NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

CTU Monthly Economic Bulletin

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Taxing times[1]

Discussion of parties' tax policies alongside a discussion of what is needed to ensure wage and salary earners aren't the only ones 'paying their fair share'.

Share and bond markets slightly down with house prices continuing to rise and income support recipients plateauing.

Introduction

This month you get tax. And for an election period we are, more than ever, spoilt for tax content.

- Labour is proposing a new top rate of 39% in the personal tax scale for taxable incomes over $180,000[2].

- National is proposing lifting the existing thresholds in the personal tax scale with the effect that people's personal income tax will reduce, to varying degrees, on their taxable income; linking tax brackets to inflation and increasing depreciation deductions on plant, equipment and machinery.[3]

- Greens are proposing a wealth tax and two new top rates – 37% over $100,000 and 42% over $150,000.

- ACT are proposing a temporary cut in GST from 15% to 10% and a raising of the 17.5% threshold to $70,000.

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[1] This commentary is heavily based on a recent article I wrote for interest.co.nz. https://www.interest.co.nz/opinion/107117/andrea-black-probes-ways-making-tax-settings-fairer-and-more-sustainable-so-wage-and

[2] https://www.labour.org.nz/tax

[3]https://www.national.org.nz/responsible-economic-management

- TOP are proposing a tax on an imputed level of income on the equity of property investments.[4]

[TOP, although a party outside Parliament, are included in this discussion due to their continued contribution to progressive tax thought.]

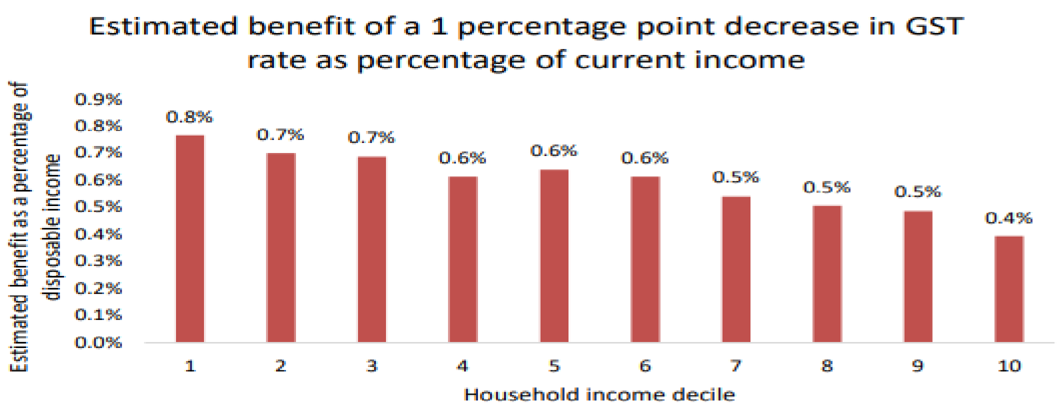
Applying a tax policy lens – this means:

- Labour and the Green Party want to make personal taxation more progressive;
- National and ACT want to reduce or eliminate fiscal drag – more on that later – while National also want to restore the depreciation concessions they removed in 2010 as part of the price for a reduced company tax rate;
- ACT wants to temporarily reduce GST to 10%;
- The Greens want to add another tax base – wealth and
- TOP wants to specifically remove the current tax preference on property.[5]

No one is looking to increase or decrease the trust or the company tax rate and no one is looking to increase GST. No one is looking to implement a land tax – although a wealth tax and TOP's policy have aspects of this.

GST[6]

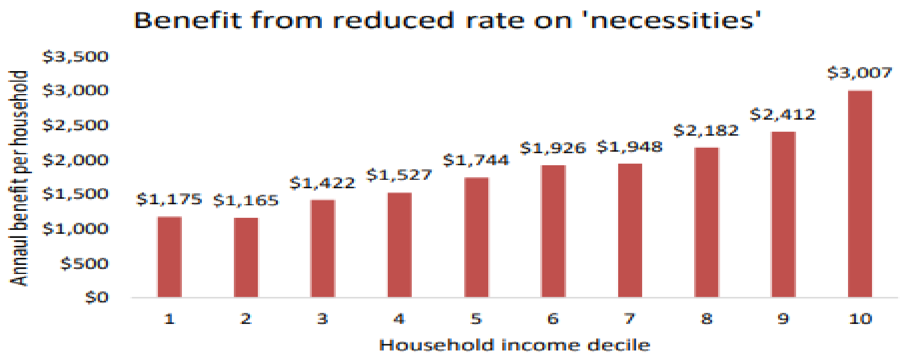
GST is an interesting one as hated by the left due to its regressive nature ...



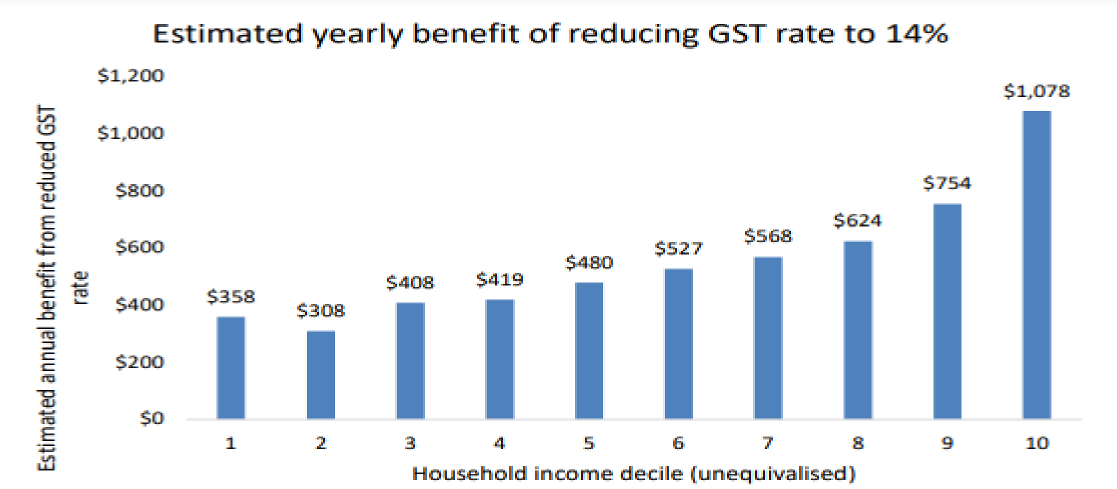
Estimate based on figures provided in (Thomas, 2015)

[4]https://d3n8a8pro7vhmx.cloudfront.net/garethmorgan/pages/2959/attachments/original/1599719623/Property_Tax_Policy_Sept_2020.pdf?1599719623
[5] Technically it is the same tax preference shares and other assets enjoy. However, with property the scale and the ability to gear is much greater.
[6] https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3996822-note-on-effect-of-decreasing-the-rate-of-gst.pdf

… but it is also really useful in always taxing those that are rich - even if they haven't paid income tax in some form – as they have to eat and so GST gets paid by them then.



Also because the rich have more money, they spend more than those on lower incomes, meaning that in absolute terms they pay more GST than those on lower incomes.

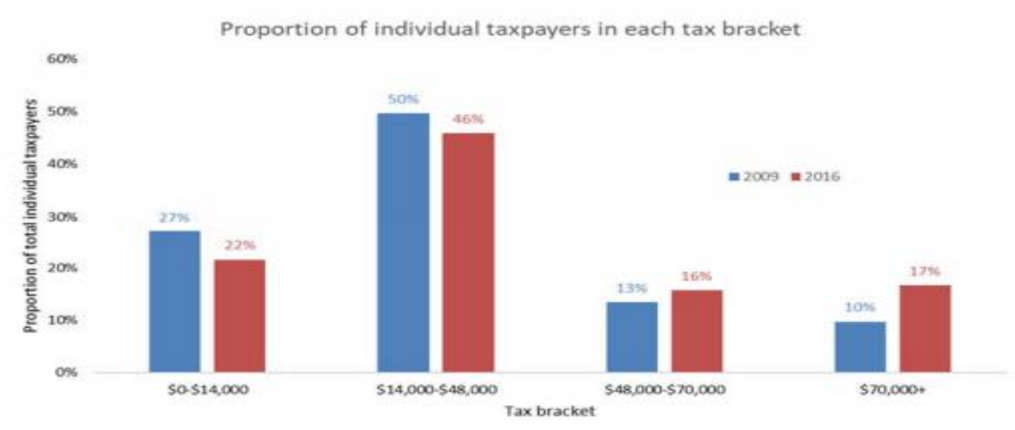


So in the event that GST were to be cut, as is being temporarily proposed by ACT, although it would benefit those on lower incomes disproportionately, it would mean that significant revenue needed to be made up somewhere else in the system.[7]

[7] Or public services cut or debt increase.

Fiscal Drag[8]

Fiscal drag, also known as bracket creep, arises with a progressive tax scale when taxable incomes rise moving their incomes into higher tax brackets. This means that individuals pay comparably more tax even though their incomes had only risen because of inflation.



As seen by the diagram as thresholds are not indexed for inflation, in 2016, 7% more people are paying tax at 33% on their last dollar compared to 2009. The raising of thresholds proposed by both National and ACT would address this to some degree.

The Tax Working Group also looked to address bracket creep, but it required the revenue raised from taxing more capital gains to make it revenue neutral for the government.

So what is the right answer?

While we are likely to have to increase the tax take as a whole – there are also a number of things that under the hood that also need addressing.

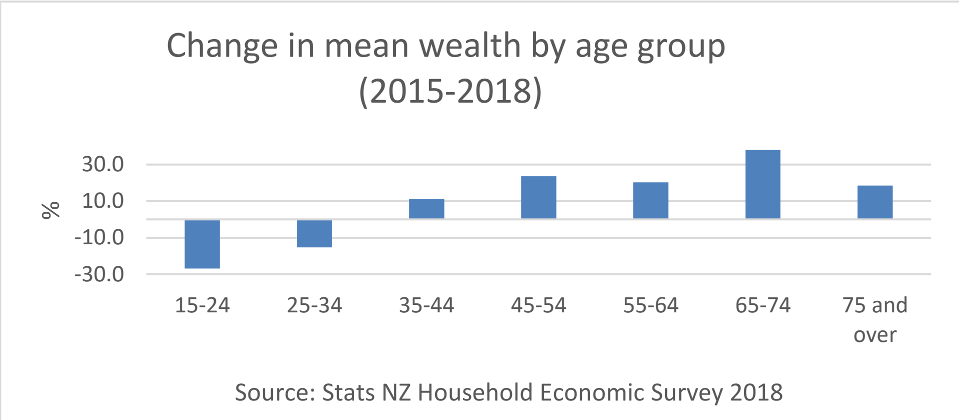
The story so far

The New Zealand going into COVID-19 was one of low wages, high rents, and rising wealth inequality.

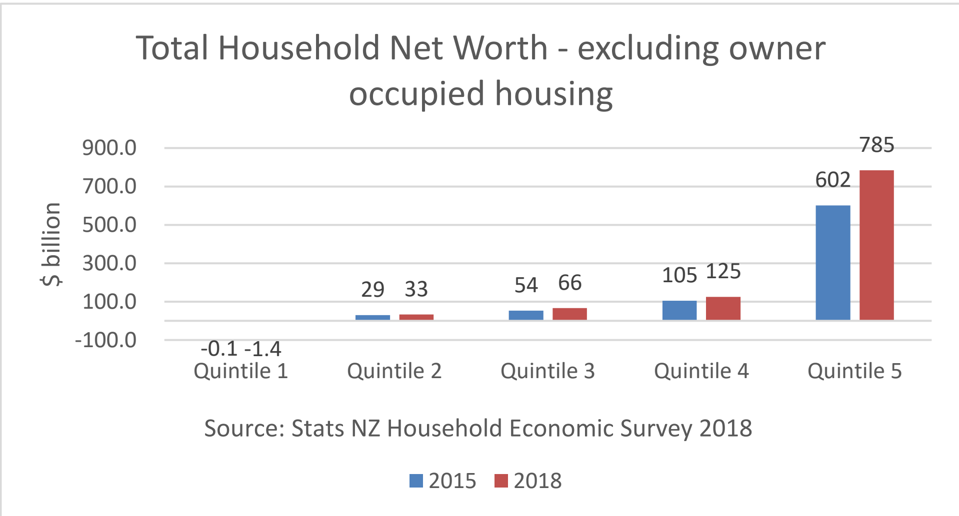
[8] https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3985468-appendix-b--changes-to-tax-rates-and-thresholds.pdf

Information supplied to the Tax Working Group showed that in 2015 the top quintile (20%) – excluding the house people lived in – owned 75% of New Zealand's wealth. $602 billion of a total $789 billion.

By 2018 this became 77% - $785 billion of a total $1014 billion.[9]

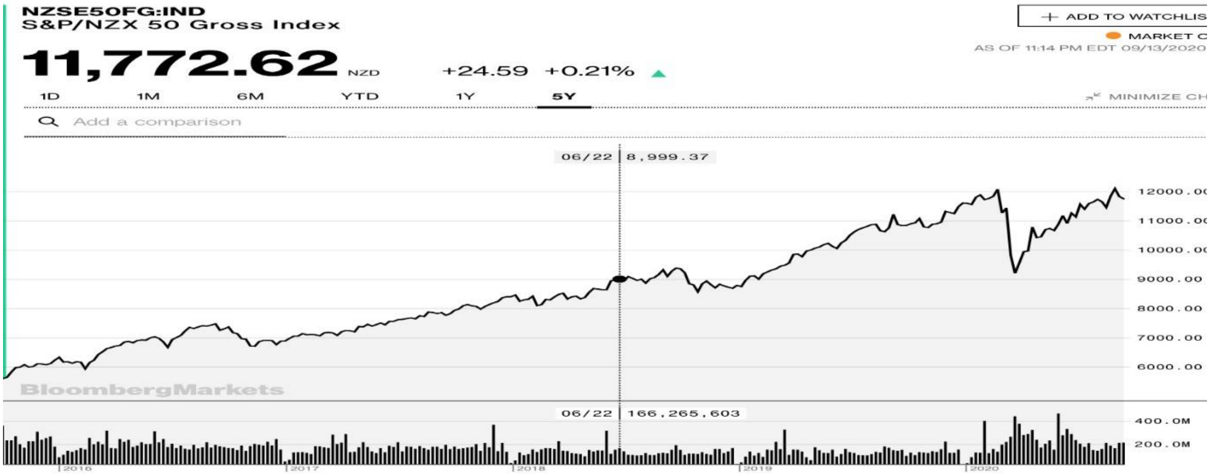


Using the most recent Household Economic Survey – 2018 – and looking at how these numbers change by age group, it is not a stretch to say the people in the top quintile (above) are over 35.

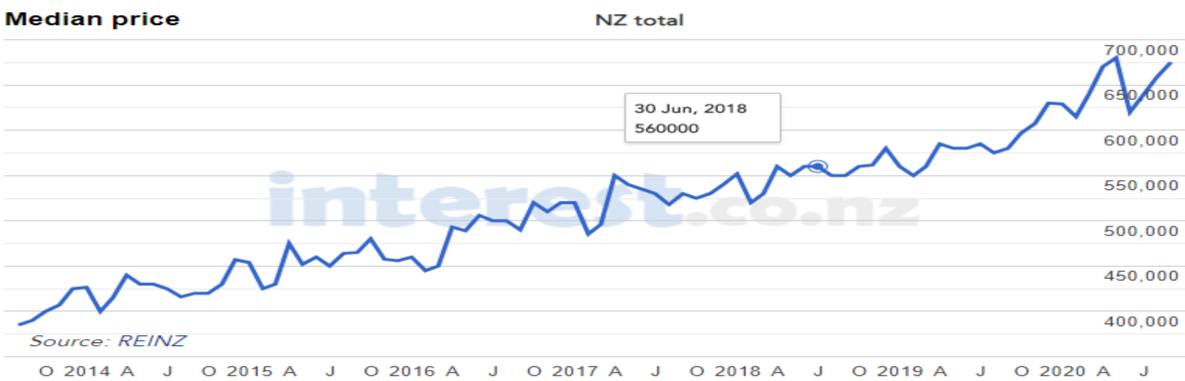


[9] These numbers were calculated by removing the assets and liabilities associated with owner occupied dwellings. However for Quintile 1 as this net figure was negative – excess of loans over assets – I have included this net negative in the calculation as it would indicate the loans were supporting more than the house itself – ie loan for private business.

And since that time the New Zealand sharemarket has increased by a further 30%[10] …

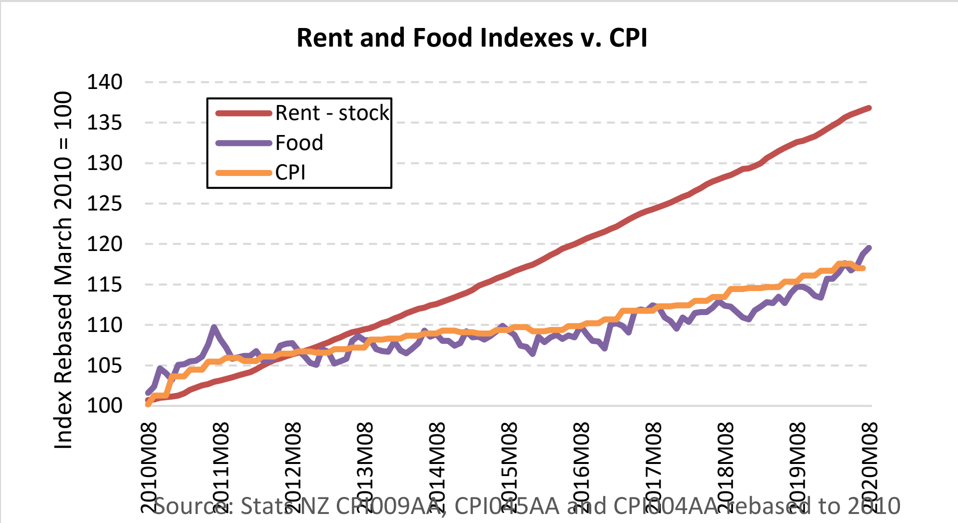


…with house prices increasing by 20%.[11]

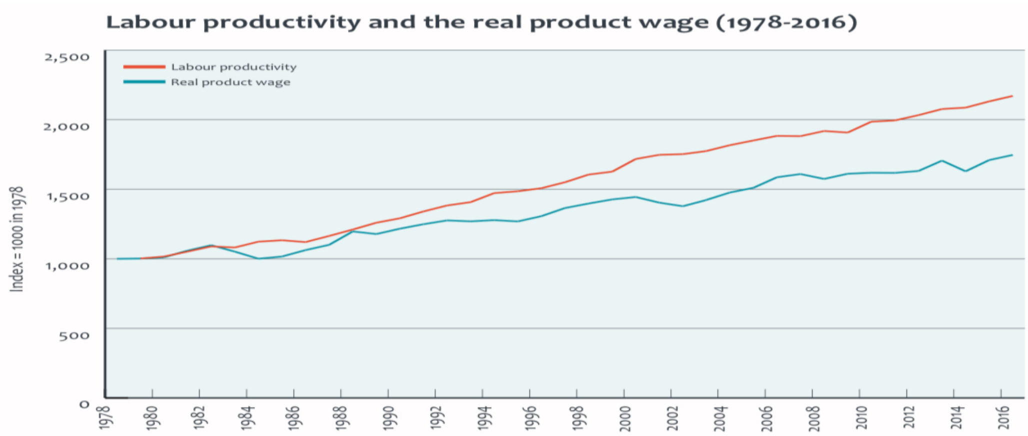


With the final piece of the puzzle, rents and food have increased by more than the CPI over the last ten years …

[10] (11773/9000)-1
[11] (675,000-560,000)-1



and wages fallen behind productivity.[12]



Putting an income tax lens on this – the following is quite well known:

- Wages are fully taxed.
- Most realised capital gains are not.
- Companies have a lower tax rate than the top personal rate.

What is less well known is:

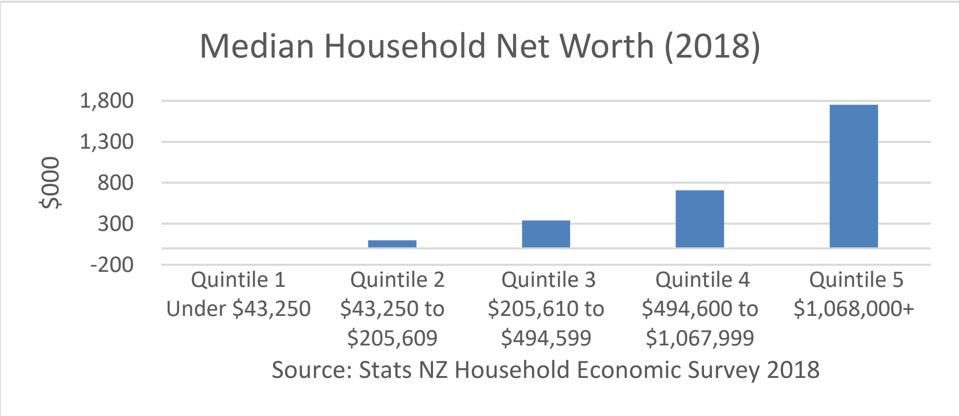
[12] https://www.mbie.govt.nz/assets/695e21c9c3/working-group-report.pdf

- Self-employed people are estimated to return 20% less taxable income than comparable wage and salary earners.[13]
- In 2014 25% of the High Wealth Individuals reviewed by Inland Revenue paid 83% of the total tax paid by that group and 10% of them paid 33% of the total tax paid by that group.[14]
- Wage and salary income has a largely smooth distribution while there is a peak at $70,000 for personal income generally.
- Inland Revenue's ability to collect debts is easier for individuals than for trusts and companies.
- The $7 for $1 invested that is widely touted as the return for investigations may not include actual cash that can be spent by the government.
- Inland Revenue spending on investigations and debt collection has fallen but its spending on processing has risen.
- Closely held companies' retention of income taxed at the lower company rate has increased at the same time loans to shareholders have also increased.

So how can we make this better? How can we make the tax settings fairer and more sustainable? So that wage and salary earners can feel confident they aren't the only ones paying 'their fair share.'

Taxation of Capital

With rising untaxed capital gains going to the older members of society, the population ageing and a declining share of the economy going to labour; continuing to tax labour at the expense of capital is hardly fair or sustainable.



[13] https://www.wgtn.ac.nz/__data/assets/pdf_file/0009/1863198/WP-07-2018_Cabral-Gemmell_NZ-compliance-income-gap_IRD_-1.pdf
https://www.wgtn.ac.nz/__data/assets/pdf_file/0012/1863768/WP-07-2019-Income-Under-Reporting-November-2019.pdf
[14] https://taxworkinggroup.govt.nz/sites/default/files/2018-05/High-wealth-individuals.pdf

There are many ways this could change:

- Taxing more realised capital gains
- Wealth tax
- Tax on imputed return from residential rental properties
- Land Tax.

The Labour Party has ruled out taxing more capital gains; the Greens have proposed a wealth tax and TOP - and the Child Poverty Action Group - is proposing a version of a tax on the imputed return from residential rental properties.

Without one or any of these options, there is no hope of ever reducing the proportionate tax increases middle income earners face when their wages and salaries go up as a response to the increase in prices.

All these options were canvassed by the Tax Working Group who recommended taxing more realised capital gains. This was also my first preference as technically it meshed better with the existing tax system. I have previously discussed these options here.

Over the last few months, I have changed my view and now prefer a form of wealth tax – ie any of the other options - with a decent threshold to take out all but the top quintile.

This is because taxing gains on a realised basis will not put a dent in the untaxed gains that are continuing to accrue.[15] I accept there are more technical issues with these options than with taxing more realised capital gains but to ensure there continues to be voluntary compliance from those who are fully taxed – those on PAYE and/or the young - something will need to be done in this area before very long.

How could a wealth tax work?

I have been asked how a wealth tax would work. To be honest, the Green Party has done a pretty good job of scoping one out – particularly with the interface with Trusts.[16]

The technical/political issues that remain are:

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[15] It is true that this wealth could include some assets that have accumulated tax paid – such as term deposits – but GST, by taxing consumption, also taxes tax paid income and with a threshold of say $1 million it is likely to target most of assets that have not had its income taxed.

[16] https://d3n8a8pro7vhmx.cloudfront.net/beachheroes/pages/12689/attachments/original/1594876918/Poverty_Action_Plan_policy_document_screen-readable.pdf?1594876918 Page 11 onward

Valuation

All assets would require a value every year to calculate the tax.

For some assets like shares and residential property – this is very simple as there are easily accessible market values. For other assets, others like closely held businesses this is potentially complex.

For those assets, valuation could be handled through rules of thumb but such approaches were staunchly resisted by the business community at the time taxing more capital gains was floated.[17] And with the Tax Working Group proposal, the valuations would only have been one offs – while a wealth tax would require regular valuations.

Rich people relocation

The way income tax works is that people who are resident here are taxed and people who are not resident here are taxed on any New Zealand income. Due to quirks in the Australia visa schemes, New Zealanders can become Australian tax resident and never pay tax on their foreign income[18].

This is the case now, but it is fair to say – pre Covid at least – that there would become a higher chance high wealth New Zealanders could move to Australia to avoid any additional wealth tax.

That is, unless it was targeted to wealth based in New Zealand. Then at least, this wealth would remain in the net. However, with migration, it could mean that a wealth tax would very quickly become a land tax in which case – maybe going straight to a land tax could have merit.

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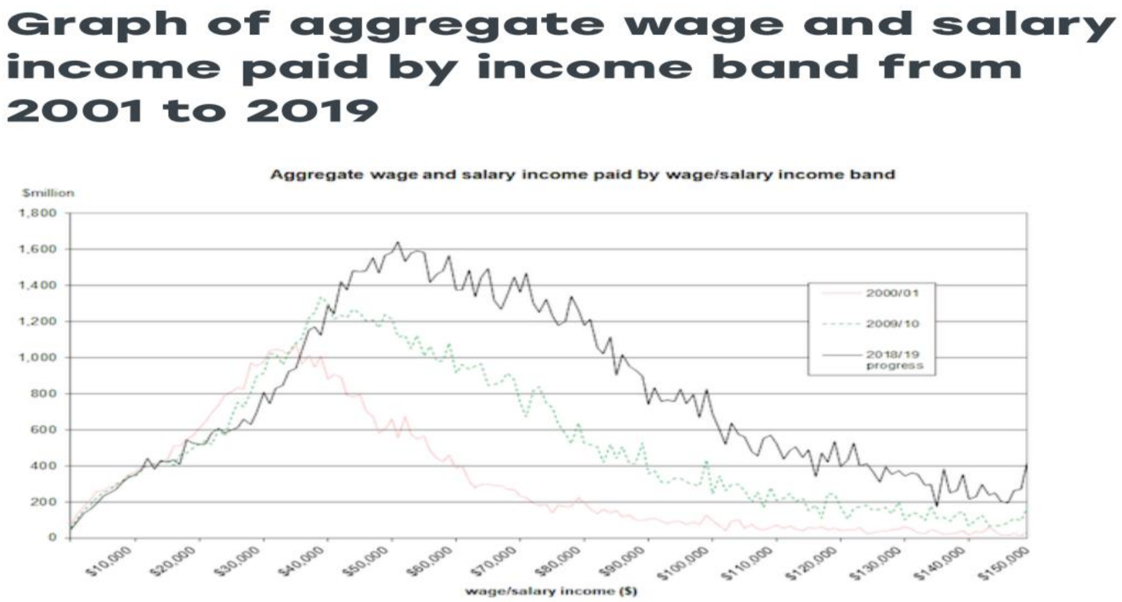
[17] https://www.stuff.co.nz/business/109024940/cullens-capital-gains-tax-comments-could-turn-the-tax-into-a-game-for-business
[18] https://www.ato.gov.au/Individuals/Income-and-deductions/In-detail/Income/Foreign-income-exemption-for-temporary-residents---introduction/

Progressive taxation for everyone

One of the few graphs on the IRD website – that doesn't relate to their performance - is that of the income distribution of wage and salary earners.[19] It has a broadly smooth distribution.



This can be contrasted with the same graph but for all personal income.

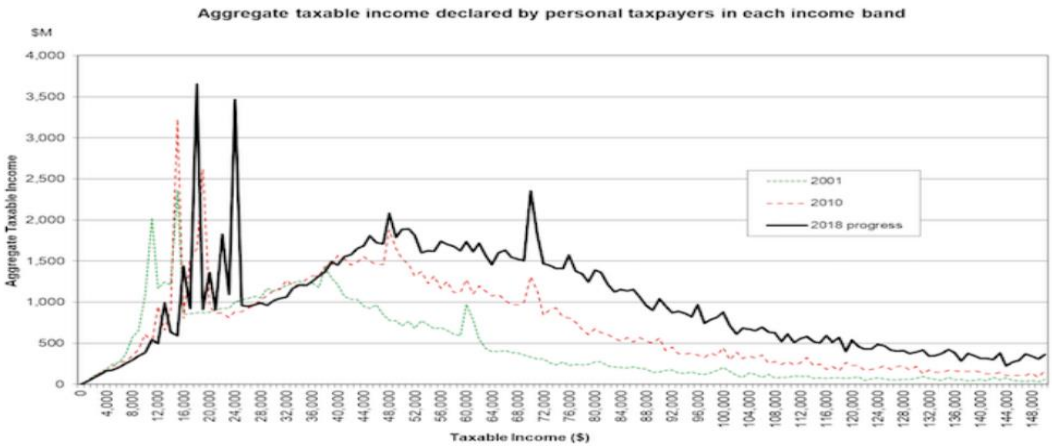
Here we see spikes at $70,000 and a smaller one at $48,000. [20] Given these spikes aren't there for wage and salary earners this indicates the payment of shareholders salaries at these income levels which also happen to be the respective thresholds for the 33% and the 30% tax rate for individuals.

This means that that either shareholders of closely held companies serendipitously earn incomes below key thresholds in the personal tax scale or a smaller salary is taken by the shareholder with the balance of income retained in the company and the lower company tax rate paid.

[19] https://www.ird.govt.nz/about-us/tax-statistics/revenue-refunds

[20] There are a number of large spikes on the left hand side too. These are correlated to benefits and income that can be earned before benefits are abated.

Graph of aggregate taxable income declared by taxpayers in each income band



This wouldn't be an issue if the retained income in the company either stayed in the company as part of its capital base or it were subsequently distributed as a taxable dividend at which time the difference between the company tax rate – 28% - and the top personal tax rate – 33% - would be paid by the shareholder.

However what the facts show is that the imputation credit account balances of closely held companies - which record the tax paid by a company - are increasing at the same time loans from the company to their shareholders are also increasing.[21] That is shareholders are receiving value from their company by way of loan instead of untaxed dividend.[22]

On the face of it, Labour's proposal to increase of the top tax rate to 39% would exacerbate this issue. However as there seems to already quite widespread 'avoidance' of the lower 33% rate; it seems unlikely that increasing it to 39% would make much difference.

The existing 'avoidance' could be countered by increasing the company tax rate to 33%. And it isn't as scary as it sounds.

Small companies can already have their income taxed directly in the hands of their shareholders via the personal tax scale and the Look Through Company rules. [23] Widely held companies

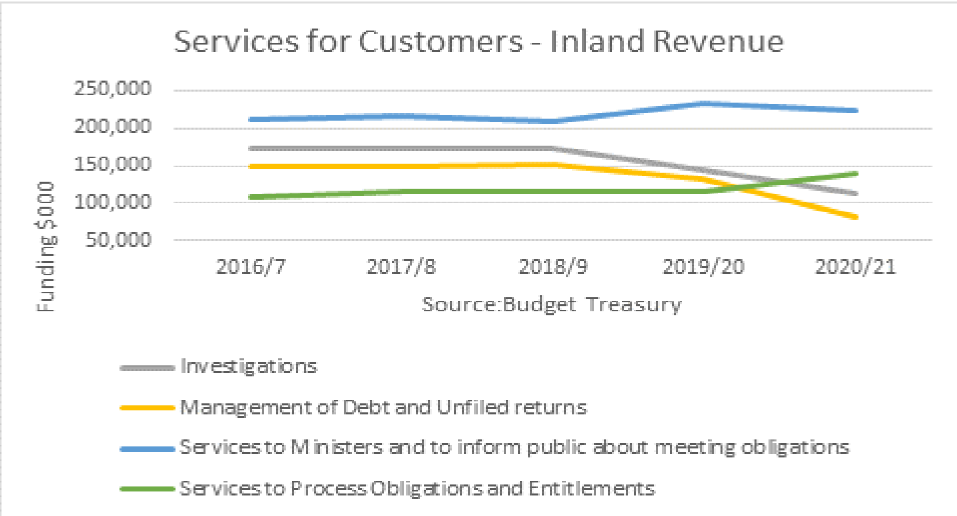
[21] https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-appendix-4--closely-held-companies.pdf
[22] It is true that there is an obligation to charge interest on these balances but given the scale and increasing level of them – either there is significant non-compliance or the cost of the interest is outweigh by the tax benefit from not paying the final 5 cents. And with interest rates falling, this requirement becomes less and less of a constraint and in any case the interest transfer does not change the net wealth of these individuals, other than tax on the interest.
[23] https://www.ird.govt.nz/roles/look-through-company

already fully distribute all their credits and foreign companies could have their deductible debt threshold increased. Therefore, a rise in the company tax rate to 33% would only affecting the New Zealand based companies currently distributing their income in the form of loans rather than taxable dividends.

Meaning that the personal progressive tax scale - before an increase in the top rate - would no longer be optional for shareholders of closely held companies.

Increased enforcement

Experience has taught me that a rule that is not enforced, either by a regulator or social conditioning, is a rule that doesn't exist. This is why the role of Inland Revenue investigations and debt collection is so critical in ensuring that only wage and salary earners pay the full amount of tax due. Which is what could be inferred from the Victoria University study which estimated the self employed were underreporting, on average, by 20%.[24]



Now to be fair some decline in the Inland Revenue's operating budget is to be expected following all the money spent on Business Transformation. However, it is very surprising that the share going to 'processing' has increased, when all those new systems should have made it more efficient, with step declines in Investigations and Debt Management.

The other thing to note is that with investigations spending there is an expected return of $7 in discrepancies for every $1 spent, so inherently with a lower amount allocated to investigations; there is lower expected return.

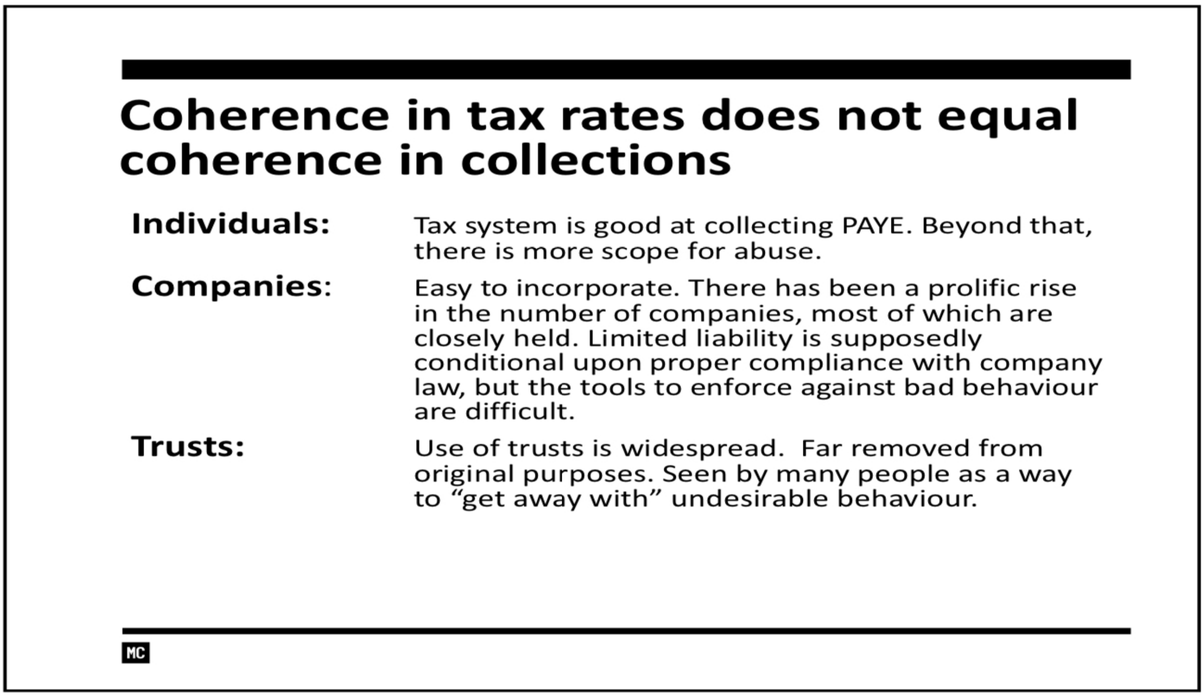
[24] https://www.wgtn.ac.nz/__data/assets/pdf_file/0009/1863198/WP-07-2018_Cabral-Gemmell_NZ-compliance-income-gap_IRD_-1.pdf

But the thing is a *discrepancy* isn't necessarily cash the government can spend. It is simply a change in a tax position which could come from a major tax avoidance case; a reduction in losses or an adjustment to a memorandum account. All which have merit from the perspective of 'cleaning up the tax system' but only the first one gives the government more money to spend.

And these discrepancies are all counted before *actually collecting the money*.

So to ensure a fair and sustainable tax system - not only do, at least, the old Budget relativities need to return with greater spending on investigations and debt management; the focus also needs to be on what everyone actually thinks the investigations money is buying – extra cash that the government can spend on public services. If that means for transparency sake - that the 'return' of $7 needs to reduce – so be it.

Collection for everyone



This was a key slide in Nick Malarao's – Collections Specialist and Tax Working Group member – presentation to the Tax Working Group.[25]

His point was that while the tax system puts a lot of emphasis on alignment of tax rates for the coherence of the tax system - individual, trust, company - there is far from alignment or coherence when it comes to tax collections from the various forms.

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[25] https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3985455-collection-challenges.pdf

That is, the ability of Inland Revenue to collect is very dependent on how the debt is incurred. Individuals are much easier to collect from than companies and trusts because there is no corporate veil or (potentially) opaque structuring separating the vehicle from its economic owners.

Source: Annual Report – Inland Revenue 2019[26]

And why this matters is there is currently $3.5 billion of uncollected tax and penalties sitting as income/asset in the Government accounts.

It is also all the more important if the *discrepancy* that forms part of the return to government for investigations stands a chance of being collected.

The Tax Working Group proposed rules which would make directors, who had an economic

TABLE 1: TAX DEBT AS AT 30 JUNE ($ MILLION)

	2015	2016	2017	2018	2019	Change since 2018
Working for Families Tax Credits	334.8	224.6	193.4	140.1	128.8	(8%)
GST	1,527.5	1,387.0	825.6	814.9	1,180.6	45%
Income tax	2,653.0	2,568.5	1,556.2	1,651.3	1,609.8	(3%)
KiwiSaver	29.4	24.9	26.5	42.4	51.2	21%
Other tax	115.9	69.7	80.0	79.8	85.0	7%
PAYE	492.4	428.9	309.7	374.9	465.9	24%
Total debt	**5,153.0**	**4,703.6**	**2,991.3**	**3,103.4**	**3,521.3**	**13%**

ownership in the company, personally liable for PAYE and GST.[27] While this still isn't comparable to individuals who are personally liable for all the tax they incur – it is a start in making the tax system fair and sustainable.

Greater Disclosure

And finally - greater disclosure is needed.

We know what the tax profile was for High Wealth Individuals in 2015 – what does it look like now?

[26] https://www.ird.govt.nz/-/media/project/ir/documents/about-us/publications/annual-and-corporate-reports/annual-reports/annual-report-2019.pdf
[27] https://taxworkinggroup.govt.nz/sites/default/files/2019-03/twg-final-report-voli-feb19-v1.pdf Recommendation 64

We know the imputation credit balances and loans to shareholders of closely held companies in 2018 – what about now?

Exactly what is the breakdown of discrepancies found by Inland Revenue? How many were collected? How much was spendable cash?

The Government had no difficulty releasing details of those who claimed the wage subsidy and that proved very useful in ensuring compliance. We shouldn't have to wait until the next Tax Working Group to find out details of the tax system.

Because maybe – just maybe – if we actually knew who paid what tax – the case for a fair and sustainable tax system would make itself.

As always, I welcome feedback to andreab@nzctu.org.nz.

Kia Kaha

Andrea

The NZIER consensus forecast was released on 14 September 2020

Annual Percentage Change (March Year)	2019/20	2020/21	2021/22	2022/23
GDP	1.7	-7.2	6.7	3.5
CPI	2.5	0.4	0.9	1.6
Private Sector average hourly wage	3.4	1.8	1.4	1.9
Employment	1.5	-5.2	3.1	2.8
Unemployment rate (% of labour force)	4.2	7.8	6.8	5.8

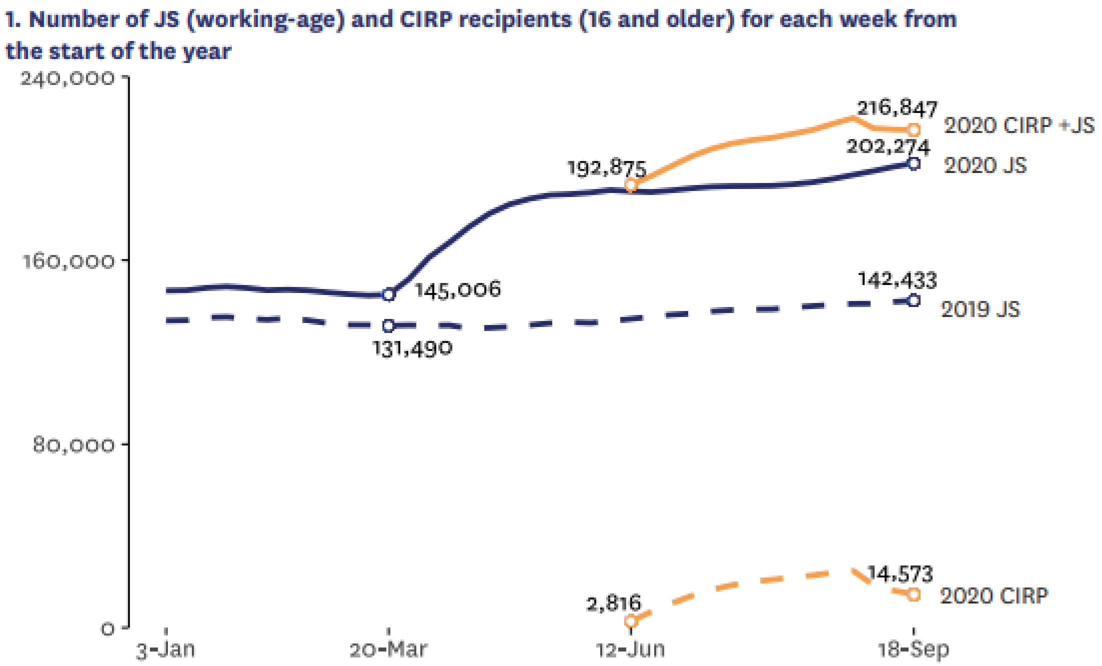
Economic Indicators – September 2020

This month the total number of people receiving income support from the Government plateaus albeit with a switch between Jobseeker Support and the Covid Income Relief Payment.

In August and September, the House market continued to rise with slight dips in the share and bond markets. Rent and Food prices continue to rise with both their indexes continuing to exceed the CPI.

1) Jobseeker Support and Covid-19 Income Relief Payment[28]

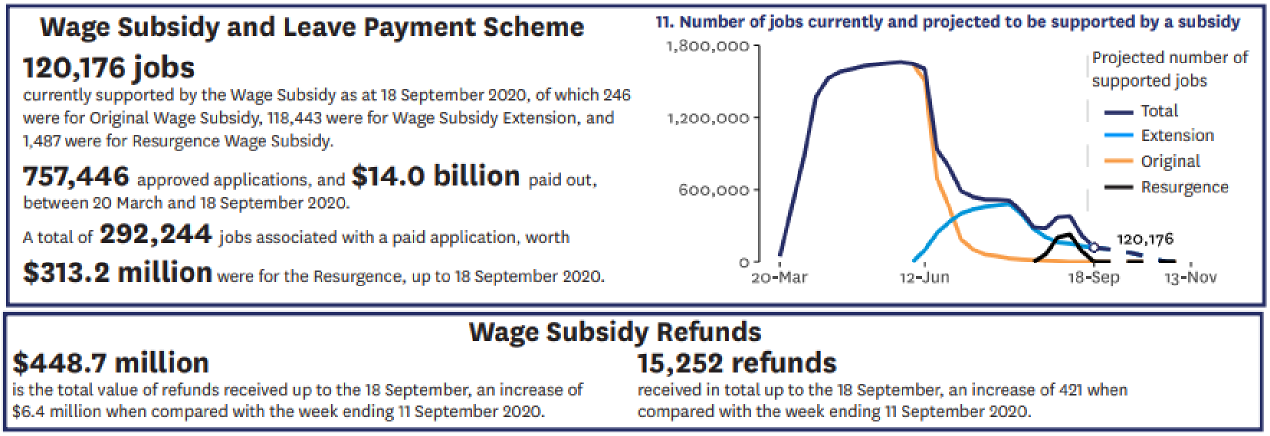
While this month has seen the total number of people on income support plateau, this has come from an increase in the numbers of people on Jobseeker Support by approximately 8,000 with an equivalent decline in those on the Covid Income Relief Payment. This could indicate that people are coming off the CIRP and going on to Jobseeker support. Although the eligibility criteria are different and partnered people are unlikely to be eligible for Jobseeker Support.



[28] https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/statistics/benefit/2020/income-support-and-wage-subsidy-weekly-update/income-support-and-wage-subsidy-weekly-update-18-september-2020.pdf

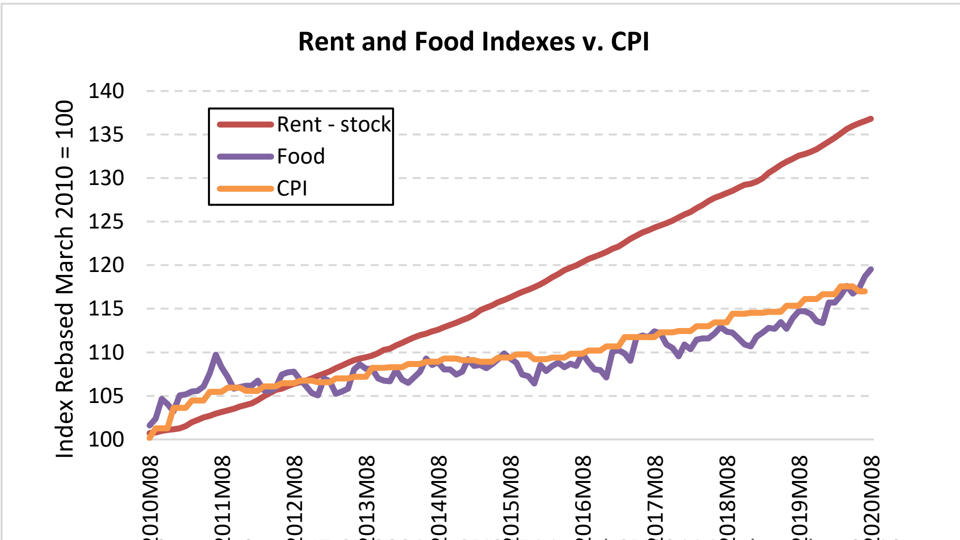
2) Wage Subsidy

As the wage subsidy winds down, at 15 September there were 120K jobs supported by the subsidy down from a peak of 1.7 million.



3) Rent, Food and CPI.[29]

The rent statistics are a little complex this month. The stock measure – all rents - of the graph has increased by 0.2% but the flow measure – new rents – has decreased by 1.12%. The reason is unclear. The Food index rose by 0.66% in August and 4.2% in the year to August primarily driven by the increase in the cost of fruit and vegetables.



Source: Stats NZ CPI009AA, CPI045AA and CPI004AA rebased to 2010

[29] This month, however, the flow measure did fall by 0.5% annually but for consistency now I am back to reporting stock measures I will continue.

4) The sharemarket

At 28 September, the sharemarket had dropped and was slightly below its late February 2020 peak of 12,073.[30]

5) Bonds[31]

Like the sharemarket, slightly down on August 2020.

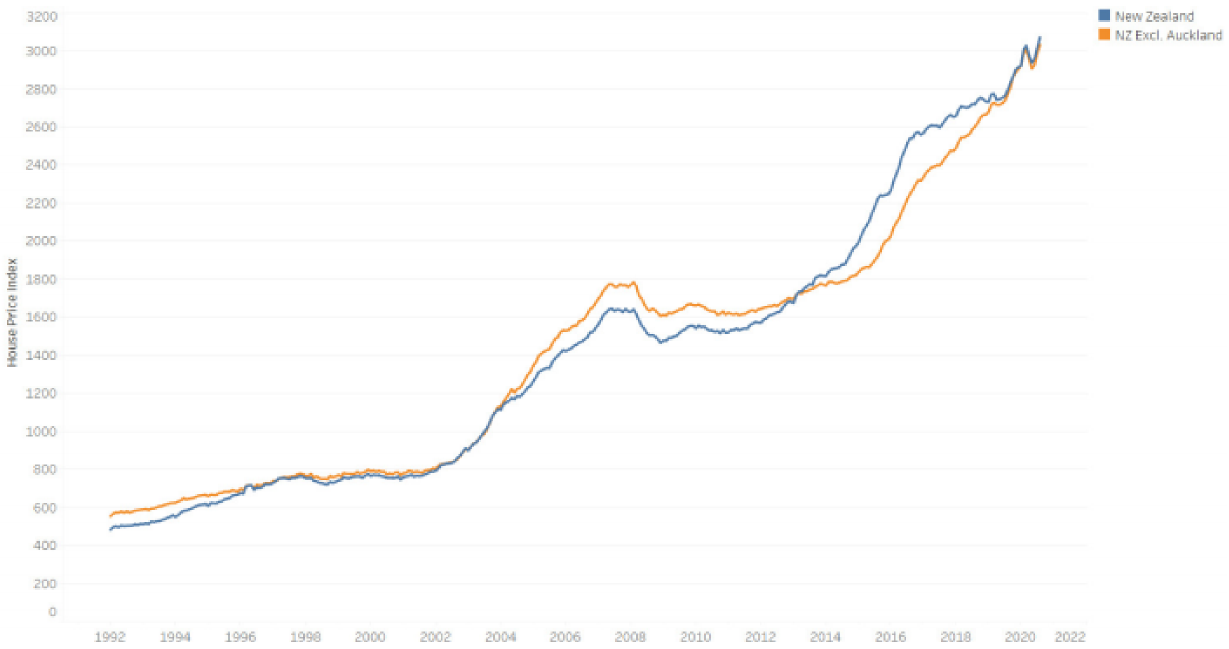
[30] https://www.bloomberg.com/quote/NZSE50FG:IND

[31] For bonds, usually it is the yields that are tracked rather than the price of the bonds and so it can be difficult to find out what is happening to the price. As a proxy I am looking at the exchange traded fund for New Zealand bonds. https://www.nzx.com/instruments/NZB

6) **House prices**[32]

The brief Lockdown 1.0 price drop is now over and house prices as at August are steadily increasing. The decline I has hoped for in March continues as a memory.

NEW ZEALAND
HOUSE PRICE INDICIES



[32] https://www.reinz.co.nz/Media/Default/Statistic%20Documents/2020/July/REINZ%20Monthly%20HPI%20Report%20-%20July%202020.pdf
https://treasury.govt.nz/publications/weu/weekly-economic-update-17-july-2020-html

Notes

This bulletin is available online at http://www.union.org.nz/economicbulletin222. For further information contact [Andrea Black](#)