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Global Tax Alert

New Zealand rejects Tax Working Group recommendation to implement a capital gains tax

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Executive summary

The New Zealand Government has provided its responses to the Tax Working Group (the Group)'s final recommendations released on 21 February 2019. The Government has ruled out introducing a capital gains tax (CGT) in any form. This decision comes as a surprise to many who had expected a CGT on residential investment property (which received unanimous support by the members of the Group) at a minimum and potentially a wider range of assets (which received majority support).

The prior EY Global Tax Alert summarizing the final recommendations made by the Group is available here. This Alert discusses the Government's response to those recommendations.

Detailed discussion

Background

The New Zealand Government set up the Group as an independent panel tasked with reviewing the New Zealand tax system to improve its fairness, balance and structure over the next 10 years. In its final report to the Government, the Group's central recommendation was the introduction of a comprehensive CGT on a broad range of asset classes, at full rates, with no allowance for inflation and with limited roll-over relief.

Building a better working world

Under New Zealand's Mixed-Member Proportional (MMP) system of parliamentary representation, it is rare for a single political party to achieve the simple majority in the legislature required to govern alone. Often, the Government is formed through a coalition agreement comprised of more than one party, requiring compromise by participants. Critics of MMP often assert that small parties in a coalition exert outsized influence on government policy.

The current Government was formed in 2017, with the larger New Zealand Labour Party in coalition with the economic nationalist New Zealand First party and supported by the Green Party of Aotearoa New Zealand. While a CGT has been a consistent plank of Labour and Green party policy for some years, the coalition was unable to achieve consensus on CGT due to New Zealand First's opposition.

No capital gains tax

In a live-streamed press conference on 17 April 2019, Prime Minister Jacinda Ardern announced that the Government would not adopt the recommendation by the Group to introduce a capital gains tax. Ardern will not revisit this decision while she remains Prime Minister. The Government has also ruled out further changes or extensions to the "bright-line test," which taxes gains on residential land disposed of within five years of acquisition.

The Government has announced, as an alternative, the exploration of options for taxing vacant land and to seek a review of the current rules taxing land speculators.

The Group was tasked with designing revenue-neutral packages that incorporate a CGT alongside tax rate reductions. The decision not to proceed with the CGT means that these packages will not proceed.

Other recommendations

The Government periodically releases a tax policy work programme outlining its tax policy agenda. Most tax legislation changes begin as an item on this agenda. The Government has broadly adopted for further consideration many of the recommendations made by the Group.

Taxation of businesses

The Government endorsed the Group's recommendations confirming the current suitability of the imputation system, flat company tax rate and income basis of taxation (as opposed to the turnover or cash flow basis mooted for small businesses).

The Government will consider for inclusion on the work program a change to the loss-continuity rules for start-up firms and reform to the treatment of non-deductible "black-hole" expenditure, by spreading such expenditure over five years with a NZ$10,000 safe-harbor threshold of upfront deductibility for feasibility expenditure.

As high priorities for the work program, the Government will consider reinstating building depreciation for seismic strengthening and developing a regime that encourages investment into nationally-significant infrastructure projects.

Many options for reducing compliance costs will be considered for the work program (some subject to fiscal constraints), including:

- Reduction in the number of depreciation rates and simplifying the process for using default rates
- Increasing the automatic deduction for legal fees (currently NZ$10,000), and a potential expansion to other types of professional fees
- Simplification of the fringe benefit tax
- Removal of resident withholding tax on close company related party interest and dividend payments
- Removal of the requirement for taxpayers to seek the approval of the Commissioner of Inland Revenue to issue GST Buyer Created Tax Invoices

Environment and ecological outcomes

The Group's framework for taxing negative environmental externalities was considered for inclusion in the work program but work to develop further environmental tax proposals (such as a "natural capital enhancement tax") would be deferred. The Government has noted that there is already work underway in respect of many of the environmental and ecological recommendations made by the Group relating to emissions, water pollution, solid waste and transport. A number of recommendations for strengthening the capability to measure environmental and ecological outcomes would be considered for inclusion.

International income taxation

The Government noted that work was already underway with respect to participating in discussions at the Organisation for Economic Co-operation and Development on the future of the international income tax framework. In respect of the recommendation to implement a digital services tax (when there is safety in numbers), the Government pointed to its recent announcement and consultation process beginning in May 2019.

Retirement savings

The Government will further consider efforts to encourage the savings of low-income earners, such as the refund of the employer's superannuation contribution tax for KiwiSaver (a voluntary work-based savings scheme) members earning up to NZ$48,000 per annum.

Future of Work

The Government has noted its current work on many of the recommendations related to the future of work, including:

- Supporting Inland Revenue's efforts to increase the compliance of the self-employed, particularly expanding the use of withholding tax as far as practical.
- Supporting the facilitation of technology platforms to assist the self-employed to meet their tax obligations (e.g., smart accounts).
- Using data analytics to identify under-reporting of income.
- Aligning the legal definitions of employee and dependent contractor.

In addition, the Government will consider for inclusion on the work program a review of current GST requirements for contractors who are akin to employees.

Integrity and administration of the tax system

From the recommendations, the Government will consider several high priority items relating to the integrity of the tax system. These include:

- A review of loss-trading
- Lifting the corporate veil for GST and PAYE liabilities
- Imposing a requirement for shareholders in closely-held companies to provide security to Inland Revenue where there is doubt as to the ability or intention of the shareholder to repay tax debt
- A stronger enforcement of rules for closely-held companies

What's next?

Inclusion on the tax policy work program is no guarantee that an item will become policy. We will likely see the high priority items, as highlighted in the Government response, to be added in the next update to the program in mid-2019. Not all the items marked for further consideration will progress however as the program is already busy, with significant projects such as Inland Revenue's business transformation, the new research and development tax credit and ongoing international tax reform utilizing many of the available resources.

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