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Government Relations Strategy

New Zealand's Tax Working Group releases final report
February 2019

On February 21, 2019, the Tax Working Group released its final report to the New Zealand Government. The report recommends a Capital Gains Tax along with a suite of other changes to the country's tax system.

The Tax Working Group was set up by the Ardern Government following its election in 2017, with a mandate to review the tax system and provide recommendations to the Government to improve the fairness, balance and structure of the tax system over the next 10 years.

Specifically, the Government was interested in recommendations on a Capital Gains Tax, which has been a highly controversial issue in New Zealand politics over many election cycles.

The Labour Party, which relies on the Greens and NZ First to govern, supports a Capital Gains Tax as a way to reduce New Zealand's wealth inequality, particularly with regard to the residential housing market, and as a way to encourage investment into the productive sector.

The Tax Working Group is chaired by former Labour Finance Minister Sir Michael Cullen and includes representatives from business, academia, unions, Māori and the tax community.

The final report is broken into two documents; Future of Tax: Recommendations and Future of Tax: Design Details of the Proposed Extension of Capital Gains Taxation.

Timeline

The Government's full response to the report is expected in April 2019.

For now the Government has stated it will hold detailed discussions with officials and consultation between Government parties.

It is the Government's intention to pass any legislation to implement any policy changes arising from the report before the end of the Parliamentary term.

No policy measures would come into force until 1 April 2021 – giving people the chance to vote on any decisions made by the Government before they take effect.

This means the Government's response to the report – particularly the controversial Capital Gains Tax proposal – is likely to be a major issue during the 2020 general election campaign.

Government response

Finance Minister Grant Robertson and Revenue Minister Stuart Nash welcomed the report but were very clear that the Government would be selective in what it chooses to adopt.

Both Ministers said it was highly unlikely all recommendations will need to be implemented.

Ministers also said the Government's response to the report would be measured. Nash stated: "Our response will preserve the key principles of our existing broad-based low-rate tax system. In the words of the Prime Minister, we will not throw the baby out with the bathwater."

Key Government support party New Zealand First has previously opposed a Capital Gains Tax. Regional Economic Development Minister and NZ First MP Shane Jones was relatively muted in his response to the report, however he stated he would be studying the potential impact on regional New Zealand, particularly farmers and industry.

Opposition view

Simon Bridges, Leader for the opposition National Party, said in response to the announcement: "The Tax Working Group has gone much further than a Capital Gains Tax with a raft of new taxes targeting hard-working New Zealanders." Bridges described the report as an "assault on the Kiwi way of life" and said he would "fight it every step of the way".

Key recommendations

Capital Gains Tax

What to tax

The Group recommends:

- A Capital Gains Tax should include:
  - Gains and most losses from all types of land and improvements (except the family home)
  - Shares
  - Intangible property
  - Business assets

- A Capital Gains Tax should not include:
  - Personal-use assets such as cars, boats or other household durables
  - Capital gains tax on the family home

- Some types of transactions relating to collectively-owned Māori assets merit specific treatment in light of their distinct context.

- Existing rules continue to apply to foreign shares that are currently taxed under the fair dividend rate method of taxation, as well as anything taxed under the financial arrangement rules.

When to tax

The Group recommends:

- Tax should be imposed on a realisation basis in most cases

- The tax should not be retrospective, applying only on capital gains made after a proposed 'valuation day' once the tax has come into force.

- There should be rollover treatment for certain life events (such as death and relationship separations), business reorganisations and small business reinvestment.

How to tax

The Group recommends:

- Capital gains should be taxed within the current income tax system and taxed at a person's marginal rates.

- No discount for capital gains and no adjustment for inflation.

- Capital losses be ring-fenced for: portfolio investments in listed shares (other than when they are trading stock); associated party transactions; and losses from Valuation Day assets.

- Capital losses on privately used land be denied entirely.

- Capital losses (other than those described in the two recommendations above) be treated in the same way as other tax losses and taxpayers should generally be able to offset losses arising from the disposal of capital assets against ordinary taxable income.

Offsetting measures

- The Tax Working Group provides four broadly revenue-neutral packages to offset the increased revenue from a CGT. These packages include the following options:
  - Increased progressivity through reductions in personal income tax.
  - Greater focus on measures to support businesses and housing affordability.
  - Greater focus on supporting savers, particularly those on lower incomes.
  - A more diversified focus, where business tax measures are deferred to enable greater savings measures.

Digital services tax

As expected following the Government's announcement earlier this week that it would be consulting on a Digital Services Tax, the Group repeated its recommendation from the interim report that the Government should stand ready to do so if a critical mass of other countries move in that direction.

The Group notes that since the interim report a number of countries – including France and the United Kingdom – have announced their intention to pursue a digital services tax, and that Australia also recently released a discussion paper on the digital economy and the future of Australia's corporate tax system.

The Group also noted the Government would need to be reasonably certain New Zealand's export industries will not be materially impacted by any retaliatory measures.

Read Hawker Britton's paper on New Zealand's Digital Services Tax proposal.

Business taxes

The Group recommends that the Government:

- Retain the imputation system.
- Not reduce the company tax rate at the present time. However, the Government should continue to monitor developments in company tax rates around the world, particularly in Australia.
- Not introduce a progressive company tax.
- Not introduce an alternative basis of taxation for smaller businesses, such as cashflow or turnover taxes.
- Retain the 17.5% rate for Māori authorities.
- Extend the 17.5% rate to the subsidiaries of Māori authorities.
- Consider technical refinements to the Māori authority rules, as suggested by submitters, in the Tax Policy Work Programme.
- Change the loss-continuity rules to support the growth of innovative start-up firms.
- Reform the treatment of black-hole expenditure, with:

- a new rule to recognise deductions for expenditure incurred by businesses that is not otherwise dealt with under the Income Tax Act 2007, including in respect of abandoned assets and projects.
  - a clawback of tax deductions where an abandoned asset or project is subsequently restored, such that those deductions would be capitalised.
  - the spreading of black-hole expenditure over five years.
  - a safe-harbour threshold of $10,000 to allow upfront deductions for low levels of feasibility expenditure.
- Subject to fiscal constraints, consider restoring depreciation deductions for buildings if there is an extension of the taxation of capital gains. To manage the fiscal costs, the Government could reinstate building depreciation on a partial basis for:
  - seismic strengthening only
  - multi-unit residential buildings
  - industrial, commercial and multi-unit residential buildings.
- Consider tax measures that encourage building to higher environmental standards.
- Consider developing a regime that encourages investment into nationally-significant infrastructure projects.
- Give favourable consideration to exempting the New Zealand Superannuation Fund from New Zealand tax obligations.

The Group recommends the Government examine the following options to reduce compliance costs:

- For immediate action:
  - Increase the threshold for provisional tax from $2,500 to $5,000 of residual income tax.
  - Increase the closing stock adjustment from $10,000 to $20,000-$30,000.
  - Increase the $10,000 automatic deduction for legal fees and potentially expand the automatic deduction to other types of professional fees.
  - Reduce the number of depreciation rates and simplify the process for using default rates.

- Subject to fiscal constraints:
  - Simplify the fringe benefit tax and simplify (or even remove) the entertainment adjustment.
  - Remove resident withholding tax on close company-related party interest and dividend payments, subject to integrity concerns.
  - Remove the requirement for taxpayers to seek the approval of the Commissioner of Inland Revenue to issue GST Buyer Created Tax Invoices.
  - Allow special rate certificates and certificates of exemption to be granted retrospectively.

- Increase the period of validity for a certificate of exemption or special rate certificate.
- Remove the requirement to file a change of imputation ratio notice with Inland Revenue.
- Extend the threshold of 'cash basis person' in the financial arrangement rules, which would better allow for the current levels of personal debt.
- Increase the threshold for not requiring a GST change-of-use adjustment.

- The Government should also review and explore the following opportunities:
  - Adjust the thresholds for unexpired expenditure and for the write off of low-value assets.
  - Help small businesses reduce compliance costs through the use of cloud-based accounting software.
  - Consider compensation for withholding agents if additional withholding tax obligations are imposed.
  - Review the taxation of non-resident employees.
  - Review whether the rules for hybrid mismatches should apply to small businesses or simple business transactions.

Environment and ecological taxes

The Group recommends the Government tax negative environmental externalities.

Greenhouse gases

The Group recommends:

- A reformed Emissions Trading Scheme (ETS) remaining the centrepiece of New Zealand’s emissions reduction efforts but recommends it be made more ‘tax-like’ – specifically, by providing greater guidance on price and auctioning emissions units to raise revenue (as recommended by the Productivity Commission).
- Periodic review of the ETS to ensure it is fit for purpose and is the best mechanism for pricing greenhouse gas emissions.
- All emissions should face a price, including from agriculture, either through the ETS or a complementary system.

Water

The Group recommends:

- Greater use of tax instruments to address water pollution and water abstraction challenges if Māori rights and interests can be addressed.

- Further development of tools and capabilities to estimate diffuse water pollution to enable more accurate and effective water pollution tax instruments.
- Introducing input-based tax instruments, including on fertiliser, if significant progress is not made in the near term on implementing output-based pricing measures or other regulatory measures.

Solid waste

The Group:

- Supports the Ministry for the Environment's review of the rate and coverage of the Waste Disposal Levy.
- Supports expanding the coverage of the Waste Disposal Levy.
- Recommends a reassessment of the negative externalities associated with landfill disposal in New Zealand to ascertain if a higher levy rate is appropriate.
- Recommends a review of hypothecation arrangements of the Waste Disposal Levy to ensure funds are being used in the most effective way to move towards a more circular economy.

Environment

The Group recommends:

- Some or all environmental tax revenue should be used to help fund a transition to a more sustainable, circular economy.
- Consideration over the longer term of new tools, like an environmental footprint tax, or a natural capital enhancement tax.

Transport

The Group:

- Supports current reviews by the Government and Auckland Council into introducing congestion pricing.
- Recommends that the Government consider allowing employers to subsidise public transport use by employees without incurring fringe benefit tax.

Retirement savings

The Group:

- Recommends that the Government, depending on its priorities, consider encouraging the savings of low-income earners by carrying out one or more of the following:
    - Refunding the employer's superannuation contribution tax (ESCT) for KiwiSaver members earning up to $48,000 per annum. This refund would be clawed back for KiwiSaver members earning more than $48,000 per annum, such that members earning over $70,000 would receive no benefit.
    - Ensuring that a KiwiSaver member on parental leave would receive the maximum member tax credit regardless of their level of contributions.
    - Increasing the member tax credit from $0.50 per $1 of contribution to $0.75 per $1 of contribution. The contribution cap should remain unchanged.
    - Reducing the lower portfolio investment entity (PIE) rates for KiwiSaver funds (10.5% and 17.5%) by five percentage points each.
    - Recommends that the Government consider ways to simplify the determination of the PIE rates (which would apply to KiwiSaver).

Personal income tax

The Group notes that recommendations on personal income tax are dependent on the objectives of the Government. The report outlines potential options for the Government depending on its objectives, but does not make any concrete recommendations in this area.

The option of a higher marginal top income tax bracket is precluded by the Group's terms of reference.

Future of work

The Group recommends that the Government:

- Support Inland Revenue's efforts to increase the compliance of the self-employed, particularly expanding the use of withholding tax as far as practicable, including to platform providers, such as ride-sharing companies.

- Support the facilitation of technology platforms to assist the self-employed meet their tax obligations through the use of 'smart accounts' or other technology-based solutions.

- Continue (through Inland Revenue's current work) to use data analytics and matching information for specific taxpayers to identify under-reporting of income.

- Review the current GST requirements for contractors who are akin to employees.

- Align the definitions of employee and dependent contractors for tax and employment purposes.

- Provide more support for childcare costs, though the Group considers this support is best provided outside of the tax system.

Corrective taxes

The Group recommends the Government:

- Develop of a framework for deciding when to apply corrective taxes (similar to the framework developed by the Group for the use of environmental taxes).

- Review the rate structure of alcohol excise with the intention of rationalising and simplifying it.

- Prioritise other measures to help people stop smoking before considering further large increases in the tobacco excise rate beyond the increases currently scheduled.

- Develop a clearer articulation of its goals regarding sugar consumption and gambling activity.

Housing

The Group:

- Recommends that the Productivity Commission inquiry into local government financing considers a tax on vacant residential land.

- Considers that residential vacant land taxes would be best levied as local taxes rather than a national tax.

- Recommends that the 'ten-year rule' which taxes a gain from the sale of property where the property has increased in value due to changes in land use regulation be repealed.

- Recommends that disclosure of the purchaser's IRD number on the Land Transfer Tax Statement should be required when purchasing a main home.

Other tax issues

- The Group recommends a suite of changes to ensure the integrity of the tax system, improve the administration of the tax system and its treatment of charities. These are available in the report.

- The Group does not recommend a reduction in the rate of GST.

- The Group does not recommend a land tax or a wealth tax.

Further information

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