people; we must also look after the interests of portable highly skilled people upon whose shoulders the competitive success of our country depends; and we must also become expert in creating, attracting and retaining wealth in our society for the benefit of all of our citizens.

Essential strategies must be implemented and sustained across changes in Governments and not fall victim to short-term left-versus-right policy oscillations. They require a sense of national team work.

2 Core Strategy

In a world with less work available for citizens, income tax revenues will fall.

Societal wealth and the ability of the state to provide services to its citizens will increasingly be determined by the assets the society owns and the returns derived from those assets.

Net societal wealth will also be affected by the costs imposed by external owners of assets deployed within that society.

Therefore, we need to encourage societal ownership of financial assets that provide passive incomes and appreciate in value.

We need to rapidly and dramatically increase the size of our sovereign wealth funds.

We need to encourage individuals to invest in financial assets that provide passive incomes and appreciate in value to complement this strategy.

We need to create an environment in New Zealand that is highly conducive to long term ownership of financial assets and businesses that operate domestically and globally.

We need to constrain the outflows of profits from foreign investments in our economy through a strategy of achieving predominantly domestic ownership of the majority of high quality New Zealand based assets.

We need to leverage improving life expectancy and health status to reduce superannuation costs in a compassionate manner.

We need to recognise that the world must address core problems relating to climate change and ecological stress and that the required changes are opportunities that we should embrace through research and development, commercial innovation, business development and ownership positions in emerging technologies and businesses. For example, by adopting biofuels, electric vehicles and hydrogen fuel cell vehicles, we could avoid purchasing $10b of foreign sourced fossil fuels each year.

Implications for Taxation Policy

- Introduce an additional specified-purpose progressive income tax to fund the expansion of New Zealand's sovereign wealth funds.

- Avoid the introduction of taxes that discourage ownership of financial assets by New Zealand citizens (eg wealth taxes, land taxes, capital gains taxes).

The latter step should be seen as a clear point of competitive differentiation that will attract wealth to New Zealand over the long term.

3 The Housing Market

The housing market is a market.

Markets behave as markets do - supply and demand drive pricing.

This is stating the obvious.

Let us review specific examples of Government stupidity in respect of the housing market:

- Failing to expand the Auckland Metropolitan Urban Limit in a timely manner in the face of constrained land supply and growing demand.

- Failing to implement coordinated central and local government responses to increase national housing supply following the Christchurch earthquakes and the relocation of people away from the earthquake zone.

- Failing to manage immigration numbers in line with the capacity of the building industry to create new homes.

  This has resulted in many people being priced out of their traditional market segment and cascading down to less desirable options (eg Owned Home → Rental Home → Extended Family Homes → Garages → Cars → Shelters → Streets).

- Exposing the domestic property market to international investors through foreign trade agreements without proper safeguards such as capital gains taxes or land taxes to constrain foreign speculative investment and national interest tests.

- Selling State houses when we are short of State houses.

Rather than taxing New Zealanders because the market has run away to price bubble territory as a direct result of Government mismanagement, the housing market needs to be managed as a market using market fundamentals in order to achieve worthy societal goals aligned with the common good and the needs of all New Zealanders.

Specifically, market prices (and price points within the market) need to fall to align with income levels which are linked to international labour cost structures and cannot easily be raised without jeopardising business viability.

Actions to Remedy the Housing Market

- Reduce immigration levels to better match supply and demand and vary immigration numbers upwards only in response to sustained improvement in housing market conditions.

- Distribute immigration-linked growth around New Zealand rather than allowing it to be concentrated in Auckland driving huge infrastructure costs.

- Implement a substantial social housing programme based on mass production and Government-funded bulk land purchases.

- Remove the tax deduction for rental property losses where a person has a beneficial interest in more than one rental property and phase this remaining deduction out completely after a period of time.

- There is strong anecdotal and preliminary evidence of significant offshore investment in the New Zealand property market and the likelihood of windfall profits being made.

  The Government has failed to take adequate steps to measure this issue.

  New Zealand needs to implement a strict data acquisition law that requires the legal owner of any land or property in New Zealand to register their details with the Government and to maintain this information as current at all times. Where trusts or companies are involved, then the details provide must identify ultimate shareholders or beneficiaries and define their country of residence.

- Retain current settings for income tax but vigorously enforce tax rules around 'trading for profit' ensuring that investment intent is statutorily declared when land and property is purchased.

- Consider making large scale Government land acquisitions on the perimeter of major cities before changing land zones to help provide more affordable housing to lower income people.

- Apply a citizenship test to residential property purchases.

Implications for Taxation Policy

- Implement an 80% capital gains tax on **foreign individuals and organisations** investing in the New Zealand property market. A punitive rate should be defined to send a clear message that foreign speculation will not be tolerated.

- Implement a 1% annual property value tax on all **foreign individuals and organisations** owning land or property in New Zealand.

4 Issues with Capital Gains Taxes

Various pundits are in favour of implementing a capital gains tax with exceptions for the family home and perhaps the land that it sits upon but not the other land in the property title.

Computation

Even without the complexities in the ideas floated in the introductory comment above, the manner in which CGT is computed is intrinsically problematic.

To be precise it should reflect:

- Purchase cost
- Interest costs
- Maintenance costs
- Insurance costs
- Repair costs
- Improvement costs
- Rates
- Inflation
- Sales Price

and appropriately reflect net present values of prior investments.

To maintain accounting records to capture such data and maintain it over an extended period of time is a serious if not impossible burden.

Simplistic workarounds such as setting arbitrary CGT rates of say 15% fail to recognise the underlying commercial reality and will inevitably lead to injustices.

Lossless Conversion Between Asset Classes

In a dynamic and responsive economy based on lightly capitalised small businesses, people need to be able convert an asset from one asset class to another without incurring ‘transactional losses’ arising from capital gains taxes.

For example, a person having created a business should be able to sell that business without incurring a capital gains tax liability and be entitled to the full value of that asset either for their enjoyment or to reinvest in their next venture.

Asymmetry

Capital gains taxes are implicitly asymmetric.

Liabilities are incurred and must be paid when asset values increase and the increase is realised.

However, Governments never actually pay capital gains tax credits to tax payers when asset values decline and losses are realised. All one will get is a credit to offset future liabilities, which may or may not arise.

The cyclic nature of some markets means that Governments may make repeated tax gains from the cyclic upswings in the value of the same asset (depending on the timing of sale & purchase transactions).

Capital Gains Taxes Are Selective

Capital gains taxes focus on the gains people might make but studiously ignore the costs people incur through the depreciation of assets such as home appliances, vehicles and indeed older houses as they reach their end of working life (eg 50-60 years).

Capital Gains Taxes & Housing Markets

There is no evidence that **domestic** capital gains taxes prevent house price bubbles.

Indeed, the exemption of residential property from most capital gains regimes distorts asset values as people pursue profits from the exempted asset classes.

5 Changing Our Mindset

Foreign Investment

Foreign investment is in general bad for our country.

It nearly always results in greater outflow of funds than inflow – otherwise the foreign investor would not bother making the investment.

The alleged benefits foreign investment brings are seldom uniquely associated with foreign ownership. Kiwis are excellent at running companies. Kiwis can take our products to foreign markets. Every technology is a commodity or soon will be. Every business model will soon be improved upon.

Virtually every Kiwi business that falls into foreign ownership is run leaner, offshores manufacturing, loses autonomy and is optimised to serve the best interests of its foreign owners by maximising exported profits. The banking industry is a classic example of an offshore profit pump.

We have allowed our share market to be hollowed out though companies being bought and delisted. Then we complain when local investors turn to the property market in an effort to secure their future.

Around fifty percent of the New Zealand share market is owned by offshore interests.

This means fifty percent of listed company profits are exported to fund other countries' future success not ours.

End Free Trade Agreement Over Reach

There is no good reason that our country should give a damn about the 'rights' of freedom-hating Chinese communist party acolytes to make money from investments in New Zealand.

The free trade agreement with China gives a Chinese communist the right to sue the New Zealand Government if we damage their returns on property investments they have made in New Zealand.

However, a New Zealander cannot even buy a property in China.

One must seriously question the negotiating skills of the New Zealand Government.

It is time to address such asymmetries in free trade agreements.

Furthermore, it is time to work to limit the scope of scope of free trade agreements to trade in goods and services and to reject their incursions into our ability to govern independently or run independent sovereign strategies that serve the common good interests of New Zealand.

Play Economic Hardball

We need to play economic hard ball just like countries such as China, Japan and America already do.

New Zealand is a tiny economy by comparison.

We genuinely need to run unique strategies to prevent businesses in our economy being subsumed as 'minor branch offices' exporting profits to foreign companies.

We need to remember that our exports are of increasing value in a growing world busy trying to feed itself. We must not under-estimate the value of what we have to offer by making concessions we do not need to offer or by accepting bad deals that have no basis in fairness (eg you cannot buy our real estate but we need to be able to plunder and pillage your real estate market).

For example, a hungry China will quickly revolt and the Communists know that. They should therefore pay top dollar for the privilege of buying our high quality food.

The Chinese already dominate global manufacturing and they should not be permitted to buy up our remaining productive assets and extract profits from our few remaining sources of potential wealth. We should not be afraid to tell them why we do wish to be dominated by their country with its offensive internal politics and freshly minted dictator.

Visions of Alternative Outcomes

There is at least a $15 billion per annum net deficit in our investment returns with the rest of the world.

Over 60 years this is worth a nominal $900 billion dollars – and likely far more than we received when we sold off the related companies and assets to foreigners.

In the current environment, we have to earn that money as a country or become poorer.

Imagine how different the New Zealand Government accounts would be if instead our sovereign wealth funds generated a steady 5-8% return on $900 billion dollars.

It might take two, three or four generations of work by New Zealanders to achieve such a change in our net financial position but we need to make a start and sustain the effort.

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