



KPMG Tax Chat



Tax Working Group – Let's broaden the base and lower the rate

"For a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle" – Winston Churchill.

It is difficult to argue with that sentiment and so it is with great interest that we will all watch the submissions to, and the recommendations that are released by, the Tax Working Group ("TWG").

The process kicked off in earnest on 14 March when the TWG released its paper on the *"Future of Tax"* as a background to its call for public submissions. As is well known, the TWG has been given a very broad remit to consider the future of the New Zealand tax system, with a particular focus on fairness and a clear instruction to consider matters other than pure tax system design, such as the future of how we will all work and the ageing population.

In our view, of primary concern to the TWG should be the fact that the New Zealand tax system has for decades now been typified in its design by a 'broad based, low rate' approach. Whatever is ultimately recommended by the TWG we sincerely hope that this approach continues.

During the 2017 General Election many expressed concern that the TWG would be established with a preconceived agenda to enact a capital gains tax ("CGT"). However, the Government has consistently maintained that all options remain on the table and this is made clear in the Future of Tax document. We endorse the wide remit of the TWG. As our population ages, our traditional reliance on income tax cannot continue in its current form and so we need to have a real discussion about the future need for other sources of revenue.

However let's address the primary issue that everyone is concerned about – a CGT. A clear gap in the broad-based nature of our tax system is that we do not have an extensive mechanism to tax capital gains. As demonstrated by the election rhetoric, a common reaction to the idea of a CGT is to frame the possibilities of enactment through a predominantly negative lens. For example, it is often conceptualized as a component of an over controlled and over taxed society. This is a narrow perspective and fails to acknowledge the full range of positive consequences that are potentially available.

There are a number of reasons why now may well be the right time to introduce a CGT:

- The concerns about rising inequality and wealth disparity are greater than ever before and there seems to be a change of public sentiment around taxing capital gains. At a societal level, a CGT could help take some of the pressure off the 'housing crisis' and additionally address growing concerns surrounding income and wealth inequality.

This is because overseas experience has shown that high income earners typically pay the most CGT. Therefore, a CGT should result in a higher level of tax fairness from both a vertical and horizontal equity perspective.

- There are many studies that endorse a comprehensive approach to taxation, including capital gains, in order to ensure that different taxation treatments do not distort economic decision making (e.g. favouring untaxed passive investment over fully taxed productive investment). Boiled down to a point of extreme simplicity we've heard the US approach to taxation described as *"a buck, is a buck, is a buck"* – i.e. it doesn't matter how you made the money, if you've made money you should pay tax on it.
- The introduction of a CGT could present an opportunity to further broaden our tax base and lower tax rates across the board.

Elaborating further on the third point, the TWG has not been established to raise additional revenue for the Government. Instead it is intended to determine a strategy to ensure that the current level of revenue can be maintained. This leaves scope for other areas of tax to be adjusted in order to partially offset the revenue raised by a CGT. New Zealand currently has one of the highest corporate tax rates in the OECD and there continues to be a worldwide trend of lowering corporate taxes (demonstrated recently by the US lowering its federal corporate tax from 35% to 21%). A similar move in New Zealand would surely be welcome by businesses in the productive sector of our economy. It could also fund the reduction in personal taxes as well, giving salary and wage earners some relief from tax rates and tax brackets that have not been adjusted since 2010.

New Zealand once had the "holy grail" of an aligned corporate tax rate, trust tax rate and top personal tax rate of 33%. Corporate taxes have reduced and will probably continue to fall, while the other taxes have not. This creates incentives for taxpayers to structure their income earning activities into unnecessary complex arrangements in an effort to reduce their tax bill. Alignment of these rates would eliminate these distortionary effects and needless tax compliance costs and complications. Imagine if a CGT could fund a reduction in all of these rates down to a rate of 25%? That would truly be a continuation of our broad base low rate approach and something that surely most sectors of economy would support.

So we encourage the TWG and others to see the potential introduction of a CGT not as an attempt to tax ourselves into prosperity but an opportunity to more fairly share the taxation burden across all sectors of the economy and reduce the burden on the taxation of productive income in the process.



Bruce Bernacchi
Partner



Alexandra Birch
Tax Consultant