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Global Tax Alert

New Zealand Tax Working Group considers future of tax in New Zealand

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Executive summary

The New Zealand Government created the Tax Working Group (the Group) to provide recommendations to improve the fairness, balance and structure of New Zealand's tax system over the next 10 years.

The Group was granted a wide Terms of Reference, however the Government has set out some areas outside the scope of the review, including increasing any income tax rate or the rate of goods and services tax (GST). Changes to the taxation of the family home or the land under it have also been excluded.

Following a public consultation process, the Group released their Interim Report (the Report) in September 2018 ahead of its final recommendations due in February 2019.

The Report explores the possibility of extending the taxation of capital income and makes a number of comments across a wide range of issues, including:

- Environmental and ecological outcomes
- Taxation of business
- GST and financial transaction taxes
- Personal income and the future of work
- International income tax and the digital economy
- Charities
- Integrity and administration of the tax system

Building a better working world

Detailed discussion

Extending the taxation of capital income

Overview

While certain capital gains are already subject to tax in New Zealand (such as gains on property acquired for the purpose of sale), New Zealand does not have a general capital gains tax (CGT).

The Report examines the possibility of extending the taxation of capital income (in other words, a CGT). The Group is yet to make specific recommendations but intends to do so in its final report.

Currently, the Group is considering two main options: taxing realized gains from specific asset classes that are not already taxed, or taxing certain assets on a deemed return basis, such as a risk-free rate of return method.

Realization-based CGT

The main focus of the Report appears to be on a realization-based CGT targeted towards the following asset classes:

- Interests in land (excluding the family home)
- Intangible property, including goodwill
- All other assets held by a business or for income producing purposes
- Shares in companies and other equity interests
- Certain choses in action (such as trade tie agreements)

Taxation would not extend to nonresidents, other than those holding New Zealand land (or shares in land-rich companies), or those holding business assets through a New Zealand branch.

"Valuation day" approach to transition

The Group prefers a "valuation day" approach to transition, where assets held on "valuation day" would be valued. Only increases in value from that day onwards would be taxed. A number of possible valuation methods are discussed in the Report.

No adjustment for inflation

At this stage, the Group has not recommended any allowance for inflation, such as indexing the cost base of the asset or a rate reduction depending on the asset holding period. Tax would apply at ordinary income tax rates to nominal gains and losses, and costs would generally be deducted at the time of sale to arrive at the net capital gain.

Environmental and ecological outcomes

The Group recognizes there is significant scope for tax to play a greater role in delivering positive environmental and ecological outcomes in New Zealand. The Report contains a draft framework identifying a range of criteria and design principles for environmental taxes to be effective.

In the short-medium term, the Group has suggested strengthening New Zealand's Emissions Trading Scheme, enhanced congestion charging and greater use of tax instruments to address water pollution. The Group notes that over the long term, new tools could eventually allow tax to play a role in addressing more complex environmental challenges such as biodiversity loss and impacts on ecosystem services.

Taxation of business

The Group has not recommended any reductions in the corporate tax rate or a progressive corporate tax rate. The preferred approach appears to be the reduction of fixed compliance costs for smaller businesses.

GST and financial transaction taxes

The Group does not see a compelling case for changes to New Zealand's broad-based GST regime. The Report has not recommended a financial transaction tax, viewing it as inefficient and unlikely to raise significant revenue in New Zealand. It notes, however, that the continued international debate on such taxes should be monitored.

Personal income tax and the future of work

The Report does not contain any recommendations around changing the level of personal income tax. However, the final report is likely to make recommendations on reducing income tax, specifically on lower income individuals.

In relation to the changing future of work, the role of technology and of the "gig economy," the Group believes the Government is satisfactorily addressing these issues. The final report will make soft recommendations as to the administration of taxation of contractors and the self-employed.

International income tax and the digital economy

The Group has recommended New Zealand be prepared to implement an equalization tax on digital services if a critical mass of other countries also adopt such a tax. The tax would need to be narrowly focused on digital services that involve user-generated value in New Zealand and would be an interim measure pending OECD[1] developments in this area.

Charities

The Group believes the Government should periodically review the charitable sector to examine whether forgone tax revenue has been used to achieve the intended social outcomes. The Report recommends the Government considers other matters further, such as a distinction between private foundations and other charitable organizations (with more restrictions on the former), the tightening of the deregistration rules to keep assets in the charitable sector and potential limits on GST concessions for charitable entities.

Integrity and administration of the tax system

Integrity

The Group believes the most significant threat to integrity relates to the taxation of capital income, which is dealt with elsewhere in the Report. The final report is likely to recommend a raft of changes to specific regimes where the Group considers individuals have the ability to avoid proper procedure or otherwise minimize their tax obligations. Specifically targeted groups include those who engage in the hidden economy.

Administration

The Group encourages the Government to release aggregated data and statistics about the tax system to enrich research and debate. It has also recommended the establishment of an independent taxpayer advocacy service to assist with the resolution of disputes.

Next steps

Public submissions on the interim report are open until 1 November 2018 and the Group's final report is due in February 2019. Any significant changes adopted by the Government as a result of the final report will not come into force until 1 April 2021 (after the next New Zealand election to be held in 2020).

In response to the Report, the Government has directed the Group to consider whether a tax on realized gains or the risk-free rate of return method of taxation (or a mix of both) is the best method of applying a potential CGT.

Endnote

1. Organisation for Economic Co-operation and Development.

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