Tax Working Group Public Submissions Information Release

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Submission to the Tax Working Group

Bren Mackenzie and Logan Penniket - 29 April 2018

Introduction

1. We believe that a tax system should be efficient, equitable, and fair. There should be minimal opportunities for tax avoidance, compliance should be easy and low-cost, and it needs to raise enough money for government to provide services that the population of New Zealand needs.
2. Taxes also have a role to play in incentivising behaviour. That role might be to discourage smoking, encourage companies towards more environmentally-friendly practises, or provide an incentive for New Zealanders to save more.
3. We believe that New Zealand has a good tax system compared to many other OECD countries - in particular its relatively simple approach with few exemptions. However we also think the system could be improved to give a better balance between different taxes and their impacts, and to better meet the challenges of the

21st century. Through this submission we look to propose solutions that will edge us closer to a more ideal system.

4. We thank the Tax Working Group for the opportunity to submit on this important matter. We are happy to be contacted on the matters raised in this submission.

We support the use of environmental taxes to incentivise sustainable behaviours

5. We support the use of the tax system to incentivise more environmentally sustainable behaviours, as well as the use of Pigouvian taxes to address activities which produce environmental damage as a negative externality.
6. We note that the primary greenhouse gases (carbon dioxide, methane and nitrous oxide) are already included within the emissions trading scheme (ETS). We hope that the ETS will become more effective at reducing the emission of these gases in the future (as the unit price increases and agriculture is included).
7. However, there are a number of other environmental taxes that may merit consideration, from both a revenue-gathering and environmental perspective.
8. Examples from other jurisdictions include:
    a. taxes intended to reduce emissions from motor vehicles (eg differential car registration costs based on emissions or vehicle age)
    b. a severance tax on extracted fossil fuels (coal would be particularly relevant in the New Zealand context).

We support introducing a charge for water use

9. We support introducing a pricing system for water. This would acknowledge the importance of this resource critical to all life, as well as its increasing scarcity.
10. The current water allocation system does not adequately incentivise efficient and effective use of water. It also enables environmentally unsustainable behaviours, such as extensive use of irrigation to support dairying in areas where it would not otherwise be possible. While we acknowledge the importance of the dairy sector to the New Zealand economy, expansion of dairying to such marginal landscapes must be balanced against other impacts, such as the depletion of our natural capital.
11. We note that the Labour Party campaigned for a 'water tax', but that this was not progressed following the coalition agreement with New Zealand First. We therefore support the introduction of a water tax after the current term of parliament, once the coalition agreement has expired.

We support a capital gains tax

12. We believe that income derived from capital should be subject to tax, to the same degree that income derived from labour is. The absence of a capital gains tax is the most obvious missing component of the New Zealand taxation system, in particular compared to other OECD countries.
13. The current approach to (not) taxing capital relative to other income sources distorts the playing field by incentivising investment in sectors that are not subject to taxation (eg capital gains from property) at the expensive of investment in sectors that are taxed. This results in adverse outcomes such as our overheated property market.

14. Introducing a capital gains tax could incentivise greater investment in productive sectors and direct more capital to the sharemarket and other private enterprise, thereby supporting the growth of New Zealand businesses.
15. We strongly support introducing a capital gains tax as a key step towards a more equitable tax system.

We support progressive income tax and advocate for a tax-free bottom bracket

16. Personal income tax should remain progressive, as this means that those with a greater capacity to pay contribute more to the services funded by taxation.
17. Further, we recommend that the income tax system be made more progressive by introducing a tax-free bracket. We suggest that income up to $10,000 should be tax free. This would reduce the tax burden for those on low incomes. It would also partially offset the regressive impact of GST.
18. The reduction in revenue to government could be compensated for by a new top income tax bracket.
19. We believe that tax rates should be aligned between the top income bracket and the rate for trusts to prevent tax avoidance. Ideally, the rate for the the top income bracket and the company rate should be aligned for the same reason but we also believe that this should be only one consideration among many when deciding on the rate. We don’t advocate for alignment between the top income rate and company rate at this time.
20. Tax brackets should be indexed to the CPI or an equivalent wage index to prevent bracket creep and prevent a person’s income from falling into a higher tax bracket if their nominal income goes up but real income goes down.

We favour retaining the status quo for GST

21. The current Goods and Services Tax appears to be working effectively in gathering revenue for government.
22. We support the current New Zealand approach of very few exemptions to the application of the GST. We note that New Zealand’s value-added tax is more effective than value-added taxes in most jurisdictions, which often apply exemptions that decrease the effectiveness of the tax in gathering revenue and can significantly increase its complexity and administration costs.
23. We acknowledge that GST is inherently a regressive tax, and on this basis would not support increasing the current rate any further.
24. On the other hand, some evidence suggests that a small decrease in the level of GST would not decrease prices for goods and services in proportion to the rate of the cut, as retailers and service providers are likely to retain a proportion of the gains for themselves.

We favour retaining the current company tax rate and do not support introducing differentiated tax rates for companies

25. We are aware that discussions around the company tax rate are complex and hotly contested. It is important to separate ideology from what is actually supported by evidence.
26. It is suggested that reducing the company tax rate would incentivise businesses to invest further in measures that would help them grow, as they will be able to keep a greater proportion of the profits. From our research, it appears that this assertion has not been satisfactorily demonstrated. If there are activities which would increase a business's profitability, it is reasonable to assume that they would be likely to undertake these measures anyway (unless there is a very high level of company tax).
27. Another argument is that companies will be in a better position to pay their workers more if they generate more profits. This seems a dubious claim - it's hard to see why a company would be likely to pay workers more rather than, for example, returning a greater dividend to its shareholders.
28. Reducing the rate of company tax would have a distributional impact, with the gains disproportionately realised by wealthier people, while ceteris paribus other groups would have to pay more tax to make up the government's reduced revenue from this tax source.
29. It is argued that reducing the company tax rate could help attract companies to locate in New Zealand. We think this is unlikely. A range of factors influence company location decisions. The tax rate would have to be cut substantially before it had a material impact in attracting companies to New Zealand.
30. The most compelling argument in favour of reducing the company tax rate may be its potential impact on retaining companies in New Zealand. That is, if our company tax rate is significantly out of line with comparator countries, this may incentivise some types of companies to relocate their businesses in jurisdictions with a lower company tax rate. However, it should be noted that only a small proportion of businesses are mobile in this way - in particular, small and medium-sized businesses would be quite unlikely to relocate, as would large companies whose business is inherently tied to New Zealand for either geographic reasons (eg Fonterra) or because that is where the company provides its services (eg Spark). In addition, while New Zealand's current company tax rate is now relatively high compared to the OECD average, it is hardly an outlier.
31. On balance, we can't see any compelling reason to lower the rate of company tax.
32. On the other hand, we also do not favour increasing the rate. Increasing the rate would act as a negative signal to businesses, and in the longer term could mean that New Zealand does become an outlier - especially if other jurisdictions continue to reduce their company tax rates.
33. We do not support introducing differentiated company tax rates. We understand that the intention of such an approach would be to support small and medium-sized businesses. However such an approach could have unintended impacts, such as incentivising companies being structured to avoid this tax. It is also hard to say where

the incidence of a company tax will fall - meaning that the higher rate could have unexpected adverse impacts.

Saving for your retirement should be further incentivised

34. According to Statistics New Zealand projections, the proportion of the population aged 65+ is expected to increase dramatically. In 2016, there were 4.4 people aged 15-64 for every person aged 65 and over. By 2068, that ratio is expected to drop to 2 people.
35. This illustrates the need to encourage people to pursue their own retirement savings, with Kiwisaver the ideal vehicle for that.
36. Gearing more incentives towards saving will introduce more capital into New Zealand markets while helping New Zealanders save for a more financially secure retirement.
37. To improve the effectiveness of Kiwisaver as a vehicle for retirement savings, we suggest that the annual PIE tax that a Kiwisaver fund incurs is deferred to when a saver withdraws their money rather than on an annual basis.
38. This will leave more funds in a Kiwisaver account and allow for greater compound growth. This will leave savers with a higher savings balance by the time they retire. While this will result in reduced revenue for the government, we deem this to be an acceptable trade-off.
39. We also suggest changes to the Kiwisaver scheme so it becomes closer to how it was originally designed. These suggested changes are all about encouraging people to save:
    a. The $1000 kickstart should be reintroduced, to provide an incentive for people to join, and to provide a good base to start with so that initial investment gains aren't cancelled out by fixed fees.
    b. The member tax credit should also be bought back up to its $1042.86 level, though we should retain the rate we have now so that someone will need to contribute $2085.72 annually to get the full credit -- or about $40 a week.
    c. The mandatory employer match should be increased to 6%, though allow the option for someone to remain on 3% (with an employer match of 3%) if they wish.

We support giving local governments greater flexibility to introduce new types of funding mechanisms

40. We note that the Tax Working Group is not considering changes to local government taxation in New Zealand, but still would like to express our views on this topic.
41. Many local governments across New Zealand are experiencing considerable funding pressures as they struggle to deal with rapid growth and the corresponding demand for infrastructure. The current rates system appears insufficient to deal with ongoing funding pressures, and ratepayers are understandably opposed to ongoing double-digit rates increases.
42. We support allowing local governments greater flexibility to introduce new funding mechanisms to support their activities. A good example is the proposed 'bed tax' in Queenstown, which would help the town to better address its considerable

infrastructure deficit and acknowledges the challenge of its low rate-payer base relative to the number of visitors.

43. On the other hand, this flexibility should be balanced against the potential negative impact of creating differentiation in systems between regions, thereby generating higher compliance costs for businesses and individuals working across different regions. On these grounds, we would oppose the introduction of local sales taxes, for example.
44. We recommend that the Working Group recommend to the Government that it grant local jurisdictions greater flexibility to introduce tailored funding measures appropriate to their challenges and needs.

We would support a wealth tax if implementation challenges could be mitigated

45. Wealth in New Zealand is more unequally distributed than income. People with more assets and capital are able to use these to generate returns, thereby further increasing inequality over the longer term.
46. In principle, we agree that a wealth tax could address this cycle of growing inequality. In practice, we think there could be challenges to implementing such a tax effectively. For instance, people will be incentivised to structure their assets to avoid this tax. It will also be challenging to implement for people with less liquid assets, as they may not have the funds available to pay the tax on an annual basis.
47. If these challenges and others could be satisfactorily resolved, we would support the introduction of a wealth tax.

A land tax could work, but we think other options are preferable

48. A land tax would provide a transparent system (as land ownership is already well recorded) with few opportunities for tax avoidance. Another benefit of a land tax could be reduced land-banking (thereby freeing up more land for development).
49. On the other hand, a land tax could impose hardship on people who are 'land rich, capital poor', who may ultimately have to sell their property in order to pay the tax. The exemption for the land under the family home from the Tax Working Group's terms of reference would go some way to addressing this challenge. There is also a risk that landlords may pass the cost of a land tax directly on to tenants, thereby increasing rents for those who are less able to afford it.
50. While we are open to the idea of a well-implemented land tax, we think other options (such as environmental taxes and a comprehensive capital gains tax) would be preferable as revenue sources.

An inheritance tax and gift duty could be effective but we don't consider them priorities

51. An inheritance tax could be an effective mechanism for reducing inequality by decreasing the number of people who become wealthy simply by inheriting assets or money, rather than through their own work or investments. We do acknowledge that such a tax can be subject to avoidance, for example by securing assets in trusts. We note that inheritance tax is excluded from the scope of the Tax Working Group.

52. A gift duty could also be useful to reduce inequality, as it would help ensure that people become wealthy through their own endeavours, as opposed to perpetuating existing inequality by wealthier people gifting land (or other assets) to their children. A gift duty would be most effective in combination with an inheritance tax, as the two are a logical pair.
53. If introduced, a gift duty should have a suitably high threshold to ensure that it is targeted in a way that maximises its impact while not affecting the considerable majority of New Zealanders.
54. While a gift duty could be effective, we do not consider it a priority.

A global approach is needed for the tax treatment of multinationals and for a financial transactions tax

55. We believe that these two different issues are linked by the need for a global approach rather than being addressed at a national level. Legislation at a national level may prove ineffective so we generally support that New Zealand participates in global agreements to provide a global framework for addressing these challenges.
56. With multinationals, we recognise that it can be complex to determine the local profitability of a company that operates globally (such as Facebook or Google). However the current system which permits the shifting of profits from a New Zealand entity to one overseas does not resemble fairness. It's absurd that a company making large margins on a global level makes tiny margins on a local level (and therefore has a tiny tax bill) thanks to some accounting magic. This means that multinationals can avoid paying appropriate tax despite earning considerable profits in New Zealand.
57. If there are some policy instruments available to the New Zealand government then we'd support these, but think ultimately that approaching the issue with a global perspective will be the most effective.
58. We support a financial transaction tax to provide a more broad-based tax system.
59. The rate should be set a low enough level that the average person barely notices the impact of the tax but high enough to gather sufficient tax revenue on aggregate to make it a worthwhile endeavour. Due to the global nature of financial markets, we think this will be best achieved through a global agreement.

About the submitters

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