

Tax Working Group Public Submissions Information Release

Release Document

September 2018

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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.

Submissions to the Tax Working group

I have chosen to comment on the following matters-

Capital Gains Tax(CGT)

There are problems with both accrued and realised methods of calculating capital gain. Accrual has a relative advantage of early and steady revenue flow, but it loses revenue when there is capital loss. Neither method should be used; instead a designed for purpose capital valuation database and management system(db+ms) would be a better solution. The objective of a db+ms system would be to provide valuations, for CGT use only, which smooth out transient +ve and -ve spikes in valuations.

I suggest a db+ms with two parts. First, a current valuation database that updated as frequently as possible. Other valuations would be updated as necessary to yield a complete database that is as current and accurate as possible; for land based property this could be developed from the LINZ valuation database. Second, capital gains tax valuations would be derived by calculation from the modified LINZ database. The derived valuation would reflect database values and trends and possibly other inputs, eg land zone or legislation change, effect of interest rate change, natural disaster, etc. The db+ms would calculate the CGT valuation when required by each tax client's account cycle.

A property owner might wish to object to their CGT valuation. However, since a CGT valuation would be a derived value which does not entirely reflect market valuation, the grounds for objection would be limited.

Using this database and management system would apply db+ms valuations at the date of introduction of CGT; CG revenue would start during the second year. This system should be running 6-12 months before CGT begins in order to pre-test it. Since these valuations would be conservative there could/would be an adjustment if realised sale value was higher than the applied CGT valuation at sale date. And, since most CGT will be paid prior to death or separation causing a sale, the cost to IRD of making exemptions in these cases will be less. Also, the CGT impact of a person selling one business to buy another would be reduced.

A variant of this system might be applicable to shares.

Using this managed database system would see the business income adjusted by adding capital gain or, rarely, subtracting capital loss. It is a method of factoring a likely future capital gain into the income during each of the years the asset is held.

If the property business is running at a loss, and those losses are offset against other income, then CG income adjustment should apply. If the losses are ring-fenced then CG income adjustment should be carried forward. IRD may need flexibility here as there will be cases of genuine hardship. If the property was being held primarily for capital gain and not earning income then the CG should be taxed; it is not the function of a tax

system to facilitate valuable assets being left idle.

Other observations on CGT

Taxing capital gain would likely be integral with deducting capital loss from taxable income if CGT is introduced. However, property prices are currently at a high level and it is possible some properties may fall in value. There is a similar risk with shares. It is not the responsibility of other taxpayers to buffer these capital losses. Therefore there is no great urgency to introduce a CGT.

If inflation is taken into account then it could be argued that a property holding a steady dollar value is actually losing real value; such real loss to be calculated and offset against income. Reducing taxable capital gain or other income by means of inflation accounting is equally ridiculous. Makes about as much sense as adjusting the GST rate for inflation.

A CGT will need many exemptions- family home, charities, iwi, genuine hardship, separation and death. A realised CGT will be avoidable by not selling a property(eg iwi, family, entity) or by merging with the entity which owns the property, ie no sale is made but is effectively owned by a different person/entity. Some may defer the decision to sell.

From the point of view of house tenants(the majority of house occupiers) it would seem that the family home being exempt from CGT is unnecessary and unfair. This should be considered as an argument against CGT; the tenant will effectively be paying some of his landlord's CGT while the owner occupier pays nothing. It would be better if the effect of CGT on tenants is monitored- a website/database could be set up which tenants could use/log in to get information and advice, report rent hikes or termination, or contact an advisor or case manager. The same site could be used for business tenants. IRD might gain some value from such a website/database by linking tenant/property/owner/entity. The downstream results of a CGT should be monitored and analysed to allow rule modification which contributes to fairness.

The greatest value of a CGT is to use it in conjunction with income tax rules and not as a stand alone tax. Introducing new CGT rules in this way is, I believe, less alarming for tax payers who own property.

The Black Economies

The cash economy presents a challenge. Banknote counting machines with serial number recognition already exist, some with online capability. Electronically tracking banknotes and implementing a database would give some leads in tracking down tax evasion. General knowledge that such a system exists would provide further deterrent to tax evasion. Data could be collected at ATMs, bank teller deposits/ withdrawals, overseas remittances paid in cash, overseas transactions using NZ banknotes, and all cash transactions above a given value. Business would pass on the cost to their users, the IRD would still need to analyse note tracking data. Public reaction to these measures might be tempered by the realisation that these types of measures are predictable because of constant advances in technology.

The use of hidden systems or cryptocurrency to disguise cash movements and hide income is an increasing problem. Verifiable tax accounts are unlikely to be provided by users of these hidden systems. The weakness in using such a system is at the two points of money in and money out. Funds paid from or paid to the accounts of hidden system users could be treated as consumption and income respectively, and taxed accordingly. The difficulty is cash entering such hidden systems, which is where bank note tracking may yield its greatest return. In this case the cost and information would, no doubt, be willingly shared by many agencies and government departments internationally as well as in New Zealand.

Opportunities for tax avoidance and evasion are still plentiful. There may be merit in going back to compulsory annual returns for all taxpayers, especially with online capability. The annual legal declaration that correct and complete information was given to the IRD is compelling.

Maintaining a broad tax base

Tax should be spread as widely as possible to keep tax rates as low as possible.

Consumption tax

No new exemptions to GST should be made. Keep it simple to apply so that GST returns are straightforward. There is also the following reason to keep GST as it is now:

Any overseas company selling goods and services to New Zealand based buyers is operating in New Zealand. If considering GST, where they operate is a more relevant factor than where they operate **from**. New Zealand buyers are consuming product which, if bought in New Zealand, would be subject to GST; most overseas sellers are not obliged to charge GST on their NZ sales under a certain value. The logical step with overseas purchases is to report the GST payable to IRD, at the time of purchase, for

direct payment of GST to IRD. It would require online purchasers to have a tax id number and a debitable account. Neither seller nor fund transfer service need add the GST. The cost to IRD of setting this system up would be offset by the advantage of immediate collection of GST on overseas purchases.

Income tax

Under employment law an employment relationship is clearly defined. And this should also be the case under income tax rules. The IRD could operate a system which analyses all employee/contractor/etc cases to ensure income tax and ACC levies are not being avoided by employer or employee, ie looking at the employer/employee or employer/contractor as a **pair** to check on overall compliance.

Lost income and company tax- overseas based operators

Many transnational companies pay little tax. There are two reasons why this is likely to continue: First, as tax authorities belatedly corner transnational operators to pay more tax so those operators will develop increasingly serpentine measures to slip away from their obligations. Second, it may be optimistic to factor full co-operation between various tax authorities in extracting tax from transnational operators; if one nation's tax authority considers it is already receiving enough revenue it might opt out of tax treaty negotiations.

It may be necessary for the IRD to confront operators with a persistent tax avoidance/evasion habit by applying a levy on their NZ sales. Call it a transnational evasion prevention tax. It would at least improve the IRD's negotiating position with the transnational and refresh negotiations with other tax authorities.

Private overseas money transfers

With globalisation and the internet there has been a considerable increase in private money remittances and payments to overseas based recipients. These transactions are a loss of liquidity to New Zealand's internal economy; a loss of consumption spending and consequent downstream employment. Thus GST, company and income tax are foregone. This is a narrowing of our tax base that puts extra load on other taxpayers. A transaction tax on private overseas remittances and purchases might be a justifiable form of lost tax recovery.

Regarding fairness

I see tax fairness as avoiding undesirable human outcomes. An example is the tax treatment of investment in existing houses for use as rental properties; it has contributed to low and reducing percentage of owner occupiers, increasing house and rent prices, and capital wastage. More people now rent than own; a portion of society has become transient, including schoolchildren. The effects were predictable and observable but little effective action was taken; eg tax rules to make new house building more attractive than investment in existing houses never happened. The Policy and Strategy Group within the IRD needs to make predicting and monitoring the effects of tax policy a priority so that bad outcomes are avoided. Data collection and analytical software, plus the will to act, will be essential.

Yours faithfully
Paul Glover