Tax Working Group
Te Awheawhe Tāke

Tax Working Group Information Release

Release Document

February 2019

taxworkinggroup.govt.nz/key-documents

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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Tax Working Group
Te Awheawhe Tāke

Minutes

Date: Thursday 6 December and Friday 7 December

Location: Inland Revenue, Wellington

Attendees: *Group:* Sir Michael Cullen (Chair), Geof Nightingale, Kirk Hope, Michelle Redington (absent for 6 December), Nick Malarao, Robin Oliver, Craig Elliffe, Bill Rosenberg, Joanne Hodge, Hinerangi Raumati-Tu'ua (absent for 6 December), Marjan van den Belt
Independent Advisor: Andrea Black
Secretariat: Mark Vink, Jordan Ward, Paul Kilford, Steve Mack, Matt Benge, Bevan Lye, Scott Petty, Phil Whittington, Matt Nolan, Eina Wong, Shane Domican

1. Administration

Noted	• Minutes for previous meeting
Actions for the Secretariat	• Make changes to meeting 22 minutes as requested by the Group.

2. Final report

Noted	• Draft chapters/appendices on the following topics: o Purposes o Frameworks o Environmental and ecological outcomes o Extending the taxation of capital gains o Other opportunities to improve the tax system o Submissions and consultation o Fair rate of return method • Draft outlines for chapters on the following topics: o Business and saving o Personal income o Packages • Draft volume (II) on the detailed design of extending the taxation of capital gains • A number of Group members have already provided suggestions on the above documents • The Chair gave an update on where Welfare Expert Advisory Group (WEAG) was getting to.

Agreed (in the context of Final Report discussion	• Include somewhere in the final report an estimate of what additional tax revenue could be generated from the hidden economy.
Actions for the Secretariat	• Make substantive changes to the draft documents as set out below • Make minor changes to the draft documents as discussed by the Group

Business and savings outline (chapter 6)

- Include reference to social enterprises.
- At para 7, distinguish effective marginal tax rates (EMTRs) in a personal income sense from this chapter's discussion of marginal effective tax rates (METRs) which are focused on taxation of capital/business income.
- Include statement that the Group has not costed the recommendation that extends Māori authority 17.5% rate to wholly-owned subsidiaries.
- At paras 32-25, to refer to the issue of equity raising by SMEs and the risk that they might lose loss continuity by doing so.
- In relation to building depreciation deductions, emphasise that this is for integrity and efficiency of the tax system. The 1% allowance is not necessarily perfect; it reflects revenue neutrality of overall package.
- In para 52, in relation to lower tax for nationally significant infrastructure, also mention possibility of incentives for green infrastructure projects.
- In relation to savings, the text should reflect that the Government should consider saving in retirement (i.e. once retired), not just for retirement.
- Include statement that Government should consider how best to encourage green building development, whether through tax credits or other measures.
- Include in the chapter a series of other business tax proposals that have come to the Group's attention through consultation and submissions and/or carried over from the Interim Report, notably:
- Add previously agreed compliance measures, specifically:
    - increase the threshold for paying provisional tax from $2,500 to $5,000 of residual income tax;
    - increase the $10,000 closing stock adjustment to $20,000-$30,000;
    - increase the $10,000 automatic deduction for legal fees and potentially expanding the automatic deduction to other types of professional fees but not to other potentially capital expenditure such as repairs and maintenance;
    - review the threshold for the capitalisation of fixed assets with a view to increasing the threshold at least for SME taxpayers;
    - reduce the number of depreciation rates and simplify the process to use default rates to make this a less onerous process for SME taxpayers in particular;
    - investigate the simplification of fringe benefit tax with a focus on the motor vehicle and "other" benefits categories;
    - investigate the simplification or removal of the entertainment adjustment;
    - review the thresholds for unexpired expenditure;
    - investigate the removal of RWT on close company related party interest and dividend payments subject to integrity concerns; and

    - investigate initiatives to assist smaller businesses to use cloud-based accounting software.

- Add recommendations for additional measures arising out of consultation as per marked up text edit, subject to small fiscal cost. Note that recommendations about hybrid mismatch rules should be only recommended for review. It was noted that the cost of the measures should be checked. The additional measures are:
    - Remove the requirement for taxpayers to have to seek Commissioner's approval to issue GST Buyer Created Tax Invoices.
    - Allow special rate certificates and certificates of exemption to be granted retrospectively. Commercial payments often need to be made before a certificate can be granted, and taxpayers should be able to determine the rate at which tax is to be withheld (if at all) at that time.
    - Increase the period of validity for a certificate of exemption.
    - Remove the requirement to file a change of imputation ratio notice with Inland Revenue.
    - A review of the taxation of non-resident employees.
    - Simplifying obligations in relation to particular non-resident employees by requiring employers to consider the taxation of non-resident employees at year-end only. This would simplify the position for non-resident employees who are frequently in and out of the country and where it is unclear whether they will breach the 92-day (or 183-day) thresholds.
    - Extend the threshold of "cash basis person" which would create alignment with investment income information.
    - Increase the threshold for not requiring a GST change of use adjustment.
    - The new hybrid mismatch rules should not apply to small businesses.
    - The hybrid rules should not apply to simple business transactions such as the transfer of trading stock and utilisation of losses

Personal outcome outline (chapter 7)

- Remove the first sentence stating that most people's interaction with the tax system is through the payment of personal income taxes.
- The chapter should refer to the terms of reference, but should discuss the possible adjustments to tax rates and thresholds, consistent with the packages chapter.
- Include a comment in the body of the chapter noting that if the Government wishes to reduce income inequality through the personal income tax system, this would require increasing the higher marginal income tax rates.

Packages outline (chapter 8)

- Clarify that taxing more capital gains will produce more revenue past the five-year time horizon.

- Include in package #1 primary caregivers to receive full KiwiSaver member tax credit during statutory leave period.
- Include commentary recognising that the Government's wellbeing focus/priorities may drive increases in spending (e.g. from WEAG, Government Inquiry into Mental Health and Addiction recommendations). Government may wish to prioritise that spending over the Group's recommended revenue-neutralising measures.

Purposes chapter (chapter 1)

[No substantive edits asked for by the Group]

Frameworks chapter (chapter 2)

Noted that there would be some language to come on this chapter on how the relationship between the living standards framework and He Ara Waiora would operate.

Environmental and ecological outcomes (chapter 4)

Adoption of various marked up edits including:

- Update Box 9.1 (Framework for taxing negative environmental externalities) to acknowledge general tax policy principles, including administrative complexity
- Remove Box 9.2 (Principles for taxing natural resource use) – add note referencing MBIE frameworks and importance of intertemporal fairness
- Include recommendation for incidence studies
- Include concluding recommendation for capacity building
- Revise example of positive externalities in box X
- Remove reference to Parliamentary Commissioner for the Environment review of OVERSEER (will be outdated once report is released)
- On the issue of pesticides (para 109), include statement that regulation (including banning) may be a better response in some cases.
- On agriculture and forestry concessions (para 116, 117) expand as per marked up comments, and recommend consideration in Tax Policy Work Programme
- On petroleum mining 7-year depreciation rule (para 118), update to reflect Group has not assessed in detail, and recommend consideration in Tax Policy Work Programme
- On revenue recycling (para 121), update as per marked-up alternative text and add specific example
- Box XX - adoption of 'Natural capital enhancement tax' name

Extending the taxation of capital gains (chapter 5)

- Signal early in the chapter that more aggression from IR on taxing property would be welcome within existing rules (noting information deficiencies).
- In para 4, need to mention volatility of the tax also.
- Phrasing of majority/minority views needed in first part of the chapter; "on balance", majority of the Group prefers the set of design features set out in this report. The minority does not support the model set out in the report.

- Include a sentence describing the nature of a realisation-based tax before getting into the design features under 'what', 'when', and 'how' subheadings.
- Include principles of rollover in the Chapter.
- Need a specific point around para 26 on reduced capital gains tax rates and the compliance costs this would cause; hence Group's view that extending capital gains taxation under existing income tax system is preferable – reduces complexity and compliance costs.
- More specificity needed on loss-ringfencing and the Group's proposal here
- In para 34, reshape to reflect that Government tax revenue is from broad-based income tax, GST and excise. Include a statement reflecting that the future economy will have a greater emphasis on capital income. Tax system needs to change to anticipate this.
- Include in forecasting/fiscals section commentary as to how estimated revenues compare with forecasted GDP over time and forecasted total tax revenue over time.
- Extra paragraph needed on volatility/countercyclical nature of the tax.
- Figure 5.2 ("Share of household assets that could be subject to capital gains taxation, by income and net worth decile, 2014/15") should be assisted by commentary explaining what is included and what is not.
- Figure 5.3 ("Estimated annual average capital gains tax payment as percentage of disposable income") should have an interpretive sentence.
- In para 89, explanation/evidence needed for undertaxation of residential property sector.
- In paras 93-94, propose that it would be possible for the Government to tax some asset classes and not others. Indicate that taxing more gains from residential rental market would be easiest asset class, others would be more difficult, e.g. corporates.

Volume II – Detailed design

- Include an example of a beneficiary of a trust living in a house and then moving out to clarify that this would not be an excluded/family home.
- Include an example demonstrating that a foreign person (non-NZ resident) is not allowed an excluded/family home
- Include statement that taxing personal use assets would increase the number of taxpayers impacted by the tax (i.e. this is one of the main justifications for exemption)
- Include taonga as within scope of personal use assets exclusion
- At para 3.18, state that the Group prefers that a donation of an included asset to a donee organisation should be ignored for tax purposes, with no tax payable on the capital gain, and no donation tax credit provided. Include reason; that this is more consistent with the charities regime
- Group agrees that no time bar would apply to valuation of assets
- Group agrees that median rule should remain in the final report
- Group's view on taxation of shares and managed funds: Include comment that Group does not wish to disincentivise investment in NZ shares, and propose the following:

    - Keep FDR method and provide options to Government on whether to apply tax on realisation basis or with FDR for Australasian shares
    - Limit the ability of investors to choose between CV and FDR by asking them to elect into either CV or FDR method for a given portfolio going forward
    - Tax managed funds on accrual basis for Australasian shares/FDR for the rest

Other opportunities to improve the tax system (chapter 9)

- Categorise the recommendations in this chapter as follows:
    - Matters requiring significant attention
    - Other important matters requiring work
- Include in this chapter references to the Group's position on digital services tax, high wealth individuals, land banking, and other topics the Group has considered since the interim report.

FRRM appendix

- Incorporate into Chapter 5 (*Extending the taxation of capital gains*)

Submissions appendix

- Independent advisor will work with Secretariat on this appendix and other opportunities to improve the tax system chapter to ensure that matters consulted on are given due attention in the final report.