Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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SUBMISSION TO THE TAX WORKING GROUP

This is a personal submission to the Tax Working Group (**TWG**). I do not propose to address all the matters before the TWG. I apologise for the lateness of this.

I have experience in tax in most areas; including as a tax investigator and tax policy advisor with IRD, tax partner at Deloitte, tax advisor to the Minister of Revenue (Wyatt Creech), secretary to the Valabh Committee and, most latterly, director of a multinational company operating in 37 different jurisdictions.

OVERALL POLICY FRAMEWORK AND SETTINGS

The TWG asks "is [New Zealand's 'broad-based, low-rate' system] still the best approach for New Zealand? The answer is an unequivocal "yes". That is not to say there are not areas which could be improved, and qualitative terms like "broad-based" and "low-rate" are open to debate.

It may be oversimplification to state "tax the things you want less of and subsidise the things you want more of", but it is still mostly true. Taxes on work and investment, all other things being equal, result in less of both. These should be held as low as possible, commensurate with the government's revenue objectives, for the health of the economy.

While GST is slightly regressive, the benefits of the tax as part of the revenue mix and its relative simplicity to administer and collect make it an important component. GST is set at a relatively low rate compared with other nations' VAT systems. Clearly it could be higher. Regressive effects of GST when it was introduced and through both rate increases were addressed at the time through the tax and welfare systems.

The mismatch between company tax rates and the maximum marginal rate for individuals is clearly a tension in the system; ideally this would be solved by reducing the maximum marginal rate rather than increasing the corporate tax rate. New Zealand's corporate rate is no longer low by global standards.

Specific recommendations

1. Serious consideration should be given to increasing the GST rate (with appropriate welfare and income tax adjustments). I realise this is outside the TWG's terms so wont labour the point.
2. Extension of CGT should be limited to land sales. If CGT is extended to equities the holdings of non-residents and foreign participation holdings of residents should be exempted in accordance with international norms.
3. Existing flat corporate rates should be maintained (and ideally reduced). There should be no "small business" exemptions.
4. The existing scope of GST should not be reduced to address social concerns. These are best addressed through the welfare system.

TAX AND BUSINESS

I think there are a number of areas where the tax system as it applies to business could be simplified.

I would urge government NOT to introduce a tax credit system for research and development. R&D credits may drive the recording of "R&D" but the evidence that it meaningfully incentivises it is thin, particularly against the cost. It's a "feel good" complexity our tax system does not need.

I think the tax rate for Maori authorities should be aligned with the corporate tax rate but the benefits of the imputation system extended to them to ensure no negative impact on their shareholders/beneficiaries.

I believe the income equalisation schemes for farmers (other than adverse event and disaster relief) should be repealed. They are a needless holdover from prior eras of much higher marginal tax rates.

The tax treatment of non-cash benefits for employees should be consolidated into the FBT regime. Specifically, the provision of food and accommodation to employees. The existing exemption for charities makes no sense (as the FBT is a proxy tax on the employee), unless the desire is to exempt or concessionally-tax the employees of charities (in which case this concession should be explicit).

I think real consideration should be given to levying banks based on their deposits (possibly in conjunction with a lower corporate tax rate). This could be to fund a deposit guarantee scheme but may be worthwhile even if used for general revenue raising. Banks operate in a unique environment and benefit from an implicit government guarantee that should be charged for.

CAPITAL GAINS TAX

New Zealand already taxes many incidences of income which would be regarded as capital gains:

- Gains on financial arrangements
- Short term (<2 years, soon to be <5 years) gains on sale of housing
- Land sales in certain other specified circumstances (e.g. windfall gains from zoning changes)
- Certain FIF gains

This makes the position of New Zealand as "the only country in the OECD without a CGT" a bit less unique. We already tax many capital gains, just not all of them. And of course other countries' CGTs have many exemptions in them as well. So it's more an issue of nomenclature than any fundamental difference in scope of different countries' tax systems.

Previous reviews of the desire or need for a CGT for New Zealand have not resulted in material change to the existing tax base.

Land

Simplification of the existing complex rules for real property could be one effect of extending the base to include all gains on the sale or disposition of real property (presumably with a family home exemption). Such rules would presumably need to extend to the sale of "land rich" companies as well.

Inevitably associated anti-avoidance and compliance arrangements mean that even such a move won't be "simple". However, provided certain policy decisions were made (no inflation adjustment, same rate as income tax, repeal of existing land sale rules) this would probably be a simplification. There would still be 3 issues (at least) which would have complicating impacts (these also apply to any CGT introduced on more asset classes):

- Introduction date. The simplest approach is to impose such a tax on land acquired after a specific (prospective) date. However, that will likely delay any positive revenue impact, although I would argue it is the "fairest" way to bring in such a tax. Applying a CGT to land held at a particular date will impose compliance costs associated with valuation, but these might be ameliorated by allowing an election to use existing land valuations (e.g. for rating).
- Rollover relief. I would be particularly concerned if such a CGT extension impacted on the ability of family farms being passed on. There is a broader question as to whether testamentary dispositions should be treated as taxable (effectively a death duty or estate tax) or allowed for rollover relief.
- Scope. Should such a rule extension apply to non-New Zealand land? Many foreign CGT regimes provide for participation exemptions for foreign holdings. Should the rules apply to non-residents? Most foreign CGT regimes exempt foreigners when it comes to equities but many would tax land.

Equities

I think the case for New Zealand extending the taxation of equities is much weaker than for land:

- Almost all OECD CGT regimes exempt gains on share sales (other than land-rich companies) by non-residents. Given these comprise c50% of the listed share market holdings (and a significant portion of the non-listed market) this significantly reduces the potential scope of any such regime.
- The bulk of the remaining interests in the listed share market are held by kiwisaver funds or other group investments (mostly focused on retirement savings). While the government could decide to increase the tax on retirement saving I don't think this is the correct

direction for a small country with a relatively low savings rate (when you tax something you tend to get less of it).

- Almost all OECD regimes provide a participation exemption for the foreign holdings of domestic investors. There are good policy reasons for this. New Zealand also already has a comprehensive FIF/CFC regime for taxing foreign participations and shareholdings.

Once these items are excluded from the base, one is left to tax the non-listed shareholdings of resident investors. This group, largely SMEs, is the entrepreneurial base of New Zealand. I submit that while there may be equity bases for seeking to tax this group, the potential damage through restriction of entrepreneurial activity (particularly for geographically mobile industries like technology) by the imposition of such taxes does not justify it.

Other assets

If shares remain outside any extension of the CGT there is really no point in looking to extend the existing tax base to include other assets (e.g. intellectual property). I submit the existing rules, particularly relating to royalties and financial arrangements adequately capture gains on other classes of asset.

PROGRESSIVE COMPANY TAXATION

The TWG asks "should the tax system do more to support small businesses? In particular, is there a case for a progressive company tax."

This is a terrible idea. The tax system should not support small business; neither should it impede them. But concessions to "small" businesses (or penalties to "large" businesses) have pernicious effects. They create lock-in effects where businesses can't afford to grow outside of the small business concession. I see this overseas where businesses grow to 50 employees and then stop because the cost of tipping over the "small business" threshold is too high. To the extent progressive tax rates make any sense it is only in respect of individuals.

The best thing a tax system can do for small businesses is to be as unobtrusive as possible. This is less about rates of tax and more about the various imposts of government for compliance (and indeed it is the non-taxation compliance areas which elicit the most complaint, e.g. Statistics).

If something is so bad it needs a concession for small businesses then it is just as bad for a large business (however defined).

GST EXEMPTIONS FOR SPECIFIC GOODS

The TWG seeks submissions on whether there should be exclusions from GST for certain goods and services.

A key benefit of the GST is its relative ease of collection and administration. Overseas systems with multiple rates have ridiculous rule-sets for guidance, with courts and authorities needing to determine if a hot meat pattie between room-temperature buns is a warm or cold food. Those arguing about the regressive nature of GST conveniently forget the large adjustments made to benefits and tax rates to ameliorate those effects when the GST was introduced (and when the rates were increased).

There may be some cases where the GST system might usefully apply to achieve non-tax outcomes (for example removing zero-rating on the export of unprocessed logs as a way of encouraging the domestic industry) but I do not consider this to be in the area of end consumers.

I have kept these comments brief but would be happy to expand.

Yours sincerely

Greg Cole