Tax Working Group Public Submissions Information Release

Release Document

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Tax Working Group Submission

18 April 2018

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I have framed this submission around the questions that have been asked on the Tax Working Group website.

1. What Does the Future of Tax Look Like to You and What is the Purpose of Tax?

The purpose of tax is obviously to distribute wealth and resources to provide essential services for the good of the community and humanity as a whole. In this sense tax is a good thing. The debate comes when determining the extent and manner of the distribution.

There are three principles that I believe should apply to our tax system.

i) <u>We Need to Keep our Taxation System Simple</u>
Many countries are envious of the simplicity of New Zealand's tax system. We need to keep it that way. If we complicate the system, for example making some goods exempt from GST, or if we add new taxes, it will not only make it difficult for everyone to administer but it will also increase a totally unproductive tax industry – from government departments, to accountants to lawyers. We must not ruin the simplicity that we have.

ii) <u>We Must Not Disincentivise or Punish Effort</u>
There are several elements to this.

Firstly it is important for human wellbeing, and consequently the wellbeing of the planet, for people to know they will be rewarded for the effort they expend. People gain satisfaction and fulfilment from working hard and achieving. If those that work hard are overly penalised through tax, the point will be reached where they will not bother, as the effort is no longer worth it. That will have social consequences for themselves and for others, and lead to further community decline.

It is a fact that the majority of the tax take that funds our entire country comes from a minority of the population. As reported by Stuff Business News on 26 July 2016:

- *"The top 3 per cent of individual income earners, earning more than $150,000 a year, pay 24 per cent of all tax received.*

- *A table from Finance Minister Bill English's office shows 663,000 households - or 40 per cent - receive more in tax credits and other benefits than they pay in tax. Thousands more are neutral contributors, or are close to it".*

The high income earners are often maligned for their wealth, but they do actually fund our country.

I have no problem with the high income earners paying the high proportion that they do (which also includes greater GST on their greater level of spending). However what we cannot afford to do is to penalise and disincentivise them with taxation so much that they choose to throw the towel in, for example choosing to leave New Zealand. If it were not for the tax currently paid by these high income earners, whether companies or individuals, we would all be in dire straits.

The well-known quote says something like we cannot all just ride in the carriages, someone has to be the train engine or we will all go nowhere. The reality is we cannot afford to have those in the train engine choose to move to the carriages, or to decouple completely.

iii) <u>We Need to be Mindful of Unintended Consequences</u>

Taxes almost always result in unintended consequences, often negative. Tax distorts behaviour as people will always try to find ways to mitigate taxation effects. It is like squeezing jelly – you squeeze one part (through adding a tax measure) and it pops out somewhere else. The more complicated a tax system, the more costly it will be to administer, the more costly for businesses, and the greater the likelihood that there will be unintended consequences and mitigation effects through changed behaviours. The consequences cannot all be predicted in advance and history shows that many are likely to be negative. Having a simple tax system, as we currently have, minimise negative unintended consequences.

2. Are we Taxing the Right Things?

I believe we do have the tax mix right – with tax coming predominantly from income tax, company tax and GST. Perhaps the percentages could be adjusted, but the items are right and it is simple.

The reasons I do not like the other tax options come back to the three principles in my item 1 above, particularly simplicity and to not disincentivise effort. I will now comment on each of the other tax options.

<u>Wealth and/or Land Tax</u>

A wealth tax or a land tax would be very punitive and have negative consequences, particularly for people who have worked hard all their lives to build up a nest egg so they are not dependent on taxpayer handouts for their retirement. Why penalise these people, some of whom may have assets but little disposable income? And if we do disincetivise people from saving a nest egg for retirement, they will simply take the easier route and just rely on the government for handouts without having to expend effort.

Capital Gains Tax

I also do not believe there is any need for a capital gains tax. However if there was to be a capital gains tax it should only apply at the time of sale and to be equitable it would need to have the cumulative inflation over the ownership period deducted. Capital gain up to the level of cumulative inflation is not capital gain – it is just the value of the asset staying neutral in terms of inflation and should therefore never be taxed. It should also only apply to assets that are purchased after the date of its introduction, not to assets that are already owned.

Also, if a capital gains tax were introduced it should apply to all assets including the family home. Exempting the family home would have negative unintended consequences as has happened in Australia (see item 3 below). To be equitable there would also have to be a tax rebate where assets fall in value – which history shows they do at certain times of the economic or property cycle. We have experienced an unusual period of property value increases in the last few years. Property assets may well reduce in value in the future and if a capital gain tax applied then it might have reverse effects i.e. refunds rather than tax take.

There is also the complication where an owner has spent money to improve an asset over time and thereby increased its value which should not be taxed. This all leads to more record keeping, unwelcome complication and cost, rather than the simplicity we currently have.

Speculators who are looking to capital gain for profit do already pay a capital gains tax in New Zealand through the brightline test which is being extended to 5 years, or through the longstanding intention test. To apply a capital gains tax to the entire property market would be detrimental and is unnecessary given that the speculators are already being taxed.

Gift or Estate Tax

The same goes for gift or estate tax. Don't do it. Thank goodness we got rid of these taxes previously, made it equitable for estates to transfer assets to their families, and got away from people coming up with all manner of clever ways to mitigate or avoid these complicated taxes. Please keep our tax system simple as it is now.

Charities

I believe that genuine charities should continue to not be taxed. That is because they provide a whole raft of social and community services that the government (i.e. taxpayer) would otherwise have to pay for. They save the country significant money. Similarly the tax deductions for donors to charities should continue, as without their donation there would be a cost to the taxpayer. Just a few examples are surf lifesaving, social agencies and churches that provide essential community services, St Johns ambulance and so on.

3. Can Tax Make Housing More Affordable?

I do not believe that tax can generally make housing more affordable over the long term. This relates both to affordability of ownership (house prices) and renting.

House Prices

House prices result from the balance of supply and demand. In some, but not all parts of New Zealand there is or has been an excess of demand and a lack of supply, resulting in increased prices.

There are several reasons that house prices are significantly higher than they were several decades ago. Firstly, we have been building increasingly larger and more expensive houses. Secondly, most houses are now purchased by double income couples rather than a family having a single income earner. That means the double income purchasers can afford to pay more, including servicing a higher mortgage, which drives market pricing. Thirdly, it is now very easy to get a bank mortgage whereas previously applicants had to have a long savings record and often also needed a second mortgage. Mortgages were not easy to obtain. Fourthly, interest rates are now at historically low levels, which means that purchasers can service larger mortgages than previously. Therefore in a competitive bidding situation higher prices are paid. This is a global phenomenon not just a New Zealand issue. Notwithstanding well documented supply issues, a significant rise in interest rates is probably the one factor that would now cause house prices to reduce.

A capital gains tax has been touted as a theoretical method to reduce house prices, though the government says a capital gains tax would not apply to the family home. You only have to look at countries that already have capital gains taxes to see that they currently have the same issue of high priced housing in large cities where demand is high. The capital gains tax doesn't make any difference. As the Chief Economist of the ANZ Bank says (NZ Property Professional Magazine – Autumn 2018):

"Analysis of capital gains taxes in other countries has generally tended to conclude that they have a one-off negative impact on prices, but little ongoing impact on the magnitude of house price cycles".

Also, if there is a capital gains tax but it does not apply to the family home, any possible impact will be further reduced and there will be other consequences as the market responds. In fact if the government really believes in capital gains tax on the basis of sound economic principle, it would then also apply it to the family home. Otherwise it is being applied for the wrong reasons, such as populism or just out of envy to penalise people who have worked hard and provided for their retirement. In some states of Australia where the family home is exempt from capital gains tax, it has resulted in the unintended consequence of people pouring excessive money into the family home instead of investing in rental properties. This has resulted in larger homes being built, homes being extended and upgraded, with a consequent increase in the cost of owner–occupied homes.

House Rentals

If tax measures are directed at rental (investment) properties (including a capital gains tax), thereby making their ownership less attractive, there are two consequences. Firstly, the net return on the investment property reduces which means that rents will ultimately rise over time as the market finds a new balance to compensate for the tax measures. Secondly, some investors will exit the market, leading to a reduced supply of houses available for rent. The reduced supply then inevitably results in rent increases. This is not just theoretical; it is widely acknowledged that recent policy and legislative changes that negatively affect residential property investment are already reducing supply and causing rent increases.

Chris Wales, a tax expert appointed as an adviser by former British Prime Minister Tony Blair, is quoted in Stuff Business News on 24 March 2018 saying:

"People needed to be quite clear in their thinking about how any change in a capital gains tax would affect housing supply. I think if you introduce it there will almost inevitably be a reduction in the amount of future investment in residential real estate for investment purposes. Because it will constrain future supply, what it might do is add to price pressure, so you might see prices going up a little bit more". Wales said he believed there was a supply issue with housing in New Zealand and he would be more concerned about making that worse by taxing capital gains on housing, than he would be about the money such a tax could raise".

So for the above reasons I do not believe that tax can generally make housing more affordable over the long term. History and international experience proves it. It might even fuel further price increases.

4. What Tax Issues Matter Most to You

Noting the items that are listed under this heading on the Tax Working group website, I have answered this question in my responses above. Items 1 to 3 above should therefore be taken as my answer as to the question of which tax issues I consider matter the most.

Thank you for considering my submission.

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