Submission of the

New Zealand Council of Trade Unions

Te Kauae Kaimahi

to the

Tax Working Group

on its

Future of Tax: Interim Report

P O Box 6645
Wellington

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1. Introduction

1.1. This submission is made on behalf of the 27 unions affiliated to the New Zealand Council of Trade Unions Te Kauae Kaimahi (CTU). With over 310,000 members, the CTU is one of the largest democratic organisations in New Zealand

1.2. The CTU acknowledges Te Tiriti o Waitangi as the founding document of Aotearoa New Zealand and formally acknowledges this through Te Rūnanga o Ngā Kaimahi Māori o Aotearoa (Te Rūnanga) the Māori arm of Te Kauae Kaimahi (CTU) which represents approximately 60,000 Māori workers.

1.3. The NZCTU welcomes the opportunity to make this submission in response to the Interim Report published by the Tax Working Group. In addition to this submission, the CTU's digital campaigning arm Together.org.nz has also undertaken a survey of members asking about attitudes to taxation, with similar themes to the UMR research we submitted to the Tax Working Group in April[1]. A summary of this survey will be submitted separately to this document.

1.4. Taxes are the way that we as a society pool our resources. They are an inescapable counterpart of the government spending that is needed to promote and sustain a good society. The tightly-constrained current level of government spending is not consistent with the aspirations of the New Zealand public for health, education, infrastructure, housing affordability, progress towards the carbon-zero goal, reducing inequality, and provision of quality public services in general. Both the 30%-of-GDP target in the Group's Terms of Reference and the "revenue neutral" suggestion in the Ministers' letter of 20 September 2018 place higher priority on arbitrary fiscal bright-lines than on the well-being of our people, society and environment. We urge the Group to rise above those restrictions on its reporting mandate. As it observed in its earlier *Submission Background Paper* (p.10), "If the Government is to continue providing healthcare and superannuation at current levels, then the level of taxation will need to increase, or spending on other transfers or publicly provided goods and services will need to fall."

1.5. Given that it is apparent that *current* levels of provision of healthcare are failing New Zealanders in critical ways (such as in mental health and decrepit or inadequate hospital infrastructure), and there is evidence of widespread failings in other public services, ranging from regulatory failings in building, road safety and employment relations through financially unviable institutes of technology and polytechnics, to critical housing shortages, as well as impoverishing main benefit levels, it is not only healthcare and superannuation that demand higher levels of revenue from taxation.

[1] https://www.union.org.nz/kiwis-desire-for-tax-offers-hope-for-underfunded-public-services/

1.6. The NZCTU:

- Notes that the Tax Working Group has found that amongst high-income countries, New Zealand has one of the least effective tax systems for reducing income inequality, and also one of the least effective benefit and income support systems;

- Is pleased that a capital gains tax is being seriously considered. It is only fair to tax such income on the same basis as other income, and because wealth is so unevenly shared, would be a significant step to reduce inequality, while plugging some major holes which the wealthy are using to avoid income tax;

- Is disappointed that a land or wealth tax is no longer on the table. While recognising practical difficulties with implementing them, there is an increasingly pressing need to push back against New Zealand's high wealth inequality;

- Is also disappointed that there has been no move to address the absence of taxes on wealth transfers, in particular gifts, which are within the Terms of Reference and are presently treated inconsistently between the Income Tax Act and the Social Security Act;

- Greets with interest proposals for making saving for retirement easier for low and middle income people, and agrees that across-the-board tax incentives would favour high income savers, who have less difficulty in saving;

- Welcomes the serious consideration given to a variety of environmental taxes, but agrees with the Tax Working Group that they are often regressive and so need to be offset by assistance to low and middle income people so that they are not disproportionately affected, or designed to ensure this;

- Regrets that an extension of GST into financial services by means of a Financial Activity Tax has not been recommended, and urges the Tax Working Group to reconsider;

- Is disappointed that a reduction in the GST rate is not recommended because, as the Tax Working Group recognises, GST is regressive, hitting low income households hardest, but recognises the cost of a reduction in GST is substantial;

- Urges once again that the Government be advised to make the income tax scale more progressive to offset the effect of GST, including discussion of the possibility of a higher top rate in future, notwithstanding that the Terms of Reference do not provide for this vital consideration;

- Welcomes work to ensure that there is no tax advantage to employing people as contractors as opposed to employees, and to ensure self-employed pay their taxes;

- Agrees that company income taxes should not be lowered, since lowering them would mostly benefit overseas shareholders and the wealthiest New Zealanders, with no evidence of beneficial effects for New Zealand as a whole;

- Continues to advocate the raising of the company tax rate to at least 30% and ideally 33%;

- Welcomes the work the Tax Working Group has done on the feasibility of ensuring that multinationals providing digital services do not escape a fair level of taxation, and urges urgency in implementing the relevant taxes;

- Agrees that directors should be made personally liable for companies they head not paying their taxes. This is similar to other areas where directors are using the protection of companies to avoid their responsibilities for their employees' employment rights, health and safety, and avoiding paying creditors;

- Supports recommended moves towards much less secrecy in providing information about taxes and who pays them, but believes more could be done to ensure corporate tax payers are open to public scrutiny and analysis.

- Welcomes the explicit attention paid to Te Ao Māori in the Interim Report.

1.7. Specific recommendations made in this submission are as follows. The Tax Working Group should -

- Take note of the potential for fiscal destabilisation in the event of a systemic loss in asset values, if deduction of capital losses against income for tax purposes is allowed under a capital-income tax or under an income tax system with capital gains included as income. Such a crash in market-based asset valuations is a strong possibility given the current worldwide bubble in asset values. Rigorous ring-fencing of capital losses, to be used only to offset previously-taxed capital gains, is crucially important;

- Give systematic consideration to the economic stabilisation role of the tax system, which has been completely overlooked in the Interim Report;

- Recommend the inclusion of wealth transfers (specifically, gifts) in the recommended definition of income for tax purposes, to bring the tax legislation into line with the Social Security Act's definition of income;

- Foreshadow the possibility of increasing the top rate of income tax, notwithstanding that the Terms of Reference preclude (at this time) making any actual recommendation in that direction;

- Reconsider the Interim Report's rejection of a wealth tax, in light of the OECD's clear and explicit statement that capital income tax on its own, if not supplemented by inheritance and gift taxes, is inadequate to tackle wealth inequality;

- Recommend the creation of a New Zealand wealth register, as foreshadowed in our previous submission paragraph 12.8, and in the Ministers' letter of 20 September which has asked for "better approaches to understanding the wealth, capital income, and effective tax rates of individuals particular[ly] those in the top decile". Such a register should encompass both financial and non-financial wealth, along the lines of the Danish model.

- Keep in play the option of a Financial Activities Tax to compensate for the financial sector's exemption from GST, noting that this option was not among those explicitly ruled out in the Ministers' letter of 20 September;

- Recommend a significant expansion of the scope and depth of statistics on the tax system, and in particular call for the regular production and publication of data on the taxation paid by High Wealth Individuals;

- Include capital gains in the definition of income used when estimating effective tax rates by decile, and revise Figure 3.3 of the Interim Report accordingly.

2. Improving equity

2.1. The NZCTU notes that the Tax Working Group has found that amongst high-income countries, New Zealand has one of the least effective tax systems for reducing income inequality, and also one of the least effective benefit and income support systems.

2.2. Figure 3.3 on page 17 of the Report makes dramatically apparent the very weak progressivity of the income tax scale, and the near-complete reliance on transfers to achieve mitigation of inequality. These are useful lessons, but it looks as though even the very mildly progressive effective tax rate shown across the top half of the income distribution does not reflect the true situation.

2.3. Figure 3.3 significantly overstates the actual effective tax rates facing the top one or two deciles of the income distribution, because capital gains have not been included in the denominator of the tax rate. This needs to be remedied in order to avoid giving false impressions – both of high tax effort at the top of the distribution, and of a progressive structure of tax overall.

2.4. We therefore request the Tax Working Group, either prior to or as part of its final report, to provide a reworked version of Figure 3.3, showing the average

effective tax rates by decile when the best available estimates of capital gains are included in the denominator of the tax-rate calculation.

2.5. New Zealand's "broad-base-low-rate" model originated from the quest to maximise tax revenue as "efficiently" as possible, in a setting where "efficiency" was defined in a way that excluded consideration of equity matters. The present state of New Zealand's tax scale is the result of resolving the often-cited equity/efficiency trade-off almost entirely in favour of narrowly-defined "economic efficiency"[2]. It is therefore no surprise to see in Figure 3.4 that the redistributive impact of the New Zealand tax system is comparable with inegalitarian countries such as the USA, and far below the Nordic countries which sustain proper welfare states.

2.6. It would be useful to see how that chart would change – how far up the ranking New Zealand might be moved – if all redistributive options allowed by the constraints of the Terms of Reference and the recent ministerial correspondence with the Group were to be implemented.

2.7. We suspect that the answer to this question would be that the very restricted scope of the Tax Working Group's brief will allow very little progress towards greater redistributive outcomes, as measured by Gini coefficient reductions.

2.8. We nevertheless strongly urge the Group to be as ambitious as possible in its thinking about a package to reduce inequality, and to extend its thinking to potential packages that may have been "excluded from its terms of reference but which could benefit from being considered in the context of its recommendations", as explicitly provided for in the Terms of Reference.

2.9. The NZCTU reiterates its view that an increase in the top rate of income tax is desirable, notwithstanding the Tax Working Group's Terms of Reference.

2.10. The NZCTU supports the proposal to increase progressivity by lowering tax rates and raising thresholds at the bottom of the income distribution, and increasing welfare benefits.

2.11. The Tax Working Group should pay close attention to all options within the Terms of Reference to maximise the redistributive function of the tax system.

3. Ring-fencing capital losses

3.1. The NZCTU supports the Tax Working Group's recommendation that capital income, including capital gains, be included in the definition of income for tax purposes.

[2] We would point out that defining "efficiency" in terms of maximising revenue subject only to the constraint of "allocative" or "productive" efficiency is a narrow conception, far removed from the more general and relevant notion of efficiency in progressing the Living Standards Framework and the Sustainable Development Goals. In the latter case, mitigating inequality of income and wealth is an essential component of efficiency – not a separate, opposed objective.

3.2. In our first submission in April 2018 we noted several issues that would need to be confronted in the event that the Group opted to go down this route. Paragraph 11.6 of that submission noted that

> At the date when a capital gains tax is introduced, firms and individuals will have on their books a wide array of assets whose current valuations are far in excess of their historic cost, representing capital gains which have not been taxed. Downward revaluation of those assets subsequent to the start of CGT ought not to be deductible.

3.3. Paragraph 11.7 further said

> We agree with the Background Paper that "if capital gains are taxed on a realisation basis, tax base maintenance considerations suggest that capital losses should be ring-fenced", notwithstanding that on the face of it this is a departure from the Hicksian income definition discussed above.

3.4. The strong arguments for not making a capital-income tax symmetrical with respect to gains versus losses are greatly reinforced when a valuation-day approach is chosen as recommended in paragraph 108, page 155 of the Interim Report. This makes the scale of post-valuation-day gains or losses directly and heavily dependent on the state of asset markets on the day the tax comes into effect.

3.5. The potential fiscal costs of allowing non-ring-fenced losses to be offset against other taxable income in the event of a major market meltdown following valuation day are sufficient to conclusively make the case for ring-fencing all capital losses - not just those foreshadowed in paragraph 105 on page 155 – to be applicable only against previously-taxed capital gains.

3.6. The fiscal consequences of a "run on the Consolidated Fund" triggered by a cascade of tax-deductible asset write-downs are potentially devastating, and would eliminate the option of using other, less regressive, fiscal options to confront an economic downturn (see, for example, the discussion of household cash bonuses in section 4 below).

3.7. A further argument for ring-fencing capital losses is the need to avoid a situation where the state in effect underwrites unwise or speculative investments by taking on a share of the risk represented by the marginal tax rate, while having no say in the decision to embark on the investment – that is, no control over whether the investment is prudent.

3.8. The existing tax law already makes provision for the deductibility against income in general of loss of value of capital assets, via depreciation allowances. To offer tax reductions via both depreciation allowances and deductibility of capital losses opens the way to a wide range of opportunistic behaviours designed simply to avoid tax, often in cases where the taxpaying party is in no genuine need of tax relief. This is particularly true in the case of assets which potentially both depreciate in an economic sense and experience significant changes in market values. The principal asset class for which this holds is real estate. In this case, whether depreciation occurs is strongly contested by experts, with the result that depreciation on buildings is currently not recognised for tax purposes. We suggest that whether or not

depreciation on buildings does occur, tax deductions should not be allowed for depreciation if deductions are allowed for losses of capital value.

3.9. Opportunistic behaviour of the sort foreshadowed in the Interim Report pages 149-150 paragraph 71, page 154 paragraph 101, page 155 paragraph 106, and page 156 paragraph 109 is to be anticipated as a major threat to revenue in the absence of rigorous loss ring-fencing.

3.10. We therefore submit that all capital losses be ring-fenced so that they can only be used as a deductible expense against previously-taxed capital gains. While it may be argued that this adds some complexity to the tax system in that it requires capital value changes to be differentiated from other income, this is a relatively minor drawback compared to the risks of full deductibility. In any case, capital value changes will have to be identified separately in order to justify them.

3.11. Related to the ring-fencing issue is the treatment of "rollovers" under a realisation-based capital-income tax (Interim Report pages 149-150). Where assets change hands, the capital gains already accrued must be either deemed to have been realised at the moment of transfer, and taxed accordingly; or left untaxed until some later time. The first of these options runs into the difficulties of the accrual approach discussed on pages 142-143 of the Report; the second could enable taxation to be deferred indefinitely by continually avoiding any "sale" of the assets. If rollover relief is provided, it should not enable such indefinite deferral of tax liability. One option would be to specify a time horizon – possibly five or ten years - within which the asset must be actually realised, or else deemed to have been realised, with tax charged at that point. This would provide sufficient time for the beneficiary of the asset transfer to make provision for the eventual cashflow impact of the tax.

4. The stabilisation role of tax

4.1. The Interim Report lists (page 4) three respects in which the tax system "underpins the living standards of New Zealanders", the third of which is "as a policy instrument in its own right". However when this third role is developed on page 11 and in Chapter 10, it turns out to include only the microeconomic role of tax as "a policy instrument to influence behaviours".

4.2. In thus limiting its discussion, the Interim Report has excluded the key macroeconomic function of the tax system as one of the "automatic stabilisers", that work by loosening the fiscal stance in economic downturns, and tightening it in booms.

4.3. A key determinant of the effectiveness of the tax system as an automatic stabiliser is the progressivity of the tax scale, something that has been dramatically reduced in New Zealand over the past couple of decades. This weakening of the counter-cyclical link between the fiscal stance and the phase of the business cycle leaves the New Zealand economy more vulnerable and less resilient in the face of an economic downturn than was the case in the past.

4.4. In addition to having nothing to say about automatic stabilisers, the Interim Report contains no discussion of ways in which discretionary adjustments to tax rates have a potential role to play in stabilisation policy.

4.5. In this connection we draw the Group's attention to the very significant role that lump-sum transfers to households and/or individuals, delivered through the tax-transfer system, can have in providing a rapid discretionary fiscal response to a sharp downturn in the macro-economy. This sort of one-off stimulus played a major role in Australia's fiscal response to the Global Financial Crisis in 2008-09 and could be a crucial addition to New Zealand's available policy options to enable a similarly rapid and effective intervention here.

4.6. The A$21 billion lump-sum-cash component of the Australian stimulus packages in 2008-09 amounted to 2% of GDP paid out, primarily to low-income households, in two successive injections. There is solid evidence that the payments were effective both in sustaining aggregate demand and in reducing income inequality[3].

4.7. Such payments can be characterised in various ways: "cash-bonus payments"[4], "tax bonus payments"[5], "negative poll taxes" or "negative income taxes"[6], one-off tax rebates, or one-off benefit bonuses. They represent a flexible rapid-response option to be deployed alongside more traditional forms of fiscal stimulus operating through increased government expenditure on, for example, infrastructure investment.

4.8. It may be suggested that allowing non-ring-fenced capital losses as deductibles would strengthen the automatic stabilisers. This argument carries very little weight and should not prevail over the strong case for rigorous ring-fencing. Capital-loss deductions would benefit mainly those at the top of the wealth and income pyramid where the marginal propensity to consume is lowest, which means their counter-cyclical impact would be less than the impact of lump-sum cash distribution as described above. Furthermore, the distributional effect of capital-loss deductibility would be regressive, whereas that of lump-sum distributions would be positive.

4.9. We recommend that the Tax Working Group should address the stabilisation role of taxation in its final report.

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[3] Hyslop, D. The Distributional Effects of the Australian Cash Bonus Payments Response to the Global Financial Crisis", 2014, http://www.nzae.org.nz/wp-content/uploads/2015/01/NZAE_Hyslop2014.pdf; Leigh, A., "How much did the 2009 Australian Stimulus Boost Demand? Evidence from Household Reported Spending Effects", *B. E. Journal of Macroeconomics*, 12:1, 2012, https://www.degruyter.com/downloadpdf/j/bejm.2012.12.issue-1/1935-1690.2035/1935-1690.2035.xml.

[4] Hyslop 2014 p.1.

[5] Leigh 2012 p. 3.

[6] Christopher Green "Guaranteed income plans: which is best?", in *Breaking the poverty cycle: readings on income maintenance* ed. R.L. Edwards, New York 1972, p.37.

5. Wealth transfers: gifts and inheritance

5.1. Our April 2018 submission noted (paragraph 11.1) that "one obvious gap in the income tax base at present is that … wealth transfers (such as gifts and inheritances) are not treated as income". We accept that the Tax Working Group's Terms of Reference rule out a separate inheritance tax, but we reiterate our view that gifts and inheritances are income, just as capital gains are, and that all should be subject to income taxation at the prevailing rates.

5.2. As our previous submission pointed out (paragraph 11.3) "it is a striking anomaly in New Zealand's system of taxes and transfers that whereas the principle [that income includes wealth transfers and windfalls] is vigorously pursued in relation to (relatively poor) beneficiaries, it is set aside in the tax treatment of capital gains and wealth transfers accruing to the rich".

5.3. Given the emphasis placed in the Interim Report (page 15) on the "broad base/low rate" policy framework, it is all the more important that exclusions from the broad tax base be explicitly justified in terms of the criteria of (page 13) "efficiency, equity and fairness, revenue integrity, fiscal adequacy, compliance and administrative costs". Neither gifts nor inheritance warrant exemption from taxation under these headings.

5.4. In the treatment of welfare beneficiaries, gifts are routinely treated as income, leading directly to reductions in benefits and hence a squeeze on beneficiary budgets. The recent High Court judgment of Davison J[7], while drawing a welcome line between loans and gifts and appropriately reversing the Social Security Appeal Authority's treatment of both as income, made clear at paragraph 90 the legal position that gifts are income for the purposes of the Social Security Act.

5.5. Noting that the Tax Working Group is interacting with the Welfare Working Group, this would appear to be a crucial area in which the two parts of the tax-transfer system need to be better aligned. On the assumption that the Social Security Act is not likely to be amended to remove the treatment of gifts as income, we submit that consistency requires the inclusion of gifts as income for taxation purposes. This has nothing to do with the amount of revenue that taxing gifts might or might not yield. It is a matter of simple consistency and natural justice. The "integrity of the tax system" is definitely at stake here.

5.6. Gifts are not excluded by the Tax Working Group's Terms of Reference, and we submit that they ought to be included along with capital gains in the Group's recommended extension of the income tax base.

5.7. The Report's practice (paragraph 105 page 43) of categorising estate duty and gift duties under the heading of "wealth taxes" obscures the issue. Whereas wealth is a stock in the hands of an individual or other entity, transfers of wealth via inheritance and gifts involve flows, as distinct from stocks, and are an addition to the income of the recipient.

5.8. Taxing gifts and bequests separately from the income tax system, by means of taxes imposed on the donor or the estate, rather than the recipient, does

[7] *F v Ministry of Social Development* 2 July 2018 [2018] NZHC 1607.

have obvious negative connotations from an equity standpoint. We have not advocated, and do not advocate, the revival of separate estate and gift taxes. However, we reiterate that as income in the hands of the recipient, wealth transfers ought to be included in any proper accounting of the recipient's income for tax purposes.

5.9. We therefore urge that wealth transfers be recognised as a potential base for income tax, and specifically that the Tax Working Group should address the merits of bringing gifts into the definition of income for tax purposes. This issue lies squarely within the Terms of Reference

5.10. Notwithstanding the Terms of Reference, we still believe that the issue of inheritance as income in principle should be at least acknowledged.

5.11. Note that the discussion on how to measure capital gains on assets transferred at death or by gift on page 143 paragraph 28 of the Interim Report is entirely separate from the issue discussed here, namely taxation of the aggregate value of the wealth transferred.

6. Wealth tax and land tax

6.1. The NZCTU is disappointed that the Tax Working Group has not followed its 2009 predecessor in recommending a land tax, has not elaborated more fully on the vital role of local-body rates ("a narrow-based wealth tax in real estate" – page 16) in sustaining local government, and has rejected a wealth tax on grounds which seem to us very weak.

6.2. The Group's case for not looking further at a wealth tax is found on pages 43-44 of the Interim Report, paragraphs 106-108. The Report offers no principled grounds for abandoning the idea. Instead, the arguments against wealth taxes are entirely pragmatic: they "tend to have significant exemptions and simplified valuation rules", they "can create major distortions to savings and investment decisions"; they "tend to suffer from high levels of evasion and avoidance"; they are "difficult to apply" and "many types of assets are hard to value".

6.3. In recommending against a wealth tax, the Tax Working Group relies heavily on a 2018 OECD report[8] which, we submit, has been cherry-picked for negatives while overlooking crucial qualifications made by the OECD.

6.4. At the outset, the OECD study makes a particularly strong statement in favour of addressing wealth inequality[9]:

> Wealth inequality is far greater than income inequality, and there is some evidence suggesting that wealth inequality has increased in recent decades. In addition, wealth accumulation operates in a self-reinforcing way and is likely to increase in the absence of taxation. High earners are

8 OECD (2018), *The Role and Design of Net Wealth Taxes in the OECD*, http://dx.doi.org/10.1787/9789264290303-en .

9 OECD (2018) p.11.

able to save more, meaning that they are able to invest more and ultimately accumulate more wealth. Moreover, investment returns tend to increase with wealth, largely because wealthy taxpayers are in a better position to invest in riskier assets and generally have higher levels of financial education, expertise and access to professional investment advice.

6.5. The OECD then lays out (pages 11-12) a clear line of reasoning for recommending against wealth taxation when compared with the alternatives. We have added emphasis to some parts of the reproduced passage below:

> [T]he report concludes that from both an efficiency and equity perspective, there are limited arguments for having a net wealth tax in addition to broad-based personal capital income taxes and well-designed inheritance and gift taxes. While there are important similarities between personal capital income taxes and net wealth taxes, the report shows that net wealth taxes tend to be more distortive and less equitable. This is largely because they are imposed irrespective of the actual returns that taxpayers earn on their assets. The report also argues that capital income taxes alone will most likely not be enough to address wealth inequality and suggests the need to complement capital income taxes with a form of wealth taxation. The report finds that there is a strong case for an accompanying inheritance tax on efficiency, equity and administrative grounds … [T]he report finds that there are stronger arguments for having a net wealth tax in the absence of broad-based personal capital income taxes and taxes on wealth transfers.

6.6. In the light of these comments it has to be recalled that in its Interim Report the Tax Working Group (i) has been barred (by its Terms of Reference) from recommending inheritance tax; (ii) has not addressed other wealth transfers, and (iii) has in fact proposed "capital income taxes alone" as its sole solution to wealth inequality – precisely the option rejected by the OECD. We recommend that the Tax Working Group revisit the OECD report on wealth taxes, and pay closer attention to its conclusions.

6.7. We submit also that the Interim Report's concluding argument in paragraph 108 that "a wealth tax is … a complex form of taxation that is likely to reduce the integrity of the tax system" requires a good deal more than mere assertion. There may well be a trade-off between the equity benefits of taxing the rich to reduce inequality, on the one hand, and the general need to protect the "integrity of the tax system" on the other. "Integrity" is always hard to protect when faced with the manoeuvring, avoidance, data concealment and emigration threats of the rich. This is true in relation to income tax as much as to wealth tax.

6.8. It is unfortunate but true that reducing wealth inequality is an extremely difficult policy problem, and it seems inevitable that any and all attempts to reduce that inequality will be opposed strongly, creatively, and often effectively, by the rich. That is not, however, a solid reason for not trying.

6.9. The Crown has faced practical difficulties in extracting revenues from the rich and powerful at least since the reign of King John. Tackling inequality in 2018 will require the Crown to confront, and face down (on the basis of democratic

consent through Parliament) the opposition of strong vested interests. We submit that the Government did not set up the Tax Working Group simply to advocate surrender to those interests.

7. Broadening the GST tax base: financial services

7.1. The NZCTU once again submits that financial services ought not to be exempted from tax on their value-added. Although the authorities may not at present have the necessary information to extend GST into financial transactions, it is certain that the banks hold this information. We suspect that they would be perfectly capable of implementing the extension of GST to their activities if the exemption were to be removed.

7.2. Insofar as financial services continue to be excluded from the GST system, a Financial Activity Tax (FAT) ought to apply as an alternative means of taxing value added in this sector. The Tax Working Group's sole expressed reason for rejecting a Financial Activities Tax is that (page 90 paragraph 31) "it creates 'tax cascades' in which additional tax is imposed at each stage of the production process". In the IMF document cited in our previous submission in support of a FAT[10], the cascading issue was discussed on page 126. The solution proposed there, insofar as cascading is an actual issue, was not to leave the financial sector exempt from tax, but rather to apply a rate for FAT below that set for VAT (GST).

7.3. While acknowledging that cascading is an issue, we reiterate that, as the Interim Report acknowledges (paragraph 27 on page 89), the absence of any tax on financial services' value added is both distortionary and unfair.

7.4. There are a number of ways in which cascading can be mitigated, including (for example) allowing financial sector firms to claim rebates of all GST invoiced through to them from upstream suppliers of non-financial goods and services.

7.5. A GST-like FAT could be considered by requiring financial sector firms annually to estimate their total FAT for the coming year and strike a tax rate that they apply to the margins of all transactions that in total will raise the estimated FAT for the year. Customers would be informed of the FAT content of transactions in the same way GST is notified, and downstream businesses would be able to claim it back. A washup would occur at the end of the year to calculate any FAT owing or overpaid by the financial sector firm, with any correction applied to the tax rate struck in the following year. IRD (perhaps in cooperation with the Reserve Bank) would be given the power to audit the margins and tax calculations.

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[10] In Stijn Claessens, Michael Keen, and Ceyla Pazarbasic (eds), *Financial Sector Taxation: the IMF's Report to the G-20 and Background Material*, September 2010, https://www.imf.org/external/np/seminars/eng/2010/paris/pdf/090110.pdf.

7.6. We submit that a Financial Activity Tax remains a serious option and deserves revisiting before the final report is written.

7.7. We emphasise once again that a FAT is different from a FTT, and has not been ruled out by the Ministers' letter of 20 September. We encourage the Group to address them separately, rather than just submerging the FAT under the FTT as in paragraph 12.5 on page 92.

8. Company tax

8.1. A review of the numbers in Tables 14.1 and 14.2 on page 101 of the Interim Report dramatically illustrates the extraordinarily favourable tax treatment of New Zealand-resident shareholders relative to their counterparts elsewhere in the OECD. With imputation or its absence taken into account, New Zealand has an overall statutory top rate of 33% compared with 47% in Australia, 48% in the USA and 57% in France. The essential point is that in countries with double taxation of company profits, a nominal company tax rate that looks low can in fact be quite high, relative to New Zealand.

8.2. The New Zealand company rate on its own, at 28%, is significantly below Australia's 30%.There is certainly no case at all for reducing the company tax rate. On the contrary, the case for an increase, at the very least sufficient to align the rate with that in Australia, looks compelling on the basis of these figures – all the more so given the absence of any evidence that reducing the rate in the past has had any positive effect on foreign investment. The company tax rate should at least be returned to 30%, but ideally raised to parity with the top personal rate.

8.3. We note that the Interim Report offers no discussion on the proposal section 15 of our submission last April recommending an excess-profits tax. The NZCTU remains in favour of such a tax.

9. Information and transparency

9.1. The NZ CTU strongly supports the call on pages 124-126 of the Interim Report for much greater transparency and more thorough statistical analysis of tax data. The Australian Tax Office publishes far more comprehensive and informative tax statistics than New Zealand, and could serve as a model. In particular we congratulate the Group for making available the invaluable paper on High Wealth Individuals[11]. We strongly urge the Group to recommend production of analysis along these lines by Inland Revenue on an annual basis.

9.2. Figure 3.4 on page 18 of the Interim Report usefully shows New Zealand's low ranking, relative to other OECD economies, in the redistributive impact of its

[11] Available at https://taxworkinggroup.govt.nz/resources/information-release-high-wealth-individuals-wealth-accumulation-review

tax-transfer system. This also is an example of the sort of descriptive material that ought to be published on a regular basis.

9.3. Looking deeper into the information requirements of a more efficient and comprehensive income tax system, there is a clear need for IRD and Statistics New Zealand to collaborate in producing income statistics based on the Hicksian definition and providing more detail on the effective tax rates that are exhibited by hard-to-measure groups and sectors within the economy.

9.4. The recent work by Cabral and Gemmell[12] on using expenditure as well as income data to identify underreporting of household income is a useful step in that direction. More research into effective tax rates and income reporting by sector is needed, as is better analysis of the farming sector's avoidance practices and "farming for capital gain"[13].

9.5. It seems clear that reported incomes in the purportedly lowest decile of the income distribution are distorted by inclusion of a significant number of self-employed small businesses that are taking advantage of opportunities to conceal or under-report their actual income, while sustaining disproportionate levels of expenditure.[14] An important consequence of this is to obscure the situation of the genuinely disadvantaged individuals in that decile.

9.6. Recommendations for more focused statistical analysis and better targeted survey research would be welcome.

9.7. We note with interest that the Ministers' letter of 20 September has asked the Group to advise on how the available data on wealth distribution could be improved. This request points directly towards the usefulness of a comprehensive wealth register along the lines of the Danish system. Such a register would include, *inter alia*, bank deposits, property titles, holdings of shares and bonds, closely-held companies, unincorporated businesses, real estate. Much of this information could be collected from administrative sources.

9.8. A wealth register of this sort would be not just a valuable addition to knowledge about the distribution of wealth in New Zealand; it would also meet the clear potential need for detailed wealth data, in the event that a future New Zealand Government decides to proceed with a wealth tax. A well-established

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12 Cabral, Ana Cinta G. & Gemmell, Norman, 2018. "**Estimating Self-Employment Income-Gaps from Register and Survey Data: Evidence for New Zealand**," Working Paper Series 7625, Victoria University of Wellington, Chair in Public Finance.

13 The popular impression that "farming for capital gain" is common, is lent weight by the background paper "Effective company tax rates in New Zealand: Supplementary Background Paper for Session 12 of the Tax Working Group June 2018" (available at https://taxworkinggroup.govt.nz/resources/twg-bg-3996763-effective-company-tax-rates-in-new-zealand) which at paragraphs 39 and 40 reports that typically half of small and medium companies in agriculture report a loss in the years studied and that "Untaxed realised gains are significant for this industry."

14 See for example Perry, B. (2018). *Household Incomes in New Zealand: trends in indicators of inequality and hardship 1982 to 2017*. Wellington, New Zealand: Ministry of Social Development, pp.27, 266. Retrieved from https://www.msd.govt.nz/about-msd-and-our-work/publications-resources/monitoring/household-incomes

wealth register will be a pre-requisite for the efficient administration of such a tax.

9.9. Across the OECD the demand for taxation of wealth is likely to grow, not recede, in coming years.