Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

Release Document

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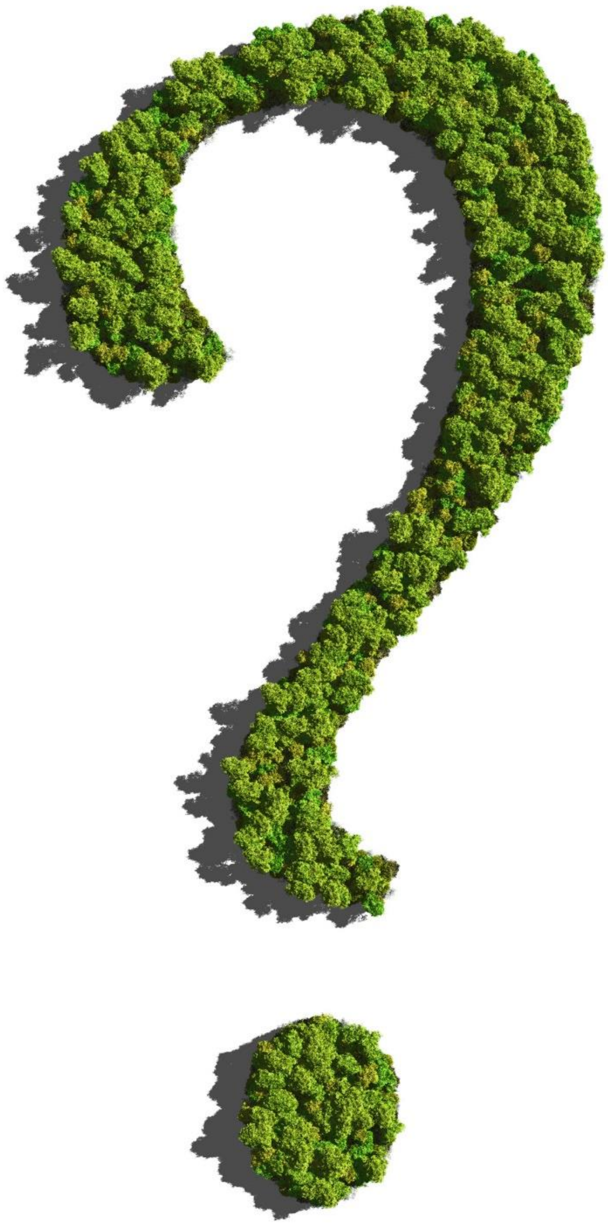
Tax Working Group



Submission April 2018

Financial Cohorts Forum
(Christchurch)

Tax Working Group Secretariat
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By email: submissions@taxworkinggroup.govt.nz

27 April 2018

Dear Sir Michael Cullen

Re: Tax Working Group Submissions

We welcome the opportunity to make submissions on the future of our New Zealand tax system and applaud the Tax Working Group in undertaking this initiative.

To provide you with some context, I am the Chairperson of a close group of financial professionals employed by a range of upper scale medium sized organisations. As a Group we seek to meet on a bi-monthly basis to discuss topical issues of interest.

This submission is made on behalf of this Group and is supported by Mark Lodder, Tax Partner, BDO Christchurch Limited (who assists in facilitating and co-ordinating our discussions). To be clear, the views presented are those of this Group and not those of BDO.

In making this submission we have observed the following directions:

- "Tax is not just for experts", this is not a technical submission and in the absence of such our submission points are posed largely as questions requiring further thought and deliberation. We acknowledge that there are many wider discussions including the existing Double Tax Treaty regime, in its current form, which may discount certain submission points.
- "Tax should operate neutrally and as much in the background as possible".
- The above point is to be contrasted with a tax system that offers equity and balance.
- Areas outside of scope of discussion include inheritance tax, increases in income tax and/or GST rates.

As a general comment, based on the current evolution of our respective businesses along with rapid technological advances we are constantly reminded that what we did yesterday and do today may not be fit for purpose tomorrow. We have considered this in light of our current tax system.

Our submission is structured focussing on each of the five key questions posed by the Tax Working Group in turn.

Thank you again on behalf of our Group for the opportunity to submit. We look forward to continued dialogue and the Tax Working Group's considerations and recommendations with interest.

Yours faithfully

[1]

Dale Andrews
Chairperson, Financial Cohorts Forum
Financial Controller, Southern Rehab

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What does the future of tax look like to us?

It is said that New Zealand operates a “broad base, low rate tax system”. As a Group we fundamentally agree with this approach and would be protective of it. In particular we see that being “broad base” (noting our comments below) supports an objective of simplicity and tax operating “neutrally and in the background”.

We do, however, question whether the current system will be broad enough in the future to meet the needs of our country. Specifically, our concerns are that the current tax system seeks, on the whole, to tax functions performed and labour.

It is yet to be determined whether digital revolution will result in fewer jobs or create new jobs, some that have not yet been thought of. With respect to an environment that reflects the former our views are that:

- The tax system is not necessarily broad enough to capture sufficient revenue streams, on the assumption PAYE monies will fall.

- We appreciate that, in theory, corporation taxes could rise, however from a social perspective does this mean a widening gulf between those who are rewarded through risk and invention, verses those who are currently rewarded through labour (if labour is to be replaced)? Our concern is that this is a very real risk.

With respect to remedies, we have discussed:

- The pending Research and Development Tax Credit and its objective of using the tax system as a tool to encourage investment in this area.

- Is it appropriate that the tax system offers an incentive to organisations that employ people as opposed to machines/technology? Conversely, should technology rich organisations be taxed at a higher rate to reflect the loss of PAYE revenues that would have otherwise arisen?

- We have some sympathy for a capital gains tax regime. We can acknowledge that arguably the absence of a capital gains tax does not lend itself to our tax system being “broad base” as it excludes a type of taxation and the absence thereof could be said to encourage certain behaviour (and not congruent with the tax system offering neutrality and operating in the background).

- A fundamental change to how organisations are taxed and globalisation. As a general premise, organisations are taxed in jurisdictions based on residency or source. Source often is dictated by a physical presence. We would like to explore whether income tax would be better imposed on the residency of the consumer, and to recognise that the consumer is the real driver of profitability.

  We note that the recently introduced “Netflix” tax and Sales Tax regimes in the US largely reflects this notion. Would this approach, which seeks to tax income based on the location of the consumer, render tax havens largely redundant (and assist with the BEPS initiative)?

  To this end, we offer the taxation of business profits to be imposed based on a pro rata apportionment of net profit to jurisdictional sales.

For example:

MeteorSoft Ltd is incorporated in Bermuda and is not subject to income tax either in Bermuda or anywhere else in the world due to tax efficient structuring. Its net profits total $10m. Its consumers, together with quantum of sales is as follows:

Residence of consumers	***Total sales ($)***	***% of total sales***	***Net profit apportionment ($)***
United States of America	*20m*	*40%*	*4m*
United Kingdom	*14m*	*28%*	*2.8m*
Australia	*7m*	*14%*	*1.4m*
Germany	*4m*	*8%*	*0.8m*
Argentina	*3m*	*6%*	*0.6m*
New Zealand	*2m*	*4%*	*0.4m*
Total	***50m***	***100%***	***10m***

Taxable income (assuming net profit equates to taxable income) totals $0.4m in New Zealand, whereas no amount is subject to tax under the current system (due to a policy of taxing based on residency and source).

What is the purpose of tax?

The Group's position is that the purpose of tax is simple. Taxation is needed to pay for things we all need and use. It ideally should be fair, simple, certain and flexible and nimble in today's evolving world (note recent discussions on cryptocurrency and how it should be taxed). It should also collect more than it costs to collect.

As per your direction it is acknowledged there is a compromise between equity and simplicity. Often simplicity creates unfairness (and vice versa). In addition, in our experience, we consider that too much certainty can lead to inflexibility in the system and manipulation.

We consider that the performance of the tax system can be measured in part by:

- Comparing total collection to the costs of collection (as a key performance indicator for Inland Revenue);
- A police force that is achieving targets;
- A health system that is achieving targets;
- An education system that is delivering a quality, innovative and adaptable future work force;
- Stability in Government;
- A reducing or relatively low hidden economy.

Equity is difficult to achieve and we concur that what is considered fair to one is not necessarily considered fair to another.

It is an example often seen, but it is difficult to argue that a tax system that offers the following as equitable:

John and Mary have three children. All children attend schools, they visit A&E from time to time and have had their house burgled (the Police found the culprits and recovered all their belongings).

Barry and Bobbi also have three children. All children attend schools, they visit A&E from time to time and have had their house burgled (the Police found the culprits and recovered all their belongings).

Apart from the names, the families are very similar, except…John had a start-up business developing new technology. The business generated tax losses and never paid any tax. John sold the business for a large capital gain, $2m. The family lives off the $2m capital gain, spending around $100,000 per year.

Barry and Bobbi live off Bobbi's $100,000 salary in a professional law firm.

Both use the same services and have very similar life styles, however one pays tax, the other doesn't.

This example, lends itself to the argument that if we all use the same public services then we should all pay proportionately to use. However, it is then necessary to balance this with ability to pay and need.

Furthermore, given the majority of taxes paid are incurred by the few, in the absence of economic information, we question whether a tax system based on "use" would generate sufficient funds? A fair system is one where taxpayers pay tax on a progressive basis.

To this end, the question arises as to whether companies should also be taxed on the same basis, rather than a flat rate? We concur that there is merit in exploring this (especially as a lower rate could be utilised using an alternative structure to an ordinary company).

We appreciate that a discussion on the welfare system is outside of the scope, but agree that empathy and looking after the whole of the population must also be considered.

We consider that a fair system generates sufficient funds for public spending, that in itself is administered efficiently.

Are we taxing the right thing?

In our working life, we are constantly reminded that what we did yesterday may not be fit for purpose tomorrow. We consider this question is somewhat interlinked to the question of "what the future of taxation looks to us".

We consider the same principle applies to our tax system. We are concerned that a tax system that focuses upon taxing function/labour could well be obsolete and wholly inefficient depending on how society continues to adopt and adapt to technological advance.

Our group considers that we should not discount exploring further a tax system that encourages or discourages certain behaviour. It can be a useful tool in a country's amour to achieve overriding desired objectives (for example in relation to alcohol and tobacco), but perhaps it should not be the tool of choice.

We have discussed four main areas:

1. **Taxation of multinationals**

   We have provided detail in this regard per above. We consider that "consumption" and "residency of the consumer" as the focal point of taxing multinational organisations, as opposed to residency and source. Taxing based on residency and source have been the foundation of the tax system, before the world was able to sell remotely. Circumstances have changed. We consider that this approach could reduce manipulation and use of tax havens.

2. **Savings**

   Given the aging population and potential burden upon society we consider a system that encourages saving appropriate. We consider a system that provides tax relief at source for those saving for retirement worthy of further discussion (and would not be incongruent with similar systems overseas).

   We agree that taxing pension receipts in the future appropriate and that the receipt of a pension should be based on means. We consider this approach in line with a progressive tax system as it currently stands.

3. **Capital gains tax**

   As a Group we have been fiercely protective and somewhat proud of our system that does not tax capital gains. However, in doing so we acknowledge that the absence of such has led inequity, complexity and uncertainty of our tax system.

   For example, the taxation of land transactions is often widely misunderstood and is complex.

   The recently introduced bright-line test is effectively a pure capital gains tax (largely because it does not discriminate as to the reasons for a disposal), operating within the confines of income tax legislation.

   As a compromised position, our Group discussed the introduction of taxing capital gains on foreign non-resident investors, especially if the investor resides in a country that operates a capital gains tax. We are aware of countries that operate systems whereby foreign investors are taxed differently from domestic taxpayers, in particular Australia and stamp duty rates. And closer to home our withholding tax regime has different rules for domestic and foreign taxpayers.

   We consider that a capital gains tax if introduced should operate on a realised basis. A mechanism should be introduced such that taxpayers cannot avoid capital gains tax merely by leaving the country (it may operate on a pro rata ownership basis and seek to tax a share on ultimate sale).

Complexity arises upon gifting of assets and requires careful consideration. For example, how do you deal with a "gift" on death? Depending on the objective of a capital gains tax, its application could be diluted in the absence of an Inheritance Tax as a backstop (which the Group is fundamentally opposed to).

We appreciate that there are many pros and cons in discussing the validity of a capital gains tax.

We look forward to continued discussions in this regard. As previously mentioned, our thoughts are softening in this area and we have increased sympathy for a capital gains tax that is carefully considered and executed.

4. "Bad" behaviour

As a general observation we consider that there are many examples within the tax system that offers elements of distortion and may encourage or discourage certain behaviours.

For example:

- The proposed research and development concessionary treatment recently a revisited topic of discussion;
- Concessionary tax treatment for the agricultural industry;
- Income tax treatment of portfolio foreign equity interests versus domestic portfolio equity interests (in particular the tax treatment of traders);
- Changes to the taxation of residential property (bright-line) and proposed future changes (ring-fencing of tax losses).

We are not convinced that there should be a greater role for tax in promoting certain behaviours, but rather it be accepted as a tool that should be used under appropriate circumstances. For example, if society's behaviour is placing too much burden on the welfare system, then we may need to introduce complexity in this regard to rebalance (i.e. a sugar tax).

Can tax make housing more affordable?

Our view is that the answer to this in short is “no”. We do consider, however, that tax in respect to housing may provide equity.

That being said, we are not convinced that it would be appropriate to discriminate between the taxation of residential housing to commercial. Could this give rise to distorted investment decisions and encourage investment in commercial property as opposed to residential, and shifting focus or creating a problem elsewhere?

As a point of note, we do not consider residential property is necessarily taxed any differently to other investments. For example, most goodwill on the sale of a business is equally not taxed as for residential property. One could argue further, in particular, that the introduction of the bright-line test could be seen to encourage more investment in businesses.

Tax issues that matter most to us as a Group

For us as a Group common issues that we currently face in our business are:

- **Double Taxation**

  We are frustrated with a global fixation on multinationals paying little or no tax and/or double dipping on deductions. More often is the case that small global organisations are paying tax twice.

  Ironically Double Tax Agreements act as a sword as much as they do a shield, giving a host country a right to tax income, which ultimately can give rise to taxation of the same income twice upon repatriation to the final shareholder. This is often seen as a deterrent for business owners seeking to take advantage of offshore markets.

  We consider that this problem is of equal significance to the legal manipulation of global tax systems by multinational organisations.

- **Cross-border transactions and working through transfer pricing requirements**

  Continuing with the theme of cross-border transactions we appreciate the existing safe-harbour thresholds for transfer pricing, but would appreciate more. Often the cost of compliance outweighs the commercial benefit in seeking to get this right.

- **The capital gains tax conundrum**

  As previously mentioned, a capital gains tax has merit. We consider it should have the following characteristics:

  - Applies on the realisation of the property (which may alleviate any concerns in relation to Maori assets).
  - It excludes the family home (only one family home). Or as a compromised alternative is excluded to a capped threshold, for example a nil rate band calculated on a multiple of median income.
  - It is taxed at a slightly lower rate, or offers taper relief, to take into account inflation.
  - Certain chattels must be excluded, it should not allow capital losses to arise for ordinarily depreciating property (non-vintage vehicles for example).

- **Future needs and a system that is fit for purpose**

  We are concerned that our tax system will be “huffing and puffing” without effect, because as it currently stands it may not have the ability to tax tomorrow’s world and provide for the needs of New Zealanders (as is its wider purpose).

  As businesses and society evolve, so should a tax system. If the purpose of a tax system is to pay for things society needs, then we may need additional complexity to achieve this objective.