

## **Tax Working Group Public Submissions Information Release**

### **Release Document**

**September 2018**

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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.

Submission to:

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Submission from:

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[1]

This submission can be released in its entirety under the OIA if required.

### **Proposal Summary**

1. The guiding principles of the NZ tax system, as stated, must be retained:
  - a. Simple and efficient.
  - b. Broad based with minimum exemptions.
  - c. Neutrally and in the background as much as possible.
  
2. Government expenditure levels should not be a principle of the tax system because:
  - a. A large percentage of expenditures are transfers which are unrelated to a tax system.
  - b. Different Governments will have different views regarding an appropriate level of expenditure as a percentage of GDP/ the New Zealand economy.
  - c. An historical level of expenditure is not necessarily a good measure of what the future may look like.
  
3. The use of the tax system to implement single issue government policies particularly those related to changing behavior should be avoided.

In line with the principles/positions above, I would like to see the tax working group consider implementation of the following specific proposals:

### **Simple and Efficient**

#### **1. Have a base level of income which is "tax free"**

The income tax rates could be amended so that the first tax rate is a Nil rate. By way of example the tax on income up to say \$300 per week (\$15,600 per annum) would be Nil with rates above that adjusted to ensure that this change was tax neutral should this be seen as appropriate by the tax working group.

There are a number of clearly identifiable benefits to such a change, as follows: -

- I. Reduction in compliance costs – a drop in the number of citizens who need to file tax returns.

- II. It increases the incentive to enter the work force especially for first time employees.
- III. Reduces the attraction of black or grey market operations.
- IV. It increases the take home pay of those on the minimum wage or working part time.
- V. Could be linked to a matching change/reduction in benefits and transfers – This could be implemented to ensure that the rates adjustment was fiscally neutral to individuals receiving Government assistance (including those receiving superannuation).
- VI. It increases the attractiveness of moving off a benefit and into paid employment.
- VII. Psychological boost to all citizens from a tax system that doesn't require those on minimum incomes to also support state services.

## **Widen the tax base**

### **2. Review the definition and application of Charitable Purposes as set out in the Income Tax Act**

Providing income tax exemptions to businesses that are registered charities fundamentally undermines the guiding principle of the tax system in relation to neutrality, being broad based and being simple and effective. It is therefore important that such exemptions are well deserved and only available for entities that truly provide charitable services.

A number of charities in NZ operate a diverse range of businesses that don't pay income tax but compete with those that do. The result is a very uneven playing field and a mayor disadvantage to, and disincentive for other businesses to operate and grow here. A number of registered charities assist a small number of recipients or those with family associations such that they look like tax paying companies or trusts. It would be appropriate for these entities to be treated in the same way as companies are for tax purposes.

In addition, it is usual for religious organisations to be registered as charities despite many being substantial entities with substantial asset bases including commercial rentals. There is a strong argument that a level playing filed would require tax to be paid in such commercial income particularly any portion that is not used for charitable purposes.

I would like the working group to consider and investigate: -

- i) That the definition of charities be tightened to:
  - a. Remove those that serve belief-based organizations
  - b. Remove those that support family groups
- ii) That all businesses pay income tax and registered charities be entitled to claim a rebate only in relation to the amount of money spent in that year for charitable purposes.

### **3. Tax overseas companies**

It has been recognized that a number of overseas based companies, particularly those operating in the IT sector, have been gaming the transfer rules to avoid paying tax in New Zealand (as well as other countries). The use of royalty and intellectual property payments to subsidiaries based in other countries, often those considered tax havens or low tax countries, has been recognized as a problem globally however it is not clear that New Zealand has been tough enough to ensure that the right amount of tax is paid in New Zealand to recognize the income earned here.

I would like the working group to review and tighten the transfer payment rules to ensure that all businesses pay tax on income earned in New Zealand regardless of the country of residence.

Further it is important that rule changes in this area are well publicized so that citizens are aware of the authorities' enforcement of a level playing field for all businesses operating in New Zealand.

#### **Neutrally and in the background as much as possible**

#### **4. No new or increases in "behavior modifying" or targeted taxes**

Targeted taxes that are designed to modify behavior (as opposed to those that charge for the service provided) create distortions and always have unintended consequences. For example, cigarette taxes are highly regressive given that the majority of people who smoke are in the lower socio-economic group. Research shows that it is also more difficult to change the behavior of this group meaning that further tax increases have reducing impacts but increasing unintended consequences such as rising family poverty.

The increase in cigarette taxes increases poverty levels and impacts on those who can least afford additional taxes. Further negative implications are increases dairy robberies, hungry children and families under stress and unable to feed their children. All are unintended and undesirable consequences.

There are strong arguments supported by economic theory and overseas research that shows that should Governments see fit to target a change in behavior doing so via targeted expenditure and using behavioural changes processes (nudge theory refers) can be as effective as using a tax or charges regime that can be avoided by those on higher incomes and are also often more regressive than the alternatives. Given that all taxes are distortionary the use of behavioural change processes should be preferable. They have been used successfully in the past in New Zealand to change behavior (seat belt use being an example).

See Tax and Benefit policy: Insights from behavioural economics from the Institute for Fiscal Studies – IFS commentary C125  
Refer to Nudge theory – see Nudging – A very short guide by Cass R Sustein from Harvard University

Submission ends

Wayne Grattan