Tax Working Group Public Submissions Information Release

Release Document

September 2018

taxworkinggroup.govt.nz/key-documents

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

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

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

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

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

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

Infrastructure
New Zealand

Crombie Lockwood Tower
Level 16, 191 Queen Street
PO Box 7244
Wellesley Street
Auckland 1141
New Zealand

Phone: +64 9 377 5570
Email: info@infrastructure.org.nz

30 April 2018

Auckland Council
Tax Working Group Secretariat
PO Box 3724
Wellington 6140
New Zealand

Per email: submissions@taxworkinggroup.govt.nz

Infrastructure New Zealand is the peak industry body for the infrastructure sector and promotes best practice in national infrastructure development through research, advocacy and public and private sector collaboration. Infrastructure New Zealand members come from diverse sectors across New Zealand and include infrastructure service providers, investors and operators.

This submission represents the views of Infrastructure New Zealand as a collective whole and may not necessarily represent the views of individual member organisations.

Infrastructure New Zealand submission to the Tax Working Group on the future of tax

Infrastructure New Zealand supports the review of New Zealand's tax system and commends the Working Group on the development of the discussion paper.

In our view, there are four "macro" questions to consider when reviewing the tax system:

1. Who pays the tax?
2. How much do they pay?
3. Where does the tax go?
4. Who allocates the tax revenue?

The Working group has discussed in some detail the first three questions, but we think needs to give greater consideration the fourth.

Both tax payers and tax spenders are incentivised by taxation policy

It is not just tax payers who are incentivised by different tax structures, it is also the administering bodies.

Central government, which is majority funded by taxes tied to economic performance, has different incentives than local government, whose funding is tied to capped property rates which are guaranteed regardless of economic performance.

Central government is incentivised to want, invest in and proactively pursue economic growth. Local government, is much more focused on cost minimisation.

Further, not all taxes are equal. Some taxes are gathered at the point of value creation, while others are gathered retrospectively from individuals and businesses.

Income tax on wages and salaries, for example, tends to be levied before payments are made to workers.

In contrast, local government rates are paid out of a home-owner's after-tax income.

To pay income tax, a worker does nothing. The money is redirected before the salary or wage is deposited into the worker's account and, other than in the unusual instance of a tax rate increase, the impact on the worker's income, earnings or wealth is unnoticeable.

To pay a rates levy, a home-owning worker must actively transfer money from their own savings account to their local council. Each payment "hurts" and every increase takes more money away from a voter which they in most cases considered rightfully theirs.

The combination of guaranteed revenue not tied to economic performance and heavily politicised taxation practices is shaping local government priorities in ways which are having severely negative impacts on New Zealand.

Most notably, the reluctance of councils to invest in infrastructure to support new housing and development and zone land sufficient to promote competitive urban land markets is the driving force behind housing unaffordability and undersupply.

A much more efficient, fair and effective taxation system needs to reallocate funding from economic performance taxes – GST, income and/or corporate tax – to local government to align councils' priorities with wider society and central government.

Whether councils are granted a share of GST, income or corporate tax, or given some scope to levy additional GST, income or corporate tax, is something that needs to be given a high level of consideration.

As long as councils have a guaranteed funding source, independent of council performance and central government direction, councils cannot be expected to act in manner which promotes wider societal objectives.

Infrastructure New Zealand

Rates and land taxes

The Discussion Document highlights an issue with the taxation of property. Most notably, Working Group evidence suggests that capital and, in particular, property is taxed comparatively little in New Zealand.

The greater part of this issue can be remedied simply, efficiently and fairly by resolving the obvious inconsistency in the way that land is taxed in New Zealand.

Unlike GST, income and corporate tax, increases in land value are for all intents and purposes not taxed in New Zealand.

Rates are charged based on a series of inputs, reflecting among other things land values. However, rates are not "ad valorem" (i.e. levied in proportion to a property's land or capital value), they are capped and reflect relative rather than absolute value.

Thus, in a city like Auckland which has seen very rapid increases in land value, rates for many residents have at times fallen in spite of land value increases because their property values have increased more slowly than others.

The complex and inconsistent way that property is taxed does have advantages, including insulating councils and residents from fluctuations in property values.

But to continue to limit the exposure of the wealthiest New Zealanders and by far the largest asset class in the country to what strongly appears to be their "fair share" of the tax burden is not only questionable from an equity perspective, it is having a deleterious effect on urban growth policies.

New Zealand's rates approach is a material factor in the housing crisis

Land use regulations, including urban boundaries to prevent urban expansion and height restrictions to limit densification, are designed to protect the interests of established residents either by controlling the speed of change in local areas or by limiting the exposure of existing residents to the costs of new infrastructure.

Land use regulation also restricts the supply of urban land, increases the cost of development and slows the supply of housing.[1]

Greater land use regulation therefore benefits existing property owners by protecting local areas and amenity from change, limiting new rates-funded capital investment <u>and</u> inflating capital values by restricting the supply of new housing (thereby increasing relative demand).

Rate (and also weak capital gains policies) should act as a counterweight by increasing the revenue to councils from rising property values caused by restrictive land use policies, but under current settings do not.

[1] Productivity Commission, *Housing Affordability*, April 2012.

Capped rates protect established residents from rising land taxes, even while their wealth expands, and provide no additional revenue to councils to address the negative externalities of restrictive land use regulation.

Under an ad valorem land tax approach, land use restrictions which slow the speed of housing and push up land values would come with three major consequences.

First, land value increases would be met with a proportionate increase in council/government revenue to address emerging needs, such as demand for subsidised housing.

Second, established residents would "feel" the impact of land use policies which constrain development by way of rapidly increasing "rates".

Third, higher and more rapidly changing "rates" would improve the price signals sent to land owners about the true value of their land.

These consequences would, in our view, provide some balance to urban land use policies which at the moment are strongly in favour of existing residents over future residents.

Furthermore, readily accessible evidence from the Auckland Council and others indicates that property owners are much more likely to engage in local body elections.

This has given rise to what the Productivity Commission has labelled a "democratic deficit"[2], whereby the interests of established voting residents has been reinforced in policies promoted by politicians striving for election.

We acknowledge that residents can be "capital rich" and "cash poor", making it significantly more complex politically to gather a pure land tax than a capped rate.

However, councils already have in place policies which allow particularly older residents on fixed incomes to defer rates payments until a home is sold.

This policy can be expanded so that those benefitting from increases in wealth can in part be insulated from the most significant impacts of this benefit, while still paying a tax rate which reflects their benefit.

Another advantage of land tax is that it operates as a much more accurate "value capture" tool, potentially removing the need for expansion of this theoretically attractive, but in practice complex, concept.

We highlight the work of Infrastructure Australia in their investigation of value capture.[3]

After significant analysis, Infrastructure Australia determined that the fairest, most efficient and effective way to capture land value improvement was as simple as a broad-based land tax.

[2] Productivity Commission, *Using Land for Housing*, September 2015.
[3] Infrastructure Australia, *Capturing Value: Advice on Making Value Capture Work in Australia*, December 2016.

A tax swap

Concerns that, with an ad valorem land tax in place, councils could be exposed to severe reductions in revenue if property prices fall could be mitigated by a "tax swap" with central government.

If central government was to receive a share of land taxes, most notably the variable component reflecting the value of overall property/land, and local councils a share of GST, income and/or corporate taxes, concerns about council financial resilience could be mitigated.

Although councils would be exposed to some risk via their share of local GST, income and/or corporate tax, the broader tax base would offset some of this risk.

More importantly, councils would have incentives realigned with wider societal objectives and central government would receive a share of the benefit from major Government decisions.

If a portion of local government revenue was tied to the value created by council activities, local government would be incentivised "go for growth", effecting a culture shift inside many councils challenged by high costs and limited revenue.

Central government and, to the extent it is exposed, local government would, meanwhile, see a direct benefit from activities which add value to land.

Major city shaping infrastructure like the City Rail Link, light rail or an eventual Weymouth crossing which unlock vast tracts of land for development would be much more likely to achieve cross-government support.

Infrastructure NZ encourages the Working Group to look closely at who gets what type of tax and whether changes to the allocation of different taxes could achieve better alignment of government generally with public outcomes.

We consider analysis of whether local government in its current form is capable of managing more complex funding systems should comprise part of this work.

Revenue bonds

A further taxation tool we consider should be given consideration by the Working Group are directly elected taxes tied to defined projects or initiatives.

Under this approach, councils could ask the electorate for support to raise debt to finance an investment as well as to levy the tax to pay off the debt over the long term.

Such tools are commonplace in the United States, where they are most commonly implemented as revenue bonds.

The principal advantage of this approach is that, while the debt sits on an organisation's consolidated balance sheet, with appropriate ringfencing of the obligation and future tax revenue, ratings agencies permit a much higher degree of leverage.

Both sales and land tax revenues are used in the US to repay bond issuances for major public projects. A 1 percent sales tax increase, for example, was supported by the greater Dallas electorate as a means to rolling out a rapid transit system.

An attractive outcome from wider use of this type of project finance in the US is some apparent depoliticisation of investments; rather that contesting projects through elections, direct votes are held helping to separate parties from projects.

We encourage the Working Group to investigate revenue bonds and whether there are barriers to their adoption here.

Road pricing and water metering

Finally, we support the wider application of direct user charges, most notably road pricing and water metering.

Traditionally, water and transport investment has been managed by councils and government agencies because charging and use for the assets has been difficult to oversee.

Technology has radically broken down the barriers to accurate and equitable charging for "public" services.

We consider that water charging should be disaggregated from local body rates and water use metered.

Charging for the operation of water assets based on consumption has been proven to lower total water demand and the presence of a revenue stream to repay debt means public water companies can be separated from council balance sheets.

This will enable water companies to borrow more heavily to invest in services, opening more land for development and promoting the government's objective of competitive urban land markets.

The technology is now available to charge all vehicles using public roads by total trip length, location and time of day.

Further, prices for using roads can be raised and lowered to reflect road scarcity, i.e. higher charges can be applied at busy times and lower charges at less busy times.

This approach is much more efficient than existing road user charges and fuel excise and is inevitable given the shift already underway to electric vehicles.

We encourage, however, the Working Group to investigate the monopoly risks of the state determining road pricing levels.

While we are strong proponents of road pricing, we observe a clear risk that suboptimal implementation could lead to an inefficient tax on travel.

That is, the objective of transport policy is always to facilitate and enable travel. Travel is essential to economic, social and political integration and any charge which exceeds the actual cost of providing services is impeding the most fundamental societal outcomes.

If other objectives prevail, for example, congestion reduction or moving trips to public transport, road users will be charged a price which overestimates the cost of their decisions, disincentivising travel.

In order for road pricing to be efficient, fair and supportive of broad societal outcomes, the revenue generated by road charges must be fully hypothecated to the people who pay the charges.

That is, revenue must be injected into maintaining existing roads, expanding capacity where revenue exceeds the cost of improvements or into alternatives which benefit the users paying the road charges (for example, a public transport solution where the contribution of road charges is proportionate to the number of vehicles taken off the road).

We consider it important that the Working Group investigate the fundamentals of fair, efficient and equitable road pricing policy as this initiative is now being worked through inside government.

We thank the Working Group for this opportunity to provide feedback.