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Richard Moore
[1]

30 April 2018

Submission to the Tax Working Group

"Future of Tax"

To the members of the Tax Working Group:

This submission is regarding the "Future of Tax" and the items set out in the "Submissions Background paper" dated March 2018, as well the spreadsheet and charts also published by the Tax Working Group which supplement the Submission Background Paper.

The issues paper covers a very large range of matters and this submission is necessarily extremely brief in comparison. Many of the issues raised have both causes and effects far beyond NZ tax system.

This submission approaches the background paper in the following order: 1) specific observations regarding the whole issues paper and tax system: 2) Answering appendix two); 3) Answering appendix three including chapter seven, and additional comments; 4) commenting on the extraordinary omission in Fig 21.

Firstly, some "big-picture" commentary regarding the background paper:

- I am strongly opposed to tax which people may not have some approximation of cash income to be able to pay with: for instance, land taxes above extremely minimal levels (IE substantially less than current land rates) and taxes on unrealised capital gains. Both such taxes are unfair by common principles and also highly regressive in that they force capital assets into the hands of those who are already cash-rich.
- I am opposed to the income tax system attempting to modify behaviour. I specifically refer to income tax because I am in favour of "excise" taxes which attempt to, in economic parlance, "internalise the externalities" of a social ill. Using income tax to attempt to modify behaviour has numerous highly negative consequences including:
    - Distortion of investment in the economy as a whole;

- Such devices being extremely regressive;
- Necessary regulatory goals are less likely to be achieved. By that I mean, just because someone has the means to pay more for it, does not mean that something should be done: pollution by a poor person is no worse than pollution by a rich person, but the latter is more able to afford it. This does not achieve regulatory goals.

- Many of the issues raised by the paper concern matters that are influenced by factors far beyond the NZ tax system, or indeed the whole NZ financial system. Purely for instance, pricing of housing in NZ is affected by numerous things, financial and otherwise, including the following:
  - Supply & demand, and also differences between ability to increase demand (via, say immigration) and to increase supply (IE by physical building of homes.)
  - Governmental stability in other parts of the world;
  - Ability to borrow from major banks secured against residential homes (contrast: ability to borrow secured against shares / commercial property / intangible assets.)
  - International financial matters; regulation as to local purchasers.

  No reasonable / imaginable change to our taxation system would counter the effects of these non-financial matters.

- I have not commented below on the "Maori Economy" as it is outside my expertise and experience. However, in general, I believe that "affirmative action" is best taken outside the normal income tax system to avoid distortions, and lack of competitiveness which inevitably comes with broad-ranging subsidies.

Secondly, to answer Appendix 2, "Design Issues With a Capital Gains Tax."

1. I support the introduction of a realised capital gains tax, as long as it does not introduce distortions into the economy or tax system and does not have other undesirable consequences. This is likely to require extensive attention to detail in drafting such legislation. I am opposed to a tax on unrealised capital gains as being extremely regressive, and unfair to people who may, for a variety of reasons, be asset-rich and income-poor. To refer in order to the points raised in Appendix 2:
   a. Capital gains as part of income tax would seem to make both drafting and administration of such a tax easier, and a separate tax would greatly increase compliance costs for taxpayers (whereas a combined tax can reduce costly analysis relating to the nuance of capital / revenue distraction.) The drawback of this is that when a low-income individual derives a capital gain it is obviously all at one time, and they may pay a higher rate of tax on it than on their average marginal tax rate in

previous years. Also, having a capital gains tax introduced into our current system would usually have negative effects on the effectiveness and fairness of a) the PAYE tax-code system including that on NZ Super, and b) the standard-basis provisional tax system. These affects could potentially be balanced with changes other parts of the tax system (for instance IRD use-of money interest rules.) See my following comments regarding "deferred tax" also. Note that that a separate tax for capital gains would also have huge implications for the administration of the company imputation credit system.

b. I strongly oppose a tax on unrealised capital gains unless full and penalty-free deferral of tax is given until the item is sold. To tax a capital asset when there is no easy possibility of realisation (for instance a property, rather than an easily divisible share investment) unfairly penalises and reduces opportunities for people who may be asset-rich and income-poor. It also penalises prudent financial management (IE people who save to buy income-producing assets over a long period of time, but do now have continued high incomes.) It is also likely to further penalise people who earn most of their income over a shorter period of their lives than most professional and trade careers (EG rugby players, or people with degenerative diseases.) While a "deferral system" (where tax is calculated but deferred until realisation) may assist those would be penalised by a single capital gain due to margin tax rates, the costs of calculation and administration would probably be prohibitive to both the taxpayer and IRD. "Disposals" of assets on death or matrimonial property settlement can probably be easily dealt with rules similar to the existing "rollover-relief" rules which apply to tax on depreciation recovered under such scenarios.

c. To avoid distortions, a capital gains tax should be as wide as possible, except of things that are totally private in nature (see "H" below). Chapter 7 refers to the possibility of double-taxation of un-distributed profits on shares. Because of the way the imputation system works, this would probably only apply to publicly-traded or widely-held shares. I believe it can be assumed that the market would "price-in" the possibility of double taxation of un-distributed capital gains on such shares.

d. Kiwisaver and other savings schemes should also be tax, to avoid ludicrous distortions. In any case, a tax on capital gains is almost always a disincentive to save, unless inflation is extremely low.

e. Integration with current tax laws: as mentioned above, making capital gains part of ordinary income tax makes this vastly easier.

f. Assets held off-shore by NZ Tax Residents should be subject to capital gains tax. (This is currently achieved in many cases through the FIF rules etc.)

g. Non-residents should be subject to tax when they sell an asset that is domiciled in NZ. Apportionment of an assets owned in NZ by foreign entities, such as internally generated good-will of businesses in NZ, should be covered by rules similar to the existing transfer-pricing rules.

h. I would argue that if we are taxing capital gains, a capital loss is just as valid an item to deduct to a capital gain is to assess. If capital gains are part of ordinary income tax, ring-fencing losses does not make sense; however care needs to be taken that totally private items that would normally be expected to reduce in value do not give rise to asymmetrical deductions.

i. Except in the case of “forced disposal” such as death, matrimonial disputes or government compulsory acquisition, rollover relief should not apply. Note: my answer to this question would be materially different if we were considering income tax on the family home.

j. Death should give rise to capital gains tax on eventual realisation by the beneficiaries, within at most two generations. Immigration should give a deduction for provable assets held at the point of immigration (+/- effect of “transitional resident” rules.) Emigration should eventually incur a capital gains tax: for instance, after four years, as a “reflection” of the transitional resident rules.

k. Gifts should be exempt from tax as long as they do not affect the integrity of the capitals gains rules. Gambling winnings should also be exempt, because a) gambling is already well taxed and b) allowing a fair system of gambling deductions would be problematic. All, of course, subject to tax-avoidance rules.

l. If capital gains taxes are part of normal income tax, normal income tax rates would apply. If not, I suggest that a concessionary rate would be appropriate given inflation.

m. Allowance should be given for inflation of capital gains, but this should be simple, and realistic.

n. A de-minimus rule is probably necessary, but given the likely extent of such a carve-out it should be relatively low (A comparison, for instance, with the FIF de-minimus rules is not sensible because income subject to FIF de-minimus rules is subject to income tax under ordinary concepts.)

o. For both the tax payer and IRD, there would be a huge administration cost of a separate capital gains tax. It is notable that the current policy of a PTS with no “taxpayer action” except under special circumstances would probably be up-ended.

p. I oppose retrospective tax of past capital gains. Value at date of introduction seems fair, but is a larger compliance cost and is probably unworkable (imagine if most of the property in the country had to be valued in such a way as have a provable value under “balance of probability rules” at, say, 30/06/2019.) Assets acquired post introduction date is almost certainly best in terms of both policy and administration.

q. Family Trusts should have the same “main-home” exemption as is currently in place for the “bright-line” rule.

To reply to Appendix 3:

2. The future environment. The greatest risks facing our tax system/ base in the medium-long term are loss of revenue from:
    a. Overseas industries using economies of scale that will never be available in NZ, along with things such as labour laws and regulatory environments which enable far lower costs of goods. Under the current tax system (including “tax residence” of non-individuals) this will inevitably result in a lower NZ tax base;

b. A combination of the above and technology allowing hugely more corporate profits while paying less wages. The former, of course, a more likely to be able to be moved away from the NZ tax base.

Against the threats, those of an ageing population are relatively small.

3. A “fair tax system” includes:
   a. “Horizontal” fairness;
   b. “Vertical” fairness having regard to the cost of living;
   c. That it is predictable and can be integrated into long-term plans;
   d. Not unduly dis-incentivising productive efforts of individuals;
   e. That it does not penalise individuals for good behaviour, including good decision-making;
   f. That it does not unduly “double tax”
   g. That it does not place unfair compliance burdens on taxpayers.

4. The current tax system in NZ is renowned for its “ease of use.” However, one disadvantage of this is that people that are not required to fill in a tax return, and as such often take the “path of least resistance” and just go with, say a PTS. The result is that many people completely ignore non-PAYE earnings (such as property income, and interest and investment income.) In particular, “quick and dirty” organisations such as can often be found in shopping malls advertising PAYE refunds, often ignore all non-PAYE income. This results in non-compliance across the whole sector. Two other points:
   a. I oppose taxes that have the dual use of being re-distributive and also modifying behaviour. Taxes to modify behaviour should be restricted to excise-type taxes. One reason for this is that there becomes a dichotomy between the desire to reduce a given behaviour and to increase revenue. (For instance: imagine the additional tax take if everyone in NZ took up smoking. Disclosure: the submitter does not smoke and doesn’t closely know anyone who does.)
   b. I have not commented on savings for retirement in this submission apart from in this section. It would seem that any special treatment for retirement savings would be inextricably linked to ongoing availability of NZ Super. In the current environment, the “tax-tax-exempt” system seems fair, and less distortionary than the alternatives; bearing in mind that special favourable treatment of retirement savings (including timing subsidies such as “exempt-exempt-tax”) are both distortionary and regressive (as “the poor” benefit far less from such systems.)

5. Our current tax system has the advantage of extreme simplicity and therefore extremely low compliance costs. At the same time, the low level on engagement necessary (See “4” above) can sometimes lead to ignorance of the law.
   The income tax system is not the place to regulate use of natural capital except to the extent that it regulates things which are nearly “public goods.”
   The only types of businesses which I am aware of which benefit from excessive deductions are those that are the focus of the general BEPS international tax rules.

6. The main inconsistencies in the current tax system concern international taxes through three mechanisms:
   a. BEPS type arrangements;

b. Overseas investments subject to FIF and similar rules which are given concessional tax treatment because of compliance issues;
c. GST on imported low-value goods.

7. To reply to the issues raised in Chapter 7 specifically:

Housing Affordability.

1. The only taxation issue raised there that is not already a fact is in relation to "ring-fencing" losses on rental properties (presumably referring to residential rental properties) from other income. I oppose this measure on the following basis:

    a. It introduces complexity into the tax system, and would be likely to lead to distortion of borrowing costs over difference types of assets.

    b. It would be somewhat "regressive" in that people with trading businesses, or a larger range of financial affairs than a single rental property, would be less likely to be subject to such a tax (in that they may obtain deductible borrowing costs in other trading rather than against a rental property.)

    c. This change would be likely to have significant immediate cashflow effect on some rental property owners, which they may not be able to afford (as opposed to say a realised capital gains tax where it could be assumed that people who have realised such capital gains could afford, cash wise to pay the tax on them.) Note: A senior government minister has said that few "mom and dad" type investors use negative gearing. This is completely at odds with both my experience in public accounting practice, and indeed with the IRD's own figures.

    I wish to emphasise that housing costs, for both owners and renters are a) not predominantly affected by the tax system and b) are not inextricably linked. (The current extremely low rates of rent to capital value are related to a low cost of capital / borrowing, including the taxation effects applying thereto. It is unrealistic to expect that additional costs on rental property owners will not eventually translate into higher rents.)

2. Capital gains tax: covered above.

3. I am against a land tax. Is represents both a double tax on many levels and also, penalises those without high cash incomes.

4. Effective environmental taxation: for reasons mentioned above, I believe that environmental regulation is more effective that taxation. For instance, introducing a tax on dairy cows in relation to effluent flowing to waterways will make farmers poorer, but

will not reduce effluence flowing to said waterways. An excise tax may be applicable here.

5. Progressive company tax. I believe that this would be an unnecessary and extremely complex item: for instance, how it would integrate with the imputation credit system. (Note: a "progressive" company tax rate would in fact be regressive; because the company tax rate is lower than the top marginal tax rate, and reducing it would be an advantage to those already on the top marginal rate, and to business owners in general, who tend to be more well off than PAYE earners.) Please note that most working company owners are able to access lower marginal tax rates through "shareholder salaries." The easy solution to the concerns regarding company tax rates is to allow non-taxed income to pass through to company owners without being tax in the company, and therefore taxed to the shareholders personally, by-passing the imputation credit system. This would allow all company owners (not only working shareholders) to take advantage of company profits (in the same way as "shareholder salaries") without penalisation of non-refundable imputation credits.

6. I am strongly opposed to GST exemptions for particular goods. One of the strongest features of the GST system in this country is its universality which makes it a) easy to administer, b) hard to avoid without blatant tax evasion, c) predictable and non-distortional. Changing this would lead to hugely higher compliance costs, and more importantly, differing perceptions of "fairness." Often-mentioned is the proposal to remove GST from "fresh fruit and vegetables." If this is accepted then it is necessary to consider all other necessary costs of living, for instance sanitary products, car registration etc. I also note here that the cost of goods which seem incredibly expensive in NZ (for instance, the said "fresh fruit and vegetables") are actually the result of far broader government policies and commercial realities, and the GST component is relatively negligible. (Kumuras are considered expensive at $9.00 a kilogram; they would still be expensive at $7.83 per kilogram if they did not incur GST.)

Other comments:

- You refer to a lower top marginal tax rate than Australia, for instance, but a higher income tax % of GDP. This is because the marginal tax rates in Australian increase at far higher levels than in NZ; you would need to be easily within the top 10% of income earners to be paying more tax in Austria than NZ.
- Likewise, higher GST to GSP rates reflect the broad nature of our GST which also applies to "government services" such as car registrations and land rates.
- You refer to an ageing population. This needs to be contrasted with a "less productive" population which may or may not be the same thing.
- The so-called "gig economy" should be revenue-neutral except for the extra deductions afforded to independent contractors. It is likely that a broader "withholding tax net" would increase compliance.
- We need to make sure we are taking items in the "sharing economy" appropriately (IE under current normal income principles.)
- Many taxes are subject to double tax agreements. This needs to be considered when thinking about the effectiveness of taxes.
- Tax charities are an ongoing loss or revenue to the system, and carry the potential for extreme avoidance. This should be considered.

- When considering tax outcomes, need to think about investment in productive assets but both private business and government. (For instance, if a company that was going to make capital investments is taxed to provide expendable items such as administration or social benefits, this has an effect on the overall productive investment of the economy.)

Figure 21.

I wish to draw your attention to the extraordinary omission in the chart “Fig. 21” and supporting figures in the relevant spreadsheet chart. This chart assumes that there are no capital gains achieved anywhere other than in housing. For instance, it assumes no capital gains either on shares or within a company (such as when a business division is sold with a goodwill profit.) I acknowledge that capital gains within a company cannot normally be distributed before wind-up, but their existence will allow distribution of other taxable retained earnings, or other “return of capital” methods. However, this omission makes Fig. 21 highly misleading. Submission regarding marginal effective tax rates that do not identify this error should be discarded.

Thank you for your time.

Yours Faithfully

Richard Moore