Tax Working Group
Te Awheawhe Tāke

Tax Working Group Information Release

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This paper has been prepared by the Secretariat to the Tax Working Group for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the whole Group or the Government.

Some papers contain draft suggested text for the Final Report. This text does not constitute the considered views of the Group. Please see the Final Report for the agreed position of the Group.

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Coversheet: **TWG's forward work plan and engagement strategy work**

Background Paper for Session 17 of the Tax Working Group
31 August 2018

This note has been prepared by the Secretariat to support the TWG in deciding on how to prioritise its work programme between the Interim and Final reports.
This memo sets out:

- the areas of remaining work
- potential items on the work plan
- suggestions on prioritisation of these items, and
- a proposed strategy for certain aspects that officials consider would most benefit from public engagement.

The Capital Gains Subgroup has proposed that some of the chapters of the Interim Report should be closed off in order to focus on the development of extending the taxation of capital income issues, which the Secretariat considers to be a reasonable approach.

Based on (i) the Group's direction of travel indicated in the draft Interim Report, and (ii) the likely timetable for ETCI reforms, we recommend that you focus on the following areas:

- ETCI (i) Design & (ii) Effects (including distributional effects where possible)
- RFRM (risk free return method)
- Implications of ETCI for Māori assets
- Finalisation of Tikanga framework
- Consideration of options for a revenue-neutral "package"

The Group may also wish to consider tax and the environment (although we consider that this area requires further work to clarify the scope), and business compliance.

We are confident about our capacity to deliver on the items above, as well as a small amount of work on other areas. However, if the Group wished to progress additional work then trade-offs would need to be made (given the limited time before the Final Report, and the Secretariat and research resources available).

If the Group agrees with this prioritisation, we recommend that the following areas should have specific, targeted engagement with small groups, beginning in late September/early October:

- ETCI - Application to Māori assets
- ETCI - Collective investment vehicles (Managed funds/PIEs/KiwiSaver)
- ETCI - Farming, including livestock and bloodstock
- ETCI - Sale of shares, and other equity interests.
- Tax and the environment (if the Group wishes to do further work in this area).

Please indicate which areas the Group would like to prioritise, and whether you agree with the level of public engagement officials have proposed for each area.

TWG's forward work plan and engagement strategy work

Background Paper for Session 17
of the Tax Working Group

August 2018

Prepared by the Inland Revenue Department and the Treasury

1. Purpose of note

This note has been prepared by the Secretariat to support the Group in deciding on its work programme between the Interim and Final Reports.

To support the Group's thinking, we propose that the Group focus on:

1. What the Group would like to achieve in the Final Report? What does success look like?

2. What is needed to support this goal, bearing in mind the short timeframe and the resources available to the Group?

2. Areas of future work signalled in the Interim Report

The Group noted in its draft Interim Report that its work before the Final Report will include further consideration of measures to extend the taxation of capital income, as well as analysis of the distributional impact of the various options for reform.

3. Priority Items

The ETCI work will require a high level of resourcing from the Secretariat. In our view, the overall effects of any ETCI depend critically on both (i) details of its design, including those on which the Group has not yet decided; and (ii) how the additional revenue raised is used.

Accordingly, in the Secretariat's view the highest priority items for the Group are:

- ETCI (i) Design & (ii) Effects (including distributional effects, where possible[1])
- RFRM (risk free return method)
- Implications of ETCI for Māori assets
- Finalisation of Tikanga framework
- Consideration of options for a revenue-neutral "package" (this is a recommendation by Secretariat)

Further detail about the prioritisation of design topics <u>within</u> ETCI are in Appendix A. This list reflects a list of topics provided by the subgroup. We consider that only decisions on the items in Appendix A that have been identified as high importance are critical to the final report. If the Group would like to finalise some of these issues, it may be most efficient for one or two TWG members to lead these items with Secretariat support.

We consider that targeted consultation on the design of ETCI will be required (discussed further below, under ***Targeted consultation on specific streams of work***).

[1] We will endeavour to provide the fullest amount of information possible on the distributional effects, but this may not be possible given the lack of information about current assets.

4. Proposal by Capital Gains Subgroup

The Capital Gains Subgroup has proposed that some of the chapters of the Interim Report should be closed off in order to focus on the development of ETCI issues (see their note of 21 August 2018, attached as Appendix B). As noted above, we agree that there will need to be trade-offs, and we consider that the subgroup's approach would be a reasonable option.

5. Other Items

There are other items that could be considered for investigation, including further work on environment and business compliance. These are listed at Appendix C. We consider that some but not all of these items could be considered further without compromising the ability to deliver on the items that we have recommended as priority items above. Given time and resource constraints, we consider that there should be a high threshold for including items on this list in the forward work programme, so would welcome the Group's direction on their relative priority.

6. Targeted Consultation on Specific Streams of Work

Appropriate consultation in developing the proposals, particularly the design issues for ETCI, is important. These have time and resource implications that again will need to be traded off against other priorities. However, a greater level of public engagement on some of these items is likely to greatly benefit the Group's final recommendations, as early testing will ensure that they are more likely to be workable and have buy-in from affected groups.

There are specific areas that we think would benefit from targeted engagement with subject matter experts. This would be in addition to the 4 week submission process following the Interim Report. This targeted engagement would be designed to obtain input from tax specialists, industry groups, and affected people (both on specific technical aspects, and on the impact of the proposals) in order for the Secretariat to better advise the Group's final recommendations. The objective of this targeted engagement is to involve a wider set of expertise in order to help the Group come to final recommendations on the topics. We envisage that these workshops would (subject to TWG agreement) include a TWG member(s), officials, and depending on the topic selected, members of the public – this could be a range of: academics, private sector advisors, industry players, representative groups, and others that the Group might suggest.

The ETCI design areas that we think would benefit from specific, targeted engagement are:

- Application to Māori assets
- Collective investment vehicles (managed funds/PIEs/KiwiSaver)
- Farming, including livestock and bloodstock
- Sale of shares and other equity interests.

If the Group wishes to take forward work on the environment for inclusion in the final report, we consider that the environmental area may also benefit from targeted consultation.

If the Group agrees, we will begin working with the Group or individual members of the Group to prepare for engagement in October.

7. Next Steps

Below in Appendix D is a list of the scheduled meetings. The November and December meetings are 1.5 days.

We suggest that the Ministers of Finance and Revenue be invited to an upcoming meeting as soon as possible after the Interim Report has been finalised.

Appendix A: Prioritisation of design topics within ETCI

No.	Issue	Comment	Importance
WHAT TO TAX			
1	What intangible assets are covered	Intellectual property and goodwill clearly included. One issue is taxation of receipts for the transfer, cancellation or breach of other contractual rights, for example an agency agreement, a franchise agreement, a contract to provide services (note that payments for loss of vocation, position or status already taxed under CE 10). A second issue is treatment of payments for grant of a contractual right, for example a payment not to compete (note that payments for not providing services are already taxable except where given in connection with sale of a business, under CE 9).	**High**, not overly technical or complex.
2	Excluded home issues	Treatment of: - change of use – to excluded home, from excluded home, temporary change – do we apportion the gain or (as per interim report) value at time of change - partial use for other purposes - period post-occupation, pre-sale (when exemption continues to be available, how long for, how it interacts with the "only one" principle - valuation issues - interactions with existing regimes - treatment of homes owned by family trusts – allowing for this while ensuring the "only one" principle applies	**High**
3	Foreign residential property	Whether or not to exclude from the base on compliance grounds. In particular, would exclusion apply to rented, non-rented or both, would it be conditional on taxation in the other country	**Medium** – may be quite easy if we don't proceed.

4	Taxation of livestock	How to integrate CGT with existing rules.	**Medium** – will need to bring in some experts.
WHEN TO TAX: ACCRUAL VS REALISATION			
5	Treatment of seismic/watertightness costs	Should there be a rule which effectively allows these costs to be immediately deductible in some cases? For example, where a sale of the property would give rise to a tax loss	**Low.**
6	Migration	Issues include: - whether to allow emigrants to defer tax when leaving, even when assets would otherwise leave the base (e.g. shares in foreign companies) - easing compliance for temporary emigrants - time for determining cost base for immigrants who are transitional residents first	**Medium** Secretariat looking at Australian scheme.
WHEN TO TAX: ROLL-OVER RELIEF			
7	Roll-over on death, gifts and trust settlements	Extent of roll-over.	**High**
8	Deemed disposals by trusts	Whether required to prevent trusts being used to defer CGT.	**Depends on No. 7**
9	Roll-over for involuntary dispositions	Whether this is a good idea, whether it should be limited to reinvestment in same or similar assets	**High**
10	Roll-over for like-kind exchange	Whether to allow and on what basis	**High**
11	Roll-over for corporate reorganisations	To be considered at shareholder and company level.	**Medium**
12	Roll-over for ToW settlement entities	To what extent should sales by ToW entities be entitled to roll-over	**Medium**
HOW TO TAX			
13	Effect on eligibility for social assistance benefits		**Low**

CAPITAL EXPENDITURE			
13A	Cost flow assumptions	When/whether to use FIFO, weighted average cost or LIFO for inventory	**Low**
CAPITAL LOSSES			
14	Loss ringfencing	How broad to go. Need to consider: - business assets - personal assets - losses arising where cost or sale price is determined in a non-market - revenue account assets (if held for a longer period) Will be affected by extent of roll-over relief, and treatment of non-resident owners of NZ companies.	**Medium and depends on rollover.**
TRANSITIONAL RULES			
15	Median rule	Whether to apply to listed assets	**High**
	Valuing property	Whether to accept local body valuations, with or without adjustments Whether rules need to be different for residential vs commercial vs industrial vs agricultural land Whether to allow valuation day valuation to be determined using a pro rata time based apportionment in some cases, either on a compulsory or optional basis. Whether to require use of IFRS or valuations prepared for lenders when available. Need for consistency with other valuation rules where property comes into or leaves the base.	**High**
TAXATION OF SHARES IN FOREIGN COMPANIES			
17	Future of FDR method	Whether to continue with or modify this method, in preference to applying realised CGT. Possible modifications include: - to rate - removal of CV method for individuals and family trusts - taxing net equity and denying interest deductions - removal of the $50,000 *de minimis*	**High**

18	Taxation of CFC interests	Whether or not to tax sales of shares in non-attributing CFCs If not taxing, how to treat partially attributing CFCs	**Low** - decision seems relatively easy
TAXATION OF NEW ZEALAND SHAREHOLDERS IN NEW ZEALAND RESIDENT COMPANIES			
19	Imputation credit continuity rules	Whether these can be relaxed, similar to the Australian rules	**Low**
20	Optional rule to prevent double taxation of unrealised gains	See Appendix para [154]	**Medium**
21	How to recapture grouped loss where loss company sold for a loss	See Appendix para [157]	**Medium**
22	How to deal with unrealised losses in a company sold for a loss	See Appendix para [159]	**Medium**
23	When company can pass out capital gains as sale proceeds or exempt dividends	When should liquidating distributions be treated as exempt (appendix para [162] et seq.)	**Medium**
24	Whether to repeal qualifying companies	See appendix para [166]	**Medium**
25	Interaction of CGT and current dividend rules, including on liquidation	To be reviewed	**Medium**
TAXATION OF KIWISAVER AND OTHER MANAGED INVESTMENT ENTITIES			
26	Interaction of CGT and MPRIEs holding Australian listed and NZ shares	Whether gains should be taxed on realisation, or accrual, subject to FDR, subject to a special fund level tax or exempt. If taxed on accrual, whether to give a discount, and if so, how much Whether to distinguish between KiwiSaver and other MRPIEs	**High**
27	Interaction of CGT and MRPIEs holding non-listed property assets	How to integrate a realisation based tax with the MR PIE regime.	**Medium**
28	Listed PIEs	How to tax sales of shares in listed PIEs	**Low** – not entirely clear

			whether issues are now resolved
29	Taxation of life offices	Life insurers make some use of the PIE regime. Position of life insurance policyholders needs consideration	**Low**
30	Taxation of Maori authorities	Taxation of distributions by, and sales of interests in, Maori authorities requires consideration	**Medium**
TAXATION OF CORPORATE GROUPS			
31	Rules to ensure corporate group transactions are properly dealt with	Principles seem to be agreed, but substantial work will be required to legislate.	**Low**
ADMINISTRATION			
32	Use of withholding taxes		**Medium**
33	Requirements for returns	Should derivation of a taxed gain require filing of a return. Should taxpayers with assets subject to CGT have to file annual cost disclosures/updates, and if so what is the effect on the time bar.	**Medium**
34	What resources will IR need to administer an ETCI		**Medium**
OTHER INTEGRATION ISSUES			
35	FA rule integration		**Low**

Appendix B: Note from Capital Gains Subgroup of 21 August 2018

DISCUSSION NOTE

For: Tax Working Group

From: Joanne, Robin, Craig Geof and Michelle

Date: 21 August 2018

Re: Process and Topics for the Final Report

Introduction

Having finalised Chapter 7 and the appendix on extending the taxation of capital gains, it is apparent to the TWG sub-group (the five of us) that there is a great deal of work still to be undertaken on these issues. Accordingly, here are our suggestions for a possible process through to the Final Report.

Ordinarily this would be discussed at the next meeting but we think the outcome of this note could affect what might be said in the Chair's Introduction chapter and that is why we've produced it before the Interim Report is finalised.

Leaving aside the next meeting (31 August) we have, say, 5 meetings in which to progress issues through to the Final Report. In our view what the Group can consider over this timeframe will be largely dictated by Government's response to the content of the capital gains tax Appendix.

Main agenda item each meeting going forward

To date we have identified various issues that need to be worked through (and have started working through them) to extend the taxation of capital income to those capital gains that are not presently taxed. If the regime is to be introduced within Government's indicated timeframes then a great deal of further work is required, in a short space of time. After our Group's work concludes, this would include finalisation of the rules, legislative drafting and moving the proposals through the Generic Tax Policy Process.

In so far as our Group is concerned, we consider that continuing to address these issues as a subgroup (in a parallel process to the main group) is not the best use of the next few months. It shortens the time available for capital gains issues and removes the entire group from the decision-making process. Additionally, if there are essentially two work streams running (one for entire group and one for the sub-group) then it doubles the work for some members and probably for the officials. We do not consider there is sufficient time to do this.

Assuming the entire group should be fully involved in the decision-making process (as we believe it should be) then the priority would be for the capital gains issues to be the main item(s) on the continuing agenda for each meeting. Issues that are still to be resolved on extending capital gains flow from the Interim Report appendix and a list can be prepared and prioritised by officials, together with sources of additional assistance needed.

In order to resolve difficult issues, we expect that we will need input from tax specialists from within and outside Inland Revenue and from industry groups. We would proceed now to identify those. This is because we need to be reasonably comfortable by the Final Report that our rules can work.

Topics that can be closed off and topics to progress

If extending tax on capital gains is to be our major focus between now and the Final Report, then we consider available time dictates closing off most of the other topics we have been considering. Doing this might affect our conclusions in the Interim Report. In particular, the Group would need to review any comments in some chapters indicating that we would be continuing to work on issues.

Accordingly, here is our listing (for consideration) of the topics that might need to be concluded now. In identifying these, we have asked ourselves how much added value we can bring to each of these "to be closed" topics (from the detail already in the Interim Report and official's papers), as compared with what we still need to do on design issues for capital gains.

<u>Chapter</u>	<u>Topic to be closed</u>
2	Purposes of tax
3	Frameworks
4	Current tax system
5	Issues and Challenges raised by Submitters
6	Structure Fairness and Balance
8	Savings (we think the chapter itself closes but there will be Savings impacts in the capital gains work)
9	Housing (again, the chapter itself closes but there will be Housing impacts in the capital gains work)
10	Environmental and ecological outcomes (not sure about this; is it intended that the group will progress the opportunities in the last paragraph/anything specifically required of the group from the assessments, or does this now go to specialists/other bodies/continue in a subgroup?)
11	Corrective taxes (probably closed)
12	International Tax and the Digital Economy (recommendations have been made)
13	GST
16	Integrity
17	Charities
18	Administration and Compliance (taxing capital gains implications can be dealt with in the new work below)

Assuming we are still progressing consideration of capital gains issues after the Interim Report has been considered then the following Chapters still have open issues and would form the basis of the next Report:

<u>Chapter</u> <u>Topic to be considered further</u>

7	Wealth and capital (probably split into Taxing Capital Gains and RFRM, if Government wants us to continue with RFRM)
14	Personal Income and the future of work (note that the only further work identified in this Chapter is on thresholds)
15	Business tax (tax simplification measures, we are not convinced we have given serious consideration to the wish list from Business NZ/CAANZ or to any tax simplification measures (eg the joint CAANZ/NZLS simplification paper))

No Capital Gains Tax

As a “wild card”, it is worth noting that we already have a fair amount of detail in the Appendix and the Interim Report for Government to consider. They could take soundings from their coalition partners and form an early view on whether the proposals can be introduced. If those are negative then (if directed) we wouldn’t continue with the capital gains design rules but would be looking at more targeted base broadening measures (taxing IP sales, goodwill and anything else we can think of). This last option might be highly unlikely but we mention it to cover the possible outcomes.

Appendix C: Other Items for Consideration

The Group has raised other items that could be explored further, including further work on environment and business compliance. We consider that some, but not all of the following items could be considered further without compromising the ability to deliver on the items which we consider to be priority items.

Environment

- Environmental tax concessions – three areas of interest
  - Identification and evaluation of tax concessions and subsidies relating to agriculture that are having a negative impact on the environment and ecosystems (as committed to in the Interim Report)
  - Broader audit of tax concessions and subsidies (e.g., review of the tax expenditure list) to identify and evaluate concessions on other industries having a negative (or positive) impact on the environmental and ecosystems (e.g., petroleum mining, forestry, fisheries, energy, etc). This picks up on the Secretariat's recommendation for further review in their paper on tax concessions and the environment
  - Comprehensive international review of new tax concessions and subsidies which could have a positive impact on the environment and ecosystems and evaluate potential merits for introducing in NZ (e.g., UK and France concessions for social ecological enterprises)
- Fertilizer tax case study – High level design of a fertilizer tax and/or scope options with focus group (MfE/officials, Fertiliser Association, Pamu (Landcorp), environmental NGOs)
- Database of current enviro taxes – create a complete list of environmental taxes in New Zealand and how they fit into Govt revenue picture (i.e., financial accounts) [70% complete]
- Distributional analysis – further review of distributional impacts of taxes on carbon, water, waste etc.
- Macroeconomic analysis – model macroeconomic impacts of environmental taxes in interim report on macroeconomic variables (e.g., employment, household income) – could outsource to ex-tax
- Testing Interim Report findings on tax and the environment with focus group, or outsource to 'deliberative democracy' provider (proposals received in range of $20k - $100k)
- New environmental tax opportunities – review of ex-tax environmental tax proposals / database to investigate if there are specific new environmental taxes the Group would like to recommend
- Review of capital income tax for natural capital impacts
- Review of Generic Tax Policy Process to see how it can better account for impacts of tax policy on natural capital
- Spatial distribution of environmental tax options and/or environmental tax concessions (i.e., map where taxes are coming from and where concessions are going) to support potential future work on economic footprint tax / 'upgraded land tax'

Compliance

- More information on business compliance costs
- Seeing if there are any other simplification options that could be considered for business – particularly small business (there is a short list in the current draft of the business chapter, which effectively signal other things the Government could do rather than have a lower headline rate for small businesses).

Land banking

- Anything further that could be done on land banking

Further information

- What information IR could gather that would be most useful (the Secretariat is unsure if 'useful' was in the context of future tax reviews/policy or independent researchers on things like distributional analysis?)

Administration

- A truncated tax disputes process

Future of work

- Personal income and future of work

Appendix D: Upcoming Meeting Dates

14 September	Wellington	1 day
28 September	Auckland	1 day
12 October	Wellington	1 day
26 October	Auckland	1 day
8-9 November	Wellington	1.5 days (including Thursday 1-5pm)
22-23 November	Auckland	1.5 days including Thursday 1-5pm)
6-7 December	Wellington	1.5 days including Thursday 1-5pm)
20-21 December	Auckland	1.5 days including Thursday 1-5pm)