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PERSPECTIVES ON PROSPERITY

Taxing Times

THE QUEST FOR CERTAINTY AND COHERENCE

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PERSPECTIVES ON PROSPERITY

Introduction

To maintain the integrity and long-term sustainability of the New Zealand tax system, a reasonable degree of certainty for the taxpayer is critical

Tax is one of the defining issues of the 2017 New Zealand General Election. Taxing Times: The quest for certainty and coherence is Chartered Accountants Australia and New Zealand's (CA ANZ) contribution to the election debate about what and who to tax, and how. In it we call for a considered approach to tax, avoiding ad hoc changes that are designed to meet political objectives, but are inconsistent with principles of sound tax policy design.

The medium to long term sustainability of New Zealand's tax base rests on a combination of managing rising government costs and the fiscal challenges of an ageing population.

Informed debate and decisions are required before action is taken. Pressure on the current overall tax base will increase as the number of retirees grows and as government spending increases, relative to a reducing workforce and income tax base.

Trade globalisation, the digitalisation of the economy, and the increasing mobility of labour and capital, will additionally have an impact on revenue collected from our current tax base settings. Taking all of the above into account it is likely that the tax base will need to be broadened or tax rates increased.

To maintain the integrity and long-term sustainability of the New Zealand tax system, a reasonable degree of certainty for the taxpayer is critical. Our tax system is based on taxpayer trust and voluntary compliance. Certainty, or at a minimum predictability, is premised on coherent tax law, tax policy outcomes and tax administration practices and decisions.

Ad hoc changes to the tax system have the potential to undermine its integrity, acceptability and political sustainability.

Chartered Accountants Australia and New Zealand believes that tax reform should be viewed as a long term or quasi-constitutional exercise.

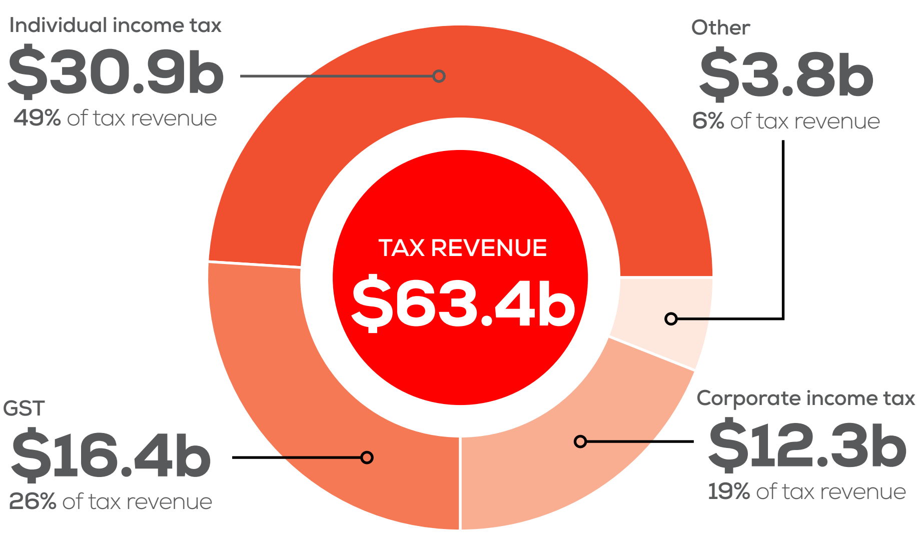
Sustainability of the tax base

New Zealand is currently reliant on tax bases that are essentially mobile with personal income tax and corporate tax accounting for 68% of total tax revenue in the 2015-2016 year. In our view this reliance needs to be reduced in the medium to longer term.

Continued reliance on these tax bases, in the face of future fiscal pressures, raises questions about the long-term sustainability of the tax system.

Reliance on personal income tax in particular heightens risks given that a relatively small number of individuals pay the most significant portion of income tax under a progressive tax system. Put in perspective, 3% of New Zealand's adult population pay 25% of the 'gross' income tax collected (i.e. income tax before Working for Families and certain other transfers are made) and 14% of the adult population pay over 50% of the 'gross' total. Conversely, 9% of the total income tax collected is contributed by just under 50% of the adult population. These numbers are placed into sharper contrast when the 'net' position (i.e. after the

Revenue collected 2015-16



source: Inland Revenue

payment of Working for Families assistance) is used as the measure.

The emigration of even 10% of the highest earning group would have a material effect on total income tax collected. This risk is something that cannot be taken lightly-given the increased mobility of highly skilled and paid people.

GST rate increases over time have also broadened the tax base mix with GST accounting for 26% of total tax revenue in the 2015-2016 year.

The GST base provides a useful counter to, and reduces reliance on the income tax base. It is based on consumption and has the added advantage of being a relatively immobile base. New Zealand has a highly efficient GST with very few exclusions (ie a broad base approach).

Successive governments have wisely resisted calls to narrow its application. The end result is that New Zealand's GST is the envy of many other countries. However, further rate increases would be a significant political challenge given the perceived regressive nature of consumption taxes.

A coherent tax system – the impact of ad hoc changes

The past year has seen a proliferation of proposals for "taxes" on capital gains, land, transport, water, beds and tourists – really a mix of taxes, user charges, levies and royalties. They should all be tested against the broad principles of good tax policy.

While we welcome debate and discussion on variations or extensions to the tax base, we caution that change should be well considered and compatible with our tax system. Public and taxpayer acceptance is key given that our tax system is based on taxpayer trust and voluntary compliance. If a tax is to broaden the tax base substantively, its introduction needs to be considered in conjunction with existing taxes and social assistance programmes.

Ad hoc changes threaten the sustainability of the tax system – a risk heightened when the policy and design process is rushed and the legislation introduced lacks clarity and impacts on taxpayer certainty.

Taxing capital

Base-broadening options include (among others) a capital gains tax (CGT) and a land or property tax.

It is argued that a CGT, and an increase in property or land taxes, will facilitate a more efficient and equitable tax system and that the lack of a CGT reinforces a bias toward speculative housing investments and undermines housing affordability.

In our view, a CGT is unlikely to deliver all of the benefits touted in some quarters. The 2009 Tax Working Group, the last time New

Zealand had a comprehensive look at the challenges facing the tax system, did not recommend the introduction of a CGT because of its complexity and practical challenges. We understand the rationale for the group's view.

A comprehensive CGT, including the family home, would give rise to significant practical challenges. A partial CGT (excluding the family home and levied on realised gains only), on the other hand, would create distortions and inefficiencies of its own, undermining to some extent the very rationale for the introduction of a CGT.

It seems unlikely that the fiscal return would justify the complexity, compliance costs and administrative burden that a CGT would bring with it. This said, there is a need to review tax settings for property to address current distortions in the tax system which in part impact on current housing affordability and raise concerns about equity (between those who own property and those who do not).

A review of tax settings for property could include (but not necessarily be limited to) a detailed non-political discussion of a CGT; an extension of the existing property bright-line test in the Income Tax Act beyond two years and the possible introduction of a land tax. As regards the bright-line test, the existing family home exclusion should eliminate most unforeseen sales through changed circumstances.

Land is immobile and therefore, potentially, a more sustainable tax base than personal and corporate taxes. A low-rate land tax has some appeal, but also raises challenges – notably the likelihood that it would reduce the value of land on introduction, to the detriment of existing landowners.

Although a land tax would be relatively simple to administer, the design of such a tax would need to address significant equity concerns in relation to, for example, communally owned land, farmland and land owned by people in retirement. The ability of people to pay on an unrealised basis could be addressed by way of targeted relief or deferral (of payment, not liability).

The introduction of a low-rate land tax to broaden the current tax base would need to be implemented as part of an integrated package to receive taxpayer buy-in. This could be combined with corresponding income tax reductions and targeted social assistance.

International tax law changes

New Zealand, as a trading nation and importer of capital, is susceptible to international tax law changes that may deliver inappropriate outcomes for our country. The G20 and OECD are committed to addressing Base Erosion and Profit Shifting (BEPS). Indeed, there has been a real sense of urgency and impetus surrounding this work with the release of the OECD's BEPS action plan and related reports, and the development of a multilateral instrument to strengthen existing Double Tax Agreements between countries that elect to opt in.

Given the relative global importance of this work, it is pleasing to see that the New Zealand Government has been fully engaged in the multilateral discussions and negotiations through its active participation in the OECD work programme. In our view, it would have been a mistake for New Zealand to act unilaterally.

CA ANZ has two main reservations in relation to the proposed New Zealand legislative response to BEPS. The first stems from early enactment and the second from the degree of assumed knowledge of overseas' associates' filing positions.

Following an initial consultative process, the Government recently announced its intended direction of travel for BEPS with the expected introduction of a BEPS-related tax bill in December 2017.

We have two main reservations in relation to the proposed New Zealand legislative response to BEPS. The first stems from the intended timing of enactment, with the measures to be broadly effective from 1 July 2018. We do not believe that it is in the country's best interests to be an early adopter and instead would have preferred waiting until key trading partners have locked in their legislative reforms.

The second stems from the Government's intention to adopt comprehensive rules for hybrid mismatch arrangements. We believe that these proposals impute a degree of knowledge on New Zealand taxpayers about the tax filing positions of their overseas associates which in practice will often be difficult to obtain. This will unduly increase uncertainty and complexity when computing local tax positions.

The proposed hybrid rules also have the potential for overreach with wider application than perceived by the general public. The reach will not be confined to multinational corporations.

Company tax rate

The global trend to lower company tax rates continues apace. New Zealand needs to be mindful of this trend, but comparing baseline rates can be misleading. Countries such as New Zealand tax resident companies on their worldwide income; other countries adopt a territoriality approach taxing only income sourced in their tax jurisdiction. Deductions and allowances against taxable income also vary significantly between countries, altering the effective tax rate.

The most important issue for New Zealand is to have a close alignment between the company, personal and trust tax rates. History shows that when these rates are significantly out of alignment, pressure is put on the tax system to counter potential avoidance activity (perceived or otherwise).

Tax harmony with Australia – slow progress

In the past three decades there has been significant progress in terms of alignment between financial markets, competition and tax policy and the broader regulatory settings that impact on businesses operating on both sides of the Tasman. However, progress is slowing and there are challenging hurdles to further integration.

The non-mutual recognition of imputation and franking credits is one such long-standing issue which adversely affects trans-Tasman investment flows and has yet to be resolved.

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 117,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that influence the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.