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Submission to the Tax Working Group
of Roger Laurence Gadd

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SUMMARY

A summary of my analysis, thoughts, and suggestions is as follows. These thoughts are generally a package, that is, are generally not stand alone items.

- Whatever is implemented by Government, be it taxation or initiatives, it should be planned through systems thinking. Ad hoc social policy type tax changes often don't work or have the opposite effect of what is espoused.
- I suggest the GST Act should be simplified to remove measures of the past 15 years to "broaden the tax base", because these create economic distortions. Examples include zero rating of commercial real estate coupled with the inability to claim GST on assets held when registering for GST.
- The current GST rate is harming NZ business activity. I suggest reducing it to 11.11%.
- GST should be applied to all items including financial services and residential rental.
- Rather than applying Capital Gains tax measures, I suggest a Land Tax (i.e. a type of asset holding tax) is far more suitable to achieve the stated aims, and would also compensate for lost GST revenue were the GST rate to be lowered. Public amenity land, perhaps owner occupied (but not Trustee owned) "family homes", and some Maori land should be exempt.
- I am unable to genuinely suggest a sensible land tax rate because I have not obtained land value and use data for the country, nor have I performed detailed extensive economic analysis of the consequences. However, if the "Fair Dividend Rate" principle were broadly applied, 1.65%, being 33% of 5% would be a starting figure.
- Provided Land Tax provides sufficient Government revenue, income taxes for low earners might be reduced.
- A carbon emission tax may be more effective in discouraging CO2 emissions than an ETS.

The following paragraphs are my more detailed answers to the questions posed.

Q. WHAT DO YOU SEE AS THE MAIN CHALLENGES AND OPPORTUNITIES FOR THE TAX SYSTEM? HOW SHOULD IT CHANGE TO MEET THEM?

A. The main challenge to the tax system is governments that impose ad hoc changes they would promote as solutions without applying systems thinking. For example, the recently imposed Capital Gains (Bright Line Test) Tax on residential rental property within the prescribed period from purchase was stated as being implemented to free up residential property to become available for home owners. Clearly this tax must act as a disincentive to sell residential rental properties, and so will most likely incentivise those who purchase residential rental property to hold it for longer, thereby achieving the opposite of the stated aim. Granted, this tax may discourage people from purchasing property for rental use, but this assumes the motivation is for quick capital gain. Similarly, a proposal to limit deductibility of interest on monies borrowed for rental property purchase, so that this deduction may only be applied against future rental income is dangerous because it creates a precedent of effectively disallowing a deduction for expenses incurred in deriving income.

Q. SHOULD NEW ZEALAND USE THE TAX SYSTEM TO ENCOURAGE BETTER CHOICES AND DISCOURAGE HARMFUL ONES?

A. Generally no, but incentive effects must be considered in every tax raised. I suggest "targeting" only be used cautiously, and then only where boundaries are clear. For example, tobacco tax works well because tobacco and cigarettes are clearly defined, and the risk of having to force a distinction from similar products is almost nil. However, targeting taxes at residential rental property to increase availability of residential real estate to owner occupiers is problematic because this will discourage people from letting out their home when they are not using it, say when being overseas for some months, and despite government and local government's best attempts, the distinction between residential, commercial, and other uses is not clear (and in my opinion should not be). Further artificial boundaries can be legislated to try to tidy up those boundary problems, but those additional distinctions create further problems.

Designing taxes or the taxation process as disincentives or incentives almost always creates boundary problems, creates unfair and prejudiced distinctions based on usually narrow assumptions of how people should live or want to live, and may unfairly trap people. The tax system has increasingly become a quagmire over the past eighteen years. We do not need it made more so.

Q. HAVE WE GOT THE MIX RIGHT, OR SHOULD WE START TAXING SOME THINGS MORE AND OTHER THINGS LESS?

A. I do not think the current "mix" is perfect. I would suggest a lower GST rate, lower income tax, and application of a tax on the value of land.

Income Tax

Taxing labour (PAYE income tax) is a disincentive to work and be productive. I suspect this lowering of productivity may actually lower employment availability for those out of work and seeking work through the opportunities lost by those with skills avoiding applying those skills.

Income taxes for lower paid people might be reduced. One approach might be to make every individual who does not have children eligible (subject to the same income test) for half the Working For Families Tax Credit for two children that would be received by a couple with two children (but not pay this extra amount to those already receiving WFF).

As an aside, I observe that when the top marginal income tax rate was raised in late 1999, it was a mistake not to also increase the Trustee tax rate to match.

Good and Services Tax

GST at the high rate of 15% creates significant economic distortions.

An examples of a GST distortion is New Zealand retailers being almost forced to charge 15% more than those selling to New Zealand out of Australia, or alternatively forcing NZ retailers to sell for lower revenue with a corresponding reduction in profitability and reduction in product viability. Potential customers see additional cost as a major disincentive, and so (in this general example) purchase from the Australian supplier. Disparities of this nature with Australia and other countries are destroying NZ sellers' businesses.

Another 15% GST distortion is around commercial real estate. The 0% rating between GST registered parties creates its own problems. When an entity becomes GST registered, the current GST Act excludes claiming Input GST on assets held at the time of registration. It may be the case that the GST Act as it currently stands prohibits an entity registering for GST from ever claiming credit for GST it already paid on Commercial Real Estate. This is an example of legislation being overly complex through being written and distorted for a particular lobby group.

Solutions I would suggest are: (i) The GST rate should be lowered to 11.11% (so that GST is close to 10% of the GST inclusive price). I understand there are historic studies that 10% seems to be the threshold above which people become much more cognisant of a tax. (ii) All traders that have a New Zealand (.nz) internet domain name should be required to be registered for GST in New Zealand. (iii) Commercial real estate should be rated at the standard GST rate.

I strongly suggest and request no further exemptions from the standard GST rate should be added, such as various lobbyists promoting food to be zero rated, or even more complicatedly, food being GST Exempt.

Land Tax

I believe a Land Tax should be seriously considered to part replace GST and maybe entirely replace income tax. This would encourage greater productivity in use of land.

A land tax forms a disincentive to hold land, or more importantly provides an incentive to either use land productively or sell it to someone who can. Of the three basic economic inputs - capital (i.e. the technological means of production), land, and labour – land is the only one that is naturally fixed. All capital can be either moved or decommissioned. Labour is mobile in all but oppressive regimes.

Looking at a different consideration towards Land Tax, contrary to what many commentators espoused, the study released several years ago did not show only three percent of Auckland residential real estate sales were to foreigners. The study indicated a range of 3% to 48%, meaning the study indicated one in four sales were to foreign interests, albeit with a high margin of uncertainty. Some pundits and politicians also confused tax residency with residency. Anyone who has been in NZ for 183 days or part days in a given 365 day period is probably a tax resident. There is some evidence, which I accept is only anecdotal and therefore not conclusive, that some foreigners hold residential real estate, and don't rent it out. A land tax would discourage owners from "land banking", and would lower entry costs by reducing the overall return from land.

Ultimately, landlords will rent dwellings for at most what the highest bidder is able to pay. Imposing a land tax would not cause rent increases.

I would not suggest a property tax which taxes the full capital value because this discourages improvement, i.e. discourages the creation of capital.

Issues to be considered are whether land tax should be universal, economic impacts to existing productive businesses such as farms, whether different land uses should be differentiated, and whether there should be exemptions for some uses, and the Land Tax rate or rates. I commenced a study about ten years ago, but did not find an accessible database of rateable land values along with areas, locations, and use types. If "the family home" were to be exempt, I would suggest this exemption should be limited to owner occupiers, and Trustee owners should be excluded from such an exemption. Other use exemptions should perhaps be for wilderness, some but not all Maori land, and public amenities such as parks, roads, schools, hospitals, and libraries.

Q. SHOULD THE TAX SYSTREM MAKE HOUSING MORE AFFORADABLE?

A. As noted above, I don't think the current changes and proposed changes are the right solution. Over the last 15 years, it appears real estate values have been largely driven by foreign money. As noted above, roughly one in four residential property sales in Auckland have been to foreigners over recent years. That number of people with relatively deep pockets either moving to NZ or buying remotely are ample to have caused the inflated property prices observed, particularly in Auckland.
A land tax would disincentivize anyone from owning land they are not using productively, and would lower property values so that entry costs would be lower.
Other non-tax initiatives are also necessary. Systems thinking is required.

Q. WHAT TAX ISSUES MATTER TO ME MOST?

A. I consider the points raised in the Fact Sheet

Capital Gains Tax

Capital gains taxes are taxes on selling. They encourage owners to hold their assets in perpetuity. Ample evidence exists that such taxes do not meet the goal of achieving housing affordability, even in part. In order to ensure capital gains are taxed similarly to other gains, I suggest it would every bit as sensible to remove income tax.

Land Tax

As may correctly be inferred from what is written above, I strongly support the investigation of implementing a land tax to at least in part replace GST and income tax. I suggest if people are not using land adequately to afford (a reasonable) land tax, they are underutilising it, and should sell it to someone who can better use it.

I understand that in the 19th century, a land tax was very successful in encouraging owners of huge tracts of land in the South Island to break up and sell off smaller parcels of land that became the many farm titles in place today, and I speculate without this tax forced change, NZ would not be the prosperous place it is today.

Progressive Company Tax

No.

Tax and the environment

I suspect a carbon emissions tax will be far more effective than the ETS put in place by the previous administration(s).

Should GST be on everything?

My answer is 'tentatively yes', but given the systems already in place, it may be difficult to impose GST on financial services and residential rental.

I also believe businesses should be able to claim GST on assets held at the time of registration. Maybe this reversion should be applied at the same time the GST rate is reduced to 11.11%, GST is imposed on residential rental, and a land tax of say 1.65% per annum is introduced.