

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

### **Release Document**

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### **Submission on the *Future of Tax Submissions* Background Paper**

#### **Introduction**

1. I welcome the opportunity to provide a submission to the Tax Working Group (“the Group”) in examining further improvements to the structure, fairness, and balance of the tax system.
2. The experience I draw upon in preparing this submission is a combination of qualifications such as a chartered accountancy; employment in private sector businesses of all sizes including: multinationals; public sector; local bodies; the NFP sector; as a SME business owner; medium sized employer; also a property developer and landlord. Countries I have lived and worked in are the UK, NZ and Australia. Countries I have worked but not lived in include France, Germany, Holland, Belgium, Switzerland and briefly, the USA and Poland. In the past I had a detailed knowledge of much of the UK tax system, including VAT, CGT and NI plus have exposure through my work to taxation in a number of European countries, the USA and Australia.
3. It was disappointing to note the composition of the Group lacked direct representation of some sectors that will nevertheless be affected by the outcomes. An example of this is the lack of representation of small and medium sized employers, the self-employed, the SME sector and the rural sector. The omission of these sectors is a common theme in policy making as is the lack of robust follow-up

up as to how these groups are affected after changes have been implemented. At a meeting at which the Minister was present, I mentioned this noting that broadening the composition of the working party should increase the credibility of the findings of the Group and reduce the occurrence of unforeseen adverse consequences.

4. It is noted that page 54 of the Background paper refers to the use of an independent advisor to “analyze ... and help distil the information to assist the Group”. This raises questions in the minds of those preparing submissions as to whether the content will be read in its entirety or will be selectively edited to remove statements the advisor considers not important.
5. As a general principle the timing of applying taxation should be when a gain is realised. Realised gains generate cash which also makes some cash available to pay tax; unrealised gains or assets based taxes do not. Taxation on unrealised gains or assets can create cash flow problems, force the sale of productive assets, inhibit business growth and create problems for trustees in meeting their responsibilities to act in the best interests of the beneficiaries of the trust.

### **Capital Gains Tax**

6. Disregarding the Bright Line Test for the purpose of this comparison, a person earning \$50,000 receives \$42,000.<sup>1</sup> A person earning \$50,000 from selling a revenue generating property, or business, receives \$50,000. To tax one of the \$50,000 and not the other is inequitable and unfair. Furthermore, the addition of CGT would further broaden NZs tax base.<sup>2</sup> See Appendix A for responses to the specific points on CGT in Appendix 2 of Background Paper - Design Issues with a CGT.

<sup>1</sup> Calculated using IRD Tax on Annual Income Calculator and rates for the YE 2018

<sup>2</sup> “The UK Government has announced that from April 2019, UK tax will be charged on gains [corporation tax or CGT] made by all categories of non-UK resident sellers on both direct and indirect disposals of UK real estate, extending existing more limited rules that apply only to residential property.” So any affected property will need to be rebased).

### **Land Tax**

7. Land tax is opposed as it bears no relationship to the ability to pay, only taxes one form of wealth, and singles out a particular productive tangible asset for taxation. If land is to be taxed then all tangible business assets used to generate income, such as buildings, plant and equipment should also be taxed. The principles of equity could also be used to argue that some intangible assets used to generate income should also be taxed, for example intellectual property.

### **Environmental Taxation**

8. I support the general principle that environmental costs should be borne by the business that is making the gain on the activity that is creating the negative impact on the environment. Equally where taxpayers are incurring costs that benefit the environment for the public good such as QE II covenants, the general principle should be that those expenses should be deductible.

### **Progressive company tax**

9. Progressive company tax with a rate for SMEs at 26% is not supported as it would add complexity and cost to the process, raise issues of definition, and would increase the incentive to direct time and energy into tax planning to minimise tax. Many SMEs are not companies but sole traders, partnerships or trusts. Look-through companies are treated for tax purposes as a partnership, or as sole traders if there is one shareholder. Of the ownership structures only SME companies would benefit which is inequitable and unfair.
10. I would however strongly support a more progressive tax regime but for personal income tax, with a top rate of 65%.

### **GST exemptions for particular goods**

11. New Zealand's approach is a good one. While it has resulted in a more regressive tax than in many other countries and there are periodically calls for GST to be removed

from healthy foods stuffs, sanitary items and so on, the regressive nature of GST could be offset by adjustments to other taxes, such as income tax including an amount of income, possibly only earned income, on which no tax is charged. New Zealand has wisely avoided the anomalies and complexity of administration that came from matters such as cakes are zero-rated (0% VAT charged) and biscuits are standard rated (20% VAT charged) also eating the food inside a café resulting in VAT but none if your took it away.

### **Relationship between Tax, Affordability of Housing and Effect on Retirement Savings**

12. Reduce the incentives to invest in housing by reducing the risk of other 'safe' investments such as deposits with banks by replacing the OBR with a bank deposit scheme and by requiring the Reserve Bank, and Government, to keep investors (depositors and shareholders) fully informed. Housing presents as a less risky investment as although housing can also fall in value, while this loss remains an unrealised loss and the property continues to generate a rental income stream, the investor is not disadvantaged. In addition the investor has some control over their income generating asset if it is a piece of property. Small investors have no control over the actions of either banks or fund managers. Refer Appendix B for a comparison of the bank deposit guarantees of New Zealand and other countries.
  
13. Other matters of serious concern with the OBR from a business perspective relate to access to business cash for matters such as payroll, taxes and paying business expenses. In the Government's concern to "reduce the pressure for Government to provide a bail out for a failed bank" it would appear that failed businesses, inability for unpaid employees to pay mortgages etc., is seen as mere collateral damage. Confidence in banking systems is important for business investment however it would be naive to be confident in the banking system in New Zealand. <sup>3</sup>

<sup>3</sup> Interesting to note support for the lack of confidence in being able to leave funds in NZ Banks from former BNZ chairman Kerry McDonald "giving the Reserve Bank both barrels for its hands-off, "naive" and "not fit for purpose" regulation of New Zealand banks, and for "consistently ignoring" the interests of bank customers"... "McDonald notes that New Zealand's big four banks - ANZ, ASB, BNZ and Westpac - are all Australian owned with parental representatives on the New Zealand

14. Reduce the attractiveness of housing as an investment by the introduction of CGT (except for the family home), and by requiring housing stock to be of an acceptable standard.
15. Increasing the attractiveness of other investments. For example the availability to small savers of Government national savings bonds with a guaranteed positive rate of interest on savings and a maximum holding per person.
16. As a general principle, tax retirement saving more lightly.

### **Deductibility of expenses for Salary and Wage Earners**

17. Attached as Appendix E is a copy of a paper from the Journal of the NZ Accountants Society dating from 2012. Since that time the line between work and home and where and with whom expenses fall, has blurred, plus changes in employment practices have increased the work related expenses now becoming a cost to the employee. The loss of the right for employees to deduct tax occurred over 30 years ago. In the interests of equity, fairness and of having a tax system that reflects the reality of New Zealand's work environment as it is today, it is time this was reviewed. This review should include whether there should be any deduction for child care costs and if the conclusion is that there should, at what level it should be capped.

### **Estate Duty.**

18. To a certain extent I depart from the 'no tax on unrealised gains' view with respect to estate duty and believe this should be further reviewed in conjunction with any proposed changes in other taxes such as CGT and individual tax rates. If a comprehensive CGT and higher top tax rates are not introduced than estate tax should be considered but not if the costs of collection are excessive and with

subsidiaries' boards. Additionally they organise/control many of the senior executive appointments, their systems and processes and policies, and most importantly influence how the New Zealand offshoots respond to a crisis". <https://www.interest.co.nz/business/91672/ex-bnz-chairman-kerry-mcdonald-lambasts-rbnzs-oversight-banks-being-unacceptably>

appropriate exemptions to avoid the burden of two lots of estate duty being incurred close together in the event of two deaths occurring within a relatively short time frame.

### **Taxation on Tobacco and Alcohol**

19. There is a role for taxes intended to modify behaviour however the regressive nature of these taxes needs to be balanced against their behaviour modifying role. Tobacco taxes are currently too high and are causing adverse social and economic consequences.

### **Gambling winnings**

20. These are realised gains and should be taxed. The tax should be deducted by the organisation paying out the winnings (Lotteries Board, Casino and so on) and the costs of setting up a system to gather and pay this tax should be also borne by the body organisation paying out the winnings .
21. It is inequitable and inconsistent to tax alcohol and tobacco but not gambling when the harm caused by gambling is well documented. Refer Appendix C for further information.

### **SMEs and Medium sized employers**

22. The lack of knowledge of the reality of SMEs, including SME employers, is evidenced in past tax policy decisions which both unfairly burden SMEs with taxation and require an inordinate amount of compliance. Recent changes as part of the tax simplification process and system changes should deliver considerable benefits to central Government in terms of tax administration savings, improved data collection and cash flow. However some of these changes while clearly beneficial for central Government as was their intent, for the SME business owner, have increased the workload. A simple example is Payday filing. An employer with a fortnightly payroll now has to file 26 times a year instead of 12. Another simple example if the inability

of SMEs to communicate with the IRD in a timely way via secure messaging in myIR. A response from the IRD can take two weeks or more. If the response is inadequate or raises additional questions, more weeks elapse before the taxpayer received the required information. However the responsibility and costs for any errors or delays falls on the taxpayer. In spite of the current inability to provide a timely response the IRD is understood to be cutting 1500 jobs. It is also understood that part of the reason for this reduction is because some analytical work will be undertaken by analytical software. This will raise more queries on SME accounts creating more work for SMEs which will further exacerbate the existing problem of not being able to communicate in a timely way with the IRD.

**Example 1: An example to illustrate the unfairness of applying large company business practices to SME businesses is FBT on company vehicles.**

23. The general assumption behind FBT is that the employee is provided with a vehicle of up to three years old, often leased. In this situation the use of the cost price or tax value is reasonable. However the reality for many SMEs (including shareholder employees) is they retain vehicles for many years<sup>4</sup> even to the end of their useful life of 20 plus years. Yet these businesses are burdened for much of the life of that vehicle with a tax that assumes a new or nearly new vehicle. This is neither equitable or fair thus breaches the second of the principles of a good tax system.
  
24. While after five years of its inclusion in a FBT return there is some recognition of loss of benefit when the vehicle ages by allowing a minimum tax value, this value - based on an assumption of a vehicle purchased from new - is too high for what may be a very old vehicle. The current minimum value at five years be further reduced for older vehicles and be based on the age of the car.



**Example two: 50% non-deductibility of some entertainment rule**

25. An example that illustrates the inappropriateness of applying large company business practices to SME employers, plus is unfair, inequitable, inefficient, illogical in itself, and departs from the principles of low tax compliance costs, is the 50% non-deductibility of some entertainment rule. Refer Appendix C for two examples of the inequitable treatment of SME employers.

**Conclusion**

26. I thank the Group for the opportunity to submit on this Paper. I would greatly appreciate the option to appear before the Group in support of this submission. Please contact me on [1] if you wish to discuss any part of this submission or to obtain more background information on any of the points raised.

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[1]

## **Appendix A – Design issues with Capital Gains Tax**

If you think the Group should design a capital gains tax (CGT) for Government consideration, we need your feedback now on a number of detailed design issues:

- a) Should the CGT be a separate tax or part of the income tax? Most countries tax capital gains as part of the income tax. *Income tax*
- b) Should capital gains be taxed on an accrual basis or only when realised (i.e. only when the asset is sold)? *Only when realised*. Most countries tax on a realisation basis. How should matrimonial property settlements and disposal of assets on death be treated? *Technically should be taxed if realised however consideration could be given to related party relief*.
- c) What assets should be covered given that the terms of reference exclude any tax on the family home? Should it include just rental properties, shares, collectibles, private assets such as cars? *Shares and sale of a business should be taxed, these are revenue generating assets. Collectibles -prima facie suspect the cost and complexity of tax calculation and collection would make a tax on collectibles not worthwhile. Plus would need to consider intention - is there intent to make a gain or is the collection essentially for private purposes. Private assets such as cars should not be taxed (unless part of a collection in the event that collections acquired for the purpose of making a gain, become taxable)*
- d) Should assets held by KiwiSaver and other savings schemes be taxed? *New Zealand is TTE, most developed countries are EET. Why New Zealand is different should be reviewed as prima facie it is hard to see how TTE is advantageous to most New Zealanders*.
- e) Should assets held offshore be subject to tax? *Yes*<sup>5</sup>
- f) How would a capital gains tax integrate with current tax laws, such as when land sales are already taxable, our company imputation system and our CFC/FDR rules? *Too complex an issue for me to answer here in the time available*.

<sup>5</sup> “The UK Government has announced that from April 2019, UK tax will be charged on gains [corporation tax or CGT] made by all categories of non-UK resident sellers on both direct and indirect disposals of UK real estate, extending existing more limited rules that apply only to residential property.” So any affected property will need to be rebased

- g) When should non-residents be subject to tax? *In most cases on realisation of gains. (There may be occasions when a wealth tax is appropriate).*
- h) Should capital losses be ring-fenced to be offset only against capital gains income or should they be offset against any income? If capital gains are taxed on a realisation basis tax base maintenance considerations suggest that capital losses should be ring-fenced. *Should be able to be offset against other income, would be inequitable otherwise. Is galling enough to lose on the sale of a business asset (including property) without the added fiscal burden of not being able to deduct the loss for tax. There may be no other capital to offset the loss against hence a small investor, single rental property owner or business owner would never be able to claim their losses whereas those for example with multiple rental properties would eventually make a gain and be able to use their losses. Again this would favour large organisations over SMEs and small investors.*
- i) Should there be roll-over relief allowing capital gains re-invested in similar assets to be treated as unrealised? If so, when should roll-over relief apply? For example, should a farmer selling a farm and buying a new farm be taxed on the increase in value of the old farm? *Depends on the assets. Too complex an issue for me to answer here in the time available.*
- j) How should death, emigration and immigration be handled? *Too complex an issue for me to answer here in the time available.*
- k) How should gifts and gambling winnings be taxed? *As income tax, could consider a special lump sum rate for a lump sum win over a certain amount.*
- l) What should the rate of tax on tax on capital gains be – the normal income tax rates, or some other rate(s)? *Normal tax rates. Could consider amount per annum an income equalisation approach for gains over a certain amount e.g. on the sale on retirement of a business of farm. The amount would need to be high enough to exclude gains from the sale of a single residential property.*
- m) Should any allowance be given for inflation in calculating capital gains? *Yes. Taxation should be on the real gain. The use of an existing index makes this considerably less complicated than many other tax matters.*

- n) Should there be a de minimis rule? *Don't believe this is necessary if CGT is part of income tax.*
- o) What administrative implications would there be from a capital gains tax? *Too complex an issue for me to answer here in the time available.*
- p) What rules should govern the transition into a capital gains tax? The options seem to be cost of the assets (retrospective taxation of past accrued gains), valuation at date of introduction or only assets acquired post introduction (the Australian rule). *Not the Australian rule as is neither equitable nor fair. Any gains made prior to the introduction of CGT would be locked out of being taxed if the base rate was valuation at date of introduction so existing asset holders would not be disadvantaged other than having to have a valuation done (which could be a deductible expense). Valuations are commonly done for other reasons, sale of a business, a Trust requiring an asset etc.*
- q) How should family trusts be integrated into the system? *Too complex an issue for me to answer here in the time available.*

**Appendix B – Bank Deposit Guarantees, New Zealand compared to other countries**

<p><b>U.S.A.</b>  <i>US\$250,000</i>  <i>(NZ\$346,000)</i></p>
<p><b>Canada</b>  C\$100,000  <i>(NZ\$107,000)</i></p>
<p><b>France</b>  € 100,000  <i>(NZ\$170,000)</i></p>
<p><b>U.K.</b>  £85,000  <i>(NZ\$165,000)</i></p>
<p><b>Germany</b>  €100,000  <i>(NZ\$170,000)</i></p>
<p><b>Norway</b>  NOK2,000,000  <i>(NZ\$353,000)</i></p>
<p><b>Australia</b>  A\$250,000  <i>(NZ\$265,000)</i></p>
<p><b>New Zealand \$0</b></p>

**Appendix C: Nine facts about gambling**<sup>6</sup>

- a. Every day New Zealanders lose \$5.5 million on gambling. That is around \$2 billion each year. Half of this, around \$1 billion, is lost on pokie machines.
- b. It is estimated that approximately 54,000 people in New Zealand are gambling at pretty harmful levels. In addition, almost 110,000 people are also experiencing some low levels of harm and would be potentially at risk of further problems in the future.
- c. New Zealand has more than 18,000 non-casino pokie machines, each of which take in an average of \$125 each day.
- d. The 2006/07 New Zealand Health Survey reports that almost 3% of adults (87,000) had experienced problems due to someone's gambling in the previous 12 months.
- e. It is estimated that between five and 10 people are negatively affected by the behaviour of a serious problem gambler.
- f. One in five New Zealanders feel that someone close to them has had a day or occasion in the past 12 months in which they've spent too much time or money on gambling.
- g. Māori and Pacific adults are more than three and a half times more likely than adults in the total population to be problem gamblers.
- h. Two out of five regular pokie players is likely to have a gambling problem.
- i. The social costs of gambling are out of proportion to the numbers of problem gamblers. Gamblers may commit crimes to finance their gambling, causing harm to their victims and their families as well as themselves, and incurring costs in the criminal justice sector.

<sup>6</sup> <https://www.hpa.org.nz/what-we-do/minimising-gambling-harm>, accessed 26 April 2018

**Appendix D: The 50% non-deductibility of business expenditure by categorising it as entertainment**

***Example One: Staff functions***

IR268 says “The following types of entertainment include a private element and can't be 100% deducted. In general, an entertainment away from work or out of usual work hours has a private element.... Offsite food and drink - Food and drink provided away from your business premises is only 50% deductible”

**Issue: Site of staff function**

1. An increasing number of SME businesses including employers do not have work premises in the traditional or large employer, sense of the word. Cloud based systems, home based offices, staff who work on clients sites or from their own homes have all combined to increasingly create an environment in which there is no “place of work” at which the employer can have a function for their staff.
2. There is no reasonable logic in any event of the location of a staff function being a determinant of whether a staff functions has a private element.
3. There is no reasonable logic in allowing businesses with premises to fully deduct the cost of light refreshments for staff at a function whereas those without premises cannot.

**Issue: “out of usual work hours”**

1. What are “usual work hours” for a SME? Does “usual work hours” include the evenings and weekends spent stocking shelves, dealing with email queries, taxation matters, payroll preparation, filling web generated orders, communicating with overseas suppliers and customers in different time zones, supporting customers through your helpdesk, and writing submissions to Select Committees and tax working groups? The reality for many SMEs is that there are very few hours that are not “usual working hours”.
2. If a business’s revenue is generated, for example, by chargeable staff time on client sites Monday to Saturday then it may not be possible to hold staff functions at any time other than Sundays or possibly Monday to Saturday evenings. There is no

reasonable logic in the nature of the business, being the determinant of whether a staff function has a private element.

3. There is no private element for a SME owner in hosting, organizing and attending staff functions. Such events are an important part of being a good employer and are business activities. Private activities are time spent with family and friends, pursuing personal interests such as sport or music, reading and so on, things that SME owners have little time for. To not be able to deduct 100% of a business cost because of some flawed logic and understanding about the reality of being a SME employer is risible.

***Example Two: Deductibility of food and drink at a conference or education course.***

IR268 says “ You can deduct 100% of the food and drink you provide at a conference, education course or similar event that lasts for four consecutive hours or more (not counting meal breaks).”

Using education and training as the example this thinking appears to have been based on the assumption of a large employer with a course not involving significant travel and who can take staff off the job in traditional working hours, say between 8 and 5.30.

**Issue: travel.**

Where staff have to travel one or two hours each way to attend a course then the combination of travel time and course is a full day. The course itself spans the lunchtime and it is unreasonable that a business who has staff at dispersed geographical locations cannot claim 100% of food and drink provided simply because the actual training time itself is under four hours

**Issue : timing of training.**

SME employers are more likely to run courses and training in the evenings, for example, from six to eight or nine p.m. maybe over a couple of weeks. Providing some food and drink for staff arriving straight from their place of work is appropriate and reasonable, 100% business and should be fully deductible