Tax Working Group Public Submissions Information Release

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Tax Working Group

CA ANZ Submission on the Future of Taxation, April 2018

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Introduction

Sir Michael Cullen,

Secretariat of the Tax Working Group

By Email

We welcome the opportunity to make a submission to the Tax Working Group on the future of taxation in New Zealand. CA ANZ would like make an oral submission in relation to our submission.

Chartered Accountants Australia and New Zealand

We are a professional body of over 117,000 Chartered Accountants around the world. We focus on the education and lifelong learning of our members, and on advocacy and thought leadership in areas of public interest and business.

General Position

In formulating its submissions, Chartered Accountants Australia and New Zealand takes a best practice, public policy perspective. That is, we endeavour to provide comment on a "what is best for New Zealand" basis.

We recognise Government's legitimate right to set tax policy direction. We comment on those policies, and also make comment on their practical implementation. Our public policy perspective means we endeavour to provide comment free from self-interest or sectorial bias.

Research confirms that in practice the best tax system is one with a broad tax base and low tax rates. Such an approach restricts the conditions that make tax avoidance attractive.

Our guiding principles in formulating this submission are that New Zealand's tax system must not impede New Zealand's international competitiveness; growth of the New Zealand economy; and innovation and entrepreneurship.

- Recognising there are judgments and trade-offs, taxes should, as far as possible:
- be simple in their application;
- provide certainty in their application;

- be perceived as broadly fair;
- minimise the costs of compliance and administration;
- minimise distortions to the economic behavior of individuals and businesses;
- utilise businesses' own accounting systems as the data source for calculation;
- align the obligations with the businesses' own cash flows; and
- be imposed at an overall rate which allows adequate retention of investment funds within businesses.

We believe one of the pillars of an effective and efficient tax system is taxpayer certainty. This will increase voluntary compliance, decrease administration costs, and deliver positive economic benefits. Tax legislation must be as clear in its policy intent and application. Further, any identified errors post-enactment should be corrected without delay.

In Chartered Accountants Australia and New Zealand's view tax legislation should not be retrospective unless it corrects an anomaly to ensure taxpayers pay no more tax than Parliament intended. Retrospective application dates undermine the principle of taxpayer certainty and the Generic Tax Policy Process.

Our Submission and Recommendations

Relevant recommendations are included at the end of each section and are summarised in full in chapter 10 of our submission. We have broadly addressed the "Questions for Submitters" throughout the document but for ease of reference, have compiled these in Appendix 1. In addition we have addressed the specific design issues with a capital gains tax which you requested comment on, in Appendix 2.

We are happy to discuss our submission further, and any questions can be addressed to [1] .

Yours Sincerely, [1]

[1]

John Cuthbertson, CA

CA ANZ New Zealand Tax Leader

Paul Dunne, FCA

Chair, Tax Advisory Group

Contents

Current Tax System

Current Policy Settings

New Zealand's key current tax policy settings include:

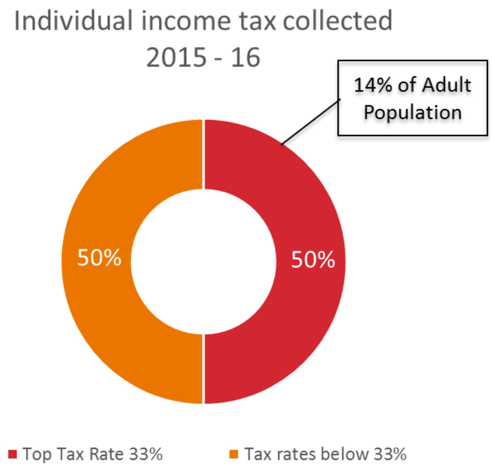
- a broad base and low rate (BBLR);
- progressive individual tax rates;
- a relatively low company tax rate (taking into account imputation);
- close alignment of income tax rates for individuals, companies and trusts;
- comprehensive GST
- an efficient tax administration system (compared with other OECD countries)

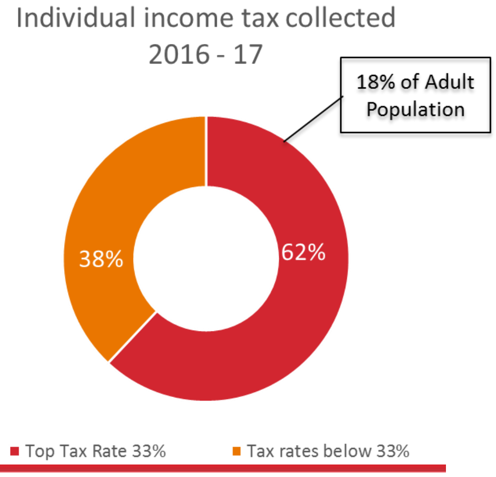
The current sources of tax revenue are:

- Individual income tax
- Company income tax
- GST
- FBT
- Resident and non-resident withholding tax
- Excise duties.

While we are comfortable with these settings in the sense that we see no need for urgent action or change, the illustrations to the side highlight a potential risk to the tax base that should not be ignored. The risk is the high level of reliance on a small number of individuals who contribute over 60% of the individual tax base – the largest source of the country's tax revenue. This analysis shows that this bias is increasing. Exposure to the risk of relying heavily on the individual tax base is likely to increase with advances in technology, the continuing growth of the 'gig' economy and the trends/changes in the future of work. Going forward, we expect these and other developments will have the potential to reduce the overall tax contribution from individuals. Therefore, we support the Tax Working Group

" Exposure to the risk of relying heavily on the individual tax base is likely to increase with advances in technology "



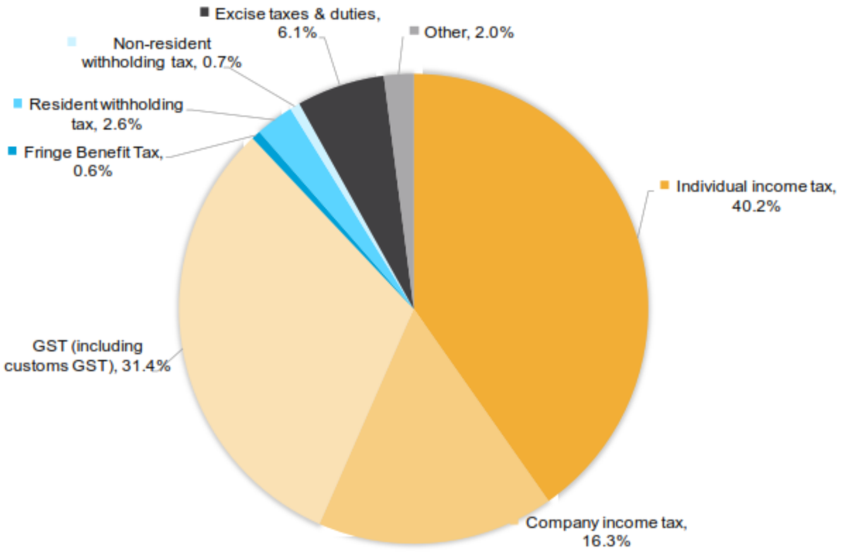


spending time to focus on identifying strategies to manage or reduce this and other anticipated future risks to the New Zealand tax base.

New Zealand Sources of Taxation Revenue 2017

Composition of Existing Tax Base[1]

Figure 4: New Zealand source of taxation revenue (2017)



Broad Base Low Rate

Broad Base Low Rate (BBLR) has been the mantra for the New Zealand tax system for over three decades. Generally, we consider that this approach has served New Zealand well. Sufficient revenue has been raised to support successive governments in providing services and overcoming economic challenges and natural disasters.

While BBLR is often referenced, it is important to note that a 'broad base' can have two meanings:

- first, that there are few tax exemptions or deductions;
- second, that tax is collected from a number of sources/bases.

[1] Tax Working Group "Future of Tax Submissions Background Paper" 2018

Each of New Zealand's three main tax bases (individual income tax, company tax and GST) are broad in themselves but overall the total tax base is relatively narrow compared to that of other countries.

Adopting the first meaning, GST is an example of BBLR in its purest sense. There are very limited exemptions from GST and the rate is 'low' in comparison with many OECD countries with a consumption tax.

Adopting the second meaning, it is arguable that the current tax system is not truly BBLR. This is illustrated in the pie chart above which shows that over 87 percent of New Zealand's tax take comes from only three sources (individuals, companies and GST). Also, notably absent are additional tax regimes for items such as capital gains, land, wealth and inheritance taxes (noting that a tax on the latter is excluded from the Tax Working Group's terms of reference). In the last 30 years or so a number of taxes have been abolished – most recently, gift duty in 2011 and cheque duty in 2014.

When assessing the current and future New Zealand tax system, it will be important that the Tax Working Group is clear on the definition of BBLR that is being applied.

We do not believe that there is a need in the short or medium term to move away from or replace the BBLR approach. Not only has it served New Zealand well to date, we consider that it will continue to do so - it is still relevant to the tax system. However, we note that there may be pressure in the future to widen the tax base as revenue requirements or social and business norms/expectations change. This pressure may influence government and stakeholders' views on the role of BBLR in the future tax system.

Regarding whether the tax system should have a greater role in intentionally modifying behaviour (e.g. to increase savings or to reduce consumption of particular goods or services), we caution against using BBLR to justify such approaches. Other criteria, for example, coherence, fairness, simplicity and efficiency, and the rights and fundamental freedoms enacted in the Bill of Rights Act 1990 must also be considered. Furthermore, the tax system should be assessed/reviewed in conjunction with other Government policies that may influence the tax system or effect the administration and collection of tax (for example, child poverty/Working for Families, which we acknowledge is outside the scope of the Tax Working Group's terms of reference and will be considered by the Welfare Working Group). However we have a preference that Government social goals be achieved outside of the tax base to ensure that the tax system is not overly complicated and avoids distortions that can drive behavior.

Generic Tax Policy Process

A unique feature of our current tax system is the use of the generic tax policy process (GTPP) to develop tax policy. This involves engagement and consultation between Government, Inland Revenue officials, Treasury officials and the public on tax policy matters. GTPP provides the opportunity for key stakeholders such as Chartered Accountants Australia and New Zealand to provide input at the gestation stage of policy development.

GTPP has three key objectives:

- to encourage early consultation on technical policy and implementation issues;
- to obtain input from the public;
- to clarify the responsibilities and accountabilities of the parties involved in the process.

There are five stages to GTPP:

- strategic – development of economic strategy, fiscal strategy and three-year revenue strategy;
- tactical – development of a three-year work programme and annual resource plan to implement the revenue strategy;
- operational – detailed policy design and consultation, and gaining Ministerial and Cabinet approval of recommendations;
- legislative – inclusion of the tax reforms in a Bill introduced in Parliament;

Five stages of GTPP

Strategic
Development of economic strategy, fiscal strategy and three year revenue strategy;

Tactical
Development of a three-year work programme and annual resource plan to implement the revenue strategy;

Operational
Detailed policy design and consultation, and gaining Ministerial and Cabinet approval of recommendations;

Legislative
Inclusion of the tax reforms in a Bill introduced in Parliament;

Post-implementation review
A 'health' check to assess whether the laws enacted are achieving the policy intent, to identify any operational or administrative issues, and to recommend remedial action/legislation.

- post implementation review – a 'health' check to assess whether the laws enacted are achieving the policy intent, to identify any operational or administrative issues, and to recommend remedial action/legislation.

The ultimate goal of GTPP is to ensure quality and effective tax policy development. This lays a strong foundation for the New Zealand tax system.

Since its introduction in 1995 GTPP has become embedded in the tax system. It has also captured the attention of tax policymakers in many other countries and can now be considered a global benchmark for tax policy development.

For the most part CA ANZ considers that GTPP has worked well. However, recent reforms (e.g. the Base Erosion Profit Shifting measures on interest limitation) have indicated that the framework is under threat. There have also been situations where GTPP has not been followed in full or in part (e.g. increasing the bright-line threshold from two years to five years via the introduction of a Supplementary Order Paper). In addition, it is not uncommon for the post implementation review phase to be significantly delayed or not actioned due to changing priorities and resource constraints.

We believe that GTPP should continue to be the lynch pin in shaping the New Zealand tax system.

Tax policy development needs to be an agile process. Tax policies should not be developed in haste. Tax policy positions must be founded on sound principles that are broadly accepted and the rules must be easy to comply with. These objectives would be furthered by, for example, adhering to the principles and goals of the Income Tax Act rewrite project carried out in the period from 1992 - 2007[2] (e.g. eliminating the use of complicated economic

[2] "The purpose of rewriting the Income Tax Act was to produce tax law that is clear, written in plain language and is structurally consistent. That makes it easier for users to find what they need, to understand it, and to apply it, which in turn helps them to comply with the law.

"Where possible, the language of the law has been made more concise, legalese has been avoided, and archaic terms have been removed or replaced." (Source: joint press release on 25 October 2007 by Minister of Finance, the Hon Michael Cullen and Minister of Revenue, the Hon Peter Dunne).

formulae); utilising specific anti avoidance rules to target extreme behaviours (i.e. legislating for the majority of taxpayers rather than the minority); and accepting, where appropriate, a result that is less than precise (i.e. “near enough is good enough”). In our view, the quality of some of the legislative reforms in recent years have been tainted by the failure to fully embrace the GTPP process.

It is timely for the Tax Working Group to consider introducing measures to ensure that GTPP is followed and hold the government and policy officials to account if it is not. To achieve this, an independent body similar to the US Joint Committee on Taxation[3] could be established to oversee/enforce the GTPP process and manage concerns parties involved may have with it.

Another measure worthy of further investigation is a follow up process after tax legislation has completed the Select Committee stage. CA ANZ and other key stakeholders devote a significant amount of time and resources to GTPP (much of that time is given voluntarily). While we do not expect GTPP to result in consensus on all issues, nonetheless at times it is difficult to understand why a recommendation/submission has been declined by Officials or the Finance and Expenditure Select Committee (FEC). This can lead to negative views of, and doubts about the effectiveness of GTPP. Having an opportunity to discuss these issues post FEC stage may help to ensure continued faith in the system.

A related issue is the resources available to follow up on or action recommendations made by the FEC, its advisors and Inland Revenue officials during the submission/consultation process. Once the legislation has been enacted it is not unusual for other recommendations to be shelved or left unactioned. This leaves the job essentially incomplete and will likely give rise to challenges on implementation or downstream difficulties in compliance with the enactments.

[3] The Joint Committee on Taxation is a nonpartisan committee of the US Congress established under Revenue legislation. The Joint Committee is comprised of a group of experienced professional staff of PhD economists, lawyers, accountants and other specialists. The Committee is closely involved with every aspect of the tax legislative process from policy formation, development and analysis to drafting of legislation and post-implementation review and enforcement (including recommendations to the Senate on remedial amendments).

Recommendations

- We do not consider that there is a need for urgent changes to the current tax policy settings.
- The Tax Working Group should identify strategies to manage or reduce the risk of relying heavily on the individual tax base and other potential risks (e.g. advances in technology) to the broader New Zealand tax base.
- We do not consider that there is a need in the short or medium term to move away from or replace the BBLR approach.
- GTPP should continue to be the lynch pin in shaping the New Zealand tax system.
- The Tax Working Group should consider introducing measures to ensure that GTPP is followed and to hold the government and policy officials to account if it is not.

Guiding Principles (Framework)

Traditional Measures

The Tax Working Group submissions background paper summarises the criteria traditionally applied when considering the costs and benefits of tax reforms:

- efficiency – tax should maximise national welfare and remove bias;
- equity and fairness – fair treatment of those in similar circumstances and of those with differing abilities to pay tax, procedural fairness;
- revenue integrity – minimise opportunities for tax avoidance and arbitrage;
- fiscal adequacy – sufficient revenue raised to meet government requirements;
- compliance and administration costs – taxpayers' and government's costs (including deadweight costs) kept to a minimum;
- coherence – individual tax rules/regimes 'fit together' to form a well- balanced tax system overall.

These criteria are relevant and robust and should continue to be applied.

Also relevant are certainty and predictability of both tax law and the Commissioner's interpretation of tax law. This is critical not only to upholding the integrity of the tax system but also to the performance and success of business and the New Zealand economy.

“The criteria summarised in the Tax Working Group background paper are relevant, and robust and should continue to be applied”

Fairness

Fairness is a concept that is often raised or cited when a new tax is being proposed or existing tax rules are being reformed. The Tax Working Group submissions background paper asks submitters how they define “fairness” in the context of the tax system, and what a fair tax system would look like.

The concept of "fairness" is subjective and will mean different things to different people. The nature of the issue being considered or addressed and a person's personal circumstances and experiences will "colour" their view of fairness. Determining what is fair is an art rather than a science; therefore, a blanket definition would be inappropriate.

In the context of the tax system it would be helpful if the tax policy framework included a list of criteria that could be applied to measure and assess fairness. For example, the nature and scope of benefits created by the proposal, the group(s) expected to benefit, the associated costs, the group or groups who will bear the costs, concepts of "user pays" and "the greater good". The weight to be given to each criterion would be determined by the nature of the issue being considered and/or the objectives and outcomes that are sought to be achieved.

Ironically, in some situations, fairness in the tax system may be undermined by fairness measures targeted at a particular group. For example, fairness is a common justification for introducing a capital gains tax (CGT). In its purest form, (i.e. a CGT with no exemptions) fairness may be achieved. However, it would not be unusual to have an exemption from CGT on the family home on the grounds of fairness. This exemption could apply to a significant group resulting in the CGT burden falling on a smaller group. Such an outcome challenges the fairness of introducing a CGT in the first place. As this example illustrates, the issue of fairness can lead to circularity. It is critical that safeguards are put in place to minimise the risk of this occurring.

Societal Measures

A priority of the current coalition government is to look beyond the financial and economic measures and include consideration of the impacts of tax policies on the wellbeing of New Zealanders. The framework that has been developed to do this is the living standards framework (LSF).

The LSF comprises four interlocking capital stocks considered to be crucial to intergenerational wellbeing:

- financial and physical capital – infrastructure and other material assets that support income and living conditions;
- human capital – people's skills, knowledge and physical and mental health (what allows us to participate in society)
- social capital – the norms and values that define our society;
- natural capital – our natural environment.

The LSF therefore extends the traditional framework which is focused on financial and physical capital. In some circumstances this can create tension which may be resolved by a tradeoff between each capital stock. If tradeoffs were to occur, such should be explicitly acknowledged and recognised.

The LSF is continually evolving. The tax system will need to be agile and flexible to ensure that it operates consistently with the views reflected by the changes arising from the LSF evolution.

Other non-financial measures could also be relevant, for example, sustainable development goals and child poverty reduction threshold measures. In some situations, it would also be appropriate to consider these criteria.

While it would be admirable to take into account nonfinancial measures in the tax system to achieve a more balanced position, we recommend that caution should prevail. Given the financial nature of tax it would be unlikely in many cases that nonfinancial measures would be relevant to the debate/assessment. This would make it difficult to embrace or seamlessly incorporate nonfinancial measures into the tax system. There is also a risk that using the tax system as the primary means of delivering social and environmental objectives would sacrifice certainty, simplicity, efficiency and coherence.

Recommendations

- The traditional measures of efficiency, equity and fairness, revenue integrity, fiscal adequacy, compliance and administration costs, and coherence should be retained.

- Certainty and predictability should also be promoted.
- A blanket definition of “fairness” would be inappropriate.
- It would be helpful if the tax policy framework included a list of criteria that could be applied to measure and assess fairness.
- The tax system will need to be agile and flexible to ensure that it operates consistently with the evolving views formed through the living standards framework.
- Incorporating nonfinancial measures in the tax system should be done with caution.

Challenges (Sustainability of the Tax System)

The intention of the working group is to retain the current level of taxation to continue to achieve 30% of GDP. However, we believe the working group should take advice on whether 30% of GDP is sustainable. New Zealand has an aging population – it is estimated that by 2036 approximately one in four and a half New Zealanders will be aged 65 or over. Thus, it is likely that a smaller working population will support a larger number of retirees. We do not believe that this income can be provided by the current New Zealand superannuation fund and understand that the Government will need further income over the next ten years to fund national superannuation and the increased health costs that will result from an ageing population.

Individual income tax is our highest revenue earner at 40.2% of the total tax take. The current tax rules in relation to labour/personal exertion are broadly based on the premise of an employer/employee relationship, one workplace, and separate premises for work and home. This model is unlikely to truly reflect the workplace of the future, as more people embrace different ways of working and move to multiple revenue streams.

The current PAYE rules do not apply to independent contractors. At present our tax system taxes the "gig economy" through withholding taxes and is reliant on each individual to get their tax correct. This is a key risk for the New Zealand tax take because of our reliance on individual income tax. The working group should consider whether changes in technology (within Inland Revenue and in business) will be sufficient to achieve the same level of revenue going forward, or whether further change is needed.

In our view, the combination of the ageing population and the rise of the gig economy make it likely that New Zealand will need to rely more heavily on business taxation and/or consumption taxes in future.

New Zealanders' Rate of Saving

New Zealanders are said to have relatively poor rates of savings[4] and this has said to have hindered New Zealand's investment in infrastructure. Household saving has decreased over the last five years and the current level is -2.8%[5]. We believe the Tax Working Group should consider what level of savings is necessary to fund New Zealand's future and whether the tax treatment of saving should change to incentivise further saving.

The previous Labour led Government introduced the Kiwisaver scheme in 2007 to encourage more New Zealanders to save for their retirement. Prior to the scheme's introduction, extensive changes were made to the taxation of savings. The principal change was the introduction of new tax rules for certain savings vehicles, or Portfolio Investment Entities. The new rules allowed income on savings in the PIE to be taxed at a lower rate than employment income and provided that capital gains derived in the PIE would be tax free. This latter change was made to replicate the tax treatment of a direct investor.

However, New Zealand is unusual among OECD countries in that it requires taxpayers to save out of tax-paid income. Other OECD countries allow savings to be taken from pre-tax income. In considering whether we should change to a pre-tax model, we have listed the primary considerations below.

Should we change from TTE?	
Pros	Cons
A model of EET would increase rate of savings	Current model is well understood and works well
Other countries have different regimes which result in complex transition rules (e.g., our rules around foreign super) which could be eliminated if our treatment was consistent with international norms	Current model does not tax withdrawals. This is arguably "fairer" as it does not tax older people / those on fixed income
Aging population – tax base may be more sustainable in future if we tax incomes of those of retirement age, including super	

4 The OECD ranked New Zealand 17th out of 33 developed countries in 2015, with a 6 per cent national savings as a proportion of GDP.

5 https://www.rbnz.govt.nz/statistics/m6

The Tax Working Group should consider:

- whether the scheme has been successful to date; and
- whether a greater rate of saving is required; and, if so,
- whether the current tax concessions are sufficient.

International

Corporate Tax Rate

It is often said that international investors look at headline tax rates when deciding where to invest. New Zealand's corporate tax rate of 28% is in the mid-range of OECD rates. New Zealand needs capital for infrastructure building. The Group should consider whether a lower headline rate would encourage international investment in New Zealand.

This raises the question as to how sensitive international investors are to the corporate rate. To evaluate fully the tax imposed an investor should also consider that:

- New Zealand has a full imputation system (although this is more relevant for residents)
- New Zealand taxes worldwide income for residents but otherwise on a source basis

It is also worth noting that most investors will consider the total cost of doing business here, not just the tax rate, and will also look at non-monetary considerations.

We favour alignment of tax rates as much as possible to support the overall integrity of the tax system. A large differential between the top corporate, trust and personal rates would result in an increase in avoidance activity, which would then require further legislation. Where the business is owned by New Zealand resident investors, the corporate tax rate is essentially a withholding tax and the income is subject to tax at the shareholder level on pass-through.

Country	Corporate Tax Rate
France	33%
Australia	30%
New Zealand	28%
South Africa	28%
United States	21%
United Kingdom	19%
Switzerland	18%
Ireland	12.5%

If New Zealand needs to lower its headline corporate tax rate in order to remain competitive, we would recommend a lower corporate rate for non-residents only.

Previous Tax Working Groups have considered introducing a lower corporate tax rate for non-residents and we believe this should be investigated further.

Recommendation

We recommend the Tax Working Group investigate the sensitivity of overseas investors to the corporate tax rate as part of any decision to reduce the rate.

Permanent Establishment

International tax models have traditionally used the permanent establishment as the taxing model for business. The OECD has retained the requirement for a physical presence as a necessary condition for determining the existence of a PE. The changing nature of business models means that a PE is no longer a reliable proxy for where an entity should pay its tax. Distance selling has allowed business to operate from low-tax jurisdictions and sell into high-tax jurisdictions. Thus it may be the case that high tax jurisdictions have lost some of their right to tax businesses operating in their country and low-tax jurisdictions have increased tax revenue as a result.

To date the OECD BEPS project has not addressed the issue of how the international tax pie should be divided, i.e. whether a country's "right to tax" should be determined on profit or revenue. This question is growing in importance with the exponential growth of the digital economy where businesses sell goods and services worldwide without the need for a physical presence in the country where its customers are.

There are signs that some countries are acting to increase their share of the pie by moving toward a right to tax based on revenue. Examples include: India which imposes a six percent "equalisation tax" on digital advertising sold by Google and Facebook; and in March this year the European Commission proposed two new laws on the taxation of digital activities in the EU: a corporate tax on profits generated from a "digital platform"; and an indirect tax on revenues created from selling online advertising space, digital intermediary activities, and selling data generated from user-provided information.

The OECD position on taxing digital is still being developed and New Zealand needs to be a part of this international response. New Zealand has a lot to lose. If an OECD solution results in our exporters paying tax on sales in foreign jurisdictions without a corresponding increase in tax take for New Zealand for overseas businesses, any OECD solution may result in a reduction in Government revenue, rather than an increase.

"We believe New Zealand's tax system is built on sound principles but taxpayer's confidence and trust in the system could be improved."

Recommendation

We recommend that the Tax Working Group consider New Zealand's revenue needs going forward before any changes are made to domestic tax legislation.

In addition, we recommend that New Zealand remain an active participant at OECD level regarding the concept of a PE and a potential solution.

Tax Administration

Background

For any good tax system to be "fair", it must also be well administered

It has been widely written about and agreed that the pillars of tax administration are fairness, transparency, equity and accountability. Inland Revenue's role is to ensure willing and widespread compliance with the tax laws. Taxpayer's trust and confidence in the tax system underpins voluntary compliance.

Our submission considers:

- the dispute process
- the role of the tax agent
- the role of audits

We believe New Zealand's tax system is built on sound principles but taxpayer's confidence and trust in the system could be improved.

Dispute Process

Disputes between Inland Revenue and taxpayers are unavoidable and are a part of the tax administration process. It has been stated that "the tax dispute process is vital to the health of the New Zealand tax regime. It provides the only method for resolving disagreements over the tax liability of citizens. As such, the procedure must not only be accessible for all taxpayers but manifestly be seen as fair and reasonable. Unfortunately, while the aims of the procedure are laudable, it is widely recognised the current New Zealand procedure has failed."[6]

It has been said "complying with tax liabilities should not be like walking through a minefield where an inadvertent error produces dire consequences. Taxpayers should be able to get on with their affairs while spending as little time and as few resources as possible while consulting the Income Tax Act or Goods and Services Act (GST Act) or seeking tax advice[7]".

Due to the significant costs involved in the tax dispute process and the length of time it takes, taxpayers are being "burned off" by the process and are choosing not to pursue disputes as a consequence.

The disputes process has been at times characterised by the Commissioner taking a position based on expediency rather than principle. The Commissioner should be required to follow her own arguments. At present the Commissioner is bound by any binding rulings but is otherwise free to disagree with herself if and when officials require. There should be further limits on her ability to disagree with herself. For example, Policy reports should be followed. It should not be open to other parts of Inland Revenue to take a different interpretation of the law when the Government intention is clear based on policy reports.

[6] Developments in Tax Disputes Procedure – Another Step Backwards; Michael Lennard and Mark Keating
[7] Briefing to the Incoming Minister of Revenue 2008

In our view a free independent Taxpayer Advocate Service (TAS) should be established. It will protect taxpayers' rights and promote taxpayers' confidence in the integrity and accountability of Inland Revenue. Its functions should be to:

- assist individual and business taxpayers in resolving problems with Inland Revenue
- identify areas in which taxpayers are having problems dealing with Inland Revenue;
- propose changes, where possible, in administrative practices of Inland Revenue to mitigate those identified problems; and
- identify potential legislative changes that may help mitigate such problems.

This role could also be performed by the body having oversight of the GTTP process, rather than having two separate bodies. In our view the key consideration is that the body remains independent and reports to Parliament rather than the Commissioner or a member of Inland Revenue.

Role of the Tax Agent

Tax agents play a crucial intermediary role between taxpayers and Inland Revenue. Tax agents contribute to the smooth functioning of the tax system and facilitate tax compliance. In collecting and collating information tax agents effectively act as an internal auditor, checking that the information is correct and consistent.

The OECD has asserted that:

"A strategy of positive engagement with tax advisors offers potentially significant benefits to all parties in the tax system. In particular, it can add to revenue bodies' understanding of tax advisers and the role they play in the tax system, as well as understanding of their clients and broader developments in the economy. This, in turn, should result in improved risk and compliance strategies and better-focused information requests and dialogue with taxpayers, resulting in reduced compliance costs for all."[8]

[8] Study into the Role of Tax Intermediaries; OECD 2008, pg. 14

Many tax agents are concerned that we are moving towards a future where tax compliance obligations will be encapsulated in a self-service system which will eliminate or minimise the need for tax agents. However, in our view it is essential that tax agents continue to be recognised for their contribution to the integrity of the tax system and that their role is not diminished. If taxpayers prepare returns without the oversight of tax agents, it is likely tax revenue would reduce.

It should also be noted that tax agents are an invaluable source of knowledge and practical experience which may be drawn upon to develop more effective and efficient tax laws and administrative practice.

Role of Audits

Risk management is an essential tool for Inland Revenue. The increased amount of data available as a result of Business Transformation will be valuable if it reveals undetected problems. However, public confidence will be eroded if Inland Revenue is unwilling or does not have adequate resources to deal with this data. The OECD[9] suggest that "utilising audits to detect and visibly address and remedy cases of tax evasion is essential not so much for the revenue they generated in individual cases, but to maintain or enhance trust in the tax system".

At present trust in Inland Revenue is being eroded by the lack of commercial knowledge within the investigations area where Inland Revenue staff do not always view errors in a commercial context. In addition unnecessary admin structures and inefficient processing often result in a delayed process, creating uncertainty and frustration for the taxpayer.

A trust approach, based on co-operation and persuasion, can increase trust and may lead to voluntary compliance.

[9] The Changing Tax Compliance Environment and the Role of Tax Audit; OECD 2017, pg. 38

Recommendation

As noted above the tax system is built on sound principles but is not operating as effectively as it could. To improve effectiveness we recommend an independent Taxpayer Advocate Service be established; audit be adequately resourced and Inland Revenue continue to support tax agents.

Shadow Economy

The shadow economy has been defined simply as unreported economic activity.

The shadow economy is made up of a broad scope of activities and behaviours including:

- Undisclosed or under-reported income
- Non-registered businesses
- Expense manipulation or inflation including the claiming of private expenditure as a business deduction.

Inland Revenue believes the New Zealand shadow economy is made up predominately of cash trade jobs, crimes, wages paid under the table, undeclared property sales and online trading.

The Inland Revenue has been given additional funding of $83 million since 2010 to combat the shadow economy. This has proven to be money well spent as Inland Revenue uncovered $159 million in tax in the 2016 year and significant amounts in all years since 2010.

Inland Revenue's main focus has been on the hospitality and construction sectors, as international research has shown these industries to have the most risk of tax evasion.

"When other legal structures available to business are included… the shadow economy is likely to be in the excess of $1 billion per annum.

This tax gap must be a focus for the Tax Working Group."

What is the Size of the New Zealand Shadow Economy?

There have been many estimates of the size of the New Zealand shadow economy. However none has provided an appropriate level of analytical analysis or comparison to Inland Revenue business data to give any degree of confidence in their findings.

Latest research from Victoria University in conjunction with Inland Revenue suggest that undeclared self-employed business tax is approximately $800 million. When other legal structures available to business are included the amount of undeclared tax from the shadow economy is likely to be in the excess of $1 billion per annum.

Given the relative size of this tax gap, the shadow economy should be a focus for the Tax Working Group.

OECD Strategies to Combat the Shadow Economy

The OECD suggests three pillars for tax administration to deal with the shadow economy:

- Educating taxpayers and making compliance simpler
- Reducing the opportunities and increasing detection
- Reinforcing social norms

We agree that these multifaceted strategies and activities are appropriate for dealing with the shadow economy. However none of these strategies will in themselves provide a solution to non-compliance in the shadow economy. They are inter-dependent and will need to form part of a comprehensive cross-government strategy if meaningful change is to be achieved.

Taxpayer education and simplicity of compliance

The starting point is to make registration and payment of tax easier. The Government and Inland Revenue have made considerable progress in making registration for, and payment of, tax simpler and automatic. However this work needs to continue.

Reducing the Opportunities and Increasing Detection

The opportunity to work outside the tax system must be reduced and the chance to be detected increased.

While we accept that Inland Revenue audit function is not the total solution to the shadow economy, there is still a need for Inland Revenue to have a strong and visible presence in the shadow economy. They must be appropriately resourced to put the required amount of pressure on those not complying.

Inland Revenue's use of digital information for targeting has increased. We recommend that Inland Revenue be funded appropriately to continue to increase its audit activities to detect and tax non-compliant taxpayers in the shadow economy.

Reinforcing Social Norms

The tax gap from the shadow economy impacts on the fairness and the integrity of the tax system as a whole. New Zealanders need to believe that the tax system is fair and user friendly and that all sectors pay their share.

Any real success in taxing the shadow economy will only happen when there is a change in the community's attitude to those operating in the shadow economy. There needs to be a shift in public attitude so that:

- Undeclared cash jobs are considered not to be okay or just a perk of business
- Tax fraud is not a victimless crime and affects all New Zealanders
- Trading with those in the shadow economy is not ok.

This can be achieved by wider public awareness campaigns (using multiple mediums) that are not just targeted at offenders but include the public as a whole. The message needs to be that the tax evaded by those operating in the shadow economy affects all New Zealanders' as it limits the government's ability to provide essential services.

What Could This Additional Tax Do If Collected?

If an extra $1 billion a year was collected from the shadow economy we would be able to significantly assist in reducing child poverty in New Zealand. The additional funds could assist in providing; school lunches, shoes and raincoats for children in need. In addition it could contribute to the provision of additional social housing, mental health units and further funding for the health system.

The shadow economy's potential tax gap is equivalent to the amount the government's Provincial Growth Fund will invest in regional development.

Recommendation

Tax from the shadow economy is potentially the largest untapped revenue source available to the government. We recommend that additional resources be given to the Inland Revenue to increase their efforts in dealing with the shadow economy. This would ensure that the effect of the shadow economy is minimised and taxation due from this sector is collected.

Dealing with the shadow economy and making significant in-roads into the tax gap will require a long term commitment and a multifaceted approach.

Most importantly there needs to be a shift in attitude, so that "it's not ok" for anyone to work in or deal with the shadow economy. This message should also come from the Tax Working Group.

Role of Inland Revenue in New Zealand society

Many individual taxpayers have no interaction with Inland Revenue at any time because their income is all taxed at source. Many like it that way.

However, there are concerns that New Zealanders are becoming less financially literate and that there is less understanding of how we pay tax, and why. This lack of understanding affects the integrity of the tax system.

The automated nature of tax administration means many taxpayers are not aware of the role of Inland Revenue. The Working Group should investigate whether it would be useful for Inland Revenue to have more contact with taxpayers.

We suggest sending every taxpayer correspondence at the end of the year. The letter should say how much they have paid in income tax (or received, if net of Working for Families). The message should thank the taxpayer for their contribution and include a prompt to get in touch with Inland Revenue if they have received any other income

Māori tax base

The Māori business sector is now a significant component of and contributor to the New Zealand economy. The issue for the Tax Working Group is how Māori can help to create a fairer and future-focused tax system.

The central question is how future changes in the economy will influence and be influenced by the tax system as the Māori economy continues to grow.

At present, a specific regime applies for the taxation of Māori authorities and individuals who derive benefits from those organisations. All eligible persons who elect to be Māori authorities are taxed on income at the rate of 17.5%. The regime includes a credit attribution system similar to the company imputation regime.

We understand that the policy rationale for the changes in the early 2000s still holds. This recognised the unique characteristics of the system for administering Māori Iwi assets and we believe requires continuation of a separate tax regime. We do not believe there is any particular need to change the taxation of Māori authorities at the present time. However this will need to be monitored as the Māori business environment changes and develops further

Recommendation

We recommend no change is needed to the taxation of Māori authorities at the present time. However this will need to be monitored as the Māori business environment develops.

Small Business

Need for Reduction in Compliance, Complexity & Administration

There is a need for the reform of small business taxation. Small businesses do not have the resources to comply that larger businesses do and this often results in inadvertent or known non-compliance. Simplification would make it easier for small businesses to voluntarily comply, which is the aim of the tax system.

It is well known that complex taxes have a detrimental effect on an economy. In particular they:

- reduce voluntary compliance
- increase taxpayer and administrator error
- increase taxpayers' perceptions that the tax system is unfair
- undermine the integrity of the tax system
- increase the economic drag on businesses as they divert resources away from their most productive use

Whilst compliance costs affect all businesses, they fall disproportionately on smaller businesses. Focusing on compliance cost reduction for small business will create growth across the small business sector.

In our view there are four options for reform of small business taxation:

1. Limiting the application of various tax regimes

2. Introduce a single business tax
3. Presumptive taxes for very small businesses
4. Reduction of the corporate tax rate

Limiting Application of Certain Regimes

The "one size fits all" approach to taxation in New Zealand has given rise to complexity creep for smaller businesses. In the micro and small business context, rising complexity means disproportionately rising costs. An example of this was the changes to our fringe benefit tax rules when the multi-rate method of taxing fringe benefits was introduced. We do not believe that one size should always fit all. The Tax Working Group should consider the introduction of de Minimis thresholds for complex tax regimes that are complex to comply with but result in very little revenue for Government.

The following are compliance cost intensive but result in disproportionately small adjustments for the taxpayer that do not generate significant Government revenue as a result:

- Entertainment regime
- Adjusting for private use of business motor vehicles (GST)
- Business use of taxpayer home
- FBT log books
- Mixed use asset regime
- Interest deductibility
- Interaction of GST and Income tax adjustments
- Thresholds for accruals adjustments

The impact of compliance costs for each of these issues can be mitigated by either having:

- a standard fixed deduction amount set by Inland Revenue;
- a fixed adjustment rate; or
- setting a small business de Minimis before a regime applies.

A further consideration for start-up or small entities would be to allow losses to be carried back to past years (subject to appropriate size and related tax entity consolidation requirements). Loss continuity rules could be linked to a small business test instead of the present ownership test.

The Tax Working Group should consider a suitable threshold for these exemptions but we believe a turnover of $1.2m would be appropriate.

Single Business Taxation

In 2011, our organisation (in its previous incarnation, as NZICA) researched and developed an alternative tax regime for small business with the aim of simplifying the tax system for those businesses and thus lowering compliance costs.

The model would apply for small businesses with turnover of less than $1.2 m and would be based on GST. Our model was based on the "rule of one" – one return every month taking no more than one hour to complete.

Criteria	Features
Turnover less than $1.2m	Small business that trades through a company or partnership will be taxed analogously to a sole trader by taxing the entity based on the personal marginal tax rate structure
Designed for more established businesses but could also be used for start-ups if desired	Transactions such as dividends and salaries between the business entity and its owners are eliminated, as is the need to maintain an imputation credit account
Income tax will be calculated on a cash basis on the GST return, as an adjustment to the GST result	Income tax and GST will be calculated and paid two monthly on a simplified cash basis
Like GST, income tax will be paid every two months: there will be no year-end adjustments, no provisional tax and no fringe benefit tax	No balance date and square up issues
	Trading stock (except for livestock) purchases are deducted on a cash

	basis – no need for stock takes for tax purposes
	No provisional tax, no fringe benefit tax and no entertainment tax
	Simplified rules for depreciation

Last year the Government introduced the AIM provisional tax method – in part, to address some of the concerns we have raised. In our view, AIM is an example of an over engineered tax change for small business. It should have been a simple system based on "real cash flow" utilising accounting software to calculate provisional tax. What has eventuated is a system with multiple adjustments based on accounting concepts not on real cash flow.

Moreover, AIM is a provisional tax option so does not solve the problem of the complexity faced by small businesses in completing income tax returns.

AIM should be retained as a provisional tax option. It should be simplified so it mirrors cash flows with a limited number of adjustments and targeted for its intended audience – small business.

However, Government needs to address complexity in the system for small businesses and to allow significant simplification for those businesses.

Presumptive Taxes for Very Small Businesses

At the same time as we developed our "rule of one" concept, we proposed a very simplified basis of taxation for micros business taxpayers.

We considered a micro business to be someone who:

- is unregistered for GST
- has no employees
- have a turnover of less than $60,000 at the time of opting to use this model
- runs a small business or is in the process of business start up

- is a person earning periodic cash receipts from "under the table" operations

The tax paid will substitute for income and fringe benefit taxes (if applicable). More specifically, a final income tax rate of 15 percent will be paid on business turnover (later reduced to 7% for those retailing goods and 14 % for others)

- Tax payments made monthly or at any time
- No end of year tax returns
- The micro tax of 15% includes a component for Accident Compensation levies

Income for the purposes of social policy commitments (child support, student loans and working for families tax credits) is 50% of gross income.

The income will be transferred to the taxpayer's summary of earnings and no further income tax will be payable on this business income.

- A transitional rule for people who earn cash "under the table" will give a 12 month window for people to enter the tax system without further repercussion for past year's earnings from undeclared income from these sources provided all tax is correctly accounted for going forward

This last point should assist to transition those from the shadow economy into voluntary compliance. At the present time this transition remains difficult. The Tax Working Group should also consider what other measures may encourage voluntary compliance from those in the shadow economy.

Reduction of Corporate Tax Rate

A lower or progressive tax rate for corporate taxpayers can be a fiscal stimulus for a small business. This would allow more cash to be retained in the business. However, there is a school of thought that says this would incentivise businesses to stay "small".

Feedback we have received from small businesses is that they are less concerned about the company tax rate than they are about the cost of complying with health and safety rules, costs of employment and managing their businesses cash flow and commercial risks. Thus, we do not believe a reduction in the corporate tax rate for small businesses would necessarily provide the fiscal stimulus required.

While New Zealand retains its full imputation system the company tax rate for New Zealand residents it is in effect a withholding tax on future dividends. Under present rules dividends have 33% tax withheld either in the form of imputation credits or Resident withholding tax deducted from the cash dividend. A lower or progressive tax rate will only have a timing benefit for undistributed profits. Most small business profits are distributed as salaries or dividends in the year earned to cover drawings from the company by shareholders.

Other Countries' Experiences/Plans

Australia has a number of income tax concessions for small businesses; simplified stock rules, simplified depreciation and immediate deductions for prepaid expenses plus a two-tier company tax rate for companies - a 2.5% concession for 2017/18 years moving to a 5% concession by 2026/27.

Hong Kong is also to introduce a progressive business tax. From the 2018/19 year a rate for all businesses (irrespective of size and industry) taxing the first HK$2M of profits (subject to grouping rules) and at half the normal rate. Corporations 8.25%, normal rate 16.5%. Partnerships and sole traders 7.5% normal rate 15%.

However, from speaking to Australian colleagues and businesses we understand that a bifurcated rate comes with a significant increase in complexity and compliance costs. Thus, it has not provided the desired fiscal stimulus to the Australian economy.

As a result, we do not see a marginal/progressive corporate tax rate as fiscal stimulus to small business. We favour comprehensive changes to small

"We do not see a marginal/progressive corporate tax rate as fiscal stimulus to small business."

business tax to meet the goal of simplifying small business tax, as discussed above, rather than a lower or progressive tax rate.

Recommendations

- There is a need to simplify tax and tax compliance for small business. Our one size tax system does not fit all. A "close enough is good enough" approach should be acceptable for small business taxation.
- A low cost approach is to redesign the tax system for small businesses to allow for certain expense item either as a standard fixed deduction set by Inland Revenue or a fixed adjustment rate or setting appropriate small business de minims before a regime applies.
- However, we believe the Tax Working Group should investigate a model where a small business is given the option to move to a single business tax reflecting the marginal tax rate of the shareholders/owners.
- In addition, it should investigate introducing a form of presumptive taxation for micro businesses.
- We do not see a marginal/progressive corporate tax rate as a fiscal stimulus to small business while the dividend imputation regime exists and do not believe this should be pursued.

Tax on Capital

The Tax Working Group has been tasked with reporting to Government on whether the tax system:

- Operates fairly in relation to taxpayers, income, assets and wealth; and
- Promotes the right balance between supporting the productive and speculative economies.

This will require the Group to consider whether income from labour is overtaxed relative to capital and whether the tax base should be broadened to further tax capital.

The taxation of capital has the potential to capture all investment returns, both income from savings/investment and the accretion in value of assets held. Savings are currently taxed as income with debate over the years as to whether it is appropriate to capture inflation within the return.

This chapter will consider whether New Zealand should adopt a:

- capital gains tax (CGT) and to what extent gains should be brought to tax;
- Land tax; or
- Wealth tax.

It will also consider appropriate settings for the taxation of savings and whether any concessions should be provided to encourage saving for personal retirement.

Capital Gains Tax

Is a CGT required?

In theory, introduction of a comprehensive CGT (inclusive of the family home) should broaden the tax base and facilitate a more efficient and equitable tax system.

Proponents for a CGT argue that its absence supports investment in the speculative economy to the detriment of increased investment in the productive economy, impacting GDP growth and ultimately living standards.

In this context the speculative economy has broadly been considered to comprise investment in residential property. Recent public focus has been limited to the investment in residential property for rental. Home ownership is still however an aspiration for most New Zealanders, with 64.8% living in owner occupied accommodation at the time of the 2013 Census.

> **CA ANZ is not convinced that a comprehensive CGT is required or appropriate**

The Tax Working Group terms of reference specifically exclude the family home from a potential CGT. Given the relative level of owner occupied home ownership in New Zealand, this political expedient will limit the effectiveness of a CGT to address horizontal equity concerns (between those that own property and those that do not).

The McLeod and Victoria University of Wellington Tax Working Group reviews of our tax system in 2001 and 2009 respectively both recommended that a CGT (which excludes the family home and is levied on realised gains) not be implemented. Both reviews expressed concerns about the increased complexity and costs associated with a CGT relative to the likely level of revenue that would be raised.

Based on the work undertaken for this submission CA ANZ is not convinced that a comprehensive CGT is required or appropriate.

Problem definition needed

Careful consideration should be given to what the introduction of a CGT is seeking to address with our existing tax system (i.e. is our existing tax system absent a CGT deficient when measured against traditional and living standards frameworks?). Given the complexity and costs of compliance associated with a CGT, are their better alternatives to address any deficiency?

The public's perception of a CGT is limited to property. It is broadly viewed as a tax on the sale of physical assets, with residential rental property (considered undertaxed) a proxy for the tax base. The reality of a comprehensive CGT is very different with coverage extending to intangibles, intellectual property rights and the extinguishment of rights.

The Australian CGT events framework contained in Div. 104 of the Income Tax Assessment Act 1997 - "CGT events" (whilst not necessarily comprehensive) provides a useful illustration of the breadth of property/dispositions to be covered in the design of a CGT:

- [A] Disposal of a CGT asset;
- [B] Use and enjoyment before title passes;
- [C] End of a CGT asset (loss or destruction, cancellation, surrender etc.);
- [D] Bringing into existence a CGT asset (creating contractual or other rights, granting an option etc.);
- [E] Trusts (creating a trust over a CGT asset, transferring a CGT asset, disposal to/by beneficiary etc.);
- [F] Leases (granting a lease, payments for changing a lease);
- [G] Shares;
- [H] Special capital receipts;
- [I] Australian residency ends;
- [J] CGT events relating to roll-overs;
- [K] Other CGT events (CGT asset becomes trading stock, FOREX realisation etc.);
- [L] Consolidated groups (tax cost base adjustments).

A comprehensive CGT has to address all property rights, transfers and realisation events, and deal with valuation, measurement of gains and treatment of losses. Appropriate exemptions/concessions (either to assist compliance or as a compromise to ensure public support) then need to be added to the mix. There are numerous design considerations and tradeoffs.

As a result CGT legislation is complex even by tax legislative standards, yet all taxpayers will potentially be affected and required to comply, unless sufficient de Minimis exemption thresholds are in place. Specialist guidance would be required, increasing compliance costs.

A comprehensive CGT which does not distinguish between income and capital gains does however have the ability to simply other aspects of our existing tax system. While it would not fully remove boundary issues, it would allow for the rationalisation or conversion to timing rules for various gains currently included in our income tax legislation.

A CGT (particularly where less comprehensive) would need to be carefully integrated with specific tax regimes contained in our income tax legislation to ensure that the objectives and outcomes of those regimes are not distorted. Interaction with the international tax regime and in particular FDR and the active business exemption represent one such example. A number of countries with a CGT manage the later by having a participation exemption for gains on shares in active businesses.

Relevant design issues

The Tax Working Group submissions background paper refers to the design of a [comprehensive] CGT for Government consideration. A "comprehensive" CGT in reality will be something much less. The family home (a significant asset base) has already been excluded based on the Tax Working Group terms of reference. Other concessions and exclusions will also likely be required and could potentially include a form of roll over relief, de Minimis thresholds and removal of small business sales. Any gains are then likely to be taxed on a realised basis (in line with other countries taxing capital gains) impacting the efficiency of a CGT.

While we do not support introduction of a comprehensive CGT, we have responded to your specific queries and provided comment on the relevant design issues with a CGT. Please refer to appendix 2 of our submission – "Capital Gains Tax Evaluation".

We question whether an outright exemption for the family home is appropriate. An alternative approach would be to include a dollar value exclusion threshold and only tax gains above this threshold – targeting overcapitalisation. Some jurisdictions have set a specific dollar threshold (i.e. $1m). Regional property valuation variations could however be addressed with a separate threshold set for each region. This would have the risk of adding significant complexity and boundary issues.

We also include as Appendix 3 a worked example prepared by our Rural Advisory Committee setting out the potential impacts of a CGT or land tax on a farming operation.

The Tax Working Group should also be mindful of wider considerations and unintended consequences when evaluating a CGT:

- Given the family home exclusion, introduction of a comprehensive CGT may have limited impact on the desired investment[10] in productive assets;
- In the SME space business owners often borrow against their home or second property, using mortgage based financing to fund their business. Again this is often the best form of security to satisfy lenders and provides the best lending rates.
- New products are often developed/trialed in New Zealand prior to taking to the main markets offshore. One factor in this equation is that we do not have a CGT. If a CGT is put in place, this development may simply move offshore, close to the ultimate markets, which would have a drastic impact on the ability to attract talent. This would additionally impact the innovative economy.

Partial CGT options

Partial CGT options include:

- Retention of the status quo inclusive of the recently extended (five year) residential bright line test;

[10] We note preferences for investment likely to be based on bank lending criteria

- Introduction of a risk free return method (RFRM) on certain asset classes.

A RFRM taxes everyone on an “average” return under a standard distribution bell curve plus margin. It uses a smaller asset pool than “all assets” under a wealth tax. The key decision (other than determining the margin) is about what assets to include.

New Zealand currently has an RFRM on foreign portfolio shares in the form of the fair dividend rate (FDR) method. Possible extensions of an RFRM could include residential property and/or New Zealand shares.

Inclusion of either would require careful consideration of existing income tax provisions and integration (shares - taxation of dividend income and the imputation system, residential property – the land taxing provisions).

Pros

An RFRM on residential rental properties would reduce/mitigate existing investment distortion and would eliminate any lock in issue associated with a CGT where roll over relief is provided.

Cons

An RFRM on residential rental property or New Zealand shares has the potential to subject the recipient to tax regardless of how the investment has actually performed. There may be insufficient cash flow to cover the taxes due.

Retention of the status quo brings to tax a number of “capital gains” as ordinary income under our Income Tax Act. This currently includes (but is not limited to):

- The taxation of property gains under the land taxing provisions;
- Financial arrangement income;
- Sale of personal property purchased with the intention of resale;
- Sale of shares held on revenue account;

- FDR on non-resident portfolio shares;
- Various lease related inducements;
- Various employment related (entry and exit) inducement payments.

The (non) taxation of certain property gains has brought in to question the need for a CGT. Speculative property activity is, however, already subject to tax. Section CB 6 (the purpose and intention test) and the bright line buttress to it (CB 6A - now extended) should adequately address most mischief.

In our view Inland Revenue has plenty of tools under the existing land taxing provisions to address speculative behavior and it should use these to greater effect.

The arguments for a comprehensive CGT are substantially weakened when the family home is removed. Bank lending and New Zealand's desire to own their own homes will ensure that housing remains a prominent form of investment savings.

Property speculation does not include long term investment in residential property for rental. The speculative economy referred to by the Tax Working Group does, however, include this segment (although owner occupied housing is by far the largest component).

If it is determined that gains from sale of properties used for residential rental should be subject to tax, this can be adequately dealt with via extension of the existing land taxing provisions.

In our view, there is no need to introduce a comprehensive CGT with all of its complexities if the required practical effect can be achieved more simply on a targeted basis.

"In our view there is no need to introduce a comprehensive CGT with all of its complexities if the required practical effect can be achieved more simply on a targeted basis."

Recommendation

CA ANZ recommends that the status quo be retained and that any extension to the taxation of speculative investments required are included within the Income Tax Act framework.

Taxation of Savings

If savings are to be tax-neutral ("fairness" criterion), any capital gains tax should apply across all types of savings. At present, housing is said to be tax-preferred. This is because many taxpayers borrow to fund real property investments, but fewer taxpayers borrow to fund equities. A deduction is allowed for the interest on the loan which results in lower taxable income for real property investors. The Government's new proposals regarding the loss ring-fencing of rental properties may assist to level the playing field – however we believe these proposals will not assist with housing affordability and should be considered only as part of a broader discussion.

At present, PIEs do not pay tax on their capital gains. The rationale for this exemption was to replicate the tax treatment for direct investors so that the tax treatment would not be a disincentive for entering Kiwisaver.

From a political point of view, any CGT would likely need to exclude PIEs or at least Kiwisaver funds. This suggests a further exemption is likely.

In addition, CGT is incredibly complex for direct investment funds (wholesale funds in a fund-of-funds structure). They are required to track buy & sell dates of every investment. Fund managers usually use complex software and require at least one FTE resource to comply with the administration requirements. It is likely that these additional costs would be passed on to savers in the form of increased fund management fees.

Thus, if the Government wishes to encourage further saving, it may not wish to impose a tax on the capital gains; or it would need to introduce additional incentives to encourage saving.

Recommendation

Any capital gains tax should include an exemption for Kiwisaver funds, and possibly for all savings vehicles.

As we have discussed above, the wide range of exemptions that would be needed suggest an extension to existing rules, where required, would be a preferable solution to a comprehensive capital gains tax.

Tax on Labour

Driven by advances in technology and increased digitalisation the organisation and activities of the New Zealand labour force is undergoing more than a face lift. To fully understand the nature and extent of the changes in this sector we need to peel back the surface and examine the underlying issues.

Like Medusa, the issue is complex and multifaceted. It is not just all about robots and machines. Demographics (i.e. the ageing population, increasing life expectancies and falling birth rates) and the evolution of the 'new world' economy are also in the mix.

Given the high level of reliance on the individual tax base the changes and challenges in the labour force cannot be ignored.

> "The tax system needs to be agile and flexible to quickly respond to emerging trends and changes in the way people work"

Workplace of the Future

The current tax rules in relation to labour/personal exertion is broadly based on the premises of an employer/employee relationship, one workplace, and separate places for work and home. This model is unlikely to truly reflect the workplace of the future.

International and domestic borders are being eroded not only in relation to trade and commerce but also in the workforce. Studies predict that the number of independent contractors and remote workers will continue to increase. A growing number of these workers will offer and provide their services both domestically and overseas without having to relocate. Many will base themselves at home and may not necessarily have a separate office or designated area in the home from which they carry out their work. This mode of working is also becoming more common in the employer/employee model as more employers agree to flexible working arrangements. This merging of the workplace and home may give rise to difficulties in determining when a person's activity is work related and when it is private.

Another developing change is the increasing number of individuals who frequently relocate across countries to perform services on a contract basis. This model will challenge the appropriateness or fairness of the current labour tax rules, for example, the 92-day rule for the taxation of personal services income, the 90-day rule under many of NZ's DTAs, and the withholding tax rules.

It is also predicted that it will become more common for an individual to have multiple jobs at any one time. Furthermore, the individual may be an employee in one job and a contractor in another. This will put pressure on the way in which an individual working multiple jobs or contracts is taxed, how much they are taxed and when they are taxed.

The current tax system is slow to adapt to these changes. It often relies on business and taxpayers to identify and draw attention to inadequacies in the legislation or difficulties in compliance due to the new ways of working. In the future legislative responses will need to be made in a timely manner to minimise uncertainty and avoid stifling business confidence.

We believe the tax system needs to be agile and flexible to quickly respond to emerging trends and changes in the way people work. It should facilitate and embrace, rather than dictate and constrain, how people work today and in the future. A tax system that supports the workforce and its structure will boost innovation and productivity.

Future of Work/Technology

Few would have predicted 30 years ago the revolutionary impact of technology on our lives. Things like the internet, social media, smart phones and the sharing economy have transformed not only the way we live but also the way we work.

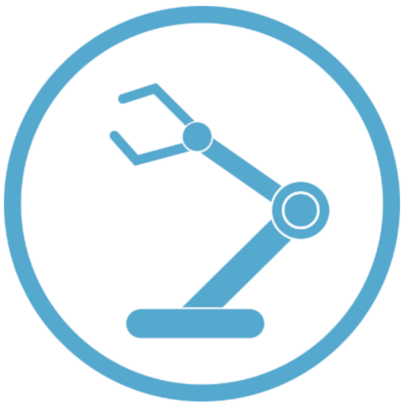
Technology has and will continue to define and redefine what work is, how it is performed, and by whom it is performed. It is imperative that the tax system be able to respond to these changes in a timely manner.

Robots

First came the computers. Now it is the rise of the machines – artificial intelligence and robotics. There is much discussion and many studies carried out about the risk and fear of robots taking peoples' jobs – both blue and white collar jobs. This possible reduction in the labour force is a potential future risk to New Zealand's tax base.

The potential increase in the number of people whose jobs may be displaced by technology has led to suggestions of a 'robot tax' (a tax on the use of robots). The rationale of this tax is to slow down automation, help fund retraining of those who have been displaced by automation and/or to fund a universal income.

Opponents of a robot tax say that such a tax would have a negative effect on the economy as it would stifle innovation, investment and business growth. It also overlooks the benefits that can be gained from automation, for example, improved efficiencies, increased productivity and cost savings. Furthermore, it ignores the many new jobs and opportunities that the use of technology will create. We believe this to be the better view. Automation is part of the solution to increasing productivity; increasing productivity will be part of the solution to the adverse effects of a reduced workforce.



While it is not possible to determine the nature and number of new jobs that will come into existence, it is possible that they will exceed the number of jobs eliminated. If this were to be the case, the potential risk to the tax base from the number of workers displaced may be alleviated.

The increased use of robotics and automation raises a number of practical difficulties such as: defining what a robot is (i.e. is it hardware or software), how to determine whether or not a person's job has been displaced by a robot, and how to identify the point in time when the displacement occurs.

In the international context automation may bring challenges to NZ's tax base. For example, if a robot or other form of machine is imported/based in NZ uncertainty may arise regarding whether this presence is sufficient to be a PE in NZ, or whether it is "substantial equipment".

The abovementioned issues only scratch the surface. These and other related issues will need to be worked through carefully and considered together with other wider government policies.

Training/Retraining Costs

With the probability of new jobs being created in the future, there will be a need for employees to retrain and learn new skills. This raises the question of whether the tax system should be used to ensure people have the right skills to remain employed/employable.

Under the current tax system support may be provided by allowing a deduction and/or giving a tax credit. We note that an officials' issues paper was released in November 2006 seeking feedback on the design of a skills training tax credit.

Looking ahead we envisage that the tax treatment of training/education expenditure may require review as the future of work unfolds.

Recommendations

- Given the high level of reliance on the individual tax base the changes and challenges in the labour force cannot be ignored.
- The tax system needs to be agile and flexible to quickly respond to emerging trends and changes in the way people work – it should facilitate and embrace the workplace of the future.
- The Tax Working Group should consider the impact, both positive and negative, robots and automation will have on the labour force.
- The future of work may require a review of the tax treatment of training/education expenditure.

Corrective Taxes

Background

Broadly, corrective taxes are aimed at modifying behaviour that is considered harmful. They can encourage healthier, safer and less polluting behaviour. A prime example is a "sugar tax" which has recently been the subject of much debate.

A sugar tax is a tax or surcharge placed on fattening (unhealthy) foods or beverages with the aim of reducing obesity and improving the health of New Zealanders. Other corrective taxes include excise taxes on tobacco and alcohol, as well as environmental taxes.

Other tools that are available to the Government to modify behaviour include:

- Regulation

  This involves imposing standards, targets or outright bans. For example, regulation has been used to reduce the harm caused by tobacco by: (1) prohibiting smoking in workplaces and other public areas; (2) prohibiting the promotion and advertising of tobacco products and tobacco sponsorship; and (3) controlling the sale and labelling of tobacco products (e.g. mandatory pictorial health warnings on tobacco products). Banning is also the tool used to prevent or reduce hard drug use.

- Anti-product campaigns

  This involves Government using education and advertising campaigns. For example, there is strong evidence to suggest the use of mass media campaigns for reducing alcohol-impaired driving and alcohol related crashes is effective when implemented in conjunction with other ongoing prevention activities, such as high visibility enforcement.

Our submission specifically considers whether there should be a greater role in the tax system for taxes, such as a sugar tax, that intentionally modify behaviours.

Environmental taxes are considered separately below.

Should Corrective Taxes be Part of the Tax System?

Corrective taxes can be viewed as:

- another source of revenue for the Government and used to reduce other taxes or boost spending; and/or
- covering costs related to the taxed activity. For example, revenue from a sugar tax could be used to assist individuals in their battle with obesity by subsidising healthy foods and education; and/or
- disincentivising behavior that is perceived to be detrimental to society or specific parts of the community and environment.

On the other hand, corrective taxes:

- are often regressive and people on lower incomes will pay disproportionately more of the tax than people on higher incomes;
- impose costs on consumers;
- can slow overall economic growth;
- can have substantial distributional effects, creating winners and losers (consumers may substitute non-taxed products for taxed products);
- reduce the benefits of other policies aimed at the same goal.

The success of corrective taxes has been mixed. Denmark introduced a tax on products with a saturated fat above a certain level. It was abolished a year later as it failed to change eating habits, it encouraged cross-border trading, put local jobs at risk and was a bureaucratic nightmare for producers and retailers.

“CA ANZ does not support the use of additional corrective taxes, such as a ‘sugar tax’.

The evidence to support the introduction a sugar tax is not compelling”

In addition, it was viewed as another government revenue source rather than a health initiative.

On the other hand, the use of corrective taxes to reduce the demand for tobacco and tobacco products and the associated health costs can be seen as a success story. Simply put, due to tax increases, tobacco has been priced out of reach of many. Tax has been a very effective tool in reducing consumption. However, it should be acknowledged that there has been a comprehensive campaign in all spheres of influence - health education, legislation, smoking cessation, and tobacco taxation. It is important to note that the campaign against smoking has been a long term strategy. Behavioural changes cannot be achieved by tax alone. A long term, sustained and adequately resourced campaign is also required. A whole of government approach with community support leads to success.

Unfortunately, a by-product of the increase in the cost of tobacco has been an increase in the black market demand and criminal targeting of tobacco retailers.

Recently tourism has undergone rapid growth and attention has been directed at the idea of taxing tourists (via a levy) to cover the cost of using our infrastructure (e.g. roads and public facilities) and going toward protecting and enhancing our natural environment.

Tourists already contribute revenue through GST (they pay GST on all their purchases and, unlike other countries, GST is not refunded at the border on goods that they take back with them), petrol tax and border clearance levies. In addition, businesses which increase their revenue through tourism end up paying proportionately more tax with the increased economic activity.

Recommendation

CAANZ does not support the use of a “sugar tax”. The evidence to support the introduction of a sugar tax is not compelling.

CAANZ does not support a tourist levy. The use of infrastructure by tourists varies. It will also often be confined to specific areas. A national levy could deter tourists who are price sensitive and object to being charged for infrastructure they do not use. GST collected from tourists should be sufficient. Targeted levies such as for use of walking in our national parks seem more appropriate.

Ignoring environmental activities, we have not identified any additional products or activities where the use of a corrective tax should be used to modify behaviour.

Environmental Sustainability

> **It is important we protect both New Zealand's environment and economic growth**

Background

New Zealand has an abundance of land and water and a temperate climate. It is well suited to a comfortable lifestyle and a range of industries. The world is short of land and freshwater, meaning New Zealand has a strong competitive advantage. In managing these natural resources, we need to balance economic imperative with sustainability.[11]

"The Living Standards Framework" (Natural Capital) identifies the following environmental issues that New Zealand is facing:

- Fresh water -

Population growth, irrigation expansion and climate change are increasing pressure on freshwater quality, with the major risks being agricultural and urban storm water run-off;

- Threatened species -

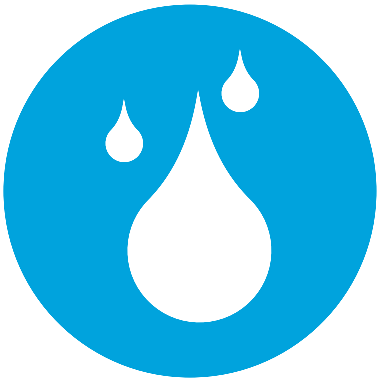
More than 3000 of our native species are classified as threatened or at risk with around 800 at risk of extinction and the remainder vulnerable to small changes in the environment. Many of these are unique to New Zealand. Threats to biodiversity have the potential to reduce social and economic capital as well as natural capital

[11] Future Inc - Developing a plan for New Zealand's continued prosperity pg. 17

- Climate change -

Growing the economy while meeting emission reduction ambitions requires a focus on productivity, innovation, technology uptake and better environmental management. There are particular opportunities for New Zealand to build on our current strength as a highly efficient global food producer.

It is important we protect both New Zealand's environment and economic growth or at least minimise trade-offs. New Zealand's largest export is 'dairy'. It earns over $15 billion a year and is dependent on abundant land and water. Over the last decade dairy farmers have produced 23% more milk. However, it is imperative that we find smarter and more productive ways of using New Zealand's natural capital while limiting the environmental degradation caused by farming. Good management of land and water is crucial. Damage to the environment can linger for many generations.



Top 25 Environmental Concerns

1	Air pollution	14	Ozone layer depletion
2	Water pollution	15	Mining
3	Soil and land pollution	16	Natural resource depletion
4	Climate change	17	Natural disaster (earthquakes, goods, tsunamis, cyclones, etc.)
5	Global warming	18	Nuclear issues (radioactive waste)
6	Deforestation	19	Loss of endangered species
7	Increased carbon footprint	20	Acid rain
8	Genetic modification	21	Agricultural pollution
9	Effect on marine life	22	Light and noise pollution
10	Public health issues	23	Urban sprawl
11	Overpopulation	24	Medical waste
12	Loss of biodiversity	25	Littering and landfills
13	Household an industrial waste		

What are Environmental Taxes?

Environmental taxes can be classified as:

- Cost covering charges – designed to cover the costs of environmental services and abatements;
- Incentive taxes – designed to change the behaviour of producers and/or consumers;
- Fiscal environmental taxes – designed primarily to raise revenues.

Environmental taxes are only one of the possible environmental policy measures. Regulation, economic and suasive instruments are other types of measures that can be used to control activities that affect the environment.

Regulation is more prescriptive. It is aimed at directly influencing environmental performance of polluters by regulating processes or products used, by abandoning or limiting the discharge of certain pollutants and/or by restricting activities to certain times, areas through licensing, setting of standards, zoning etc.

Economic instruments use pricing to achieve the desired result, leaving producers and consumers free to decide how to respond. Economic instruments include charges, subsidies (designed to provide rewards to reduce negative environmental impacts), deposit refund systems, market creation and financial enforcement incentives.

Suasive instruments seek to internalise "environmental awareness and responsibility into individual decision-making by applying pressure and/or persuasion either indirectly or directly. Examples include education and voluntary agreements reached through negotiation between industry and government.

New Zealand Environmental Policy Measures

Carbon tax	Central government
Fishing (Quota System)	Central government
Home insulation subsidies	Central government
Heat pumps - subsidies	Central government
Motor vehicle registration	Central government
Petrol tax	Central government
Road user charges for diesel vehicles	Central government

Pollution – fines	Local bodies
Water and wastewater	Local bodies
Fuel tax (proposed)	Local bodies
Transport levy	Local bodies
Rubbish	Local bodies
E-waste	Local bodies
Hazardous waste (batteries, paints)	Local bodies
Air pollution	Local bodies

Forestry rights	Regulation - RMA
Water rights	Regulation - RMA
Land rights	Regulation - RMA
Minerals, sand	Regulation - RMA

During the period 1999-2016 energy and transport taxes contributed, on average, 48% of New Zealand's environmental taxes. During this period energy taxes increased from $856 million to $2.5 billion and transport taxes increased from $637 million to $2.3 billion. On the other hand, pollution and resource taxes declined from $138 million to $93 million.[12]

Carbon Taxes

The emission trading scheme (ETS) is New Zealand's principal response to climate change. It came into force in September 2008 with the Climate Change Response Act. The ETS supports and encourages global efforts to reduce greenhouse gas emissions by assisting New Zealand to meet its

[12] New Zealand environmental-economic accounts 2018

international obligations and reducing New Zealand's net emission below business as usual levels. The ETS puts a price on greenhouse gas emissions with the intention of creating a financial incentive for businesses to invest in technologies and practices that reduce emissions. It also encourages forest planting by allowing eligible foresters to earn New Zealand emission units (NZUs) as their trees grow and absorb carbon dioxide.

ETS requires all sectors of New Zealand's economy to report on their emissions and, with the exception of biological emissions from agriculture, to purchase and surrender emissions units to the Government for those emissions.

In 2016-17 ETS entered a review process. Although this review process is still underway it was found the framework and settings are not fit for purpose after 2020.

Quota Management System

The cornerstone of New Zealand fisheries management is the Quota Management System (QSM). Under the QMS a yearly catch limit is set for every fish stock (a species of fish, shellfish or seaweed from a particular area). By controlling the amount of fish taken from each stock, the QMS helps keep New Zealand fisheries sustainable.

Resource Management Act 1991

The Resource Management Act 1991 (RMA) is New Zealand's primary piece of legislation that sets out how we should manage our environment. It is based on the principle of sustainable management which involves considering effects our activities have on the environment now and in the future when making resource management decisions.

As well as managing air, soil, fresh water and coastal marine areas, the RMA regulates land use and the provision of infrastructure which are integral components of New Zealand's planning system.

Although the RMA provides an overarching guide on what's best for our environment, with national direction on significant issues, it allows communities to make decisions on how their own environment is managed through regional and district resource management plans. Decisions on resource consents are made with consideration to these plans, national direction and the objectives in the RMA. This framework means that most decisions on resource management are made by local government which also have a wider planning role in transport, infrastructure and economic development.

Overseas Experience

Environmental taxes include:

Fiscal environmental taxes	
Sulphur tax	To increase penetration of low-S fuels and adoption of S-abatement measures
CO_2 – tax	To reduce CO_2 emissions
Tax on domestic flights	to reduce emissions by nationally operated air transport
Waste charge	to reduce waste generation and increase recycling and reuse

Incentive charges	
Fertiliser charge	to reduce demand for fertiliser
Pesticide charge	
Toxic waste charge	to reduce the amount of toxic waste
Water pollution charge	To support adoption of water pollution abatement in permit application process
Packaging charge	To reduce demand for packaging

Cost covering user charges	
Water pollution	to finance wastewater treatment plants
Household waste charge	to promote a fair distribution of waste management costs over users

Cost covering charges	
Battery charges	to cover costs of collection and disposal
Aircraft noise charge	to finance insulation and redevelopment programmes around airports

It is interesting to note OECD environmental taxes made up on average, 5.2% of total tax revenue. In comparison, OECD estimates for New Zealand are 4.2% (2014).

In 2013 the incidence of OECD environmentally related taxes was similar to that for New Zealand. Revenue was dominated by taxes on energy products which included motor vehicle fuels (69%) and motor vehicles and transport (28%). Other environmental taxes, such as those on resources and pollution, made up 3%, but unlike New Zealand, the share of these taxes across the OECD is growing.

Scope

The Tax Working Group has asked:

Should current polluters incur the cost of any future financial loss being caused by their activity?

Should they also pay for a possible loss in our future quality of life?

This ties in with Treasury's Living Standards Framework and sustainability "sustainable development is development that meets the needs of the present without comprising the ability of future generation to meet their own needs".

Recommendation

CAANZ is not convinced current polluters should incur the cost of any future financial loss being caused by their activity or pay for a possible loss in our future quality of life. First, it is not always possible to determine the extent of any potential damage or identify the environmentally damaging pollutant or activity. For example, the long term environmental effects of genetically modified organisms is uncertain. Second, the economic problem of comparing costs and benefits is immeasurably more difficult in the area of environmental harm. Because environmental harm, together with any efforts to undo or mitigate the harm, takes place over decades or centuries the weighing of the costs and benefits involves both the current and future generations' assessments of those costs.

> **"In our view the current policy measures in place provide incentives for producers and consumers to change their behaviour"**

In our view the current policy measures in place (taxes and regulation) provide incentives for producers and consumers to change their behaviour towards a more eco-efficient use of resources; to simulate innovation and structural changes. Current measures such as regulation are aimed at minimising or eliminating environmental deterioration. As more environmental problems come to light, the policy response should be tailored to address the specific environmental problem.

GST

Background

New Zealand GST has been around since 1 October 1986 and was introduced as part of a broader tax reform package. GST was designed:

- to be borne by the domestic household consumer and overseas visitor;
- to be broad based (capture the widest range of goods and services with few exemptions);
- to be a single rate but there are zero-rated supplies - e.g. exported goods and services (so that GST does not apply to items consumed outside of NZ), sale of going concern businesses, land (to manage cash flow and fiscal risk on large amounts of GST);
- based on the destination principle (which prevents double taxation of goods and services traded between New Zealand and other countries as others apply this principle too);
- to operate efficiently and impose the lowest possible compliance and administrative costs on New Zealand;
- to reduce the extent to which GST distorts the relative prices that New Zealand businesses are paid for the sale of goods and services, and the relative prices they pay for their purchases.

As acknowledged in the "Future of Tax Submissions Background Paper" New Zealand's GST is amongst the most comprehensive in the world. In fact, the New Zealand GST system is rated as one of the best in the world because of its simplicity.

Given that New Zealand has one of the most comprehensive GST regimes in the world we need to consider what changes, if any, should be made. Our submission specifically considers should:

1. the GST rate be changed?
2. the GST base be broadened?

3. the GST base be narrowed and if so what else should be taxed to make up for lost revenue?

GST Rate

New Zealand GST collections amount to 31.4% of the total tax collected in 2017 (10% of GDP). Notably, New Zealand has the sixth lowest rate of GST in the OECD.

Whilst increasing the rate of GST is outside the scope of the Working Group's review we make the following observations:

- Lowering the rate should not be considered. The Government may need to raise revenue in the future and GST is likely to be the most efficient tax to raise that revenue.

Broadening the base

Given GST is our most efficient tax, we have considered whether the base should be broader.

The measures we have considered are:

- Narrowing the exemption for "financial services", so that it no longer includes "arranging" a financial service;
- Including residential property within the GST net; and;
- Low value imported goods.

Should financial transactions be subject to GST?

Generally the supply of a financial service is an exempt supply (there is an exception for those that are zero rated because they are exported or supplied to a fully taxable business). The definition of "financial services" very broadly covers transactions that involve the provision of finance or services relating to finance (for example, the exchange of currency, the issue of a debt, the provision of a life insurance contract). The term also includes agreements to carry out any of the defined activities, and arranging any of them, other than advising thereon.

During the policy development of GST in 1984-1985, a number of options were considered and evaluated to establish whether financial services could be fully integrated into the GST base.

Part of the difficulty with taxing the service component of a financial supply is measuring the payment for services supplied on a transaction-by transaction basis. Financial intermediaries earn income from the margin between the price charged for applying funds and the price charged for receiving funds, as in the case of banking, lending and borrowing. The substantial component of that price will represent interest, which is generally outside the scope of a consumption tax.

The treatment of financial services was one such area where the practical difficulties associated with correctly applying the tax could not easily be resolved. Exemption was seen as the best option given these constraints as it included financial services within the GST base but did not have to address the measurement difficulties associated with charging GST on supplies of financial services.

However, the New Zealand definition of “financial services” is wider than in many other countries. We have considered whether the base could be broadened by narrowing the definition.

“Arranging”

One way to narrow the definition would be to remove “arranging” a financial service from the definition of “financial services”.

This could be done without encountering valuation problems because “arranging” is generally valued separately from the financial services. In the past, “arranging” has often been remunerated under commission arrangements, but regulatory changes have meant that separate fees for financial advisors and other intermediaries are becoming more common.

There are other countries that do not include "arranging" within their definition of financial services, such as Australia.

It is likely that imposing GST on "arranging" of financial services would create tax "cascades" if the services are charged to financial service providers who cannot claim the GST back. This problem is not as severe as it would first seem however, because:

- The GST will be claimable where it is directly attributable to an on-supply of a taxable service;
- Financial service providers are able to zero rate supplies to fully taxable businesses, so are able to claim back a greater percentage of their input tax than they were when GST was first introduced.

However, the primary difficulty with such a change is that it would create an in-source bias within the financial services industry. Financial services entities would prefer to obtain "arranging" services from within their own organisation so that they ae not required to pay GST, because any GST paid to a separate organisation will not be fully claimable.

We do not believe that tax should drive business decisions. Thus, we do not believe any amendment should be made until it is possible to solve the issue of the in-source bias.

Residential Property

Supplies of residential property are currently exempt from GST. However, commercial property rentals (broadly, short term rents) are subject to GST.

We have considered whether residential property should be brought within the GST net. However, the principal issue is that this would leave renters at a disadvantage over property owners (who do not pay GST on the cost of mortgage repayments).

One of the principal Government aims is to improve housing affordability. The above change would give home owners a significant advantage over those who rent. Therefore, we do not believe the change should be pursued.

Low Value Imported Goods

The GST base is at some risk as online shopping and the import of low-value goods (under approximately $400) increases. We understand that this has already been referred to and considered by the Tax Working Group. However, we consider that New Zealand needs to address the challenge and implement a strategy to protect the GST base in an efficient and effective way.

Narrowing the Base

Since the introduction of GST there have been suggestions by the public that the base is too broad and that GST should not be charged on particular "necessities". We have considered whether GST should be removed from either of the following:

- Fruit and vegetables; and/or
- Health care costs.

Fruit and Vegetables

There have been calls for GST on "fresh food" to be removed to encourage the public, especially low income families, to eat more fruit and vegetables to the benefit of their health.

Many countries justify reduced rates as a way of not penalising the poorest households who spend more of their income on food and clothing. However, research suggests reduced rates are rarely effective in achieving distributional objectives. The wealthy also benefit from reduced rates and as they consume more, they benefit more.

Other countries, such as the United Kingdom (UK), also have high rates of obesity and low rates of fresh food consumption. However, the difference between New Zealand and the UK is that the UK has food exemptions on VAT. Despite the food exemptions, there is no evidence that food is more affordable and people in the UK are eating better than New Zealanders.

In addition, removing GST from "fresh food" will:

- result in increased compliance and administrative costs;
- add complexity to what is now a relatively simple and efficient tax;
- create boundary issues;
- not make a difference to food affordability. Prices are mainly driven by elasticity of demand, supply constraints and competition. A reduction in GST is unlikely to be passed on to the consumer.
- result in a reduction of GST revenue which must be offset by an increase in GST on other goods or an increase in other taxes.

This is not the first time the issue of removing GST from food has been raised. The topic was subject to some debate when the Goods and Services Tax (Exemption of Healthy Food) Amendment Bill 2010 was introduced. The Bill did not receive enough support and did not survive its first reading.

CA ANZ does not support removing GST from food. A reduction in GST is not an effective way of providing support to low income families. Targeted assistance should be provided through the social assistance programme.

Health Care

In New Zealand, health care services are subject to GST at the standard rate. Many other countries which charge a zero rate or exempt health care services. Their rationale for this is generally that health care is a necessity and should not incur an additional tax cost.

However, we do not believe this is something that New Zealand should implement.

We have already discussed New Zealand's ageing population and the associated costs to the Government associated with the change in demographic. In addition, we understand that many elderly people (over the age of 80) are not big consumers. However, they do spend significant sums on health care. It is likely that the Government will need the revenue from GST on health care costs.

In addition, we believe that this would create boundary issues that would increase compliance costs within the healthcare industry.

Recommendation

CA ANZ is of the view that the 2010 Tax Working Group recommendation for GST is still appropriate. GST should continue to apply broadly. There should be no exemptions. Narrowing the base will substantially increase administration and compliance costs and add complexity.

CA ANZ also supports expanding the GST regime to include low value imported goods. Consideration should also be given to increasing the GST rate as part of a future package of broader policy measures.

Summary of Key Recommendations

Current Tax System	We do not consider that there is a need for urgent changes to the current tax policy settings.
	The Tax Working Group should identify strategies to manage or reduce the risk of relying heavily on the individual tax base and other potential risks (e.g. advances in technology) to the broader New Zealand tax base.
	We do not consider that there is a need in the short or medium term to move away from or replace the BBLR approach.
	GTPP should continue to be the lynch pin in shaping the New Zealand tax system.
	The Tax Working Group should consider introducing measures to ensure that GTPP is followed and hold the government and policy officials to account if it is not.

Guiding Principles (Framework)	The traditional measures of efficiency, equity and fairness, revenue integrity, fiscal adequacy, compliance and administration costs, and coherence should be retained.
	Certainty and predictability should also be promoted.
	A blanket definition of "fairness" would be inappropriate.
	It would be helpful if the tax policy framework included a list of criteria that could be applied to measure and assess fairness.
	The tax system will need to be agile and flexible to ensure that it operates consistently with the evolving views formed through the living standards framework.
	Incorporating nonfinancial measures in the tax system should be done with caution.

Challenges (Sustainability of the Tax System)	The combination of the ageing population and the rise of the gig economy makes it likely that New Zealand will need to rely more heavily on business taxation in future.
	The Tax Working Group should consider whether the Kiwisaver scheme has been successful to date, whether a greater rate of saving is required and, if so, whether the current tax concessions are sufficient.
	We recommend the Tax Working Group investigate the sensitivity of overseas investors to the corporate tax rate as part of any decision to reduce the rate.
	We recommend that New Zealand remain an active participant at OECD level regarding the concept of a PE and a potential solution and that the Tax Working Group consider New Zealand's revenue needs going forward before any changes are made to domestic tax legislation.
	The tax administration system is built on sound principles but is not operating as effectively as it could. To improve effectiveness we recommend an independent Taxpayer Advocate Service be established; audit be adequately resourced and Inland Revenue continue to support tax agents.

	Tax from the shadow economy is potentially the largest untapped revenue source available to the government. Dealing with the shadow economy and making significant in-roads into the tax gap will require a long term commitment and a multifaceted approach. Most importantly there needs to be a shift in attitude.
	We recommend that every tax payer receives correspondence from Inland Revenue on an annual basis stating the amount of tax paid in the year.
	We recommend no change is needed to the taxation of Māori authorities at the present time. However this will need to be monitored as the Māori business environment develops.
	There is a need to simplify tax and tax compliance for small business. Our one size tax system does not fit all. A "close enough is good enough" approach should be acceptable for small business taxation.

Tax on Capital	CA ANZ recommends that the status quo be retained and that any extension to the taxation of speculative investments required are included within the Income Tax Act framework.

Tax on Labour	Given the high level of reliance on the individual tax base the changes and challenges in the labour force cannot be ignored.
	The tax system needs to be agile and flexible to quickly respond to emerging trends and changes in the way people work – it should facilitate and embrace the workplace of the future.
	The Tax Working Group should consider the impact, both positive and negative, robots and automation will have on the labour force.
	The future of work may require a review of the tax treatment of training/education expenditure.
	Given the high level of reliance on the individual tax base the changes and challenges in the labour force cannot be ignored.

Corrective Taxes	CA ANZ does not support the use of additional corrective taxes, such as a "sugar tax". The evidence to support the introduction of more corrective taxes is not compelling. The use of a corrective tax to modify behaviour is a blunt tool that affects all consumers and takes away a consumer's right to choose.
	CA ANZ does not support a tourist levy. The use of infrastructure by tourists varies. It will also often be confined to specific areas. A national levy could deter tourists who are price sensitive and object to being charged for infrastructure they do not use. GST collected from tourists should be sufficient. Targeted levies such as for use of walking in our national parks seem more appropriate.

Environmental Sustainability	CA ANZ is not convinced current polluters should incur the cost of any future financial loss being caused by their activity or pay for a possible loss in our future quality of life. First, it is not always possible to determine the extent of any potential damage or identify the environmentally damaging pollutant or activity. For example, the long term environmental effects of genetically modified organisms is uncertain. Second, the economic problem of comparing costs and benefits is immeasurably more difficult in the area of environmental harm. Because

	environmental harm, together with any efforts to undo or mitigate the harm, takes place over decades or centuries the weighing of the costs and benefits involves both the current and future generations' assessments of those costs.
	In our view the current policy measures in place provide incentives for producers and consumers to change their behaviour towards a more eco-efficient use of resources; to simulate innovation and structural changes.

GST	CA ANZ is of the view that the 2010 Tax Working Group recommendation for GST is still appropriate. GST should continue to apply broadly. There should be no exemptions. Narrowing the base will substantially increase administration and compliance costs and add complexity. CA ANZ also supports expanding the GST regime to include low value imported goods. Consideration should also be given to increasing the GST rate as part of a package of broader policy measures.

Appendix 1

In Response to Questions for Submitters

The Future of the Environment	What do you see as the main risks, challenges, and opportunities for the tax system over the medium- to long-term? Which of these are most important?	• New Zealand's ageing population and the rise of the "gig economy" mean New Zealand will be less able to rely on personal income tax in the future • It is possible that our headline corporate tax rate is too high for some international investors – and this sensitivity should be investigated • Potential OECD recommendations may affect New Zealand's tax base and should be considered carefully before implementation • Our tax administration system is not operating as effectively as it could and we believe more trust in the integrity of the tax system is needed • Tax from businesses in the shadow economy could be a large revenue source for the New Zealand Government but at the present time it remains largely untaxed • There is a need for reform of small business taxation
	How should the tax system change in response to the risks, challenges, and opportunities you have identified?	• The tax system may need to consider ways in which it can broaden the current bases to protect future Government revenue • The Tax Working Group should investigate the sensitivity of international investors to the headline corporate tax rate and should consider reducing the corporate tax rate for non-residents • New Zealand should consider carefully the OECD work on permanent establishments prior to enacting any domestic legislation and, in particular, the implications for New Zealand's revenue base • The Government should establish an independent body to address taxpayer complaints and to ensure GTPP is being followed. This could be done as two separate bodies or as a single entity. • The Government has a great opportunity to increase tax revenue if it can effectively tax the shadow economy. This will requires a multifaceted approach, changes in societal norms and public acceptance. • The Government should introduce a separate tax regime for small business and presumptive taxes for micro businesses.
	How could tikanga Māori (in particular manaakitanga, whanaungatanga, and	This has not been addressed in our submission

	kaitiakitanga) help create a more future-focussed tax system?	
Purposes and Principles of a Good Tax System	What principles would you use to assess the performance of the tax system?	Efficiency, equity and fairness, revenue integrity, fiscal adequacy, compliance and administration costs, coherence
	How would you define 'fairness' in the context of the tax system? What would a fair tax system look like?	Fair treatment of those in similar circumstances and of those with differing abilities to pay tax; procedural fairness
The Current New Zealand Tax System	New Zealand's 'broad-based, low-rate' system, with few exemptions for GST and income tax, has been in place for over thirty years. Looking to the future, is it still the best approach for New Zealand? If not, what approach should replace it?	Yes however we believe the mix of taxes will change over the next twenty years and New Zealand will need to become less reliant on personal income tax
	Should there be a greater role in the tax system for taxes that intentionally modify behaviour? If so, which behaviours and/or what type of taxes?	We have not identified any additional behaviours for which corrective taxes would be appropriate. However, if problems are identified in the future, the policy response, (regulation and/or tax) should be tailored to address the specific problem.
	Should the tax system encourage saving for retirement as a goal in its own right? If so, what changes would you suggest to achieve this goal?	The Tax Working Group should take advice on whether New Zealanders' current level of saving is appropriate and, if not, we have suggested changes that could be made
The Results of the Current Tax System	Does the tax system strike the right balance between supporting the productive economy and the speculative economy? If it does not, what would need to change to achieve a better balance?	The Government's recent tax amendments should go some way towards removing any bias towards speculative investment.
	Does the tax system do enough to minimise costs on business?	No – especially for small business where compliance costs fall disproportionately on them.
	Does the tax system do enough to maintain natural capital?	Protecting natural capital is best achieved through a combination of regulation, incentive and taxation. Our tax system has a part to play but we believe regulation is a better tool for behaviour change in the short to medium term.
	Are there types of businesses benefiting from low effective tax rates because of	We have not addressed any preferential treatment for particular businesses or industries as part of our submission.

	excessive deductions, timing of deductions or non-taxation of certain types of income?	
Thinking Outside the Current System	What are the main inconsistencies in the current tax system? Which of these inconsistencies are most important to address?	The disproportionate compliance costs for small businesses
	Is there a case to consider the introduction of any new taxes that are not currently levied? Should any taxes be reduced if new taxes are introduced?	No but we believe that the Government should look to increase tax compliance from those in the shadow economy as we believe this is the greatest untapped revenue source for Government
Specific Challenges	How, and to what extent, does the tax system affect housing affordability for owners and renters? Is there a case to change the tax system to promote greater housing affordability? If so, what changes would you recommend?	Housing affordability is impacted by multiple factors including; limitations on land supply (RMA impediments and land holding), demand in certain locations exacerbated by high levels of immigration, bank lending criteria. A multifaceted solution is required to address this problem. Taxations settings for property are but one component.
	Should New Zealand introduce a capital gains tax (that excludes the family home)? If so, what features should it have?	CA ANZ is of the view that there is no need to introduce a comprehensive CGT with all of its complexities if the required practical effect can be achieved more simply on a targeted basis.
	Should New Zealand introduce a land tax (that excludes the land under the family home)? If so, what features should it have?	CA ANZ does not recommend the introduction of a land tax that excludes the land under the family home.
	What are the main opportunities for effective environmental taxation?	New Zealand currently uses a variety of measures, such as tax, subsidies and regulation, to address environmental issues. Any future measure to control environmental activities, not already covered, should be designed based on the specific facts.
	Should the tax system do more to support small businesses? In particular, is there a case for a progressive company tax?	Yes. We favour comprehensive simplification measures for small business tax. We do not see a progressive corporate tax rate as a fiscal stimulus for business.
	Should the tax system exclude some goods and services from GST? If so, what should be excluded? What else should be taxed to make up for the lost revenue?	New Zealand's GST system is rate as one of the best in the world and continues to be the best approach for New Zealand now and in the foreseeable future.

Appendix 2

Capital Gains Tax (CGT) Evaluation

	Key Design Considerations	Comment
1	Should CGT be a separate tax or part of income tax?	Best taxed as part of income tax, holistic and simple rather than a separate Act. This is the most common approach internationally. If the purpose is to ensure that the tax base is broad, different gains should be taxed on the same or similar basis.
2	Should capital gains be taxed on realisation or accrual basis?	In an idealistic world gains would be taxed as they accrue. This would tax the real economic income and avoids the distortions that a realisation basis can have. However this approach has not found favour anywhere in the world on implementation. It has clear cash flow impacts.
		Taxing on a realisation basis akin to transactional tax on asset disposal (issue as to what constitutes disposal), significantly decreases effectiveness of CGT (as do exemptions and concessions discussed below)
3	What assets should be covered?	While CAANZ does not support the introduction of a CGT, if a CGT is to be introduced it should be comprehensive, covering not only physical assets but intangible property, rights and extinguishment of rights. However this broad base will increase the complexity. A comprehensive CGT would aid simplicity of design and administration, reducing complexity associated with threshold issues of exemption, exclusion, roll over relief, avoidance, and simplify boundary issues with existing income tax legislation ensuring coherence. The family home is a significant asset base and goes to the heart of the investment in productive assets debate. Its exclusion as a political expedience will significantly impact the effectiveness of a CGT and will likely create further distortions. It discriminates between home owners (especially those mortgage free) and renters.
		Alternative approaches could be to include the family home but provide a regionally based threshold exemption i.e. first $x to remove more modest houses in full, with balance subject to CGT. This could target over capitalisation or the "Mansion effect". However this will come with its own complexities and boundary issues that will make compliance very difficult.
3a	Should assets held by KiwiSaver and other savings schemes be subject to tax?	The tax treatment of assets held in these savings schemes should be consistent with assets held independently for retirement / long-term saving. Absent a deliberate concession to such saving, all investment gains would be subject to tax (income/CGT).

	Key Design Considerations	Comment
3b	Should assets held offshore be subject to tax?	On the basis that NZ residents are subject to income tax on worldwide income, assets held offshore should be subject to CGT (subject to a participation exemption regime for interest in active CFCs to match exiting international tax rules). To avoid double taxation a credit for foreign tax of similar type should be allowed. DTA impact would need to be considered more fully. Real property and land rich companies typically taxed in source country - fine as NZ would not be asserting primary taxing rights, treatment of shares may vary.
3c	How should gifts and gambling winnings be taxed?	If a relatively comprehensive CGT is introduced, gambling winnings should be taxed as a capital gain (note subject to rates/design issues it would not matter whether a capital gain or ordinary income - the later would need to be adjusted though to deal with working for families' entitlements and parental support etc. Consideration would need to be given to a de Minimis to deal with minor Lotto, instant kiwi, school raffle winnings etc. An alternative would be to subject Lottery and TAB winnings to a withholding tax and collect on payment. Gifts would also need to be subject to CGT as an anti-avoidance mechanism but a pragmatic solution could be found with an appropriate de Minimis to exclude smaller personal items.
3d	Should there be a de Minimis rule?	There should be a de Minimis rule to reduce compliance costs and deal with personal gifts. An appropriate level would need to be established. One option would be to have a bright line annual exclusion. This will result in valuation requirements for items of more substantive value/ close to threshold. Given that CGT is a progressive tax, an annual exclusion could be set at a threshold level that excludes the majority of taxpayers from the CGT net without a large revenue or efficiency cost.
4	CGT events/realisation	Further to 3 above a comprehensive CGT needs to address a myriad of CGT events and timing that realisation is triggered in its design. The Roadmap to CGT events in the Australian Legislation (ITAA 1997 Div. 104) provides a useful summary – A. Disposals; B. Use and enjoyment before title passes; C. End of CGT asset; D. Bringing into existence a CGT asset; E. Trusts;

	Key Design Considerations	Comment
		F. Leases; G. Shares; H. Special capital receipts; I. Australian residency ends; J. CGT events relating to roll-overs; K. Other CGT events; L. Consolidated groups etc.
4a	How should matrimonial property settlements be treated?	Treatment should be in line with existing relationship property transfers. Specifically a property transfer in these circumstances should be excluded for CGT purposes. This could be achieved via exemption, exclusion as a realisation event, or through some form of roll over relief.
4b	How should disposal of assets on death be treated?	Under a comprehensive CGT, disposal of assets on death would need to be treated as a CGT disposal/ realisation event and be subject to CGT. However we doubt that this would be politically acceptable. We expect that the treatment would be in line with existing rules on the disposal of assets on death. If death is considered to be a taxable event, it will be important from a design perspective that the transfer on death to an executor of an estate and then subsequently to the beneficiary does not create two disposals for CGT. An allowance or extended de Minimis in the year of death would deal with equity concerns re breach of threshold (bunching) due to a single realisation event i.e. death versus regular gifting over time.
4c	How should emigration be handled?	Important from an anti-avoidance perspective that people/organisations with large potential CGT liabilities not be able to escape CGT via migration to another country. We would expect that an emigration or cessation of residency is a CGT disposal event.
4d	How should immigration be handled?	The time at which immigrants enter the CGT taxing net needs to be carefully considered, including whether transitional residence rules extend. Assets will need to be valued either on expiration of the transitional residents' period, on initial arrival or some combination of the above. Design considerations should take into account that some of our treaty partners preserve their rights to tax former residents for a period of time subsequent to emigration.

	Key Design Considerations	Comment
4e	When should non-residents be subject to tax?	From a design perspective non-residents should be subject to CGT on realisation of NZ sourced assets. The application of DTAs to CGT will need to be fully considered. It is noted that most conventions apply to substantially similar taxes imposed after the date of signing. NZ treaties typically retain taxing rights in the source country for immovable/real property and the sale of shares in land rich companies. The sale of moveable property/shares in non-land rich companies will however typically only be subject to tax in the non-residents home country. A limited number of treaties preserve a residual source taxing right for capital gains in circumstances where the DTA does not otherwise specifically allocate a taxing right.
4f	How should family trusts be integrated into the system?	Transfers of assets to or from a family trust should represent a CGT realisation event subject to CGT. If concessions are to apply, concessions provided to individuals should equally apply to a family trust i.e. family home exemption.
5	Should capital losses be ring fenced?	If a comprehensive CGT were introduced and gains taxed at normal rates then on a coherent basis capital losses should be offset-able against all income.
6	Should there be roll over relief?	Roll over relief will impact the effectiveness of a CGT in terms of revenue raised (i.e. it will generate a deferral) and can have a negative impact in terms of lock in to a particular asset type (i.e. typically based on like for like asset acquisitions). Whether a concession is provided (i.e. in the form of roll over relief) or certain targeted assets are specifically excluded from a CGT are key to design. For NZ business to remain competitive roll over relief should exist where gains are reinvested in similar assets or due to natural events such as earth quakes. From a policy perspective decisions will need to be made on how to address publicly or Iwi owned land.
7	Should any allowance be given for inflation in calculating capital gains?	As with the taxation of income on savings there is often the call to only tax real as opposed to nominal gains (i.e. to exclude the effects of inflation). In a capital gains setting this will be more prevalent where either the rate of inflation is higher or the gain is derived over an extended period of time. Mitigating for the effects of inflation via for example indexation result in increased administrative cost/complexity.

	Key Design Considerations	Comment
		A more pragmatic solution would be to compensate for the effects of inflation via either the rate or rates of CGT imposed or the level of inclusion of capital gain subject to CGT (discussed in more detail below). Additionally it would be possible to differentiate between short and longer term gains with reduced inclusion/rate of CGT applied to the latter.
8	What should the rate of tax on capital gains be?	This question should best be addressed in conjunction with the level of capital gain inclusion. There are a number of options: 100% inclusion at a flat rate (say 15%); 100% inclusion at full (normal) rates; 50% inclusion at above rates or marginal rates; or split inclusion or rate depending on the duration of time the asset has been held (i.e. short and long term gains threshold distinction). The main attraction of the first option (100% inclusion at flat rate) is its simplicity. From a tax policy design perspective it is however less progressive than the other options. 100% inclusion at normal rates is likely to bring the greatest integrity and coherence to the tax system as it largely eliminates the capital/revenue distinction. The downside to this option however is that it brings to tax nominal gains inclusive of inflation unless adopted in conjunction with indexation. A possible balance would be to tax at normal rates but provide for a 50% inclusion for long term gains (for example on assets held for 5 years or more). This would partially address inflation concerns.
9	How would a CGT integrate with current tax laws?	This question is very much dependant on the level and extent of a CGT ultimately put up for consideration. There will still be a need to include within income all revenue gains/business income. The capital gain derived on sale of property should however be addressed within a CGT (unless the property is held for resale as part of the persons business - i.e. land taxing provisions relating to dealers / developers / builders). Existing cross over extensions taxing capital related gains as income could be removed from income and taxed as capital gains under a comprehensive CGT. There would be boundary issues as to whether certain deemed income gains should be unpicked or left within income i.e. the financial arrangement rules, lease inducements, inducements to take or leave employment etc.

	Key Design Considerations	Comment
10	What administrative implications would there be from a CGT?	Administrative and compliance costs and overall complexity are often cited as arguments against the introduction of a CGT especially if the revenue uptake is likely to be modest. Depending on design there will potentially be greater inclusion of taxpayers having to file returns and obtain valuations. Threshold issues, integration with income taxing provisions, and anti-avoidance measures add to complexity. Compliance with CGT legislative requirements would be beyond the majority of average taxpayers necessitating the use of professionals and increasing compliance costs.
11	What rules should govern the transition into a CGT?	The options include: assets acquired post introduction (pre CGT assets excluded = lock in effect); market valuation on introduction (fairer as includes all assets but resets value - most common); and all assets at original cost - retrospectively captures gains pre-implementation – not appropriate in general policy terms. Adoption of a valuation based approach removes legislative complexity around countering avoidance by taxpayers trying to shift investments into assets held prior to CGT introduction where pre-CGT assets are excluded (the Australian experience). A clear disadvantage of the valuation approach is that valuation is required. Valuation issues are likely to pose significant problems: cost; regulation of valuer's; valuation issues/complexity around for example intangibles. There can be winners and losers. Capital losses prior to valuation date may be taxed. Key advantage of the assets acquired approach is that the tax status and the original investment decision making assumptions are preserved.
12	Other matters for consideration	The impact on SMEs and innovation needs to be carefully considered in the design of a CGT.

Appendix 3

CA ANZ Rural Advisory Committee: Submission to the Tax Working Group

This submission focusses on the impacts of additional taxes on parts of the farming sector that do not have sufficient cash flow to service those additional taxes. In particular this submission focuses on the impacts of the following on the farming sector by way of example:

- Capital gains tax working on an accrual basis
- Capital gains tax working on a realisation basis without roll-over relief
- Land tax
- Environmental taxes

The example uses the Beef and Lamb economic service:

- Sheep and beef farm survey results for 2008 to 2018 for North Island hard hill country east coast;
- Sheep and Beef on farm inflation 2016 – 2017;

This is publicly available information from the Beef and Lamb website.

The survey shows the following average profit before:

- Current income tax
- Drawings for the farming family to live on;
- Capital replacement costs in excess of depreciation

Beef + Lamb New Zealand Economic Service										**20-Mar-18**
Sheep and Beef Farm Survey - $ Per Farm Analysis										Notes tab
Class 3 N.I. Hard Hill Country - East Coast										
									Provisional	**Forecast**
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
Farm Profit before Tax	**50,221**	**20,630**	**159,960**	**256,125**	**69,419**	**142,903**	**168,697**	**85,476**	**112,700**	**185,300**

If we take into account those items missing from the cash flow we estimate it would look like this:

Beef + Lamb New Zealand Economic Service										**20-Mar-18**
Sheep and Beef Farm Survey - $ Per Farm Analysis										Notes tab
Class 3 N.I. Hard Hill Country - East Coast										
									Provisional	**Forecast**
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
Farm Profit before Tax	**50,221**	**20,630**	**159,960**	**256,125**	**69,419**	**142,903**	**168,697**	**85,476**	**112,700**	**185,300**
Less income tax @ 28%	14061.88	5776.4	44788.8	71715	19437.32	40012.84	47235.16	23933.28	31556	51884
Less living costs	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Less capital replacement @ 10%	30967.9	32730.7	32066.6	35405.1	37611.6	37666.1	33874.2	37601	37552.9	38609.9
Profit/loss available for servicing additional tax	-64,809	-87,877	13,105	79,005	-57,630	-4,776	17,588	-46,058	-26,409	24,806

Clearly there are many years under the current system where the average farm is going further into debt or delaying the replacement of capital items. Generally this has resulted in on-farm capital infrastructure such as buildings and fencing getting older and in dis-repair instead of increases in farm debt.

If we include an accrued capital gains tax based on 28% of gains in value of the capital value of the farm excluding homestead in the survey we get the following result:

Beef + Lamb New Zealand Economic Service										20-Mar-18
Sheep and Beef Farm Survey - $ Per Farm Analysis										Notes tab
Class 3 N.I. Hard Hill Country - East Coast										
									Provisional	Forecast
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Farm Profit before Tax	**50,221**	**20,630**	**159,960**	**256,125**	**69,419**	**142,903**	**168,697**	**85,476**	**112,700**	**185,300**
Less income tax @ 28%	14061.88	5776.4	44788.8	71715	19437.32	40012.84	47235.16	23933.28	31556	51884
Less living costs	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Less capital replacement @ 10%	30967.9	32730.7	32066.6	35405.1	37611.6	37666.1	33874.2	37601	37552.9	38609.9
Profit/loss available for servicing additional ta›	-64,809	-87,877	13,105	79,005	-57,630	-4,776	17,588	-46,058	-26,409	24,806
Accrued capital gains tax @ 28%*	0	0	39822.72	93031.68	96921.44	57927.24	0	150667.16	0	0
Profit/loss after land tax	-64,809	-87,877	-26,718	-14,027	-154,551	-62,703	17,588	-196,725	-26,409	24,806
* based on change in capital value (excl homestead)										

If we replace the capital gains tax with a land tax based on 1.5% of the capital value of the farms in the survey excluding the homestead we get the following result:

Beef + Lamb New Zealand Economic Service										20-Mar-18
Sheep and Beef Farm Survey - $ Per Farm Analysis										Notes tab
Class 3 N.I. Hard Hill Country - East Coast										
									Provisional	Forecast
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Farm Profit before Tax	**50,221**	**20,630**	**159,960**	**256,125**	**69,419**	**142,903**	**168,697**	**85,476**	**112,700**	**185,300**
Less income tax @ 28%	14061.88	5776.4	44788.8	71715	19437.32	40012.84	47235.16	23933.28	31556	51884
Less living costs	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Less capital replacement @ 10%	30967.9	32730.7	32066.6	35405.1	37611.6	37666.1	33874.2	37601	37552.9	38609.9
Profit/loss available for servicing additional ta›	-64,809	-87,877	13,105	79,005	-57,630	-4,776	17,588	-46,058	-26,409	24,806
Land tax @ 1.5% of capt value (excl home)	58,264	54,446	56,579	61,563	66,756	69,859	63,344	71,415	68,262	68,262
Profit/loss after land tax	-123,073	-142,323	-43,475	17,442	-124,385	-74,635	-45,756	-117,474	-94,671	-43,456

It is difficult to guess what form environmental taxes will take, be they inclusion of agriculture in the ETS, nutrient taxes, water taxes etc. However, the environmental effects are caused by livestock so as a proxy if we assume a 1% tax on livestock value in the survey we get the following result:

Beef + Lamb New Zealand Economic Service										20-Mar-18
Sheep and Beef Farm Survey - $ Per Farm Analysis										Notes tab
Class 3 N.I. Hard Hill Country - East Coast										
									Provisional	Forecast
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Farm Profit before Tax	**50,221**	**20,630**	**159,960**	**256,125**	**69,419**	**142,903**	**168,697**	**85,476**	**112,700**	**185,300**
Less income tax @ 28%	14061.88	5776.4	44788.8	71715	19437.32	40012.84	47235.16	23933.28	31556	51884
Less living costs	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Less capital replacement @ 10%	30967.9	32730.7	32066.6	35405.1	37611.6	37666.1	33874.2	37601	37552.9	38609.9
Profit/loss available for servicing additional tax	-64,809	-87,877	13,105	79,005	-57,630	-4,776	17,588	-46,058	-26,409	24,806
Environmental tax based on 1% of livestock value	8,548	8,935	11,300	13,233	9,874	10,822	10,090	10,749	12,415	13,096
Profit/loss after land tax	-73,357	-96,812	1,805	65,772	-67,503	-15,598	7,498	-56,808	-38,824	11,710

We have not modelled a capital gains tax on realisation without rollover relief but unquestionably the effect of that will be to encourage farmers to hold on to their farms when the best thing for the country as a whole would be to sell them. Examples would include:

- Discourage farmers from retiring and allowing the next generation with the energy and enthusiasm to work the farm;
- Prevent good farmers from selling existing farms to upscale;
- Stop bad farmers from selling the land and letting better farmers work it.

The interesting thing about all of these taxes is that because they are not an income tax they will impact those with the worst cash flow the most. If you look at the farm survey's these are the classes of farm that have the least environmental impact. The only way for these farmers to respond to these increased costs and continue farming is to intensify their farming activities. That is the only way for them to respond is to increase the impact on the environment which is the opposite of what we understand the Government wants.

This submission is prepared on behalf of the Chartered Accountants Australia and New Zealand rural advisory group. Any questions in relation to this submission can be directed to:

CHARLES RAU

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