Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax Policy Report: Joint Report: TWG Final Report - Draft Cabinet paper and draft briefing materials

Date:	1 February 2019	**Report No:**	T2019/155 IR2019/048
		File Number:	SH-13-7-9

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Provide feedback** on the enclosed documents	5 February 2019
Minister of Revenue (Hon Stuart Nash)	**Provide feedback** on the enclosed documents	5 February 2019

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
s9(2)(a)	Analyst, The Treasury	s9(2)(a)	n/a	✓
Jordan Ward	Team Leader, The Treasury		n/a	
Emma Grigg	Policy Director, Inland Revenue		n/a	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Tax Policy Report: Joint Report: TWG Final Report - Draft Cabinet paper and draft briefing materials

1. The Tax Working Group (TWG) has provided you with its Final Report.

2. We understand that you would like to brief your colleagues on the Final Report, and take the Final Report to Cabinet before it is released.

3. We have prepared a draft Cabinet paper for your consideration (enclosed). The paper is structured in three parts:

   a A summary of the key findings of the Final Report;

   b An explanation of how potential tax changes could support the Government's economic strategy. We have linked this to the economic narrative draft Cabinet paper [T2018/2108, MBIE 0709 18-19 refers];

   c The next steps for how the Government plans to respond to the final report, including key messages for Ministers.

4. We have also prepared three draft products to support communication materials and briefing your colleagues. The focus of these three documents is the TWG's recommendations on capital income taxation, although they also summarise some of the TWG's other findings. The documents are:

   a an 8-page 'covering note' to inform possible communication materials;

   b an A3 for briefing colleagues;

   c a short slide pack which could also be used for briefing colleagues.

5. We welcome your feedback on these documents and will continue to work with your Offices on further edits over the coming week.

Recommended Action

We recommend that you:

a **provide feedback** on the enclosed documents

Jordan Ward **Team Leader** **The Treasury**	Emma Grigg **Policy Director** **Inland Revenue**
Hon Grant Robertson **Minister of Finance**	Hon Stuart Nash **Minister of Revenue**

Tax Working Group Final Report

Summary note ('Covering note')

The Government's priorities and links to the tax system

1. This Government has the goal of building an inclusive, sustainable and productive economy, improving the wellbeing of New Zealanders and their families.
2. The tax system plays a critical role in supporting the wellbeing of New Zealanders. As highlighted in the Tax Working Group's Final Report:
    a. Taxes create a fairer, more inclusive society by redistributing income, reducing inequality and allowing New Zealanders to fully participate in society regardless of their market income.
    b. Taxes fund essential public goods and services that underpin our living standards.
3. Achieving this requires thoughtful, balanced tax policy. This Government's objectives for the tax system are:
    a. a progressive tax and transfer system for individuals and families;
    b. a system that treats all income and assets in a fair, balanced and efficient manner;
    c. a system that promotes the long-term sustainability and productivity of the economy;
    d. a system that supports a sustainable revenue base to fund government operating expenditure around its historical level of 30 per cent of GDP; and
    e. a tax system that is efficient, fair, simple and coherent, collecting the tax that is due on time and in full.

An assessment of the tax system

4. New Zealand's tax system has many strengths. It allows the Government to raise significant amounts of revenue at rates lower than in most other OECD countries.
5. However, as the Group's Final Report highlights, our tax system has weaknesses.
    a. It is not fair for all New Zealanders. It does not treat all income equally. Some forms of income go untaxed, most notably many types of capital income. This means that there is less revenue available to improve the wellbeing of New Zealanders and their families.
    b. It is not particularly progressive. Wealthier individuals receive more of their income through untaxed capital income that poorer individuals. Wealthier individuals are also able to use complex tax planning to reduce the tax they paid. Tax and transfer systems in other countries combat inequality more effectively than we do. Further, the inequality-reducing power of our tax and transfer system has fallen in recent decades.
    c. The system also relies on a relatively narrow range of taxes. For example, as well as not taxing many types of capital income, New Zealand uses environmental taxes less than most OECD countries.

Measures already taken

6. The Government has started to improve the tax and transfer system.

Supporting low- and middle-income families

7. *Families package*: In our first 100 days, this Government passed the Families Package, supporting especially low- and middle- income families with children. Key measures included:

    a. boosting the incomes of low- and middle-income families with children by increasing the Family Tax Credit and raising the abatement threshold. An estimated 26,000 families are eligible for Working for Families as a result of the changes;

    b. introducing the Best Start payment to help families with costs in a child's early years;

    c. increasing the Accommodation Supplement and Benefit;

    d. introducing the Winter Energy Payment to help older New Zealanders and New Zealanders receiving a benefit with costs over winter, which around 1 million people can receive if necessary;

    e. increasing the period for paid parental leave to 26 weeks;

    f. reinstating the Independent Earner Tax Credit, cancelled by the previous Government, which provides up to $520 per year to some individuals earning between $24,000 and $48,000; and

    g. rolling back the previous Government's planned tax cuts, which would have provided a larger tax cut for the top income earners than those earning less than $52,000.

8. The fiscal implications of the Families Package are shown below:[1]

	$m - increase/(decrease)					
	2018/19	**2019/20**	**2020/21**	**2021/22**	**2022/23 & outyears**	**5-YR total**
Total expenditure impact	(1,157.000)	(1,309.000)	(1,525.000)	(1,616.000)	(1,616.000)	**(7,223.000)**
Total revenue impact - *Tax Revenue*	1,904.000	1,904.000	1,993.000	2,077.000	2,077.000	**9,955.0000**
Total fiscal impact	**747.000**	**595.000**	**468.000**	**461.000**	**461.000**	**2,732.000**

[1] The Families Package included the repeal of tax cuts, which had a total positive revenue impact of $8.364 billion over the forecast period beginning 2017/18.

9. *Secondary tax changes*: The Government is in the process of addressing concerns with secondary tax codes, which will ultimately mean they are no longer necessary. We are changing the law to make it easier for taxpayers with multiple jobs to pay the right amount of tax from the start, rather than receiving a tax refund or debt at the end of the tax year. These changes will apply from 1 April 2019. There are no material fiscal implications arising from these changes

Levelling the playing field

10. *GST on low-value imports*: The Government has introduced legislation that will require businesses selling low-value goods into New Zealand to collect GST. The changes put local retailers on a level playing field with foreign firms who have taken advantage of this tax break.

11. *Extending the bright-line:* The Government has extended the bright-line test to five years in order to better ensure that speculators pay tax on the capital gains they make on their property investments.

12. *Loss ring-fencing:* Legislation has been introduced to ring-fence residential rental losses. Currently, property investors can subsidise part of the cost of their mortgages through reducing their tax on other income, helping them outbid owner-occupiers.

Ensuring multinationals pay their fair share

13. *Base erosion and profit-shifting (BEPS):* The Government has introduced and enacted legislation to restrict the ability for multinationals to use base erosion and profit shifting (BEPS) tactics to reduce the tax they pay both in New Zealand and overseas.

14. The expected revenue of these measures are as below:[2]

	$m - increase/(decrease)					
Vote Revenue	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23 & outyears**	**5YR Total**
GST on Low Value Goods *- Tax Revenue:*	-	66.000	100.000	112.000	126.000	**404.000**
Residential loss ring-fencing. *- Tax Revenue:*	-	35.000	190.000	190.000	190.000	**605.000**
Extending the bright-line *- Tax Revenue:*	-	-	10.000	30.000	50.000	**90.000**
Base Erosion Profit Shifting *- Tax Revenue:*	112.500	206.000	206.000	201.000	187.000	**912.500**

[2] Figures are as at HYEFU 2018.Figures are shows as fiscal years ending 30 June.

15. *Taxing the digital economy:* The Government is prepared to take further action to ensure multi-national companies pay their fair share. We are working with other countries at the OECD on a multilateral solution, but we need to be ready to act earlier if that process does not speed up. The Government has directed officials to conduct a public consultation process to consider options for taxing the digital economy. While the challenges created by the digital economy require significant discussion both internationally and within New Zealand, the Government cannot sit and wait for these companies to pay their fair share of tax voluntarily, or wait for multilateral processes to play out.

The Tax Working Group

16. The Government established the independent Tax Woking Group in November 2017 to examine improvements to the structure, fairness, and balance of the tax system.
17. The Group delivered its *Interim Report* in September 2018, and its *Final Report* on 1 February 2019.
18. The Group's reports deal with a number of complex tax issues in significant detail and makes a large number of recommendations.

Challenges to the structure, fairness and balance of the tax system

19. The Group finds that one of the key issues impacting the structure, fairness and balance of the tax system is the inconsistent treatment of capital income.
20. A fair tax system should have two main features:
    i. A tax base that taxes a wide range of income, so that the tax paid is spread fairly – put simply, people earning the same amount of income should pay the same amount of income tax regardless of its source (see example below).
    ii. People with more capacity to pay (i.e. richer people) should pay a greater share of their income in tax. This is what makes a tax system progressive.

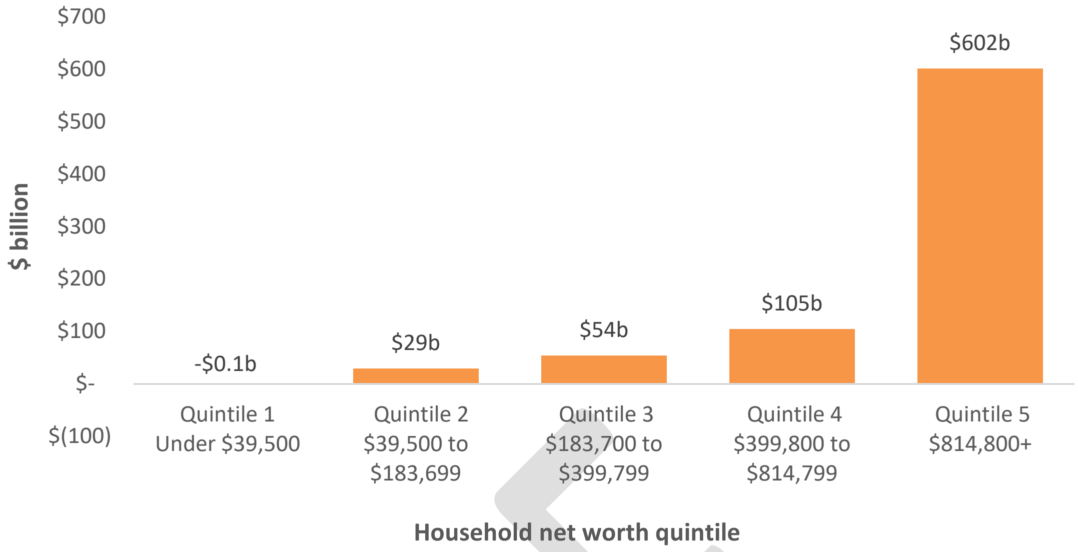
21. The current treatment of many types of capital income fails the first test of fairness. This is illustrated in the example below.

22. The Group also finds that the current treatment of capital income undermines the second test – the progressivity of the tax system.

23. Overseas studies show that high-income earners derive a much greater share of their income from capital gains than low- and middle-income earners. When capital gains are not taxed, those on higher-incomes benefit the most.

24. We also have evidence of this unfairness In New Zealand. Figure 1 below shows the distribution of wealth. A vast majority of wealth owned by New Zealanders is held by the wealthiest 20% of households. This suggests that a vast majority of untaxed capital income is also going to wealthy households.

Figure 1: Total net worth (excluding owner-occupied housing) by net worth quintile (2015)[3]



Source: Stats NZ (HES 2015)

25. Extending capital income taxation will also improve the integrity of the tax system. It will prevent some high-income individuals from using complex tax planning to reduce the tax they pay.

26. Extending capital income taxation over a broad range of assets will also help level the playing field between different types of investments.

The Tax Working Group's recommendations

Capital income taxation

27. All of the Group support extending capital income taxation to at least residential rental investment properties In addition, a clear majority of the Group support a broader extension that applies to most asset types (but not the family home).

28. A minority of Group did not support a broad extension of capital income taxation, in part due to concerns about compliance and administration costs. They only supported extending capital income taxation to cover residential rental investment properties.

29. The TWG has made it clear that a spectrum of choices is available when considering an extension of capital income taxation. These choices include which types of assets should be subject to the tax, and how best to stage the timing of introduction.

High level design

30. A clear majority of the Group supported a broad system for taxing capital income. This would involve:

    a. taxing increases in value on a broad range of assets including residential, commercial and industrial property (but not the family home), shares, and business assets;

[3] Note: Net worth estimates exclude owner-occupied housing. Quintiles are based on household net worth, including owner-occupied housing

b. only collecting tax when an asset is sold or transferred (with some exceptions e.g. managed funds);

c. deferring tax in some circumstances (e.g. inheritance, relationship property transferred, sole trader putting business into a company);

d. treating capital income the same as other income, which means taxing it at appropriate income tax rates (e.g. 28% for companies and marginal rates for individuals) and with no adjustment for inflation; and

e. only taxing gains that occur after the tax is implemented (e.g. 1 April 2021).

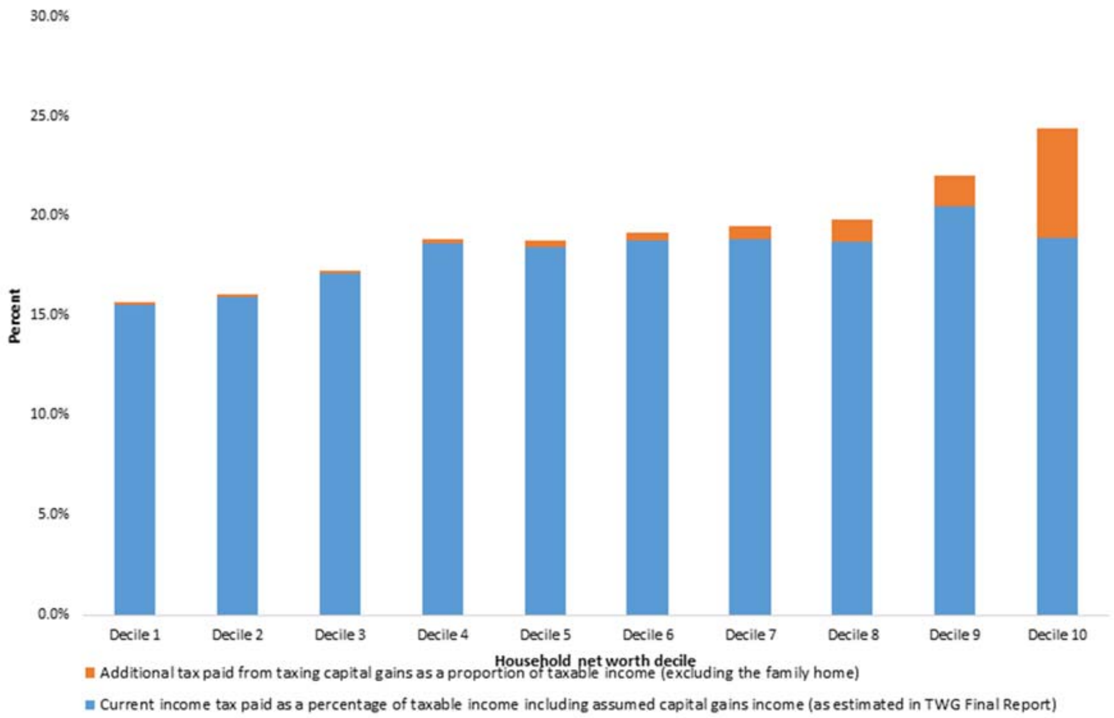
31. Most of these high-level design principles are similar to how other jurisdictions tax increases in the value of capital assets. Areas where the TWG's recommendations differ from the international norm are:

    a. **The tax rate** – the proposal would result in capital gains earned in companies and distributed to individuals beings taxed at the low end of effective tax rates internationally. This is because of our imputation system which relieves double taxation of income earned through companies. The proposal would also tax capital gains earned by individuals directly relatively highly.

    b. **Capital loss ring-fencing** – the TWG is recommending a relatively generous treatment of losses compared to many other countries. This would limit the impact that the tax would have on risk-taking.

32. Indicative analysis has found that the impact of the tax would generally fall on the wealthiest households (see Figure 2 below). Extending capital income taxation would have a minor impact on the average effective tax rate paid by most households, with the most significant impact occurring for wealthiest 10% of households.

Figure 2: Average effective income tax rates by household net worth decile [4]



Source: Stats NZ (HES 2015); the Treasury

Disadvantages

33. The Group has acknowledged that extending capital income taxation will lead to compliance costs for asset owners, particularly when the tax comes into effect. However, they have identified a number of options which could minimise these costs.

    a. Some assets with clear market values (e.g. listed shares) will not need to be valued.

    b. There will be a set of default valuation rules for asset owners that do not want a valuation.

[4] Capital gains: The estimates for capital gain used in this analysis are from the Tax Working Group Final Report. The share of capital gains tax liability by household net worth decile is based on the share of assets (excluding cash, deposits and owner occupied housing) by household net worth decile. Capital gains tax revenue estimates have been discounted to tax year 2021/22 (assuming 3 percent annual capital gain, and taxed at an average marginal tax rate of 26 %). Revenue from taxing more capital gains will be low in the first 4 years after implementation. For this reason, revenue from taxing more capital gain is discounted from year 5, or tax year 2025/26. The imputed capital gains excludes gains that would be subject to rollover relief.

Data: Although the taxation of capital gains is envisaged to take effect after tax year 2021/22, the corresponding data on personal income tax by household net worth decile is not available for this period. The data for household economic survey used is 2014/15. While Stats NZ released Household Economic Survey 2018 (for tax year 2017/18) in December 2018, the underlying data is not yet available for the purpose of this analysis. Specific data relating to capital gains in New Zealand is highly limited. The estimate is subject to significant uncertainty and should be considered as indicative only.

c. Asset owners that do want a valuation would have up to 5 years to determine the value of their asset.

34. The Group also acknowledged that extending capital income taxation could also have some negative impacts on saving and investment. However, the Group identified a number of complementary measures that could help offset this effect. These measures were considered as parts of a series of complementary packages of measures that could be considered alongside an extension of capital income taxation.

A complementary package of measures

35. The Group estimates that extending capital income taxation over a broad range of assets would generate approximately $8.3 billion over the first five years of the tax (2021/22 – 2025/26).

36. Any revenue generated from extending capital income taxation will be recycled to increase the income of New Zealanders, and to support businesses through the changes to the tax system.

37. The Group has proposed a range of measures designed to achieve this goal. The Government will carefully consider what measures would be appropriate to complement the gains in fairness achieved and to promote a productive and efficient economy.

Business/housing measures

38. The Group has identified a wide range of opportunities to reduce compliance costs (especially for small businesses), remove investment distortions for New Zealand businesses, and promote a more efficient housing market. Some of the key measures are:

    a. **allowing businesses to claim depreciation expenses on buildings** – encourage more business investment (range of options);
    b. **allowing business to deduct expenses for "black hole" expenditure** – encourage innovation and entrepreneurship;
    c. **allowing businesses to keep losses when the owner changes** – make it easier for small companies to expand; and
    d. **removing residential loss ring-fencing** – recognising that gains would be taxed and could reduce upward pressure on rents.

Savings measures

39. Extending capital income taxation would also result in higher taxes for people who are saving for their retirement, including people who are using KiwiSaver.

40. The Group has identified some measures that would help compensate for these higher taxes. These measures are:

    a. **a KiwiSaver tax exemption** – remove tax on employer KiwiSaver contributions to lower income KiwiSavers;

    b. **increase the KiwiSaver member tax credit –** increase Government contributions to all KiwiSavers; and

    c. **reduce KiwiSaver PIE rates** – give lower income KiwiSavers the same benefit as those in the highest tax bracket.

41. These measures could offset the impact of extending capital income taxation on KiwiSaver earnings.

The digital economy

42. The Group has explored opportunities to ensure that the tax system deals appropriately with the digital economy. The Group recommends that the Government stand ready to implement a tax on digital services if a critical mass of other countries moves in that direction, and if it is reasonably certain that New Zealand's export industries will not be materially impacted by any retaliatory measures.

43. In response to this recommendation, the Government has directed officials to conduct a public consultation process for options on taxing the digital economy. While the challenges created by the digital economy require significant discussion both internationally and within New Zealand, the Government cannot sit and wait for these companies to agree to pay their fair share of tax, or wait for the multilateral processes to play out.

Environmental taxation

44. The Group has noted that New Zealand makes relatively little use of environmental taxes, and believes that taxation could be used further to enhance environmental outcomes. The Group has developed a policy framework for assessing when environmental taxes could be usefully applied.

45. The Government welcomes the development of this framework as a tool for delivering positive environmental and ecological outcomes for New Zealand.

46. The Government also welcomes the Group's efforts to highlight specific areas where there is greater scope to use environmental taxes (subject to further design work). The Government has ongoing work programmes on all of the issues highlighted as immediate priorities by the Group.

Personal income taxation

47. The Group has considered a range of options to increase the progressivity of the personal tax system, including the possibility of a tax-free threshold. The Group's preferred option is to increase the bottom threshold of income tax, with a potential increase in the second marginal tax rate.

48. The Group notes, however, that choices around personal income taxation should depend on the objectives of the Government. For example, if the Government wishes to improve the

incomes of the very poorest members of society, then changes to benefit rates are likely to be a more effective policy tool than changes to tax rates.

49. The Group also suggests that the Government consider increasing net benefits to match any personal tax changes. This would provide a fairer redistribution of revenue across individuals, and have a greater impact on poverty reduction.

Future challenges

50. The Group has also identified a need to future-proof the tax system. Changes in society and technology may undermine the current structure of the tax system.

51. In the future, for example, it is likely that more people will work for themselves and operate in the 'gig economy.' This may reduce the effectiveness of the PAYE system of withholding tax, which has previously been a reliable means to collect tax from individuals' employers.

Next steps

52. The Final Report provides a range of choices and options for the Government's consideration. The Government will need to work through all of these choices and options before arriving at policy decisions. Consultation between coalition and confidence and supply parties will be an important part of this process.

53. In a number of areas, the Government is already taking steps in the direction suggested by the Group, such as the areas of taxing the digital economy and using environmental taxes to promote a sustainable economy.

54. There will be further opportunities for the public to have its say as any legislative process will include a period of public consultation on these issues.

April 2019* *subject to consultation between coalition and confidence and supply parties	Cabinet decisions on Group's recommendations
April to August 2019	Consultation on government proposals (if any)
October - December 2019* *additional time to incorporate legislative package	Bill introduced
July 2020	Legislation passed and enacted
April 2021	Implementation

Tax Working Group – Summary of Final Report

The Tax Working Group was asked to examine improvements in the structure, fairness and balance of the tax system.

Taxing capital income (capital gains)

What the Group is proposing

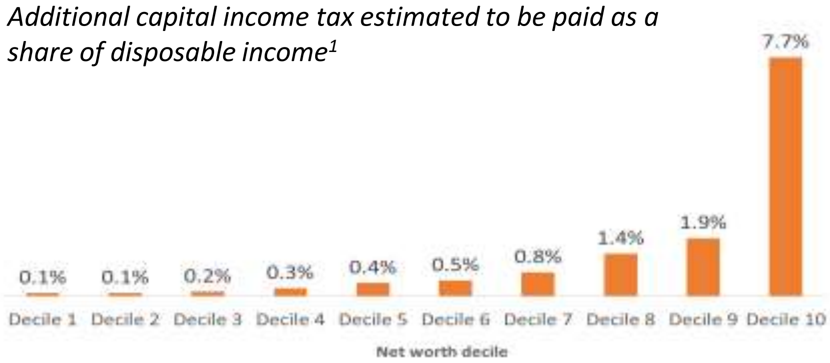
- All members of the Group recommend extending capital income taxation, although there is disagreement about how far this should go.
- **Majority**: Recommends gains should be taxed for most assets. Projected to raise $8.3 billion in first five years (2021/22 - 2025/26).
- **Minority**: Recommends only taxing gains from selling residential rental properties.
- There is a spectrum of choices available to the Government regarding what types of assets to tax and how to stage the timing of introduction.

What to tax?	• Land and buildings (except the family home) • Intangible property (e.g. intellectual property) • Assets held by businesses • Shares and other equites	Similar to most countries, except that many countries also tax collectibles
When to tax?	• Only collect tax when an asset is sold or transferred (with some exceptions e.g. managed funds)	Similar to all other countries
When to defer tax? *Rollover (no tax is collected until the asset is sold again)*	• Small business assets (selling one asset to buy another) • Some transactions related to Māori collectively-owned assets (e.g. recovery of ancestral land lost through Crown action) • Inheritance • Transfer of relationship property (e.g. divorce) • Business reorganisations (e.g. sole trader putting business into a company)	Very similar to most other countries that have rollover relief Many countries have no small business concession.
From when to tax gains? (April 2021)	• Only tax gains that are made after 'Valuation Day'. There are various ways to determine what the value was at that date e.g. ratings valuation, professional valuation, and default valuation rules • The Group proposes allowing up to 5 years to get a professional valuation	Same as some countries (e.g. Canada), but other countries only tax assets purchased after the tax came into effect (e.g. Australia)
How to tax?	• Capital income treated the same as other income and taxed at appropriate income tax rates (e.g. 28% for companies and marginal rates for individuals), with no adjustment for inflation	Low end for gains earned by companies, but higher end for gains earned directly by individuals
How to deal with losses?	• Allow most losses, once the asset is sold, to be offset against other taxable income. • To prevent gaming of the tax system, 'ring-fence' some types of losses to offset only against other capital gains • No losses for land/property held for private use	What is recommended is relatively generous compared to other countries and would limit the effect the tax would have on risk-taking

Rationale for extending capital income taxation – improving the fairness of the tax system

Reason #1. Shift more of the tax paid to wealthier households

Additional capital income tax estimated to be paid as a share of disposable income[1]

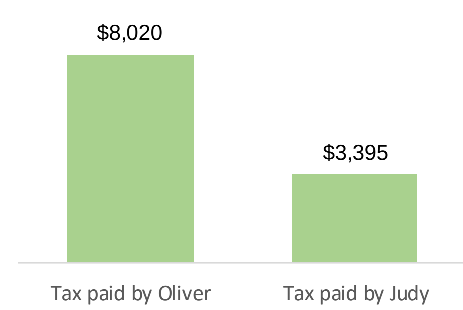


Reason #2. Help fix the current problem of people paying different amounts of tax if they earn income in different ways

Example:

In 2018, Oliver earned $50,000 in wages. He paid $8,020 in tax on this income.

Judy earned $25,000 from part-time work. She also sold shares in a business, and received non-taxable income from a capital gain of $25,000. Under current law, Judy will pay $3,395 in tax.



Other key recommendations

Business and Housing Measures[2]

▪**Allow businesses to claim depreciation expenses on buildings** – encourages more business investment (range of options)
▪**Allow businesses to deduct expenses for "black hole" expenditure** – encourages innovation and entrepreneurship
▪**Allow businesses to keep losses when the owner changes** – makes it easier for small companies to expand
▪**Remove residential loss ring-fencing** – recognises that gains would be taxed and could reduce upward pressure on rents

Environmental Taxation

▪**Framework:** Report introduces a draft framework for deciding when to use tax instruments (e.g., emissions/resource use must be measurable)
▪**Opportunities:** Group identifies four areas where tax could improve environmental outcomes. These are currently being worked on through seperate Government work programmes

- Greenhouse gases
- Water pollution & abstraction
- Solid waste
- Road transport

Personal Income and Savings Measures[2]

▪**Income tax changes** (range of options, including a tax-free threshold – preferred option is to increase the bottom tax threshold, with a possible increase in second marginal tax rate)
▪**KiwiSaver tax exemption** – remove tax on employer KiwiSaver contributions for lower income KiwiSavers
▪**KiwiSaver member tax credit –** increase Government contributions to all KiwiSavers
▪**Reduce KiwiSaver PIE rates** – give lower income KiwiSavers the same benefit as those in the highest tax bracket

Bringing Māori Perspectives into Tax Policy

▪ The Tax Working Group engaged with Māori on how tikanga might enhance tax policy
▪There was support for this approach - many Māori recommended it should have wider application
▪The Tax Working Group recommends the Treasury further develop *He Ara Waiora* in the context of the Living Standards Framework

Next steps

Make decisions	Announce and consult	Introduce legislation	Legislation passed	Implementation
Apr 2019	*Apr – Aug 2019*	*Oct – Dec 2019*	*Jul 2020*	*Apr 2021*

1. Source: Stats NZ (HES 2015); the Treasury. This is estimated tax paid over and above current taxes. Estimates are based on the share of total household net worth that could be subject to capital gains taxation by household net worth decile, and projected revenue from the taxation of capital gains. Estimates for revenue from capital gains taxation are for the fifth year after introduction, discounted to tax year 2021/22 when the extension of capital gains tax is assumed to take effect. See the Tax Working Group's Final Report. Estimates are preliminary and indicative.
2. These measures are proposed by the Group as part of revenue-neutral packages, together with a broad extension of capital gains taxation

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax Working Group Final Report findings

February 2019

Overview

Context

- The Government established the Tax Working Group (TWG) to find ways of improving the structure, fairness and balance of the tax system
- The TWG published its Interim Report in September 2018
- The TWG has now provided the Government with its Final Report. It will be publically released on 21 February 2019

Purpose of this presentation

- Overview key issues and findings in the Final Report
- Clarify next steps after the final report is released
- Outline Government's approach to responding to the Final Report and key messages

Topics covered in the report

Key topics in the Final Report

- Extending capital income taxation – including detailed design proposal
- Environmental taxes
- Taxation of business and savings
- Personal income taxation
- Revenue-neutral packages

Topics that it reaffirms Interim Report findings on

- GST and financial transaction taxes
- Corrective taxes
- The treatment of charities
- The administration of the tax system
- The integrity of the tax system
- International income taxation
- The future of work
- Housing

Taxing capital income (capital gains)

- **All members** of the Group recommend extending capital income taxation, although there is disagreement about the scope of the extension.

- **Majority**: Recommends a broad extension that applies to most asset classes.
  - Forms basis of detailed proposal in Volume 2 of the report
  - Projected to raise $8.3 billion in first five years (2021/22 - 2025/26)

- **Minority**: Recommends a limited extension that just applies to gains from selling residential rental properties.

- The Group has also made it clear a spectrum of choices is available when considering an extension of capital income taxation. These choices include which types of assets should be subject to the tax.

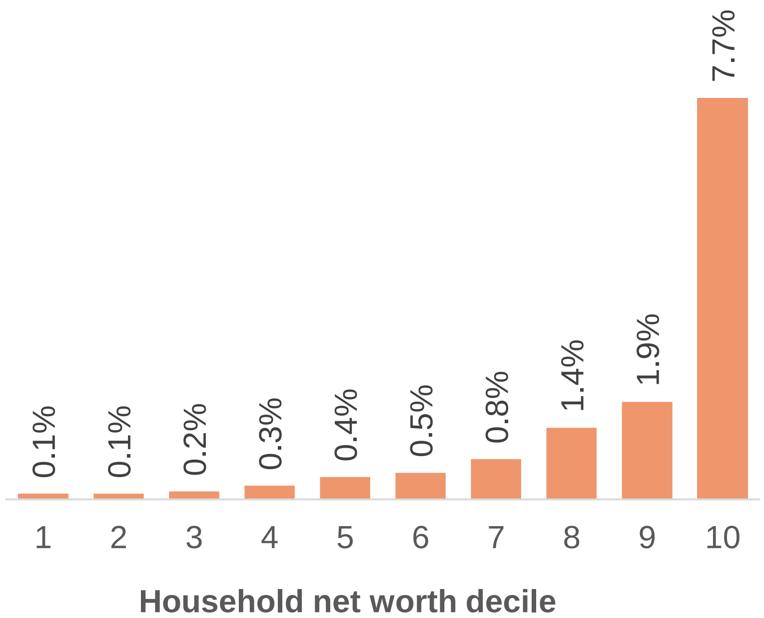
Extending capital income taxation
What the Group is proposing

Topic	TWG s recommendation (majority)	International comparison
What to tax?	• Land and buildings (except the family home) • Intangible property (e.g. intellectual property) • Assets held by businesses • Shares and other equites	Similar to most countries, except that many countries also tax collectibles
When to tax?	• Only collect tax when an asset is sold or transferred (with some exceptions e.g. managed funds)	Similar to all other countries
When to defer tax? *Rollover (no tax is collected until the asset is sold again)*	• Small business assets (selling one asset to buy another) • Some transactions related to Māori collectively-owned assets (e.g. recovery of ancestral land lost through Crown action) • Inheritance • Transfer of relationship property (e.g. divorce) • Business reorganisations (e.g. sole trader putting business into a company)	Very similar to most other countries that have rollover relief Many countries have no small business concession.
From when to tax gains? (April 2021)	• Only tax gains that are made after 'Valuation Day'. There are various ways to determine what the value was at that date e.g. ratings valuation, professional valuation, and default valuation rules • The Group proposes allowing up to 5 years to get a professional valuation	Same as some countries (e.g. Canada), but other countries only taxed assets purchased after the tax came into effect (e.g. Australia)
How to tax?	• Capital income treated the same as other income and taxed at appropriate income tax rates (e.g. 28% for companies and marginal rates for individuals), with no adjustment for inflation	Low end for gains earned by companies, but higher end for gains earned directly by individuals
How to deal with losses?	• Allow most losses, once the asset is sold, to be offset against other taxable income. • To prevent gaming of the tax system, 'ring-fence' some types of losses to offset only against other capital gains • No losses for land/property held for private use	What is recommended is relatively generous compared to other countries and would limit the effect the tax would have on risk-taking

Extending capital gains taxation
Key rationale – improve fairness

Reason #1: Shift more of the tax paid to wealthier households

Additional capital income tax estimated to be paid as a share of disposable income[1]



Source: Stats NZ (HES 2015); the Treasury

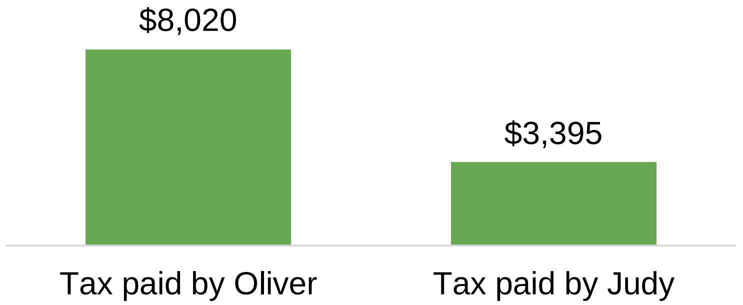
Reason #2: Help fix the current problem of people paying different amounts of tax if they earn income in different ways

Example:

In 2018, Oliver earned $50,000 in wages. He paid $8,020 in tax on this income.

Judy earned $25,000 from part-time work. She also sold shares in a business, and received non-taxable income from a capital gain of $25,000.

Under current law, Judy will pay $3,395 in tax.



[1] Estimates are tax paid over and above current taxes. Estimates are based on the share of total household net worth that could be subject to capital gains taxation by household net worth decile, and projected revenue from the taxation of capital gains. Estimates for revenue from capital gains taxation are for the fifth year after introduction, discounted to tax year 2021/22 when the extension of capital gains tax is assumed to take effect. See the Tax Working Group's Final Report. Estimates are preliminary and indicative.

Complementary measures
Personal and business tax options

The Group has presented options for potential tax measures to include in a revenue-neutral package alongside extending capital income taxation

Business tax and housing measures

Allow businesses to claim depreciation expenses on buildings – encourage more business investment (range of options)

Allow business to deduct expenses for "black hole" expenditure – encourage innovation and entrepreneurship

Allow businesses to keep losses when the owner changes – make it easier for small companies to expand

Remove residential loss ring-fencing – recognising that gains would be taxed and could reduce upward pressure on rents

Personal income tax and saving measures

Income tax changes (range of options, including a tax-free threshold – preferred option is increase in bottom tax threshold, with a possible increase in second marginal tax rate)

▪**KiwiSaver tax exemption** – remove tax on employer KiwiSaver contributions to lower income KiwiSavers

KiwiSaver member tax credit – increase Government contributions to all KiwiSavers

Reduce KiwiSaver PIE rates – give lower income KiwiSavers the same benefit as those in the highest tax bracket

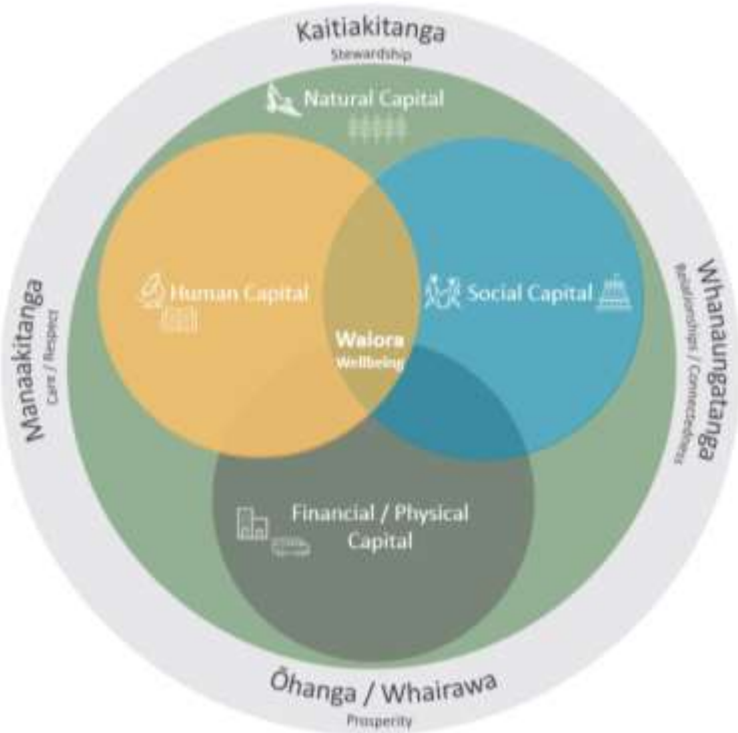
Environmental taxation

- Tax instruments are a useful tool for improving environmental outcomes – ensure we take account of the cost of our actions on the environment
- **Framework:** Report introduces a draft framework for deciding when to use tax instruments (e.g., emissions/resource use must be measurable)
- **Opportunities:** Group identifies five areas where tax could improve environmental outcomes. These are currently being worked on through seperate Government work programmes
  - *Greenhouse gases* ⇨ *ICCC, Zero Carbon Bill*
  - *Water pollution & abstraction* ⇨ *Freshwater work programme*
  - *Solid waste* ⇨ *Waste levy review*
  - *Road transport* ⇨ *The Congestion Question*
- **Concessions:** New tax concessions (e.g., e.g., QEII expenditure, fringe benefit tax on employer-provided public transport), and review of current tax measures in some industries to ensure not harming natural capital (agriculture, forestry, petroleum mining)

Māori perspectives and interests

- TWG engaged with Māori on how **tikanga might enhance tax policy**
  - Strong support for this approach - many Māori recommended it should have wider application
  - TWG recommends The Treasury further develop *He Ara Waiora* in the context of the Living Standards Framework

He Ara Waiora – A Pathway Towards Wellbeing



- **Extending tax on capital income** was identified through the Māori engagement process as having potentially significant impact
  - Report identifies some areas related to Māori collectively-owned assets where taxing capital income would not be consistent with the policy intent of the change
  - Informed by engagement, TWG recommends some types of transactions relating to these assets warrant specific treatment (eg. recovery of ancestral land lost through Crown action)

Next steps

April 2019***** *****subject to consultation between coalition and confidence and supply parties	Cabinet decisions on Group's recommendations
April to August 2019	Consultation on government proposals (if any)
October - December 2019* *additional time to incorporate legislative package	Bill introduced
July 2020	Legislation passed and enacted
April 2021	Implementation

Key messages

- The Government set up the TWG to improve the fairness and balance of the tax system, and encourage more productive investment. The final decisions will be based on an overall package that meets that goal.
- There are many options for the Government's final package. We suggest that any revenue generated from the Group's recommendations would be recycled into measures designed to increase the income of New Zealanders and to support businesses through the changes in the tax system.
- The Government is currently considering the recommendations of the TWG. Decisions will be made in the coming months. No changes from these decisions will come into effect until after the 2020 election.
- We propose that all requests for comment on the report be referred to the Minister of Finance and the Minister of Revenue.