Tax Working Group Public Submissions Information Release

Release Document

September 2018

taxworkingroup.govt.nz/key-documents

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Tax Working Group - Future of Tax

Set out below is my submission on the five key questions about which you have sought submissions.

Question one

What does the future of tax look like to you?

A taxation system which:
- is fair and equitable, meaning it takes into account a person's ability to pay and applies equally to all income earning investment activity
- is not so burdensome as to discourage savings and investment
- minimises the possibilities for tax evasion (as distinct from avoidance where eg a business expense can be offset against taxable income)
- encourages risk taking in the investment in and free flow of capital within an economy by helping to minimise risk taking in capital formation.

Question two

What is the purpose of tax?

The purpose of tax:
- is to raise revenue for government to invest in the building of a productive and harmonious society
- should not be to raise revenue for government spending at the risk of actively discouraging savings and investment.

Question three

Are we taxing the right things?

We are taxing the wrong things if:
These taxes are:
- punitive, ie a tax that singles out a certain segment of society for taxation and which has the effect of placing an unreasonable burden on that segment for meeting everyday household needs such as housing, health, food, education, transport and power needs
- they target a social practice that derives no overall benefit to society.

Question four

Can tax make housing more affordable?

A tax can have that effect if:
- personal taxes are **not** so high as to inhibit the borrowing of money from a bank for the purpose of buying a first home at current interest rates
- it does not discourage investment and the free flow of capital which are essential for the growth of income and employment
- it **does not** hinder the growth in capital stock and so give rise to an increase in interest rates.

Note: Capital Gains Tax (CGTs) have not proven to be effective in suppressing property price rises in countries where CGT's are in operation, notably Australia.

Question five

What tax issues matter most to you?

The tax issue which matters most to me is:
- A taxation policy that hinders capital formation. Capital formation and its appreciation in value is the fundamental driving force behind economic growth in a society based on such principles, as is New Zealand's. Capital appreciation is the basis of returns on shares, interest earning bank or other forms of cash deposits and corporate dividend yields.

Of particular concern therefore would be a **Capital Gains Tax** on any form of capital formation for the following reasons:
- it's manifestly unfair in that it's a form of double taxation; income earned to buy the asset has already been taxed
- it will stymie investment in productive assets in that by taxing capital gain it increases the risk in investment activity
- consumer confidence and a readiness to spend, the so called "wealth effect", that results from rising property values, would be adversely affected, an effect that has been acknowledged as an important contributor to New Zealand's survival and recovery during the Global Financial Crisis of 2008 and earthquakes of recent times.

Economic research has been done on the economic costs of capital gains taxes. David J Daniel writing for the "Tableau" on November 2014 describes what he calls "the destructive" economic effects of Capital Gains taxes and refers to the work of Jason Clemens, Charles Lammam, and Matthew Lo who produced a study for the **Fraser Institute** about the economic impact of capital gains taxation.

Says Daniel, their study focuses on Canada, but their arguments apply to every nation, as follows:

> "...Capital gains taxes, of course, raise revenues for government but they do so with considerable economic costs. Capital gains taxes impose costs on the economy because they reduce returns on investment and thereby distort decision making by individuals and businesses. This can have a substantial impact on the reallocation of capital, the available stock of capital, and the level of entrepreneurship."

The three researchers also explain the "lock-in effect."

> "Capital gains are taxed on a realisation basis. This means that the tax is only imposed when an investor opts to withdraw his or her investment from the market and realise the capital gain. One of the most significant economic effects is the incentive this creates for owners of capital to retain their current investments even if more profitable and productive opportunities are available. ….Capital that is locked into suboptimal investments and not reallocated to more profitable opportunities hinders economic output. …"

Daniel goes on to say:

> "Peter Kugler and Carlos Lenz (2001)...examined the experience of regional governments ("cantons") in Switzerland that eliminated their capital gains taxes. The authors' statistical analysis showed that the elimination of capital gains taxes had a positive and economically significant effect on the long-term level of real income in seven of the eight cantons studied. Specifically, the increase in the long-term level of real income ranged between 1.1 percent and 3.0 percent, meaning that the size of the economy was 1 percent to 3 percent larger due to the elimination of capital gains taxes."

Jason Clemens, Charles Lammam, and Matthew Lo then analysed the impact of capital gains taxes on the "user cost" of capital investment:

> "Capital gains taxes make capital investments more expensive and therefore less investment occurs. ...Several studies have investigated the link between the supply and cost of venture capital financing and capital gains taxation, and found theoretical and empirical evidence suggesting a direct causality between a lower tax rate and a greater supply of venture capital. ...Kevin Milligan, Jack Mintz, and Thomas Wilson (1999) sought to estimate the sensitivity of investment to changes in the user cost of capital...and found that decreasing capital gains taxes by 4.0 percentage points leads to a 1.0 to 2.0 percent increase in investment."

Next, they investigated the impact on entrepreneurship:

> "Capital gains taxes reduce the return that entrepreneurs and investors receive from the sale of a business. This diminishes the

> reward for entrepreneurial risk-taking and reduces the number of entrepreneurs and the investors that support them. The result is lower levels of economic growth and job creation. ...Analysing the stock of venture capital and tax rates on capital gains from 1972 to 1994, Gompers and Lerner found that a one percentage point increase in the rate of the capital gains tax was associated with a 3.8 percent reduction in venture capital funding."

The authors also discussed the impact of capital gains taxation on compliance costs, administrative costs, and tax avoidance. They also looked at the marginal efficiency cost of capital gains taxation and report on some of the research in that area. They report:

> "Dale Jorgensen and Kun-Young Yun (1991)...estimate the marginal efficiency costs of select US taxes and find that capital-based taxes (such as capital gains taxes) impose a marginal cost of $0.92 for one additional dollar of revenue compared to $0.26 for consumption taxes. ...Baylor and Beausejour find that a $1 decrease in personal income taxes on capital (such as capital gains, dividends, and interest income) increases society's well-being by $1.30; by comparison, a similar decrease in consumption taxes only produces a $0.10 benefit. ...the Quebec government's Ministry of Finance...found that a reduction in capital gains taxes yields more economic benefits than a reduction in other types of taxes such as sales taxes. Reducing the capital gains tax by $1 would yield a $1.21 increase in the GDP."

Daniel goes on to say, that politicians, by opting for a capital Gains tax are undermining economic performance with senseless **'class-warfare taxation'**.

Mathieu Bédard, an economist at the Montreal Economic Institute, writing for the Financial Post concluded that*:*

> A) "Canada's investment levels are low relative to comparable countries. But with the boom now long gone, it's becoming obvious that policies with a negative effect on investment are holding Canada back. The capital gains tax, in particular, is affecting investment levels, while bringing in negligible revenues for the federal government. As some other countries have done, we should either substantially reduce it or simply abolish it."

> B) "Just as taxes on tobacco and alcohol reduce their consumption, the capital gains tax hinders capital formation, which is one of the basic foundations of all economic growth. Reducing the supply of capital affects job creation and wages throughout the economy, as one of the functions of capital is to make workers more productive

through technological and other improvements, which is a prerequisite for wage increases."

C) "…one study looked at the case of Switzerland, where in addition to the central government, some districts (or cantons) eliminated the capital gains tax. It found that elimination increased the size of the economy by between one and three per cent. "Another study, this one of Hong Kong, found that thanks to the absence of a capital gains tax, the territory's savings rate is well above that of similar industrialised economies."

D) "In the case of New Zealand, the elimination of the capital gains tax was part of the sweeping reforms that started in the 1980s and shifted from taxing capital and savings to taxing consumption, which has less deleterious effects on economic growth. These reforms were important in improving the economic situation of the country relative to its neighbours."

To conclude with a quote from Nobel laureate Robert Lucas:

"Almost all economists agree—or at least used to agree—that keeping taxes low on investment is critical to economic growth, rising wages and job creation."

Jim Collins
April 30, 2018