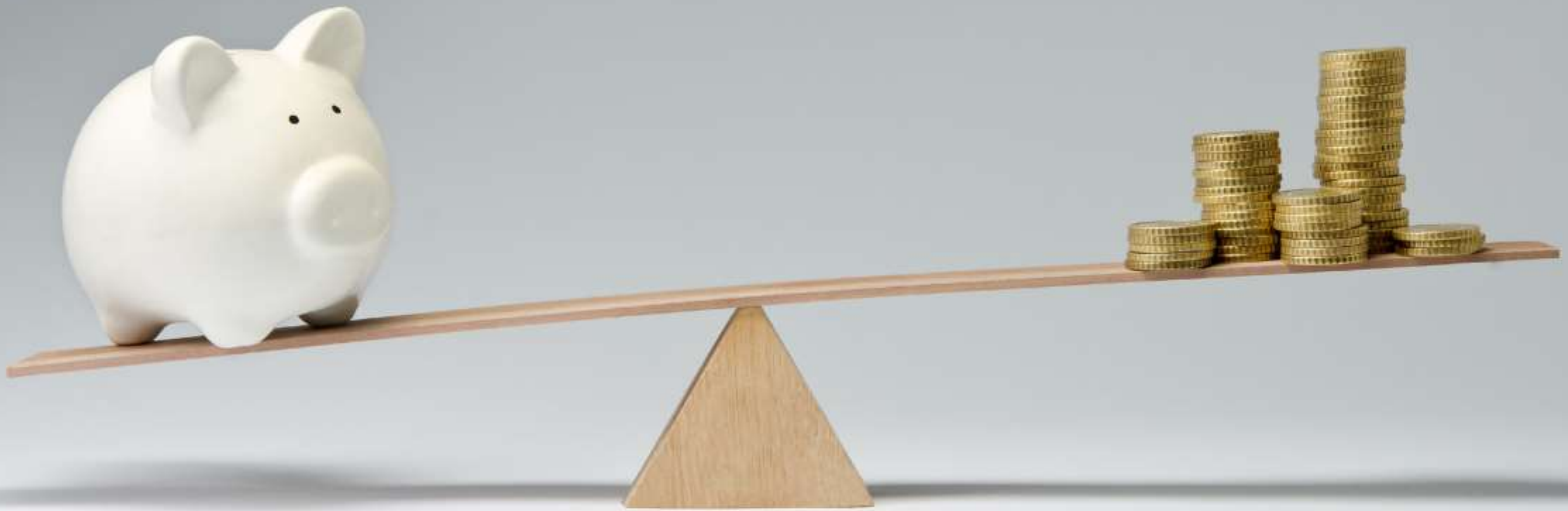
THE FUTURE OF TAX

Insight from the Tax Working Group



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Tax Working Group

FSC update

Geof Nightingale
10 October 2018

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TWG has to report on

- Whether the tax system **operates fairly** in relation to taxpayers, income, assets and wealth
- Whether the tax system promotes the right balance between supporting **the productive economy and the speculative economy**
- Whether there are **changes to the tax system** which would make it more fair, balanced and efficient, and
- Whether there are other changes which would support the **integrity of the income tax system**, having regard to the interaction of the systems for taxing companies, trusts, and individuals.

And in particular

....the Working Group should consider in particular the following:

- The economic environment that will apply over the next 5-10 years, taking into account demographic change, and the impact of changes in technology and employment practices, and how these are driving different business models,
- **Whether a system of taxing capital gains or land (not applying to the family home or the land under it), or other housing tax measures, would improve the tax system.**
- Whether a progressive company tax (with a lower rate for small companies) would improve the tax system and the business environment, and
- What role the taxation system can play in delivering positive environmental and ecological outcomes, especially over the longer term.

Out of scope of TWG

- Increasing any income tax rate or the rate of GST
- Inheritance tax
- Any other changes that would apply to the taxation of the family home or the land under it, and
- The adequacy of the personal tax system and its interaction with the transfer system (this will be considered as part of a separate review of Working for Families).

TWG process from here:

- Interim report Sept 18
- Contains some final recommendations + ongoing work
- Seeks feedback in various specific areas.
- Ministers' letter issued on 20 September 2018
- Accepts a number of recommendations
  - ➢ Recommend revenue neutral "packages"
  - ➢ Pursue capital gains tax or RFRM
  - ➢ Focus on balanced savings culture and deeper capital markets
- Feedback by 1 November 2018
- Final Report in Feb 2019.

FS sector issues in the interim report

- No substantive changes to GST.
- Retain imputation and no reduction in company tax rate.
- Modest changes to taxation of retirement savings targeted at low income earners.
- No general wealth tax, no general land tax, no FTT.
- Detailed discussion of an approach to broadening the taxation of capital gains in New Zealand – but no recommendation until final report.
- Likely retain FDR for non-NZ, Australian shares

Retirement savings recommendations

- Review of TTE
- Link to universal super
- Treatment of inflation
- Distributional impacts
- Focus on lower income savers
- Gender impact
- Remove ESCT for employees earning up to $48k pa
- Reduce the Kiwisaver PIE lower rates by 5% points (and simplify approach)
- Revenue impact est. modest at $215m pa
- More work to be done.

CGT: Pros & Cons

Pros	Cons
Increase progressivity of the tax system (vertical equity)	High compliance and administration costs
Improve horizontal equity	“Lock in” distortions
Possible efficiency benefits	Taxes nominal as well as real gains, may discourage saving
Sustainability: broaden the tax base and raise some revenue in the future.	Potential for double taxation impacts on shares
Impact on housing prices	Impact on rents

CGT: A quick summary

- Tax gains on land, buildings, equities, intangibles, business assets
- Exclude main home, collectables
- Realisation basis (although RFRM still under consideration)
- Normal marginal rates
- No inflation indexation
- Likely valuation day approach to introduction 1 April 2021
- Loss ring fencing in some cases
- Roll-over relief principles:
  - No change in ownership
  - No realisation of the gain

CGT: Issues with taxing shares

- Double taxation of gains issue – taxed at shareholder level and at company level.
- Managed through imputed dividends for realised gains.
- Problematic for unrealised gains.
- Double deductions for losses.
- Manage through cost base changes in the shares.
- Hard complex issues – not solved overseas.
- More work and seeking feedback.

CGT: Multi rate PIEs and Kiwisaver

- Debt instruments already taxed.
- Foreign shares subject to FDR and recommend that's retained.
- Issues arise for property and Australian and NZ shares.
- Real systems issues aligning daily pricing with realisation based taxation.
- Options to consider:
  - "Partnership approach" – too complex
  - Fund level tax – compromises principles of PIE
  - Use FDR on Australian and NZ shares
  - Accrual basis – using a discounted rate
  - Retain current exemption – good politics but mkt distortions?

CGT: Property MRPIE’s and Listed PIE’s

- Taxing property MRPIE’s on accrual basis problematic.
- Realisation may work better.
- But outstanding design issues.
- Listed PIE’s could treat as companies.
- Gains/losses on sale of units taxable.
- But retain excluded dividend.
- Causes more design issues, still being worked on.

Revenue impacts (estimated annual)

Tax Policy	2022	Future
Realisation based CGT	$290m	$5,960m [by 2032]
Restore depreciation to industrial, commercial and multi-unit residential (and not to residential generally)	($870m)	($980m) [by 2025]
ESCT and PIE rate 5% reduction	($215m)	?

CGT: the pathway to introduction by 1 April 2021

1. Feb 19: TWG final report recommends; and
2. Mar 19: Coalition Government agrees to pursue; and
3. May 19: Detailed design can be completed consulted on; and
4. Nov 19: Govt determines to proceed and introduces a bill; and
5. Jul 20: Govt manages to pass the bill; and
6. Nov 20: Labour can form and lead a Govt after the 2020 election that does not involve giving CGT away; **only then**
7. Comes into effect from 1 April 2021.

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