Tax Working Group Public Submissions Information Release

Release Document

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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 by Ian Kuperus to the Tax Working Group

Capital gains tax

2. Proposal to allow CGT deposits

Executive summary

This proposal is that taxpayers and intermediaries be allowed to make non-refundable CGT tax deposits The benefits of allowing CGT deposits are –

- it would enable taxpayers to essentially opt in to paying tax on an accrual basis there by mitigating the rise in CGT rate
- it would provide the government with significantly advanced revenue- possibly in the order of $5 to $10billiion in the first 10 years.

The key features of CGT deposits are –

- They would be non-refundable
- They would be tradable in a similar way to tax pooling deposits
- They would be date stamped and accrue a non-assessable interest up to the time that they are applied against a CGT liability. I suggest a 4% rate but this is open to review.
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Increased Revenue For The Government

A key advantage of making the CGT deposits non-refundable is that all deposits can be counted immediately as revenue to the government. The combination of the variable CGT rate and CGT Deposits mean that taxpayers and intermediaries will be incentivised to pay CGT earlier. Specific motivations that will advance Government revenue are –

- No rollover relief provisions that might otherwise be introduced – if not initially then further down the track
- Virtual elimination of the lock in effect that would defer realisations and therefore defer the collection of revenue
- Incentive for voluntary CGT assessments
- An incentive for taxpayers that have latent CGT liabilities to use CGT deposits to mitigate CGT liability. Fund managers and financial institutions are likely to be in this category.
- Incentive for intermediaries to arrange deposits on behalf of others.

The Victoria University tax Working Group estimated revenue from a full accrual CGT regime at $4.5 billion per annum. It is difficult to surmise how CGT revenue might grow. But if –

- Full accrual liability was $4.5bn per annum
- Assets were held on average 10 years
- Then it would be year 10 before the Government was collecting $4.5bn pa and over the first 10 years would have collected a total of around $22bn with a further $22bn being unrealised.
- My view is that up to half of the unrealised CGT liability might be paid early by taxpayers or intermediaries. This could increase government revenue in the order of $5 to$10 billion over the first 10 years.

The following categories of taxpayers would be incentivised to make CGT deposits.

- Larger tax payers with accrued capital gains that have a marginal borrowing or investment rate that is less than the inferred 4% non-assessable compounding CGT interest rate.

- Other smaller taxpayers that wish to take a conservative approach and mitigate the cost of Future CGT liabilities.

- Financial intermediaries that wish to make CGT deposits either for their own exposures or to sell off at a future time.

Example

A fund manager makes an unrealised capital gain in 2021 of $100m . Its cash deposit interest rate is 4% -taxable. The Fund Manager therefore finds the 4% non-taxable return on CGT deposits attractive and makes a $25m CGT deposit. In 2026 when that gain is realised the tax rate on the 5 year asset is 27% giving a liability of $27m. The CGT deposit has accrued interest at 4%pa and is now worth $27m providing the required amount to settle the liability. The Government has had an increase in revenue of $25m five years earlier.

Tax treatment of the funding and sale of CGT deposits

It is proposed that the interest accrued on CGT deposits be treated as a non-taxable income. This treatment would mean an equivalent taxable interest rate of around 6%. An interest rate at that level should mean these deposits are attractive to a significant portion of taxpayers.
Any CGT deposits that are not required can be sold on the secondary market. Any gain on sale should also be non-taxable.

On the other hand interest incurred in funding deposits be should be deductible as a cost of funding business.

Reporting on CGT deposits

I propose that the government report regularly on the amount of CGT deposits and CGT assessments to allow the market to make informed investment decisions about the level of CGT deposits.

International Precedent

I am not aware of any direct parallels to this proposal but in the 1980'S the UK had Transferable Certificates of Deposit (TCD's). These were government bonds that could be converted to tax payments at the date of deposit foregoing the interest that would otherwise be payable on the bond. CGT deposits also have parallel with tax deposits can be made under the tax pooling regime. The flexibility provided by the tax pooling regime has proved popular with business and, dependent on the implied interest rate I would expect that there would be positive uptake to such flexibility with a CGT regime.

Issues that Warrant Further Consideration

- **The Interest rate payable on the CGT deposits**. I have suggested a 4% interest rate that aligns with the proposed interest rate used to calculate the increase in CGT rates. This would allow a taxpayer with perfect knowledge to pay on an accrual basis and always pay the minimum CGT rate. However these rates need not be the same and it may be that varying these rates will produce a better outcome.
- **The trading mechanism** – the tax pooling regime provides a starting point to consider but other frameworks should be considered. With all CGT deposits having a current value being interchangeable it is likely that the trading mechanism will be a lot simpler and transaction costs less than the tax pooling regime.
- **Interface with the tax pooling regime** my initial view is that tax pool deposits should only be available after a CGT assessment has been made.