Tax Working Group Public Submissions Information Release

Release Document

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Submission to

The Tax Working Group

on the

Future of Tax – Submissions Background Paper

30 April 2018

1.0 INTRODUCTION

1.1 This submission has been prepared by Bank of New Zealand ("BNZ") in response to the Tax Working Group ("The Group") *Future of Tax: Submissions Background Paper* ("The Background Paper").

1.2 BNZ is a member of the Corporate Taxpayers Group ("CTG") and has been involved in the submissions the CTG has made on The Background Paper. While BNZ is aligned with the submissions made by the CTG, BNZ wishes to make an additional submission on certain specific aspects of the proposals.

2.0 EXECUTIVE SUMMARY

2.1 BNZ recognises the importance of The Group's role to consider the future of tax in New Zealand and to provide the Government with recommendations to improve the fairness, balance and structure of the tax system. However, there is a risk of increased and excessive complexity in the design of solutions to the specific challenges noted in The Background Paper. BNZ submits that The Group should ensure that its recommendations do not introduce excessive complexity in the pursuit of improved equity and efficiency.

2.2 Compliance costs increase the deadweight cost of taxes and unnecessarily deplete valuable monetary and non-monetary resources. BNZ therefore recommends that The Group carefully considers compliance costs associated with its recommendations and that these costs should be balanced with the other objectives of the recommendations. There must be a demonstrable net benefit to New Zealand to justify high compliance costs. Excessive compliance costs risk tax system integrity if taxpayers do not have, or do not chose to allocate, sufficient resources to ensure compliance.

2.3 There is potential for the tax rules to encourage and increase the rates of private savings in New Zealand. BNZ generally supports measures designed to improve personal savings but any concessionary treatment or regime must be well designed to minimise complexity and compliance costs. Concessionary tax rates for bank deposit savings are likely to benefit those on lower income bands proportionately more than those on higher income bands, thereby improving vertical equity.

3.0 SUBMISSIONS

Complexity in tax rule design should be kept to a minimum

3.1 The specific challenges that have been identified in the Background Paper are complex in themselves, and therefore, the possible responses to those specific challenges have potential to be equally complex. BNZ submits that in forming its recommendations to the Government, The Group should carefully consider the economic impact of adding additional complexity into New Zealand's tax system. The Group's recommendations should be as simple as possible to achieve their aims of improving the structure of New Zealand's tax system.

3.2 In considering tax system design, policy makers must often decide on trade-offs between the competing principles of simplicity, equity and efficiency when raising tax revenue. For example, introducing concessions for certain societal groups may improve equity, but in doing so will generally increase the complexity in the tax system. Similarly, proposals to remove perceived biases in the taxation of different asset classes might improve efficiency but if those proposals draw arbitrary distinctions or involve many exemptions the proposals may, by necessity, involve more complex rules.

3.3 It is reasonable to expect some level of complexity in the overall design of the tax system if that system imposes taxes in a way that is equitable and efficient. However, the potential for excessive complexity should be carefully considered when The Group evaluates its range of potential recommendations. High levels of complexity must be justified by a clear net benefit to New Zealand as a whole.

3.4 While high levels of precision in tax rule design may be desirable from a tax equity and efficiency perspective, that may not be achievable without excessive levels of complexity. BNZ submits that some level of imprecision ought to be acceptable in order to maintain simplicity in tax rule design.

3.5 BNZ is of the view that certain recent New Zealand tax law reform has introduced levels of complexity that may not be commensurate with the tax revenue raised, nor the overall net benefit to New

Zealand. Examples of this are the introduction of the Common Reporting Standard, the proposed Anti-Hybrid rules and the changes to the taxation of employee share schemes. The first two examples sought to align New Zealand with international trends. However, while BNZ supports the alignment of New Zealand's tax regime with international trends, in these instances, the alignment provided minimal net benefit to New Zealand. While there may have been sound arguments on efficiency grounds for better alignment of the taxation of employee share schemes as between the company and the employee, the complexity involved is high relative to the net revenue gain.

3.6 The terms of reference in The Background Paper note that "[T]he New Zealand tax system has been justifiably commended internationally for being a simple and efficient system". Often New Zealand's GST system is held out as a particular example of a simple and efficient taxing regime. BNZ considers that this is largely due to the lack of exemptions contained in New Zealand's GST rules. BNZ submits that The Group should proceed with caution when considering recommendations that would involve arbitrary exemptions for GST, or extending GST to tax goods or services that will require highly complex rules to be effective.

3.7 Finally, high levels of complexity in tax law design risk becoming a barrier to compliance, particularly for small and medium business with limited resources to understand what is required to comply with the new rules. BNZ submits that this should not be overlooked by The Group in forming its recommendations.

Compliance costs should be minimised

3.8 Increased complexity inevitably leads to higher compliance costs for both taxpayers and Inland Revenue. Compliance costs are a deadweight cost to the economy. This is widely accepted and supported by numerous academic studies and papers.

3.9 The monetary and non-monetary costs of compliance incurred by the taxpayer are inefficient because they unnecessarily deplete economic resources and do not generate economic value for the taxpayer or for the Government. BNZ submits that in considering potential recommendations, the Group must ensure it carefully balances increases in compliance costs with other tax system design objectives. It is imperative that compliance costs are thoroughly understood and included in the analysis of the net benefit of a proposal.

3.10 BNZ notes the increase in compliance costs associated with recent reform of New Zealand's tax regime. A recent example of this is the investment and employment income changes introduced as part of Inland Revenue's Business Transformation. Businesses, but particularly intermediaries, have and will incur substantial levels of costs in redesigning and developing systems to enable compliance. The benefit to New Zealand appears to be mainly an increase in the timeliness of reporting of income to Inland Revenue with minimal additional tax being collected. BNZ recommends that The Group carefully considers the potential implications of its recommendations to impose further compliance costs on tax payers.

3.11 In addition, significant increases in compliance costs risk reducing levels of tax compliance by taxpayers. Firms and individuals that do not have (or chose not to) allocate sufficient resources to understand their tax obligations may intentionally or inadvertently fail to comply. Such an outcome reduces integrity within the tax system which is undesirable.

Should the tax system encourage saving for retirement as a goal in its own right? If so, what changes would you suggest to achieve this goal?

3.12 It is generally accepted that New Zealand has relatively low levels of savings and personal taxes on savings reduce the level of savings and the incentives to save. BNZ would support changes to the tax system that encourage savings.

3.13 The Background Paper notes a policy concern in New Zealand that there are different tax treatments of different investments. BNZ agrees that it is highly preferable that there are low or no differences in the tax treatment of different types of investment. Figure 21 of The Background Paper provides a comparison of marginal effective tax rates across asset classes. However, BNZ would appreciate more granular detail as to how that effective tax rate has been calculated in Figure 21 to enable the provision of detailed feedback on the comparisons. The noticeably lower marginal effective tax rates on real property may be due to total real returns (i.e. income plus capital returns) being included rather than comparing what is "income" under the current tax settings. Putting aside capital returns, the differences in how income returns from real property is taxed, compared to income returns from other asset classes, is likely to be less pronounced.

3.14 Nevertheless, what is clear from the Figure 21 of The Background Paper is that bank account savings suffer the highest marginal effective tax rate, equal with domestic companies that distribute earnings. This is likely to be driven in large part from the comprehensive taxation that results under the financial arrangements rules, which capture both income and capital returns on financial arrangements.

3.15 A recent report on the *Taxation of Household Savings*[1] prepared by the Organisation for Economic Co-operation and Development ("OECD") found that across the study group, bank deposits formed a proportionately larger share of total gross financial asset holdings for lower income deciles than at higher income deciles. Bank savings accounts formed a much lower proportion of total gross assets for the top income deciles.

3.16 Based on these findings, it seems reasonable to conclude that the high effective tax rate on bank account savings has a greater proportional impact on lower income deciles than it does on higher income deciles, where a wider range of asset classes are typically held. Vertical equity therefore is likely to be increased through some level of concessionary tax treatment of personal savings accounts

3.17 While BNZ is generally not supportive of different tax rules for different asset classes, it would like to see The Group consider potential options to reduce the tax burden on personal savings, provided those options are not expected to overly distort investment decisions.

3.18 A reduced schedular tax rate for interest income, possibly targeted at the low and middle income bands would be a relatively simple option to achieve this. Banks and other payers of interest are already accustomed to deducting withholding tax across a range of different interest rates, meaning that the costs to large interest payers should not be excessive. In addition, through Inland Revenue's Business Transformation project its systems ought to be well placed to administer a schedular tax rate for savings. The potential for distortions in investment decisions is likely to be kept to a minimum if the concessionary rates are targeted at those lower and middle income bands.

3.19 Alternatively, a personal savings allowance, similar to that under the UK tax system, could achieve similar outcomes as far as vertical equity is concerned. The design features would need to be carefully considered to limit the level of complexity for financial institutions and taxpayers.

3.20 A further but more complex alternative worth exploring is a regime similar to the UK's Individual Savings Accounts (ISAs). ISA's allow individuals to contribute savings up to a de minimis amount, with investments returns on that amount not being subject to tax. Like a reduced schedular tax rate for savings, an ISA like product would increase vertical equity as it would proportionately benefit lower and middle income bands. It also effectively results in a taxed-exempt-exempt outcome for qualifying accounts, increasing the compound return that savers would receive.

4.0 CONCLUDING COMMENTS

4.1 BNZ is pleased to provide this submission and the information it contains. BNZ is available to discuss any issues raised.

4.2 Should the Group have any questions in relation to this submission, please contact:

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[1] OECD (2018), *Taxation of Household Savings*, OECD Tax Policy Studies, No. 25, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264289536-en

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