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Dear Sir/ Madam

Subject: Future of Tax - Submissions Background Paper

CPA Australia represents the diverse interests of more than 163,000 members in 118 countries, including around 2,000 New Zealand members. Our organisation's vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Earlier this month we engaged with members via a number of events in Auckland, Wellington and Christchurch to help inform our organisation's thoughts for this submission to the Tax Working Group's (TWG) review.

On behalf of our members, and considering good economic and social policy in the public interest, we now provide the TWG with the following submission on the Future of Tax. These comments are also made taking into account how New Zealand's tax policy could possibly be calibrated and used as a lever to 'grow the economic pie.'

Please treat this as a public submission.

If you have any queries do not hesitate to contact us.

Yours sincerely

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Paul Drum FCPA
Head of Policy

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Introduction

The Tax Working Group's Future of Tax Submissions Background Paper presents the future domestic and international environmental challenges very clearly. Given time constraints CPA Australia has not sought to comment on every specific element of the paper. However, in good faith we provide the following comments.

This submission essentially follows the structure of the TWG background paper, focussing on Chapters 4 -7 inclusive, as well as Appendix 2 on capital gains tax specific design issues.

Our comments are also made taking into account how New Zealand's tax policy may possibly be calibrated to be used as a lever to 'grow the economic pie.'

However, before it deep dives into the some of the key issues raised, we make the following observations regarding successes and failures of tax reform by governments in Australia in recent years.

Lessons from Australia regarding tax reform

CPA Australia is of the view that there are several lessons that can be learned from Australia's prior attempts at reforming its tax system - including both its successes and failures.

One such lesson is that big reforms often take a long time to implement. This has been well expressed in the following excerpt from Australia's A Future Tax System (AFTS)[1]:

> 'From the early 1970s, a growing concern about the equity of the tax system led to the establishment of the Taxation Review Committee (Asprey et al 1975). A key theme of the Asprey Report was the need to broaden the tax base. In 1985, the Australian government released a draft White Paper which recommended a broadening of the tax base through the adoption of a broad-based consumption tax, the introduction of a capital gains tax and comprehensive taxation of fringe benefits, and a broader foreign income tax base (Australian Government 1985). The capital gains tax and fringe benefits tax were introduced in the second half of the 1980s and the GST was introduced in 2000.'[2]

In this regard, New Zealand is in a similar position. For example, there have been a number of other tax inquiries over the years that have concluded, amongst other things, that New Zealand should implement its own capital gains tax (CGT) regime. CPA Australia believes that this is one idea whose time has come – that is to broaden the New Zealand tax base and for fairness and equity reasons New Zealand should implement a comprehensive CGT.

Secondly, CPA Australia suggests a 'tax package' – or a packaged approach - is required to ensure New Zealand has the right tax mix for the future. If new taxes are to be introduced, existing taxes such as personal income tax and company income tax should be reduced accordingly - against a framework that encourages worker participation, savings and investment, while at the same time providing governments with the revenues required to meet future community needs and expectations.

The effectiveness of this so-called packaged approach was demonstrated under the Howard/ Costello coalition government in Australia in 2000 when it successfully introduced its comprehensive tax reform package 'A New Tax System'.[3]

Thirdly, for reforms to be successful it is important governments 'take the people with them' - effectively selling the economic and social imperatives for change. Unfortunately, this was not what

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[1] http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final_Report_Part_1/index.htm
[2] http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section_4-01.htm
[3] http://archive.treasury.gov.au/contentitem.asp?ContentID=167

happened in Australia under the Abbott/ Hockey led government when it undertook its Tax White Paper process in 2013.

In contrast, the TWG's report to Government has the potential to inform not only the Government, but all political parties and the community in a considered and timely way to enable them to form their tax policies accordingly and take them to the New Zealand people at the next election.

A fourth lesson is to have a bipartisan approach in the Parliament/ parliamentary process. This is of course easier said than done - and something that has not been achieved in Australia when it comes to holistic tax reform.

Initial comments regarding the tax system

Many employed individuals do not need to lodge income tax returns unless they receive 'other income' including foreign income, carried forward imputation credits, business income etc. Further, there are very few deductions available for such taxpayers. Accordingly, compliance with New Zealand's tax system is very easy for many individuals with simple tax affairs. CPA Australia members are generally of the view that this simplicity should be retained.

Donation credits are claimed via a process separate to the lodgment of individual tax returns. The process is relatively simple. This simple system could be expanded to claim other credits such as on environmentally friendly personal expenditure or investment in technology for school aged students.

CPA members have raised the issue of whether it is appropriate to add another band to allow for a higher marginal tax rate. One suggestion is that it could apply to income over $150,000 per annum and at a rate of 37 per cent.

We also note that Australia imposes income tax on individual foreign residents differently to Australian residents – that is - foreign residents have fewer tax bands and they cannot access the tax-free threshold, however they do not pay the Medicare Levy.

Losses on rental properties could be ring fenced. The existing system of allowing rental property losses to be offset against income from any source when combined with tax-free capital gains on the underlying asset is a significant tax concession - and one heavily weighted in favour of taxpayers on higher incomes and/ or significant wealth. Quarantining rental losses does come with risks – landlords could offset their ability to use these losses by increasing rents, which could be felt most severely in Auckland and Wellington, which are already experiencing a lack of rental stock. CPA Australia also notes that this is currently the subject of a separate but complementary IRD inquiry.

Chapter 4: The current New Zealand tax system

The paper states that 'New Zealand has a broad based low rate tax system.'[4] While this statement holds true if it relates solely to New Zealand's goods and services tax (GST), it does not apply to New Zealand's tax system overall. This is evidenced by the fact that 90 per cent of all tax revenues come from three main taxes - personal income tax, the GST and company tax. It is CPA Australia's view New Zealand's tax base is now over-reliant on these three taxes, and overall its tax base is too narrow.

If New Zealand is to be resilient to external shocks, and also be competitive in the decades to come, this tax mix will need to change.

For example, with an ageing population even if workers choose to work longer into what is the 'traditional' retirement phase of their lives, there will be fewer workers for each dependant. This means without other changes, personal income tax rates would need to rise, which amongst other things would discourage worker participation and impact productivity.

Further, New Zealand's company tax headline rate is becoming less competitive internationally when one considers tax reform measures being implemented by other countries. The US has successfully passed laws to lower its corporate tax rate to 21 per cent. UK has 19 per cent and closer to home Australia is currently working towards a corporate tax rate of 25 per cent by the year 2025.

As a net importer of capital, if New Zealand is to continue to attract its share of foreign investment then it needs to consider what options it has regarding lowering its corporate tax rate, and decisions that should be taken, if any, either now or in the future.

Behavioural taxes

All taxes could be viewed as behavioural taxes in many respects. However the term is often used more narrowly to refer to the so-called sin taxes – for example taxes on alcohol and tobacco, and more recently sugar.

In this regard CPA Australia submits the UK's experience regarding tax on sugar in drinks is worthy of the TWG's consideration.

When the UK sugar tax was announced by the Rt Hon George Osborne - Chancellor of the Exchequer - in his 2016 budget speech,[5] he stated that obesity drives disease and it increases the risk of cancer, diabetes and heart disease costing costs the UK economy £27 billion a year, or more than half the entire NHS paybill.

He also stated that 'a 5 year old child consumes its weight in sugar per annum.'[6]

Given the health issues associated with obesity diet - such as type 2 diabetes - and the ultimate burden on the health system and the public purse we encourage the TWG to consider such a tax.

Notably it may not raise significant revenues, but both the benefits to the ongoing health and welfare of New Zealand's citizens, as well as the future cost savings to the public purse – which is taxpayer's money – are potentially considerable.

It is also of note that a recent newspaper article[7] also observed that the UK's sugar tax has already brought about positive behavioural changes by both manufacturers as well as retail store businesses prior to the actual commencement of the tax.

[4] See p5
[5] https://www.gov.uk/government/speeches/budget-2016-george-osbornes-speech
[6] ibid
[7] https://www.smh.com.au/money/tax/the-sweetest-tax-of-them-all-20180413-p4z9ec.html

The TWG may therefore wish to consider such a tax as part of its review, or suggest that the Government consider it as part of its health reform agenda.

Retirement savings

As mentioned in the background paper, most OECD countries take an ‘Exempt, Exempt, Taxed’ (EET) approach to the taxation of retirement savings. CPA Australia supports this approach as it is the most equitable as income is taxed at the point of consumption, not the point of deferral. It better reflects the size of the accumulated benefit in retirement and how it is consumed in retirement. That is, an individual’s overall tax burden is based on the size of their benefit in retirement, not their income when contributions were made, which may be no indicator of the size of their future retirement benefit.

We recognise the unique situation in New Zealand, with the New Zealand superannuation, a universal age pension, at least partly funded indirectly by the taxation of contributions and investment earnings. The universal New Zealand Superannuation provides an important safety net but one that is becoming increasingly unaffordable. Consideration should therefore be given to means and income testing eligibility for future generations.

To reduce reliance on the universal New Zealand superannuation and to encourage additional contributions to KiwiSaver accounts, it may be necessary to move away from New Zealand's tax neutral system and introduce incentives to encourage greater self-sufficiency in retirement savings. Moving to an EET system would introduce an upfront incentive to save while also boosting accumulated savings in a tax-free environment. Deferred income would then be taxed at the point of consumption in retirement. However, placing greater reliance on accumulated retirement savings would require means-testing of New Zealand superannuation, which would have its own social impacts to be considered.

OECD analysis has shown that an EET system will provide a better net outcome for retirees than an ETT system[8].

However, in an imperfect world CPA Australia fully recognises the difficulties of transitioning from a TTE system to an EET system. This includes the cost to government revenues that would result even if done on a sliding scale over a number of years. Accordingly, we encourage the TWG to consider other options also. These include over time shifting to:

- A TEE system by removing tax on investment earnings. While the upfront incentive to save wouldn't be as great, a TEE system provides a better net benefit in retirement than TTE.
- A ‘ttE’ system (or ‘small t’, ‘small t’, ‘big E’) where the tax rate on contributions and earning is less than the current rates on contributions and earnings. For example, in Australia the tax rate on contributions is in most cases 15 per cent on contributions, 15 per cent on fund earnings until pension phase or retirement, and exempt on exit or drawdown in most cases.

  Please note that CPA Australia can provide the TWG with more detail on the Australian model if required.

[8] TAX TREATMENT OF PRIVATE PENSION SAVINGS IN OECD COUNTRIES, Kwang-Yeol Yoo and Alain de Serres, *OECD Economic Studies No. 39, 2004/2.*

Chapter 5: The results of the current tax system

Fairness and balance

Productive economy vs speculative economy.

In the public domain in New Zealand at least the conversation about taxing capital gains seems to be largely confined to taxing the profits on sales of residential property.

However, from a productive economy versus a speculative economy perspective our experience is that internationally, tax advisers, tax authorities and taxpayers are surprised when they find out that New Zealand does not have a more comprehensive tax system when it comes to taxing capital gains.

It is acknowledged that not all capital gains are exempt from tax under the current income tax regime in New Zealand. However, it is not difficult for taxpayers to step around the current regime in many circumstances.

The recent bright line rules in respect of residential property are but one example in this regard, with these provisions already the subject of modification not long after their introduction.

CPA Australia is of the view that taxing capital gains on shares, real property, rights, and collectibles amongst other things are all issues for the TWG to consider. See our further comments on a capital gains tax under Chapter 7 later in this submission.

Encouraging New Zealand business growth

Small businesses make up 97 per cent of all businesses in New Zealand, account for 29 per cent of employment, and contribute over a quarter of New Zealand's gross domestic product (GDP).[9]

To further support small business, including start-up businesses, while attracting overseas capital, there is scope for a lower tax rate for small businesses, in particular a progressive company tax rate. Our recent member consultation sessions raised the following ideas and options for the TWG's consideration. Options could include:

Options	Comment
A lower company tax rate for smaller companies – i.e. multi-rate like in Australia for base rate entities.	The threshold would need to be significantly lower than the threshold used for base-rate small business entities in Australia to reflect the size of New Zealand businesses. ***Pros*** Shouldn't have too much impact on the current imputation regime, should it be retained (see comments on imputation later in this paper). Issues and solutions would mirror those in Australia. ***Cons*** Could be issues with deferral of income to avoid exceeding the threshold and/or eligibility issues to access the lower rate (this issue applies to all of the three options discussed here).
A tax-free threshold for smaller companies and /or start-up businesses.	This option is used in the Singapore tax system. ***Pros*** A lower rate for both smaller businesses and start-up businesses (for 5 years for example) both encourages start-ups in their early years and supports small businesses, including both new and

[9] http://www.mbie.govt.nz/about/who-we-are/our-publications/briefings-to-incoming-ministers/2017-bims/small-business.pdf

	existing small businesses. Avoids complexity and possible abuse of being defined as a 'small business' or similar. Provides certainty. ***Cons*** Will add to complexity of imputing dividends. Would have to be based on a prior year effective marginal corporate tax rate unless the imputation system is replaced with a more appropriate tax regime, see CPA Australia's comments later in this paper.
Progressive tax rate for companies. Lower rate until a threshold is met, higher rate for taxable income about the band.	Malaysia applies this system for companies. ***Pros*** Avoids complexity and possible abuse of being defined as a 'small business' or similar. Provides certainty. ***Cons*** Will add to complexity of imputing dividends. Would have to be based on a prior year effective marginal corporate tax rate unless the imputation system is replaced with a more appropriate tax regime, see comments on the imputation system below.

The dividend imputation system

New Zealand members of our organisation are generally of the view that the dividend imputation regime works well and is well established. Unlike the Australian model where currently excess credits are fully refundable in the year received, in New Zealand unused credits are carried forward by taxpayers to be offset against future income tax liabilities.

However, the issue to be considered here is whether there is a more appropriate alternative to the current imputation system that would better meet the challenges of the future?

Most countries have now forgone their imputation regimes, and in fact Australia and New Zealand are now the only two OECD countries to operate dividend imputation systems. The AFTS final report[10] states 'Countries that have abandoned dividend imputation systems include the United Kingdom (in 1999), Germany (in 2001), Finland (in 2005) and Norway (in 2006). While the move away from imputation for European countries can be partly explained by European Union legal issues, the trend has also been evident in Asian countries. Both Singapore (in 2003) and Malaysia (in 2008) have abolished their imputation systems.'

It is important to note that the move away from dividend imputation systems does not necessarily mean a move back to the so-called 'classical' or double tax model, but instead moving to other models. For example, the UK now provides a dividend tax credit to resident shareholders of domestic companies, while in Hong Kong and Singapore dividends received by residents are exempt.[11]

Imputation regimes are often seen as an impediment to attracting foreign capital. Further, New Zealand residents have a poor record of personal savings. Taking these two important yet different factors into account CPA Australia submits that the TWG should consider - as a possible alternative to the current imputation system - a model where dividends in the hands of individuals are taxed at a lower rate than the individual's marginal rate. Such a model could also enable a tax exemption for

[10] http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_b2-3.htm
[11] ibid, at table B2-3

individuals up to a certain threshold. This is also discussed further in this submission under the heading ‘Lower taxes on certain passive income.’

Chapter 6: Thinking outside the current tax system.

Other specific issues

Lower taxes on certain passive income

As mentioned earlier in this submission, New Zealand has a weak record of personal savings. There are many reasons for this and it is not proposed to comment on them all here. However, in the context of the TWG's remit, one impediment to encouraging greater savings is that income derived from savings is taxed at an individual's marginal rate (unless it is exempt).

The 2010 Australia's Future Tax System report proposed a 40 per cent savings income discount be introduced for individuals for non-business related net interest income, net residential rental income (including related interest expenses), capital gains (and losses), and interest expenses related to listed shares held by individuals as non-business investments. CPA Australia notes that such a recommendation, while not a 'silver bullet' may also have an additional benefit of making investments other than residential property (that is not the family home) more attractive, which may have a positive impact on the housing affordability challenge.

CPA Australia encourages the TWG to consider whether such an option is appropriate in the New Zealand context.

Digital economy, trade and exports

CPA Australia's Asia-Pacific Small Business Survey 2017[12] again shows that New Zealand small businesses are well behind their counterparts in all markets (except for Australia) when it comes to using social media for business purposes or selling online.

It is very difficult for businesses to grow if they do not access modern platforms to enable them to gain greater access to both broader domestic but particularly international markets. Typically, when a New Zealand business seeks to expand internationally it thinks first and foremost about accessing the Australian market(s). But opportunities abound globally with the appropriate business use of technology in the digital economy.

Small businesses need to be educated about the possibilities this can bring them, and how to effectively use these mediums to grow their businesses, creating wealth and jobs.

This could be done several different ways – but one way would be to provide small business with an accelerated deduction for appropriate expenditure on education and measures that assist businesses to embrace the international trade opportunities the digital economy provides.

Digital economy and technology

Lower income households have reduced access to technology which affects school aged students' ability to engage with digitalised learning and understanding of technology in general. Rebates for parents could be available here.

Small businesses and start-ups could receive accelerated deductions for investment in technology to aid their engagement in the digital economy.

[12] https://www.cpaaustralia.com.au/~/media/corporate/allfiles/document/professional-resources/business-management/small-business-survey/small-business-survey-2017.pdf?la=en

Digital economy and crypto currencies

CPA Australia notes that the New Zealand Inland Revenue Department has issued guidance on the tax treatment of gains and losses made from crypto currencies.[13] This guidance reflects the application of the tax laws as they currently stand. However, one issue for consideration is whether the current laws provide the most appropriate outcome.

For example, in Australia the revenue is protected to some extent as crypto losses will be, in many cases, quarantined in Australia's CGT system and only available for offsetting against future capital gains.

New Zealand on the other hand has no such revenue protection mechanism. Accordingly, CPA Australia recommends the TWG pay close attention not only to Australia's approach to the taxation of crypto currencies, but also the policy responses by other jurisdictions.

Further, CPA Australia encourages the TWG to consider whether crypto currency transactions should be subject to loss quarantining.

Environmental taxes

During our recent member roadshows around the North and South Islands members expressed their concerns regarding water quality and water management, including concerns about whether New Zealand was getting a fair return on its water, particularly where it was being exported and not used domestically.

While water is generally seen as a renewable resource, demand for clean water continues to grow and climate change is also expected to adversely impact future supplies.

The imperative for better management, including pricing of water, is clearly articulated in New Zealand's recent Incoming Ministerial Briefing for the Minister of the Environment on water, that, amongst other things, states:

> *'Demand for water is increasing – for farming, for drinking water, and for industrial purposes. For example, irrigated land increased by about 70 per cent nationally between 2002 and 2017. In a growing number of catchments and aquifers, the volume of water allocated for people to use has reached or exceeded sustainable limits. For example, of the 36 groundwater allocation zones in Canterbury where quantity limits have been set, 16 are at full allocation or over-allocated. 21. As New Zealand's population and agriculture-based economy continue to grow, the demand for fresh water is likely to rise further. At the same time, climate change is projected to lead to lower rainfall in some areas of the east and north of the country, with more prolonged droughts and periods of low flows in rivers. Behaviour change and a new approach to allocation are needed to better protect waterways, place a higher value on fresh water, and encourage smarter production methods for commercial use. 22. An important factor is the framework for how water is allocated —who has the right to take water, how much they can take, and how much contamination they can discharge. The current approach to water allocation is primarily a 'first in, first served' approach, which means that rights to take water and to make discharges may not be allocated equitably, in the best interests of the water body or to the highest value use. Historical circumstances around Māori land ownership and development mean iwi and hapū have ended up at the 'back of the queue' for access to water. The water management system needs to better deliver on social and cultural values of water at the same time as supporting an economy that maximises value from fresh water through wise use and investment.'* (italics added).

[13] http://www.ird.govt.nz/income-tax-individual/cryptocurrency-qa.html

CPA Australia members recognised the complexities and sensitivities of the water issues, but were also of the view that the Government -in concert with municipal councils - should better price this resource whether by way of licence, royalty, levy or tax.

CPA Australia encourages the TWG to consider a levy or charge on water use in non-agricultural commercial enterprises.

It is also noted that there is significant concern about the health of some rivers, particularly due to farm run-off mainly from intensive dairying activities.[14] While agricultural run-off is difficult to measure, some argue that it would be feasible to put taxes on the business inputs used by farmers such as fertilizers and pesticides – for example see the following excerpt from a Canadian paper on environmental economics:

> 'A good case of this is the problem of water pollution from fertilizer runoff in agriculture. It is impossible to tax the kilograms of nitrogen in the runoff because it is a nonpoint-source pollutant and thus not directly measurable. The same problem applies to agricultural pesticides. What may be feasible instead is to put taxes on these materials as they are sold to farmers; that is, a tax per tonne of fertilizer or per 100 kilograms of pesticide purchased. This tax exists in some US states. The tax is to reflect the fact that a certain proportion of these materials ends up in nearby streams and lakes. Raising the prices of these items would give farmers the incentive to use them in smaller quantities. The higher price also creates the incentive to use the fertilizer in ways that involve less waste; for example, by reducing the amounts that run off.'[15]

CPA Australia also encourages the TWG to consider tax deductions or credits being made available for investment designed to reduce pollution run-off into water courses and rivers.

A third issue that comes under this area of environmental taxes is the impact of tourism on New Zealand's natural environment which is also of concern to members. See CPA Australia's comments under 'Tourism and infrastructure' immediately following in this submission.

Tourism and infrastructure

New Zealand has always welcomed tourists with open arms, and tourism contributes significantly to New Zealand's GDP. Tourism is consistently one of New Zealand's top two export earners and the largest services export – contributing $14.5 billion - or nearly 21 per cent to New Zealand's total exports in the year ended March 2016.[16]

This trend is expected to not only continue in the future, but also grow in the coming years. There is significant upside to the tourism sector to New Zealand's economy, however, such growth comes with both economic and social costs.

The increasing numbers of overseas tourists is increasingly putting unwelcome pressure on New Zealand's public infrastructure and residents in a variety of ways.

For example, the upkeep and maintenance of the Department of Conservation (DoC) tracks, DoC huts and campsites, public toilets, and litter collection are some of the significant challenges for New Zealand in this regard. But it is more than just a maintenance issue. There is also the issue of how appropriate tourism infrastructure for the future will be funded. These issues raise the question of who should pay.

CPA Australia encourages the TWG to consider a small levy on international visitors that could be collected at the border - either on ingress or egress. Such a levy could be imposed on airline tickets.

[14] https://www.mfe.govt.nz/publications/about-us/briefing-incoming-ministers-%E2%80%93-environment-and-climate
[15] Barry C. Field & Nancy D. Olewiler/Environmental Economics/Third Canadian Edition/ Ch 12 p11.
[16] http://www.mbie.govt.nz/about/who-we-are/our-publications/briefings-to-incoming-ministers/2017-bims/tourism.pdf

Biosecurity issues for New Zealand's farming sectors

With the continued rise of the digital economy and cross-border trade arising from platforms such as eBay, Amazon, Etsy and Alibaba, some countries are considering new approaches to deal with international parcel traffic across borders for biosecurity reasons.

New Zealand's reputation as a source of high quality fresh produce is second to none. However, increasing movement of both human traffic and parcels puts this status at ongoing risk from foreign disease and pests.

It was reported earlier this year that in Australia the Department of Home Affairs was considering a parcel levy of AUD$5 on all international parcels under AUD$1,000 in value. Australia already charges a AUD$95 levy on parcels valued at AUD$1,000 or more.

We encourage the TWG to consider such a levy for biosecurity reasons.

It has also been raised during our member consultations that if such a measure was implemented that other countries could retaliate. This remains to be seen – however it is not expected such a move would start a trade war.

Encouraging research and development

The most recent OECD Economic Survey on New Zealand[17] (June 2017) points out that expenditure on R&D as a share of GDP is low, most noticeably in the business sector. It also states that collaboration between firms, education and research institutions is low. R&D is one important way to improve productivity. The Survey also recommends that fiscal support for business research and development should be increased.

This could take a number of forms. For example, it could be by way of targeted government grants. Alternatively, R&D could be encouraged by way of an appropriately designed incentive.

CPA Australia also notes the recent release by the New Zealand government of a separate consultation process on R&D.[18]

To assist in improving productivity CPA Australia encourages the TWG to consider recommending an appropriately designed R&D tax concession. There are many overseas examples that the Government could draw on. The recent review of Australia's R&D incentive is just one case in point.[19]

Fringe benefit tax

Fringe benefit tax is essentially a set of anti-avoidance laws. As the TWG will be aware, FBT raises very little revenue but the compliance costs on business are very high.

Members have recommended the TWG consider how the FBT laws could be simplified in a way that achieves their legislative intent but at the same time reduces compliance costs for business.

One suggestion in respect of motor vehicles was whether a luxury car tax could be placed on certain cars in lieu of FBT.

Charities and tax exemption status

Some members have also expressed concern about the 'automatic charitable status' for certain bodies. They requested that the TWG consider whether tax exempt status is too easy to obtain and

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[17] http://www.oecd.org/eco/surveys/economic-survey-new-zealand.htm
[18] http://www.mbie.govt.nz/info-services/science-innovation/rd-tax-incentive
[19] https://industry.gov.au/innovation/InnovationPolicy/Research-and-development-tax-incentive/Pages/R-and-D-Tax-Incentive-Review-report-and-submissions.aspx

that the eligibility requirements for such tax exemption should be tighter/ have greater integrity. For example, perhaps including requirements to ensure the entity is actually making a contribution back to the NZ community.

Chapter 7: Specific challenges

Housing affordability

Housing affordability issues are not unique to New Zealand. However as outlined in the OECD New Zealand Economic Survey[20] the issue is quite pronounced particularly in Auckland. Housing affordability is impacted by a number of factors, including housing stock/ supply, domestic demand, and foreign demand.

Countries have responded to their own housing affordability challenges in a variety of ways. For example, by rezoning more land for residential purposes, and removing density restrictions - but also by tax measures.

For example, both Vancouver, Canada and Australia have introduced vacancy or 'ghost' taxes on foreign owned residential properties that remain vacant, thus potentially making the return on investment for foreign investors less attractive.

Further, in Australia's 2017-2018 Federal Budget the Australian Government announced a package of measures aimed at improving housing affordability for potential home buyers.

These measures included:

- Making travel expenses related to inspecting, maintaining or collecting rent for residential rental property no longer tax deductible
- Limiting plant and equipment depreciation deductions to only new items, and
- Encouraging older Australians to downsize by enabling them to put AUD$300,000 from the sale of their home into superannuation.

Further, nearly all Australian States now impose 'foreign investor surcharges' or a 'foreign persons additional duty' or similar of up to 8 per cent of the purchase price of residential property acquired by foreign persons.

Further examples of tax policy options of which the TWG should be aware can be found in the Australian Labor Party's recent policy proposals.[21] Amongst other things they state that 'Labor will reform negative gearing and the capital gains tax discount to ensure that our tax system is fair, sustainable and targets jobs and growth.'

Regarding negative gearing, it also proposes to limit negative gearing to newly constructed housing from 1 July 2017 with all investments made prior to this date being fully grandfathered.

They have also announced that from 1 July 2017 the use of losses from new investments in shares and existing properties will only be able to be offset against investment income tax liabilities or carried forward to offset the final capital gain on the investment.

Labor also proposes to halve the capital gains discount for all assets purchased after 1 July 2017, reducing the capital gains tax discount for assets that are held longer than 12 months from the current 50 per cent to 25 per cent.

All investments made before this date will not be affected by this change and will be fully grandfathered.

As is reflected by the feedback on real property taxes in the TWG's Background Paper, New Zealand's current income tax laws as they apply to real property are significantly out of step with other OECD countries. To non-residents at least, the fact that an investor can negatively gear an

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[20] http://www.oecd.org/eco/surveys/economic-survey-New-Zealand.htm

[21] https://www.alp.org.au/negativegearing

investment claiming tax deductions against their income, but then potentially not be subject to tax on profit when the asset is disposed of seems very outdated. Even with the extended bright line test for residential property[22] this seems overly generous and skews investment decisions.

Some other countries have quarantined losses from property investments to be offset only against future income from property, for example the United Kingdom.[23]

It is also of note that in Australia the Federal Labor Party has announced that if elected it will introduce laws to limit the negative gearing of existing residential property – it will only be available for new housing stock.[24]

Currently in Australia such losses and outgoings are on revenue account, but when the asset is disposed of it will be subject to capital gains tax - albeit at a reduced rate if the property was held for 12 months or more. See CPA Australia's comments on capital gains tax following in this paper.

Members have also raised the following issues during our recent member consultations - capital gains tax on investment residential properties could:

- cause investment distortions including reducing the attraction on such investments thus reduce competition homebuyers face, increasing accessibility to the housing market, but also
- cause landlords to increase rents to offset future CGT tax liabilities.

Other suggestions that have been put forward as part of CPA Australia's member roadshow include:

- Tax incentives could also be available for property developers which develop property in substantial part to rent to lower income households. This would increase the rental stock for a vulnerable part of the tenancy market.
- Owners of undeveloped land in residential zones could face penalties if land is not improved within a certain timeframe post acquisition.

Capital gains tax

CPA Australia considers the most appropriate means of broadening the tax base would be via a comprehensive capital gains tax. It also notes this is in accord with one of the recommendations of the Report of the Victoria University of Wellington Tax Working Group[25] a decade ago.

It is often argued that such a measure would not provide very much revenue as New Zealand already taxes many capital gains. Examples given as evidence of the current approach include taxing foreign debt and equity investments[26] as well as other certain short-term gains being classified as normal operating taxable income – including 'gains on the sale of personal property if the taxpayer is a trader in such property; gains from the disposal of land where the intention at the time of purchase was to sell it; and gains on domestic corporate bonds that are accruals taxed (OECD 2004, p.6)'[27] as well as more recently residential property subject to the bright line test.[28]

However, CPA Australia submits that such tests are relatively easy to step around tax-wise.

CPA Australia notes that a more comprehensive capital gains taxation regime, beyond disposals of real property would broaden the tax base but add significant complexity to the tax system.

[22] http://taxpolicy.ird.govt.nz/bills/51-249
[23] https://www.gov.uk/guidance/income-tax-when-you-rent-out-a-property-working-out-your-rental-income
[24] https://www.alp.org.au/negativegearing
[25] P11, recommendation 6 - https://www.victoria.ac.New Zealand/sacl/centres-and-institutes/cagtr/pdf/tax-report-website.pdf
[26] https://www.newzealandnow.govt.nz/living-in-nz/money-tax/nz-tax-system
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[28] http://taxpolicy.ird.govt.nz/news/2018-02-15-sop-extends-bright-line-test

Conversely, a narrow regime only taxing realised gains on commercial/ investment real property could result in distortions and structuring to avoid the realisation of the gain.

We understand of particular concern is the effect of taxing the capital gain on farm land in intergenerational transfers.

A very narrow regime taxing only gains made by non-residents on commercial/investment real property could have a detrimental effect on foreign investment.

Other issues raised by CPA members in the consultation phase include:

- A de minimus exemption of around $20,000 per annum could apply
- Personal assets excluded
- Unrealised gains not subject to tax
- Losses applied against other income
- Net gains added to assessable income to determine taxable income.

Land tax

Land taxes target real property. Typical design features of land taxes are exemptions for main residences or homes, primary production land, as well as exemptions for other property owned by approved not-for-profit, religious, educational and/ or charitable institutions.

When applied to a broad base they are generally very efficient and hard to avoid. However, the abovementioned typical exemptions distort the outcome.

If a land tax was to be proposed by the TWG it would need to take into account these base issues. The TWG will also need to weigh up the advantages versus the challenges of other issues such as:

- land rich but income poor residents
- whether introducing a land tax would result in the tax being passed on to tenants by way of increased rents and in particular low-income tenancy properties.

CPA Australia also notes that a 'low rate land tax as a means of funding other tax reductions' also had had the support of 'the majority of the Victoria University of Wellington Tax Working Group in its 2010 report.[29]

Progressive company tax

See CPA Australia's comments under the heading 'Encouraging New Zealand business growth' earlier in this submission.

GST exemptions for specific goods

The GST regime in New Zealand is well embedded, very comprehensive, simple and efficient. Despite it's relatively low rate by OECD standards it represents 31.4% of New Zealand's taxation revenue.

GST on food represents a significant cost to the community, especially for low income earners. However, while exempting some foods would ease this cost, it would result in significant complexity for certain businesses, for example owners of small food outlets.

GST is levied on medicines however these are significantly subsidised by the Government.

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[29] P11, recommendation 8 https://www.victoria.ac.New Zealand/sacl/centres-and-institutes/cagtr/pdf/tax-report-website.pdf

In our recent member consultations there was no support for the concept of narrowing the GST base in any way. We also note that changing the GST rate is outside the terms of reference for the TWG.

We also note that the OECD has stated that reducing the rate of GST to address social goals are shown to be a very poor tool for targeting support for lower income households – and it can have the perverse outcome of being of greater benefit to more wealthy households.[30] More targeted relief via welfare payments is typically considered a far better policy approach.

[30] See page 3 *The Distributional Effects of Consumption Taxes in OECD Countries,* OECD 2014 https://read.oecd-ilibrary.org/taxation/the-distributional-effects-of-consumption-taxes-in-oecd-countries_9789264224520-en#page5

Appendix 2

Capital gains tax specific design issues

Possible capital gains tax (CGT) design issues for the TWG's consideration.

1. **Should the CGT be a separate tax or part of the income tax? Most countries tax capital gains as part of the income tax.**

   CPA Australia recommends that it be part of the income tax regime.

2. **Should capital gains be taxed on an accrual basis or only when realised (i.e. only when the asset is sold)? Most countries tax on a realisation basis.**

   Capital gains should generally be on realisation – with deeming provisions where there is nil or non-market consideration. But special rules are also required for the creation of rights and also lease. The Australian CGT rules provide good guidance in this regard.[31]

3. **How should matrimonial property settlements and disposal of assets on death be treated?**

   Such issues can be dealt with by deferring the gain until the recipient ultimately disposes of the asset. For example, under Australia laws in the case of death and inheritance CGT is not triggered. If the asset is a pre-CGT asset the acquirer is deemed to have acquired it at the market value at the date of death. If it is a post CGT asset they receive the cost base from the deceased. More information can be provided on this if required by the TWG.

4. **What assets should be covered given that the terms of reference exclude any tax on the family home? Should it include just rental properties, shares, collectibles, private assets such as cars?**

   CPA Australia submits that should the New Zealand Government decide to introduce a CGT that it allows exemptions for certain private assets such as cars. Australia also has special rules for certain 'personal use assets'. For an overview of Australia's CGT rules regarding different asset types see here: https://www.ato.gov.au/general/capital-gains-tax/cgt-assets-and-exemptions/

5. **Should assets held by KiwiSaver and other savings schemes be taxed?**

   There is an argument that such gains should not be taxed at the full rate to encourage personal savings. See CPA Australia's comments elsewhere in this paper regarding a lower tax rate on KiwiSaver accounts, and also note CPA Australia's comments on the taxation of passive income such as rents, interest income and dividends outside the KiwiSaver regime.

6. **Should assets held offshore be subject to tax?**

   Yes. A New Zealand tax resident should be taxed on their worldwide income.

7. **How would a capital gains tax integrate with current tax laws, such as when land sales are already taxable, our company imputation system and our CFC/FDR rules?**

   New Zealand already taxes certain land sales. The CGT regime should apply to land sales not already captured under the current income tax laws - subject to specific exemptions and deferrals mentioned elsewhere in this submission - including the exemption for the taxpayer's main residence.

[31] https://www.ato.gov.au/General/Capital-gains-tax/CGT-assets-and-exemptions/

One issue raised by members during our consultations however was whether the exemption on the main residence should also be subject to a threshold – for example, whether net capital gains over $1,000,000 should be subject to CGT - thus carving out nominal gains for most taxpayers while at the same time providing additional fairness and equity in the tax regime.

8. When should non-residents be subject to tax?

Special rules are required. More details can be provided on this in due course if necessary.

9. Should capital losses be ring-fenced to be offset only against capital gains income or should they be offset against any income? If capital gains are taxed on a realisation basis tax base maintenance considerations suggest that capital losses should be ring-fenced.

CPA Australia supports ring-fencing CGT losses.

10. Should there be roll-over relief allowing capital gains re-invested in similar assets to be treated as unrealised? If so, when should roll-over relief apply? For example, should a farmer selling a farm and buying a new farm be taxed on the increase in value of the old farm?

Australia has a range of reliefs for businesses and more information can be provided on these if required.

11. How should death, emigration and immigration be handled?

Special rules are required. More details can be provided on this in due course if necessary.

12. How should gifts and gambling winnings be taxed?

It is suggested that a gift could trigger a CGT liability depending on what the gift was. For example:

- A gift of cash – no CGT.
- A gift of the family home to a person – no CGT as the home is exempt.
- The gift of shares, commercial property, antiques etc. – subject to CGT if a post CGT asset.

13. What should the rate of tax on tax on capital gains be – the normal income tax rates, or some other rate(s)?

CPA Australia suggest a lower rate be applied to capital gains to reflect risk and reward and to not stymie investment. For example, in Australia individuals may get a 50 per cent discount. There are other special rules for business also – retirement exemption, rollover relief, 15 year exemption, etc. We can provide more details on this should it be required.

14. Should any allowance be given for inflation in calculating capital gains?

Ideally taxing real gains rather than nominal gain is appropriate. However, in low inflationary times and for simplicity taxing nominal gains is simpler and arguably not too distortive.

15. Should there be a de minimis rule?

CPA Australia is supportive of a de minimus rule, say $20,000.

16. What administrative implications would there be from a capital gains tax?

The administrative implications for both the IRD and taxpayers will depend on the ultimate design of any CGT. But they will include changes to record keeping for New Zealand taxpayers - to enable them to correctly work out their capital gains (and losses) amongst other things.

17. What rules should govern the transition into a capital gains tax? The options seem to be cost of the assets (retrospective taxation of past accrued gains), valuation at date of introduction or only assets acquired post introduction (the Australian rule).

CPA Australia is supportive of the ‘only assets acquired post introduction model’ as per the Australian model.

18. How should family trusts be integrated into the system?

Trusts and relevant trust assets would also need to be subject to CGT.

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