



*Tax Working Group*  
*Te Awheawhe Tāke*

**Tax Working Group Information Release**

**Release Document**

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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.*

**Key to sections of the Official Information Act 1982 under which information has been withheld.**

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- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;
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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: **Extending the taxation of capital income: implications for Māori collectively-owned assets**

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*Background Paper for Session 18 of the Tax Working Group  
September 2018*

## Purpose of discussion

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This paper has three main purposes:

- Provide the Group with a high-level overview of Māori collectively-owned assets and Te Ao Māori perspectives, as a basis for understanding the impact of any changes recommended by the Group for Māori organisations.
- Explore the possible implications of the Group's consideration of extending the taxation of capital income for Māori collectively-owned assets.
- Outline the proposed approach to engagement with Māori after the Interim Report is released, and how this will inform further advice to the Group, in time for consideration of recommendations for the Final Report to be released in February 2019.

***Note: This paper is currently undergoing a review by the Crown Law Office (CLO). All statements regarding actions or omissions by the Crown or the nature of legal risks may be amended or made subject to Legal Professional Privilege, depending on legal advice.***

## Key points for discussion

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- In relation to the Te Ao Māori workstream, do you agree with the Secretariat's proposed focus on possible implications of the Group's consideration of extending the taxation of capital income?
- Do you consider the main issues have been sufficiently canvassed to inform planning for effective engagement with Māori in late September/October?
- Do you support the proposed engagement objectives of: (1) ensuring the recommendations and ideas raised in the Interim Report and any possible implications are clearly understood by Māori; and (2) seeking information about likely impacts to inform further advice?
- Do you support the proposed engagement strategy of:

- Soft-testing late September (two small-scale hui) to ensure we are engaging with an appropriate range of key stakeholders and that the materials for the consultation are fit-for-purpose.
- Holding formal hui in early- to mid-October covering:
  - the recommendations of the Interim Report;
  - the development of *He Ara Waiora – A Pathway Towards Wellbeing* (policy framework); and
  - scenarios of what the recommendations might mean in practice, with a particular focus on extending the taxation of capital income.
- Providing a summary of feedback and an explanation of how it has informed the proposals to stakeholders once the Final Report is released in February.

## Recommended actions

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We recommend that you:

- a **note** the historical context of the alienation of Māori land by the Crown and the approach to restoration (including through the settlement of historic Treaty of Waitangi claims) that impacts on the current objectives, management, and utilisation of Māori collectively-owned assets.
- b **note** that the Crown has an obligation under the Treaty of Waitangi to understand the impact of any proposed policy changes for Māori, to consider how any negative or unintended effects might be mitigated, and to balance consideration of any impacts for Māori with broader public policy objectives.
- c **note** that the impact of extending the taxation of capital income for Māori collectively-owned assets will depend on design features, including the nature of any roll-over relief.
- d **agree** to the following tiered Māori engagement strategy that will provide information about the recommendations and ideas raised in the Interim Report of interest to Māori and seek insights on their implications:
  - soft-testing in late September in Wellington and Auckland;
  - formal hui in early to mid-October in five locations throughout New Zealand; and
  - providing all participants with a summary of feedback and an explanation of how this has been reflected in the Group’s final recommendations on release of the Final Report in February 2019.
- e **agree** that the Secretariat provide advice to the Tax Working Group after the engagement in September and October to inform recommendations for the Final Report.

# Extending the taxation of capital income: implications for Māori collectively-owned assets

*Background Paper for Session 18  
of the Tax Working Group*

September 2018

*Prepared by Inland Revenue and the New Zealand Treasury*

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## Executive Summary

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Māori organisations have expressed interest in a range of issues under consideration by the Tax Working Group (the Group). Some of the ideas explored in the Interim Report, particularly extending the taxation of capital income, could have significant implications for Māori, and particularly for current and future beneficiaries of Māori collectively-owned assets.

This paper sets out some of the historical context of the Crown-Māori relationship and the implications for contemporary policy development. It examines the specific context of Māori collectively-owned assets and the possible implications of the Group's consideration of extending the taxation of capital income.

Importantly, the implications of extending the taxation of capital income will depend on the associated design features. The main design choices identified in the Interim Report include defining what assets would be included, when to tax, and how to tax. This paper focuses on the implications of a realisation-based approach, and notes that decisions regarding roll-over relief will substantially influence the nature and extent of impacts for Māori collectively-owned assets.

It is proposed that the engagement with Māori, mainly in October, aims to ensure that the recommendations and ideas raised in the Interim Report are well understood and that possible implications for Māori are socialised. In particular, it is proposed that scenarios be explored with stakeholders to test understanding of the types of transactions that might be impacted by extending the taxation of capital income (with, or without, the roll-over relief principles identified in the Interim Report).

Feedback from the engagement process will inform further advice to support the Group's decisions on recommendations for the Final Report.

# Introduction

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## Purpose

1. The purpose of this paper is to:
  - Provide the Group with a high-level overview of Māori collectively-owned assets and Te Ao Māori perspectives, as a basis for understanding the impact of any changes recommended by the Group for Māori organisations.
  - Explore the possible implications of the Group's consideration of extending the taxation of capital income for Māori collectively-owned assets, which will be more fully tested through consultation.
  - Outline the proposed approach to engagement with Māori after the Interim Report is released, and how this will inform further advice to the Group, in time for consideration of recommendations for the Final Report to be released in February 2019.

## Background

2. During public consultation in March and April 2018, the Tax Working Group received submissions from a range of Māori organisations. These submissions expressed interest in a range of tax issues, including:
  - extending the taxation of capital income;
  - land tax;
  - housing;
  - charities;
  - Māori authorities; and
  - environmental taxes.
3. The Tax Working Group Secretariat provided advice earlier this year on tax treatment of Māori authorities and charities. Following this, the Tax Working Group's Interim Report sets out the Group's broad direction with the following recommendations:
  - that wholly-owned subsidiaries of Māori authorities be eligible for the 17.5% rate, perhaps by being treated as Māori authorities in their own right;
  - that the Government investigate whether the default withholding tax rate for Māori Authorities should also be lowered to 17.5% through the Tax Policy Work Programme; and
  - that the tax treatment of charities be reviewed again following the conclusion of the current review of the Charities Act 2005.
4. This paper focuses on the impact of extending the taxation of capital income, as:
  - extending the taxation of capital income has the potential to be the most significant area of policy change recommended by the Group;
  - in other areas, such as in relation to environmental taxes, the recommendations of the Group will likely lead to, or be reflected in, policy processes in which Māori rights and interests will be addressed; and

- for other areas where the broad direction has been set out in the Interim Report, such as in relation to Māori authorities and charities, further advice will be provided to the Group about specific aspects that may require further consideration after stakeholder engagement has been completed.

### Developing a framework to support a future-focused tax system

5. The Group has indicated that it considers it is important to bring a broad conception of wellbeing and living standards to its work – including a consideration of Te Ao Māori perspectives on the tax system. To support this, a framework is being developed that reflects principles from Te Ao Māori, alongside the four capitals of the Living Standards Framework and the principles of tax policy design. This includes exploring concepts of *waiora* (wellbeing), *manaakitanga* (care and respect), *kaitiakitanga* (stewardship), *whanaungatanga* (relationships and connectedness), and *ōhanga* (prosperity).
6. The ‘prototype’ framework below represents the start of a journey to develop tax policy that reflects the distinctive characteristics of New Zealand in order to improve outcomes for Māori, and for all New Zealanders. To reflect the importance of the journey, and that we are far from our landing place of achieving those outcomes, this work is currently named *He Ara Waiora – A Pathway Towards Wellbeing*.



**Waiora** speaks to a broad conception of human wellbeing, grounded in water (*wai*) as the source of all life.

The foundations for wellbeing come through **kaitiakitanga** (stewardship of all our resources), **manaakitanga** (care for others), **ōhanga** (prosperity), and **whanaunatanga** (the connections between us).

These foundations support the development of the four capital stocks: **financial and physical** capital; **human** capital; **social** capital; and **natural** capital. Wellbeing depends on the sustainable growth and distribution of these four capitals, which together represent the comprehensive wealth of New Zealand.

7. We have integrated within this framework the established principles of tax policy design (see Appendix A):
  - efficiency;
  - equity and fairness;
  - revenue integrity;
  - fiscal adequacy;
  - compliance and administration costs; and



- coherence.
8. For example, achieving fairness can be seen as an expression of manaakitanga, efficiency as a facet of prosperity, and revenue integrity as necessary to support kaitiakitanga by maintaining the durability of the tax system over time.
  9. As such, this approach enables us to link our highest-level aspirations for our tax system with the specific design characteristics of the system. It provides a common language for us to debate the trade-offs between our aspirations, and merits of different mechanisms for achieving them.

## Background

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### Historical context

10. In order to be able to assess the implications of the proposal to extend the taxation of capital income, it is important to understand the history of and context within which Māori collectively-owned assets operate.
11. Prior to Pākehā (European) settlement in Aotearoa, Māori established territorial rights over land through the customary law concepts of tino rangatiratanga (sovereignty), asserting mana whenua (authority over a territory), and ahi kā (keeping the home fires burning / occupation).
12. Collectively, these customs awarded hapū authority over an area as well as the right to carry out social, cultural, and economic activity on the land and use of any associated taonga (assets). In turn, the hapū incurred obligations and responsibilities to protect and nurture the ecosystem, people, and way of life for current and future generations. These duties were captured in tikanga, the knowledge of which is preserved in whakapapa, waiata, korero, and Mātauranga Māori. Individual Māori identify their connection to hapū and whenua (translated as both ‘land’ and ‘umbilical cord’) through whakapapa (genealogy).
13. Prior to 1840, the Māori way of life was premised on a Te Ao Māori value system which upheld practices of tikanga and kawa (customs, protocols, practices, codes of conduct) and maintained wellbeing and prosperity by observing the balance between tapu and noa.<sup>1</sup>
14. In the years following the signing of the Treaty of Waitangi (1840), the Crown reconstructed the cultural, social, political, and commercial landscape of Aotearoa New Zealand.
15. In 1818, all of the land in Aotearoa New Zealand was Māori land and the entire resident population was Māori. By 1862, the Crown had acquired approximately two-thirds of all the land. Subsequent legislation further enabled the Crown to acquire Māori land for settlement which effectively dispossessed Māori of most of their ancestral lands, and negatively impacted the way Māori sustained their value systems and customary law. Examples include:
  - The New Zealand Settlement Act 1863 allowed for the confiscation (raupatu) of land without compensation.
  - The Native Lands Act 1865 converted customary titles (collective ownership) to individual titles on a mass scale, this led to a substantial loss of Māori land.

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<sup>1</sup> Tapu refers to the sacred, restricted, or prohibited and noa refers to the common or without restraint. Concepts of tapu and noa place restrictions or remove restraints in ways to control behaviour towards each other and the environment. These concepts enabled Māori society to maintain balance for wellbeing and prosperity.

- The Public Works Act 1928 and the Reserves Act 1977 allowed the Crown to further alienate and displace Māori from their ancestral lands.
  - Maori Reserve Lands Act 1955.
  - Māori Affairs Amendment Act 1967.
16. Today, Māori land, acquired through mana whenua and still retained by iwi, hapū, and whānau, amounts to only 5% of the total land mass of Aotearoa New Zealand. Māori make up 15% of the resident population.<sup>2</sup>
  17. The Crown has acknowledged that historical actions, such as the acquisition and confiscation of Māori land, have disadvantaged Māori economically and socially, with resulting impacts on Māori identity and self-determination. This disruption has also affected the retention of Māori knowledge systems and understanding of kaupapa Māori among individuals.
  18. During the twentieth century, the Crown began taking action to address breaches of the Treaty of Waitangi. For example, the Treaty settlement process offers redress for the Crown's actions or omissions that breached the Treaty. Principles of the Treaty remain significant in the application of New Zealand's legal framework and the Crown has accepted a moral obligation to resolve historical grievances in accordance with these principles.<sup>3</sup> While settlement redress is intended to be fair, durable, and final, it does not fully account for opportunity costs, time value of money, or factor in the resource capability of recipients.
  19. A Treaty claim arises if any Māori are prejudicially affected by Crown actions or omissions, policies or practices, or legislation or legislative instruments that are inconsistent with the principles of the Treaty of Waitangi.<sup>4</sup>
  20. The provision of land and other assets as redress is a critical element of a Treaty settlement, enabling the Crown to take the constitutionally significant step of enacting legislation to remove the right of claimants to pursue their claims in any court or other forum.
  21. Currently, there are various legislative and policy initiatives that support Māori to leverage their assets in the interests of restoring their economic base and improving wellbeing for Māori. Te Ture Whenua Maori Act 1993 intends to facilitate and promote "the retention, use, development, and control of Māori land as taonga tuku iho by Māori owners, their whānau, their hapū, and their descendants, and ... protects wahi tapu". Initiatives such as the Whenua Māori Fund and Ngā Whenua Rāhui support Māori to develop, restore, and increase the utilisation of their land. As a Treaty partner, the Crown endeavours through such mechanisms to strengthen the Crown-Māori relationship, to achieve better economic, social, environmental, and cultural outcomes for Māori, and to enhance tino rangatiratanga.

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<sup>2</sup> Census 2013.

<sup>3</sup> Office of the Treaty Settlement, *Healing the past, building a future: A guide to Treaty of Waitangi claims and negotiations with the Crown*.

<sup>4</sup> See s.6, Treaty of Waitangi Act 1975.

## The Crown's role as a partner to the Treaty of Waitangi

22. In terms of contemporary policy development, the Crown has an obligation under the Treaty of Waitangi to understand the impact of any proposed policy changes for Māori, to consider how any negative or unintended effects might be mitigated, and to balance consideration of any impacts for Māori with broader public policy objectives.
23. The Crown (through the Crown-Māori relations portfolio) has recently been consulting on the proposed intent and values for the Crown/Māori relationship. The Government's intent is to work more effectively with Māori on initiatives that will benefit Māori and the country generally.<sup>5</sup> This intent is shaped by the following values:
  - **Partnership:** The Crown and Māori will act reasonably, honourably, and in good faith towards each other as Treaty partners.
  - **Participation:** The Crown will encourage, and make it easier, for Māori to more actively participate in the relationship.
  - **Protection:** The Crown will take active, positive steps to ensure that Māori interests are protected as appropriate.
  - **Recognition of cultural values:** The Crown will recognise and provide for Māori perspectives and values.
  - **Use mana-enhancing processes:** For example, this involves a commitment to early engagement and an ongoing relationship.

## Māori collectively-owned assets

24. Since the introduction of the English legal system in New Zealand, Māori collectively-owned assets have been administered through a range of specific legal entities, such as post-settlement governance entities (PSGEs), Māori Trust Boards, Tenths Trusts, Ahu Whenua Trusts, and Māori Incorporations (see Appendix C). These entities are generally responsible for holding and managing the assets and administering any benefits to the members. Often, these entities have either charitable or Māori authority tax status and hold assets such as Māori freehold land, general title land, wāhi tapu, river and lake bed title, property (schools and buildings), fishing quota, financial assets (shares and bonds), and cultural taonga.
25. Some collectively-owned Māori assets have been returned through Treaty settlement. In the case of land, these assets generally belonged to Māori prior to European settlement but were lost due to acquisition or confiscation. These losses have prevented the descendants of the original owners from managing, using, or receiving benefit from these assets over that time.
26. A distinctive characteristic of Māori collectively-owned assets is that, generally, the ownership base (being one of whakapapa or birth right) increases as the

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<sup>5</sup> See <https://www.justice.govt.nz/assets/Documents/Publications/Cabinet-paper-Initial-scope-of-CrownMaori-Relations-portfolio.pdf>

population grows. Unlike most other types of assets, new owners do not have to pay for their ownership interest, so there is effectively a perpetual shareholder dilution. In addition, a large proportion of the land is underutilised and/or operations on the land generate relatively low returns.

27. Most collectively-owned assets are managed and developed to:
  - generate growth to restore the economic base of the iwi and hapū;
  - preserve the assets for future generations; and
  - provide benefits to current and future generations of members, typically provided through health, education, and kaumatua grants (at the individual level) and environmental restoration, marae, and community grants are provided for the benefit of the community.
  
28. Some Māori entities managing collectively-owned assets generate returns to distribute to their owners, however, many Māori entities managing collectively-owned assets do not generate large returns on equity because the land:
  - is often marginal, limiting the potential for optimal returns (i.e. best suited to forestry or primary industries rather than the higher returning industries such as horticulture);
  - is often fragmented, limiting the scalability required for productive use;
  - has sometimes been locked-in long-term to perpetual leases (e.g. 99 years) or low-returning industries, such as forestry, while under Crown ownership or management;
  - is subject to distinctive restrictions in its management and administration under legislation (e.g. Te Ture Whenua Māori Act 1993); or
  - may be predominantly used for cultural reasons.
  
29. As a consequence of the low returns obtained by many Māori entities, most entities do not focus on the payment of dividends to individual owners. Some Māori entities generate sufficient profits to make distributions to owners, while other marginally profitable entities will distribute grants for education, health, marae, kaumatua, and tangihanga. Māori entities will typically accumulate reserves, often due to a requirement in their trust deeds or constitutions, to ensure prudent management of their assets for current and future generations, or try and grow their asset base to achieve intergenerational sustainability.
  
30. Two of the major types of assets with distinctive features relevant for consideration in the context of the introduction of an extension of taxation of capital income are:
  - Māori freehold land; and
  - Treaty settlement assets.
  
31. The specific context and constraints around these assets are set out below. The implications for other types of assets will be explored during the consultation in October.

## Māori freehold land

32. Māori freehold land, as defined in Te Ture Whenua Māori Act 1993, comprises approximately 1.4 million hectares (5%) of the total land mass of Aotearoa. It is all that remains of Māori land that was acquired by hapū through mana whenua.
33. Māori freehold land is typically a place of cultural significance through which Māori connect with their whānau through whakapapa. It is often referred to as taonga tuku iho (cultural property, heritage) or *tūrangawaewae*, a place where one has rights of residence and belonging through kinship and whakapapa (representing the continuous genealogical link).
34. Some of the contextual factors around Māori freehold land include:
  - *The extent of fragmentation:*
    - The 1.4 million hectares of Māori freehold land is fragmented, making up over approximately 27,000 land blocks, with an average block size of 52 hectares.
  - *The large number of owners:*
    - Māori freehold land blocks have an average of 113 owners each, ranging from blocks with one owner to one block with 14,703 owners. There are 219 owners per 100 hectares of Māori land compared with approximately 6 owners per 100 hectares for all other land.
  - *Administrative challenges:*
    - The total number of owners recorded is 3.1 million (which exceeds the total Māori population in Aotearoa, 598,602, as recorded in the 2013 census). This indicates the high proportion of deceased and untraceable Māori owners, ownership in multiple blocks and likely errors or inconsistencies in the data. Insufficient and inconsistent owner information can be restrictive for management (e.g. when 75% shareholder resolutions are required or when administering distributions).
  - *Governance issues:*
    - Land blocks with Te Ture Whenua Māori Act 1993 administration structures represent approximately 40% of total land blocks and comprise approximately 80% of the land.<sup>6</sup> Most of them remain ungoverned.
    - A majority (58%) of Māori land blocks have no governance structure.

## Treaty settlement assets

35. Broadly speaking, the Crown has accepted that historic actions by the Crown has had a significant negative economic impact on Māori, which has had flow on effects to other aspects of Māori wellbeing.

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<sup>6</sup> Ministry of Justice Māori Land Update June 2017.

36. The settlement process provides Māori claimant groups with some redress for historic breaches of the Treaty of Waitangi by the Crown. Important elements of settlements include:<sup>7</sup>
- Crown acknowledgements of, and apologies for, Treaty breaches;
  - redress (the principle of redress was identified by the Court of Appeal in the 1987 Lands case); and
  - forward-focused mechanisms to reset and strengthen the ongoing Crown/Māori partnership under the Treaty.
37. The provision of redress enables the Crown to take the constitutionally significant step of enacting legislation to remove the right of claimants to pursue their claims in any court or other forum.

### **Other Māori collectively-owned assets**

38. There may be assets other than Māori freehold land and Settlement assets that Māori own collectively. We expect that any shortfalls in our understanding of Māori collectively-owned assets will be improved through the consultation process.

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<sup>7</sup> Historical claims relate to Crown actions prior to 21 September 1992.

## **Impact of extending taxation of capital income for Māori collectively-owned assets**

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### **Consideration of extending the taxation of capital income**

39. One of the key tasks for the Group has been to assess the structure, fairness, and balance of the tax system to support the Government in its role as *kaitiaki* of the tax system. Although the tax system has many strengths, the Group has found that the tax system relies on a relatively narrow range of taxes, and is not particularly progressive. One of the issues is that a significant element of capital income (gains from the sale of capital assets) is not taxed on a consistent basis. This inconsistent treatment reduces the fairness of the tax system, therefore undermining *manaakitanga*. It is also regressive, because it benefits the wealthiest members of our society. These effects risk undermining the social capital that sustains public acceptance of the tax system.
40. The Group indicates in its Interim Report that it is examining the merits of extending the taxation of capital income. Such a change is expected to improve the fairness and integrity of the tax system, and level the playing field between different types of investments. It will provide an increasing source of revenue over time and, depending on design, it will also enhance the sustainability of the tax system. It is also recognised, however, that extending the taxation of capital income will increase administration and compliance costs, and could lead to some reduction in the overall level of saving and investment in the economy.
41. The Group is currently considering two design options: an extension of the existing tax net (through the taxation of gains on assets that are not already taxed); and the taxation of deemed returns from certain assets (known as the risk-free rate of return method of taxation). The Group is not recommending a wealth tax or a land tax.
42. The Group has identified some design principles or rules under which the tax might be implemented, so that the Government and affected taxpayers (including Māori) can consider all the consequences.

### **Advantages and disadvantages of extending the taxation of capital income**

43. As part of its analysis that New Zealand should adopt a broad-based capital gains tax, the 2017 OECD Economic Survey of New Zealand included a useful summary of the advantages and disadvantages:<sup>8</sup>

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<sup>8</sup> Source: OECD (2006), *Taxation of Capital Gains of Individuals: Policy Considerations and Approaches*, OECD Tax Policy Studies No. 14; OECD (2011), *OECD Economic Surveys New Zealand*, OECD Publishing; Tax Working Group (2010), *A Tax System for New Zealand's Future*, Report of the Victoria University of Wellington Tax Working Group; Treasury and Inland Revenue (2009), "The Taxation of Capital Gains", *Background Paper for the Tax Working Group*.



Advantages	Disadvantages
Increases progressivity of the tax system. <sup>9</sup>	Inefficient lock-in due to incentive to hold on to assets to avoid paying capital gains tax.
Improves horizontal equity by taxing income whether it is earned on capital gains or otherwise.	Taxes accrue on nominal as well as real gains. <sup>10</sup>
Improves efficiency through reducing tax-driven incentives to make investments in assets that provide capital gains rather than income, in particular housing.	In the absence of other tax changes, can discourage saving and investment through reducing post-tax returns, particularly if there are strict limits around relief for capital losses.
Reduces incentive to shelter income from tax by transforming ordinary income into capital gains.	Taxing gains on shares has potential for some double taxation of retained profits on which company tax has already been paid. <sup>11</sup>

### Design features of extending the taxation of capital income

44. The effects of an extension of the taxation of capital income depend of the detailed design of the tax. The main design choices relate to defining what to tax, when to tax, and how to tax.

#### *What to tax?*

45. In its consideration of extending the taxation of capital income, the Group has indicated that this would result in the broad-based taxing of nearly all capital gains.<sup>12</sup> This would include interests in land (excluding the family home – see below), intangible property, all other assets held by a business or for income-producing purposes not already taxed on sale, shares in companies, and other equity interests (such as certain choses in action).
46. The Group’s Terms of Reference require that any proposed taxation of capital gains does not apply to the family home or the land under it. One of the key proposed principles to determine what qualifies as an ‘excluded home’ is whether the house

<sup>9</sup> US and Australian evidence indicates that taxation of capital gains is highly progressive. This is likely to be the case for New Zealand too, as the distribution of wealth is more unequal than that of income: the top 20% of NZ households own almost 70% of net wealth and more than 75% of net wealth excluding owner-occupied dwellings (Statistics NZ, 2016).

<sup>10</sup> This is a feature of nominal tax system more broadly and is more important for taxation of interest-bearing assets. Because capital gains taxed on realisation benefit from deferral of tax payments, real after-tax gains increase over time and thus capital gains are less affected by taxation of nominal gains than are interest-bearing assets (Burman, 2009).

<sup>11</sup> Retained profits are not subject to full double taxation to the extent that there is a value placed on unused imputation credits that can be used for future dividends, as this value will be capitalised into the value of the company and thus increase capital gains (Burman and White, 2009).

<sup>12</sup> Owner-occupied houses are excluded, as are some assets owned by non-residents as a result of practical concerns and our double tax agreements with other countries.

has been occupied mainly as a residence, by the person and their family, as their 'home' which is their 'centre of vital interests'. This is intended to be a 'use' test and not a purpose or intention test.

### *When to tax?*

47. The main options for when to tax are to tax gains as they accrue (as their value appreciates, even if they are not sold) or when they are realised. The Interim Report highlights some significant disadvantages for an accrual-based tax:
  - *Valuation challenges:* A requirement for a valuation at the end of each period to identify the gain or loss could be especially difficult in relation to assets held for non-commercial purposes, such as the wide range of Māori assets held for historical, cultural and spiritual purposes.
  - *Cash flow pressures:* As the tax would be payable at the end of a defined period, even if the asset has not been disposed of during that period. This would be particularly acute for Māori collectively-held assets that are intended to be retained in perpetuity for future generations.
48. In the Interim Report, the Group considers that extending the taxation of capital income would be imposed on realisation rather than accrual in most cases. As such, the realisation approach is the main focus of this paper.
49. Under this approach, the gain on assets is taxed only when the assets are sold. The primary concern with a realisation-based tax from an efficiency perspective is the issue of 'lock in'. 'Lock in' occurs when asset owners retain assets instead of selling them, in order to postpone or avoid realising gains and crystallising the tax liability. To remedy this, and for important fairness concerns, jurisdictions overseas often provide 'roll-over relief' to ensure that tax is deferred on what would otherwise be a realisation event.
50. Roll-over relief is a mechanism that allows a realisation-based tax to accommodate the deferral of taxation on transactions or events that would otherwise trigger a requirement to calculate a taxable gain or loss. The taxation of the gain or loss is deferred until there is a later realisation event that is not itself subject to roll-over relief.
51. Several possible principles of roll-over relief are being explored by the Group. Firstly, one principle may be where there has been a legal change in ownership of the asset giving rise to a technical realisation of the gain or loss but this change is not, in reality, a realisation as most people would understand it.
52. Under this principle, one type of scenario is where there is no change in economic ownership, for example, in a transfer of relationship property where the change in legal ownership reflects the fact that the recipient partner always had an ownership interest in the property. Similar concepts apply to transfer of property between entities owned by the same individuals or between the individual and the entities.

53. With respect to Māori collectively-owned assets this principle could be extended further to include transfers, within a wider whanaunga (family relationships) concept of ownership (e.g. iwi and hapū). In a Māori freehold land context, it may apply to whānau (e.g. preferred classes of alienees). With respect to settlement assets, it could apply to transfer between intra-hapū/iwi entities. Under tikanga concepts, property can often be seen as being held for the collective, including future generations, and these interests could be accommodated by the tax rules.
54. Transactions within a wholly-owned group would also not give rise to any change in economic ownership.
55. Another scenario under this principle is where there has been a legal change in ownership (and a change in substance) but the nature of the transaction is such that it has not given rise to a gain that can be said to have “come home” to the vendor. The clearest example of this is where land is compulsorily acquired for public works and the landowner has used the proceeds to acquire other land as a replacement.
56. With respect to Māori collectively-owned assets the broad application of this principle could allow roll-over relief to apply to Māori collectively-owned asset entities that sell less desirable settlement assets to buy more desirable assets without a tax impost from doing so.

#### ***How to tax?***

57. The Group considers that the income brought into the tax base by extending the taxation of capital income should be taxed in the same way as any other income, unless there is a reason to do otherwise. This means:
  - Taxing income from the realisation (or deemed realisation) of included assets at the person’s usual marginal rate, with no indexation for inflation.
  - Collecting that tax in the same way as income tax is currently collected.

#### **Māori freehold land**

58. Any possible taxation of gains on the sale of Māori freehold land would likely have little impact, as Māori freehold land is rarely sold. Any sale requires the consent of at least 75% of owners. In general, the poor quality of data in owner registers, and the difficulties in accessing owner details, make it challenging for owners to achieve the 75% threshold and, even then, is not assured because it is subject to confirmation by the Māori Land Court. Therefore, it is unlikely that owners of Māori freehold land would realise a capital gain in practice, particularly if the roll-over relief principles explored above were to apply.

#### **Impacts of extending the taxation of capital income to Treaty settlement assets**

59. Key objectives for management of Treaty settlement assets include intergenerational sustainability and restoration of their capital base. iwi/hapū settlement entities typically have a large number of members, and the distribution

of dividends for individual gain is not common practice among the majority of iwi and hapū organisations.

60. In the absence of roll-over relief, if these assets are included in the base for capital income taxation, business-as-usual operations could potentially be triggers for realisation events. Examples include:
- intra-group transfers (i.e. between the PSGE or a Māori authority and its subsidiaries);
  - sale or disposal of assets to exercise a right of first refusal option;
  - sale or disposal of settlement assets to purchase preferred assets of greater cultural significance;
  - sale or disposal of assets to restore the economic base of the iwi/hapū;
  - share transfers within a preferred class of alienees in Māori freehold land; and
  - Buying and selling leasehold interests.
61. Depending on what design choices the Group consider, some of these transactions may fall within the general roll-over principles. However, given that consultation will be in progress while the Group is considering the general principles, the analysis put forward will be a ‘best guess’ at that stage.
62. The Group will receive a full analysis once the general principles are decided and the consultation process is complete.

### **Other possible options**

63. Should further accommodation be considered appropriate to respond to some of the distinct context of Māori collectively-owned assets, a number of options have been identified, for example:

- **An exemption for Māori freehold land that parallels the family home exemption:** While it is unlikely that owners of Māori freehold land will realise a capital gain in practice, particularly if the roll-over relief principles discussed above were to apply, some stakeholders may be concerned at the prospect of Māori freehold land being subject to an extension of capital income taxation. One option for dealing with these concerns would be to introduce an exemption for Māori freehold land that parallels the family home exemption.

The basis for the family home exemption is understood to be that it does not increase the person’s consumption potential as it predominantly represents a place to live and connect the family. This basis for exempting the family home could be considered to be relevant to the treatment of Māori freehold land, as a place where one has rights of residence and belonging through kinship and whakapapa.

- **Involuntary compensation:** A roll-over relief principle could be introduced that applies the same logic as involuntary dispossession, but specifically for

transactions relating to compensation provided that represents less than the value of the loss that has caused the compensation.

- **Grandparenting:** Excluding assets held by iwi entities that have already settled from extending the taxation of capital income (i.e. only settlement assets received after a certain date relating to the policy decision or law change are subject to the tax).
- **Exemption for Māori authorities:** An exemption (or roll-over relief) could be considered to support restoration of the Māori economic base.

64. The merits of these options will be reviewed in further advice to inform the recommendations for the Group's Final Report. These options will not be included in the engagement with Māori stakeholders in October. However, the insights gained through the engagement will inform consideration of whether exploring such options is warranted and their respective merits.

## Next steps

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### Consultation with Māori stakeholders on the Interim Report

65. The Group has agreed to a further stage of engagement with key Māori stakeholders after the release of its Interim Report. This follows on from the Group's consultation with iwi and Māori groups in March/April this year as part of its wider engagement strategy.
66. The objectives of this engagement are:
- to test the content of this paper to ensure our understanding of Māori collectively-owned assets is accurate;
  - to ensure the recommendations and ideas raised in the Interim Report, as well as possible implications, are well understood by iwi, hapū, Māori Trusts and Incorporations, and other applicable Māori groups; and
  - to enable the implications for Māori to be analysed and inform further advice from the Secretariat to the Group to support decisions for the Final Report.
67. The following engagements are proposed:
- **Soft-testing late-September:** Two small-scale hui will be held in Wellington and Auckland in late September with a small group of Māori representatives to test our understanding of the key stakeholders that should be targeted and to ensure that the materials for the consultation are fit-for-purpose. This will support building trust, getting breadth of perspectives, and high-quality engagement for the October hui.
  - **Formal hui in early- to mid-October:**
    - 2-3 hours long.
    - Held at the following locations (based on proximity to key groups and resources of groups to travel): Whangarei, Auckland, Rotorua, Wellington, and Christchurch.
    - Covering:
      - The recommendations and ideas raised in the Interim Report with a focus on the Group's consideration of extending the taxation of capital income.
      - The development of *He Ara Waiora – A Pathway Towards Wellbeing* (policy framework).
      - Scenarios of what the Group's work might mean in practice, particularly focused on the Group's consideration of extending the taxation of capital income. (Materials would only address the content in the Interim Report. The other possible options identified in this paper would not be included in the consultation)
      - Feedback on:
        - how extending the taxation of capital income would impact Māori and particularly Māori collectively-owned assets;

- the extent to which possible roll-over relief principles would cover the range and volume of transactions that tend to occur in relation to Māori collectively-owned assets; and
- the nature and volume of any transactions that might not be captured by the possible roll-over relief principles.
- Open invitation, but specifically targeting: iwi organisations, Te Tumu Paeroa and the Māori Trustee, organisations such as the Federation of Māori Authorities, New Zealand Māori Council, Te Ohu Kaimoana, He kai kei aku ringa, the Iwi Chairs Forum, and Māori economic and social sector groups.
- All Group members are welcome.
- Once the Final Report is released in February, in accordance with good practice, a summary of feedback and how it informed the proposals would be provided to stakeholders.

### **Further advice to support final recommendations**

68. Further advice will be provided to the Group in light of the feedback from the consultation to inform decisions for the Final Report. This approach is consistent with the Crown acting in good faith as a partner to the Treaty of Waitangi and reduces the risk of any contemporary breach of the Treaty.
69. This advice will be informed by *He Ara Waiora: A Pathway to Wellbeing*, the framework currently under development.
70. Particular consideration in this analysis will be given to the Crown's publicly signalled commitments to:
  - **Protection:** The Crown taking active, positive steps to ensure that Māori interests are protected as appropriate.
  - **Recognition of cultural values:** The Crown recognising and providing for Māori perspectives and values.

## Appendix A: Alignment of tikanga concepts with established tax principles



*Waiora* speaks to a broad conception of human wellbeing, grounded in water (wai) as the source of all life.

In the **second tier**, the four tikanga concepts have emerged through the Tax Working Group's public consultation process and subsequent hui.

The **third tier** reflects the four capitals in the Treasury's Living Standards Framework.

The **fourth tier** draws on concepts from the 2018 Investment Statement (He Puna Hao Pātiki), aligned with the established principles for tax policy design (Victoria University of Wellington, 2009).

This diagram is intended to demonstrate the linkages between these frameworks. We acknowledge that the interrelationships are more complex than the one-to-one alignment here, but have endeavoured to show the primary alignment. By weaving together these frameworks, we are aiming to ground the tax system in a context and with language that has meaning for all New Zealanders.



## Appendix B: Additional information about collectively-owned Māori assets

### Asset categories

Collectively-owned Māori assets include: land, river, and lake bed titles; forestry; fishing quota; heritage assets (e.g. marae, intellectual property, and cultural artifacts); geothermal; commercial property; and various commercial operations. These assets can be grouped into a number of different categories:

- **Māori freehold land** refers to a land status created by statute. Unlike general land, the title is derived from custom (not the Crown) and ownership is derived from determinations (i.e. through the succession process) made by the Māori Land Court (originally the Native Land Court).
- **Other collectively-owned Māori land** includes general title land, wāhi tapu (sacred sites e.g. urupā), and Māori reservations (e.g. marae, papakāinga).
- **Treaty of Waitangi settlement redress** includes a variety of assets such as Crown-owned land and property, forestry registration rights, etc.
- **Fisheries:** The Māori Fisheries Act 2004 granted claimant iwi groups with shares in Aotearoa Fisheries Ltd., quota shares, and some cash to increase Māori development and involvement in the New Zealand fishing industry. A purpose of the Act is to “provide for the development of the collective and individual interests of iwi in fisheries, fishing, and fisheries-related activities in a manner that is ultimately for the benefit of all Māori”. Trading of quota is limited to iwi and entities such as Aotearoa Fisheries.
- **Cultural Assets** include marae, wāhi tapu, and other taonga (e.g. Te Reo, tukutuku panels, korowai, etc.).

### Further information about Māori freehold land

Māori freehold land, as defined in the Te Ture Whenua Māori Act 1993, comprises approximately 1.4 million hectares (5%) of the total land mass of Aotearoa. It is all that remains of Māori land that was acquired by hapū through mana whenua.

Māori freehold land is typically a place of cultural significance through which Māori connect with their whānau through whakapapa. It is often referred to as taonga tuku iho (cultural property, heritage) or *tūrangawaewae*, a place where one has rights of residence and belonging through kinship and whakapapa<sup>13</sup> (representing the continuous genealogical link).

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<sup>13</sup> Māoridictionary.co.nz

## **Ownership and succession**

Owners or shareholders in Māori freehold land blocks are either individuals or Whānau Trusts with interests in land blocks registered with the Māori Land Court (originally the Native Land Court). This narrow acknowledgement continues to cause issues for hapū members whose tīpuna were either prevented from, or unable to, have their interests recognised under the legislation governing Māori land. Although these members have a legitimate claim to the land through whakapapa, they are unable to exercise voting rights or be included in management decisions.

Beneficial owners include descendants of recognised owners. Future generations of descendants may become beneficial owners through succession, gifting, or the transfer of interests.

Successions in Māori freehold land on intestacy will generally transfer to the deceased's issue, where there is no issue the Act provides for the ownership interests to transfer to other individuals within defined categories set out in the legislation.

## **Transfer of shares**

Māori freehold land shares can generally only be sold or gifted to people defined in the Act as the 'preferred classes of alienees' – essentially, these are people with a whakapapa connection to recognised shareholders.

## Appendix C: Management structures and use of entities

### Overview

Māori utilise a variety of entity structures to hold and manage their collectively-owned assets. Depending on the nature of the asset, Māori may be required to select from the entities provided for under Te Ture Whenua Māori Act 1993 or they can select from other legislative vehicles (e.g. PSGEs can choose). However, only iwi and hapū with sufficient knowledge and/or resources can access professional advice to operate under more sophisticated and economically efficient structures.

### Te Ture Whenua Māori Act 1993 entities

Te Ture Whenua Māori Act 1993 provides for the following entities to hold and administer collectively-owned Māori assets, including Māori freehold land titles:

- **Ahu Whenua Trusts** “promote and facilitate the use and administration of the land in the interests of the persons beneficially entitled to the land.” Ahu Whenua Trusts are the most commonly used vehicle for collective owners of Māori freehold land, representing approximately 68% of total governed Māori freehold land blocks (approximately 54% of total Māori freehold land mass). Some Ahu Whenua Trusts are constituted for “general land owned by Māori” (general land beneficially owned by a Māori or by a group of persons of whom a majority are Māori).
- **Māori Incorporations** are similar to companies and have all the powers of a limited liability company. This entity type provides more flexibility for Māori collective asset owners to run commercial operations and affords more autonomy from regular Māori Land Court administration than trusts. Māori Incorporations represent approximately 12% of total governed Māori freehold land blocks (approximately 24% of the total area of Māori freehold land).
- **Whenua Tōpu Trusts** “promote and facilitate the use and administration of the land in the interests of the iwi or hapū.” Whenua tōpu trusts are a less commonly used vehicle for collective owners of Māori freehold land, representing 0.4% of all management structures.

Other entity structures available under the Act include:

- **Putea Trusts:** assets (individual ownership shares rather than collectively held land parcels) held for Māori Community Purposes.
- **Whānau Trusts:** assets (individual ownership shares rather than collectively held land parcels) held for the purposes of promoting health, social, cultural, economic welfare, education, vocational training, and general advancement in life for the descendants.
- **Kaitiaki Trusts:** assets (individual ownership shares rather than collectively-held land parcels) held in trust for minors or persons with a disability.

Te Ture Whenua Māori Act 1993 does allow for owners to alienate (sell) their land. However, this right is highly regulated, and is subject to a right of first refusal in favour of certain classes of purchasers or donees. In practice, it is difficult and time-consuming to dispose of Māori freehold land.

## Other management structures

Māori assets are also held in a number of other management structures:

- **Māori Trustee:** From the early 1900s, the Crown transitioned its focus from acquiring Māori land to protecting it from further alienation and assisting Māori owners in its development. The Māori Purposes Act 1947 saw the term ‘native’ in any official context replaced with ‘Māori’, and in 1952 the Māori Land Boards were abolished. The Māori Trustee assumed the functions of the Māori Land Boards, and continues to act as Responsible Trustee for approximately 7% of Māori freehold land.<sup>14</sup>
- **Tenths Trusts:** The New Zealand Company purchased large areas of Māori land pre-1840 with a reserves policy (commonly referred to as the ‘Tenths’ policy) providing that one tenth of the land sold was to be reserved for the original Māori owners. While Māori disputed many of the New Zealand Company’s purchases, investigation by a Land Claims Commissioner found that the New Zealand Company had made legitimate purchases of at least some of the areas they claimed. It is unclear whether Māori owners intentionally gave up their pā, wāhi tapu, and cultivations, as areas of cultural, social, and economic significance. Evidence of the inclusion of this land may indicate a lack of mutual understanding between parties.<sup>15</sup>
- **Māori Trust Boards:** Between 1922 and 1953, ten Māori trust boards were created by statute to receive and administer compensation paid by the Crown to settle a number of grievances. In 1955, the Māori Trust Boards Act (“MTBA”) was enacted to standardise and improve the administration of these boards as well as to provide a template for future organisations to follow.<sup>16</sup> Today, many iwi choose to operate as a Māori trust board under the MTBA.<sup>17</sup> One of the main reasons for using a Māori trust board is its body corporate status, which provides for perpetual succession and limited liability. This was advantageous at the time as there were not a lot of other options available for Māori collectively-owned asset entities.

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<sup>14</sup> See <https://www.tetumupaeroa.co.nz/about-us/te-tumu-paeroa-maori-trustee-maori-land-court/>

<sup>15</sup> Office of the Treaty Settlement, *Healing the past, building a future: A guide to Treaty of Waitangi claims and negotiations with the Crown*.

<sup>16</sup> The Law Commission *Treaty of Waitangi Claims: Addressing the Post-Settlement Phase* (Study Paper 13, August 2002).

<sup>17</sup> Te Puni Kōkiri (see <https://www.tpk.govt.nz/en/whakamahia/effective-governance/what-is-governance/maori-trust-board>).

## Post-settlement governance entities

- The settlement process provides Māori claimant groups with an opportunity to seek some redress for historic breaches of the Treaty of Waitangi by the Crown. The Crown prescribes the settlement process and sets out the requirements for a claimant group's post-settlement governance entity ("PSGE"). A PSGE may use a range of structuring options, including a Māori Trust Board established under the Māori Trust Boards Act 1955, a governance entity established through private legislation, or a private trust established under a Deed of Trust. With the exception of early claimant groups, such as Ngāi Tahu and Waikato-Tainui, claimant groups almost always use private discretionary trusts, with subsidiary trusts or companies to manage the settlement assets, in accordance with the group's objectives and aspirations.
- The receipt of redress is not subject to tax, however, the PSGE is generally a taxpayer and required to comply with the various obligations under the Revenue Acts.<sup>18</sup> Crown policy requires PSGEs to be clearly and directly accountable to members of the settlement group. The Crown does not accept charitable trusts as PSGEs because charitable trusts do not have full independence from the Crown (the Attorney-General has powers and duties in respect of charitable trusts). It is also desirable that the initial entity has a broad range of structuring options available when deciding how the settlement would be applied (rather than be restricted to charitable purposes).

## Companies

For income tax purposes, a company is defined as "a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere"<sup>19</sup> and is taxed at 28%. Companies which meet the eligibility criteria to be treated as a Māori authority can elect to do so for tax purposes, and are taxed at the rate of 17.5% (refer to section 8).

Companies are sometimes used as corporate trustees of PSGEs. The corporate trustee will usually not hold any assets, and the directors and shareholders of the corporate trustee (usually elected iwi representatives), who are responsible for the governance of the PSGE and the overall group, are protected against a degree of personal liability. Companies are also used as subsidiaries of both PSGEs and Māori authorities to ring-fence risk and facilitate commercial operations.

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<sup>18</sup> Including the Income Tax Act 2007, Goods and Services Tax Act 1985, and the Tax Administration Act 1994.

<sup>19</sup> Section YA 1 of the Income Tax Act 2007.

## Eligibility for Māori Authority status

<b>Organisations eligible to be a Māori authority include:</b>
A company or trustees of a trust established by an order made under Te Ture Whenua Māori Act 1993
A company or the trustees of a trust that owns land subject to Te Ture Whenua Māori Act 1993
The Māori Trustee as an agent for an owner of land that is subject to Te Ture Whenua Māori Act 1993
A Māori Trust Board
The Crown Forestry Rental Trust, Te Ohu Kai Moana Trustee Ltd and Aotearoa Fisheries Ltd
A company or the trustees of a trust that is established by a mandated iwi organisation to be an asset-holding company
A company or the trustees of a trust that on behalf of Māori claimants, receives and manages assets that are transferred by the Crown as part of the settlement of a claim under the Treaty of Waitangi.

## Limited partnerships

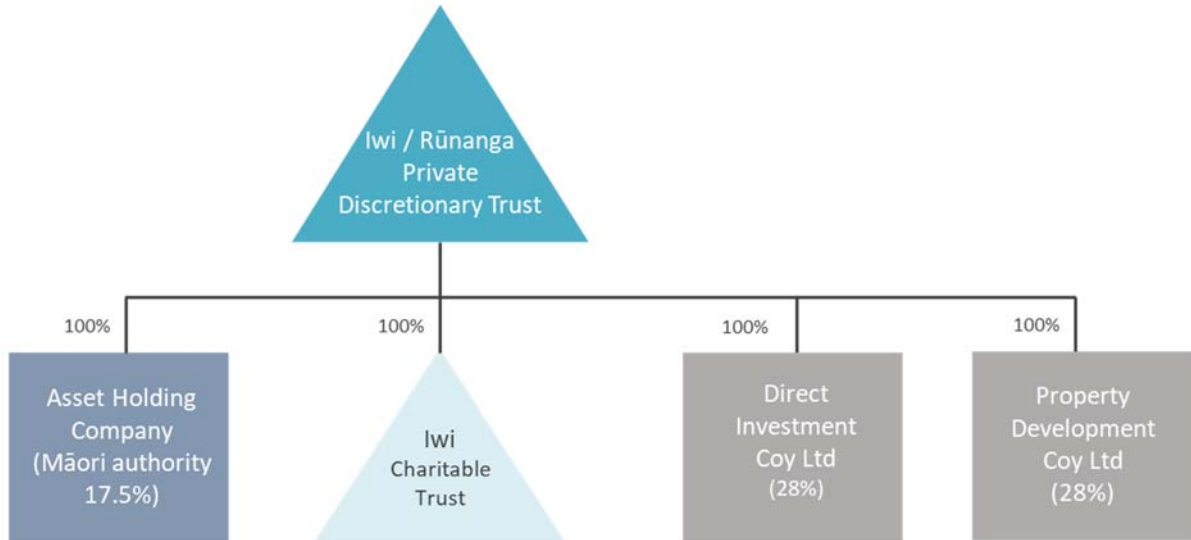
Like companies, limited partnerships have a separate legal personality from their partners. For tax purposes, limited partnerships are treated as flow-through entities, which means that all losses and gains are attributed to the partners directly.

Limited partnerships are sometimes used within Māori entity structuring as a mechanism to ring-fence risk, protect the asset base, facilitate ease of operations without being inhibited by management and administrative restrictions imposed by Te Ture Whenua Maori Act 1993, enable joint ventures to promote growth, and achieve a consistent rate of taxation between the group, afforded by the tax flow-through mechanism.

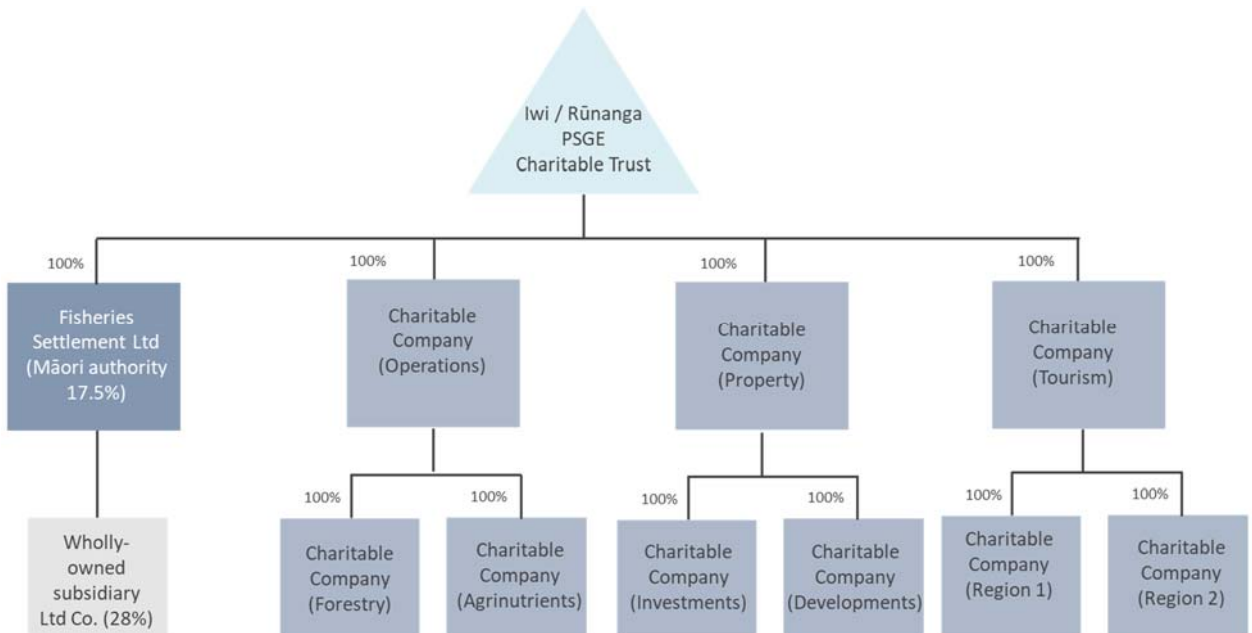
Structuring limited partnerships is complex and, as such, only well-resourced Māori organisations tend to use limited partnerships structures.

## Appendix D: Māori organisation structure examples

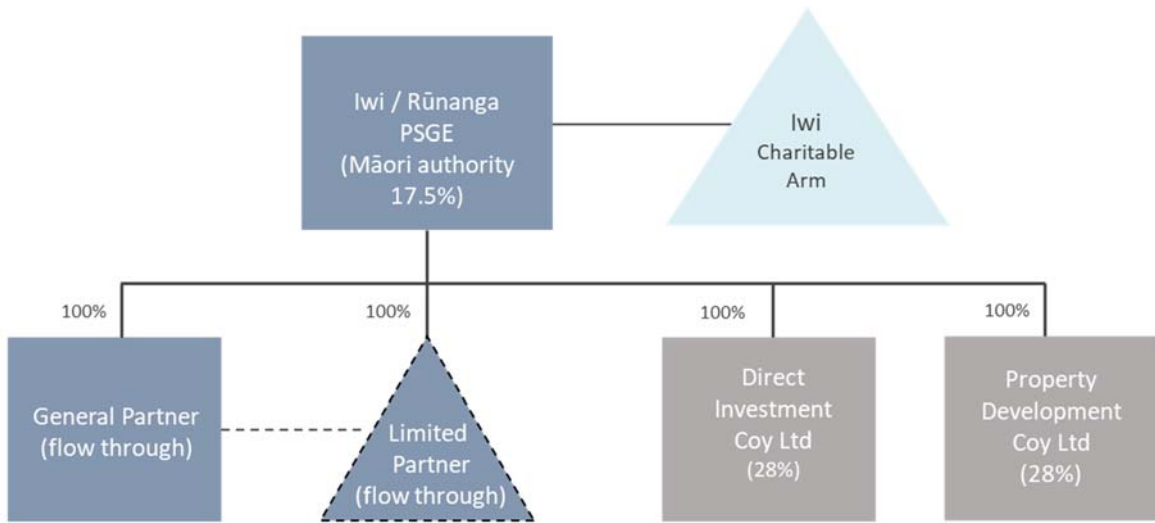
### Example 1: Iwi organisational structure:



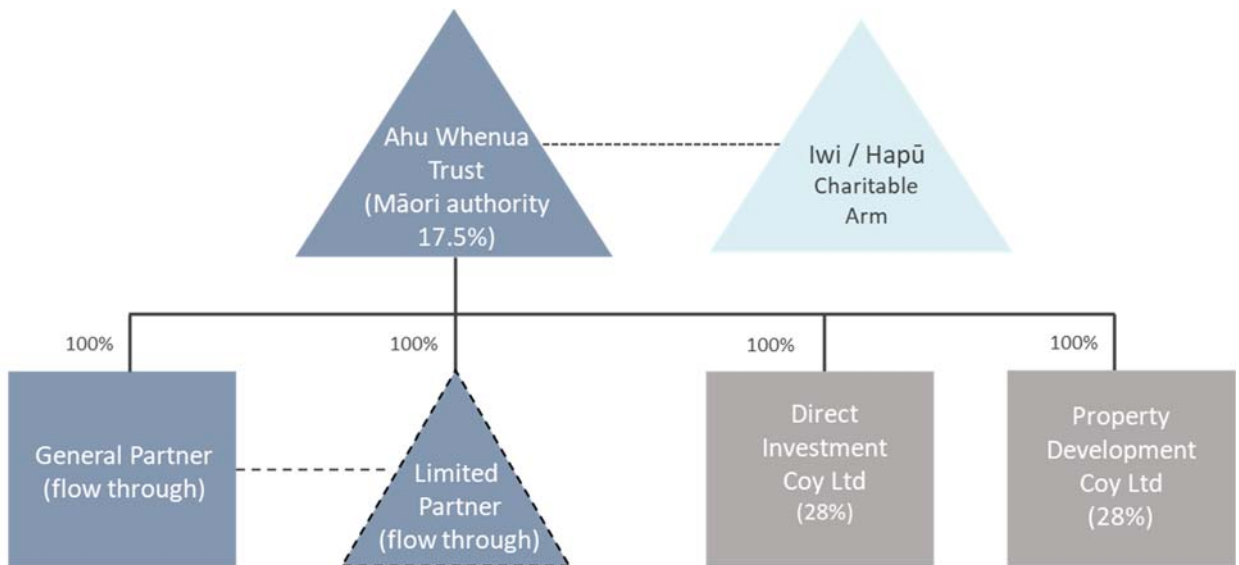
### Example 2: Iwi organisational structure



Example 3: Iwi organisational structure:



Example 4: Ahu Whenua Trust structure:





## **Glossary of Terms**

**Kaitiakitanga:** A Māori concept encompassing stewardship.

**Kawa:** Moral imperative guiding customs e.g. protocols on the marae.

**Koha:** A gift or contribution.

**Manaakitanga:** A Māori concept encompassing care and respect.

**Mana motuhake:** Māori self-determination.

**Mana Whenua:** To be completed.

**Mauri:** Life essence.

**Taonga tuku iho:** Treasured possessions handed down, heritage.

**Tikanga:** The custom, rules and lore associated with a Māori world view.

**Tino rangatiratanga:** Absolute sovereignty.

**Whakapapa:** Genealogy.

**Whanaungatanga:** A Māori concept encompassing relationships and connectedness.

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