



NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

**Submission of the
New Zealand Council of Trade Unions
Te Kauae Kaimahi**

to the

Tax Working Group

on its

**Future of Tax: Submissions Background
Paper**

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1. Introduction

- 1.1. This submission is made on behalf of the 30 unions affiliated to the New Zealand Council of Trade Unions Te Kauae Kaimahi (CTU). With 320,000 members, the CTU is the largest democratic organisation 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 background paper circulated by the Tax Working Group. Our submission does not cover all questions asked in the report, but focuses on those aspects we consider particularly require comment
- 1.4. We request the opportunity to meet with the Tax Working Group to discuss this submission. In addition to this submission on the Background Paper, the NZCTU will in due course make a submission on the Tax Working Group's draft recommendations, and will encourage its affiliates to do so also.
- 1.5. We have commissioned UMR Research to find out more about the public's attitudes and preferences on tax. We will make the key findings from the research that relate to the Tax Working Group's inquiry available to the Group to help inform findings once the research is processed and available, which should be within a week.
- 1.6. Within the Tax Working Group's Terms of Reference the NZCTU would support
 - A reduced rate of GST;
 - A Capital Gains Tax exempting the family home, but treating all other capital gains as taxable income, both for fairness and to dampen speculation in assets including housing, while encouraging investment in productive assets;
 - Consideration of a tax on wealth, including property but exempting the family home (one possible method would be a tax on a deemed "risk free rate of return" on assets);
 - Investigating other ways of removing the tax advantages that investment or speculation in property enjoys relative to productive investment;
 - Taxation of international companies like Facebook and Google which avoid tax in various ways including shifting profits overseas, not having a local presence, and other tactics not being actioned under the Base Erosion and Profit Shifting agenda;

- Taxes on excess profits resulting from windfalls or market dominance;
- A Financial Activities Tax (FAT) on financial institutions as proposed by the IMF;
- Taxes on cross-border financial transactions, both as a revenue source and to stabilise international financial flows and the exchange rate of the New Zealand dollar;
- A review of the company tax structure and its interaction with dividend imputation to ensure investment income is taxed sufficiently;
- Consideration of ending tax deductibility of interest on related party borrowing;
- A review of the taxation of closely held companies to make it difficult to use them for tax avoidance, and to provide tax relief for local owners of small firms;
- Ensuring that Trusts other than Charitable Trusts cannot be used for tax avoidance;
- Broadening of the tax base by recognising wealth transfers such as gifts and inheritances as forms of income;
- Pollution taxes to force polluters to bear the costs of all significant externalities they cause;
- Ensuring New Zealand's resource use taxes and royalties provide a fair return to New Zealanders and incentivise efficient use of those resources;
- Ensuring IRD has enough resources to track down tax evasion and abusive tax practices;

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

- Set aside in its deliberations the arbitrary 30%-of-GDP ceiling on tax revenue (paragraph 2.8);
- Take explicit account of differential impacts on men and women when considering changes (paragraph 4.2);
- Recommend further reviews to consider restoration of progressivity to income tax rates by means of for a tax-free income band up to \$35,000, a 38% rate on income between two and three times the average wage, and a 45% rate on income above that (paragraphs 5.6– 5.8);

- Look at full or partial replacement of Working for Families with a tax-free threshold on personal income (paragraph 6.3);
- Recommend that the GST rate should be reduced immediately to 12.5 percent and GST should be progressively replaced with other forms of taxation (paragraph 7.1);
- Address directly the issues raised by tax avoidance on the part of multinational companies not being actioned under the Base Erosion and Profit Shifting agenda; provide clear advice on addressing these and future challenges to the tax system in international double taxation agreements and trade and investment agreements (section 8).
- Recommend introduction of a Financial Activities Tax on the financial services sector (paragraph 9.13);
- Give consideration to a Financial Transactions Tax on cross-border financial flows (paragraph 10.2);
- Adopt the Hicks definition of income, thus bringing capital gains, gifts, and inheritance within the ambit of the income tax system (section 11);
- Urge development of a wealth-holdings register (paragraph 12.8);
- Review options for a wealth tax targeted at the top of the distribution (paragraph 12.9);
- Recommend adoption of a broad-based land tax with exemption for land under the family home, and a value-per-hectare lower threshold (paragraph 13.4);
- Recommend returning the company tax rate to 30% (notwithstanding the Terms of Reference limitation)(paragraph 14.1);
- Investigate an excess profits tax (paragraphs 14.6 and 15.9);
- Strongly recommend an increase in resources available to IRD to track down tax evasion and abusive tax practices, to ensure that everyone in the community pays their fair share of tax (paragraph 16.1);
- Review the level of existing resource levies, taxes and royalties (paragraph 18.3).
- Recommend major improvements in the quality and accessibility of tax statistics (paragraphs 19.5–19.6).

2. Funding an adequate level of Government spending

- 2.1. It is essential that the state is sufficiently resourced to carry out its functions and to perform its important redistributive role. Taxation is the means to achieve a better society and needs to be promoted as such.
- 2.2. The Government will need significantly more revenue in the coming decade to address New Zealand's social deficits, inequality including gender pay gaps, and environmental degradation, and to rebuild and sustain quality public services such as health, housing and education.
- 2.3. Currently the New Zealand public sector is in the midst of a wide-ranging underfunding crisis. In general, the infrastructure of the New Zealand nation has been severely run down, reducing the effectiveness of the public sector across a wide range of activities, from border control to conservation, from public transport to broadcasting, and from labour inspection to policing the tax system.
- 2.4. 'Wagner's Law' argues that as a nation's economy grows, the share of the public sector in the national economy tends to grow. US economist Larry Summers has recently supported this prediction for the US economy¹, and it seems likely that the same arguments apply to New Zealand in coming decades. In the long run the Government will be a larger, not smaller, part of the economy.
- 2.5. The redistribution required by the tax and transfer system is increased by poor 'pre-distribution' – the high inequality in gross or 'market' incomes such as wages, salaries and income from ownership of capital.
- 2.6. The NZCTU welcomes the clear statement by the TWG that (p.3) "Taxes allow the Government to fund the vital public services ... that underpin our living standards". However, the question of what level of Government expenditure will be required in coming decades – and consequently the volume of resources that will have to be captured by the tax system – requires far more explicit attention than the document provides.
- 2.7. Following a long period of underfunding of basic services such as health and education, and of holding benefit levels below the levels required to support an acceptable standard of living, it has to be anticipated that making up for the accumulated deficits in physical infrastructure, social, human and natural capital will be likely to push Government expenditure beyond the "historical level of 30% of GDP" mentioned in the Terms of Reference.
- 2.8. While those Terms of Reference explicitly speak of a "sustainable revenue base" to fund operating expenditure at that 30% figure, they do not rule out the usefulness of a revenue base adequate to support a higher level of government spending, or to sustain an increased operating surplus. The TWG should therefore not artificially constrain its analysis to incorporate any arbitrary cap on tax revenue, whether at 30% of GDP or any other level.

¹ David Leonhardt, 'Your coming tax increase', *New York Times* 7 September 2017, <https://www.nytimes.com/2017/09/07/opinion/trump-tax-increase.html>.

- 2.9. While the Labour Party's 2017 election manifesto and accompanying documentation referred to a target of holding Core Crown expenses around the 30% of GDP level, they contained no matching target for tax revenue. Whether or not Core Crown expenses are successfully held down to 30% of GDP, there will remain a strong case for raising a higher level of tax revenue to assist in funding capital investments and the non-Core component of expenditure.
- 2.10. The Terms of Reference explicitly require the Working Group to "consider the impact on the tax system of the likely economic environment over the next decade". Insofar as there are foreseeable justifiable calls for increased Government spending in the coming decade, any past relationship between tax revenues and GDP should be set aside in a forward-looking analysis.

3. Limitations of the Terms of Reference

- 3.1. The Tax Working Group has been instructed to work within Terms of Reference that contradict the ostensible purpose of the exercise – namely to "improve the structure, fairness and balance of the tax system". Of the four areas that have been ruled outside the scope of the Working Party's review, three (rates of income tax and GST, the tax treatment of inheritance, and the interface between the personal tax system with the benefit system) are inescapably central issues for fairness, structure and balance.
- 3.2. We submit that it will not be possible in practice for the Working Party to turn its back on those three areas that have been excluded from the Terms of Reference. The Working Party should exercise to the full the latitude granted in the terms of Reference to recommend further reviews. In doing so, the Working Party should carry its analysis far enough to make clear the ways in which all three would "benefit from being considered in the context of its recommendations", given that those recommendations themselves will be constrained from addressing these central issues.
- 3.3. We are aware that prior to the General Election of 2017 the Labour Party undertook to introduce no new taxes, and specifically no capital gains tax nor increases in personal income tax, during the current term.² The ten-year horizon specified for the Tax Working Party's analysis, however, runs well beyond the current electoral cycle, and the Group's recommendations, including recommendations for further reviews, should accordingly look beyond any short-run constraints the current Government may have imposed on itself.
- 3.4. The 2017 Labour Manifesto³ stated that "the tax system should be progressive, with those who are more able to pay tax contributing a greater share, and it should be fair and balanced across income, consumption and wealth to pay for the needs of our society." The NZCTU is in agreement with these principles, but notes that trends in the New Zealand tax system over recent decades have been in the opposite direction.

² *Labour's 2017 Election Platform: Labour's tax plan* at <http://www.labour.org.nz/tax> accessed 7 April 2018.

³ "Labour's tax plan" at <http://www.labour.org.nz/tax> accessed 7 April 2018.

- 3.5. It is therefore to be regretted that the Terms of Reference for the current review have downgraded the principle of progressivity while emphasising the narrow allocative-efficiency considerations that have dominated tax policy since the 1980s. The functions to be performed by the tax system go far beyond merely collecting revenue in the most “efficient” fashion, and there is a need to give much greater weight to fairness.

4. Gender and iwi issues

- 4.1. A disappointing feature of the Background Paper is the absence of any reference to women or gender. Women make heavy use of government services, and have earnings and savings profiles over their lifetimes that differ significantly from those of men. Consequently, policies such as tax incentives for savings will disproportionately favour men. At the same time, because of lower incomes and savings during their working years, women are more reliant than men on National Superannuation in retirement. They are also heavier users of public services and of the transfer system generally. Therefore tax cuts doubly disfavour women: they have lower incomes and so in general receive smaller tax reductions, and they suffer when public services deteriorate as the result of insufficient revenue. Tax policy is not necessarily gender neutral in its incidence.
- 4.2. In making recommendations on changes to the tax system, therefore, the Working Group should take explicit account of differential impacts on men and women.
- 4.3. Gender budgeting provides a way of analysing government expenditure and fiscal policy to promote gender equality and to provide a gender perspective on fiscal policy and fiscal decisions. The concept and practice of gender budgeting is now gaining the support of the OECD, the United Nations, the ILO, and the IMF as a way to promote and address gender equality issues. It is also gaining attention in New Zealand. In 2017 the National Council of Women (NCW) identified the lack of any national plan with targets for the advancement of women, including gender budgeting.
- 4.4. A recently published Treasury paper by Suzy Morissey⁴ examined the 2016 Tax Expenditure statement and found a number of specific initiatives that could have a negative impact on gender equality. It concluded that gender budgeting had the potential to provide greater transparency and analysis of expenditure on tax concessions.
- 4.5. Possible government actions identified in paper include:
- Mainstream gender analysis of proposed expenditure to determine its gender impact.
 - Include gender responsive documentation in the Budget documents, such has recently been introduced in Canada.

⁴ Suzy Morissey (2018). *Gender Budgeting: A Useful Approach for Aotearoa New Zealand*, New Zealand Treasury Working Paper 18/02. Available at <https://treasury.govt.nz/publications/wp/wp-18-02>

- 4.6. The section in the Background Paper on ‘Te Ao Māori’ is welcome, but devotes only two short paragraphs to inequality issues affecting Māori. This is an improvement on the Terms of Reference, which make no mention of Māori, and we hope that Māori issues will receive careful attention.
- 4.7. An important point to bear in mind is that a more progressive tax system will inherently tend to improve the position of women and Māori.

5. Progressivity and top income tax rates

- 5.1. Tax rates on high incomes have been reduced in New Zealand to levels that virtually eliminate the principle of progressivity. As noted above, while the Terms of Reference for the TWG review prevent the making of firm recommendations on income tax rates, those same Terms of Reference allow the Group to recommend further reviews, and we urge that this opportunity be fully utilised.
- 5.2. The loss of progressivity in the tax system and the increasing role of the inherently regressive GST have contributed powerfully to the rise in inequality of income and wealth that now presents a key policy challenge. Changes to the tax system – possibly radical ones – will be required in the coming decade to reverse disequalising trends across the economy.
- 5.3. Important first steps to restore progressivity would be to lower the rate of GST and bring in taxes on wealth.
- 5.4. The balance between income and wealth in the tax base has shifted massively in favour of wealth as very large personal fortunes have accumulated in a low-tax environment. There is an urgent need to bring tax mechanisms to bear on the holding and transferring of large personal wealth, and on the accrual of unearned capital gains.
- 5.5. More should be done to raise the progressivity of personal income taxes by increasing rates on the top portions of high incomes and lowering those for low incomes
- 5.6. The NZCTU’s *Alternative Economic Strategy*⁵ has suggested that there should be a tax-free income band at the bottom of the scale for those on incomes under \$35,000 p.a. Besides the fairness arguments for this, it would provide an important step toward reducing the high marginal tax rates currently faced by people moving off benefits into work.
- 5.7. A 38 percent tax rate could then apply on income between two and three times the average wage. (Average weekly earnings (ordinary plus overtime) were \$1,027 in the December quarter 2017⁶, roughly \$53,000 per year. The 38% rate would therefore apply on incomes over \$106,000 and would be adjustable as the average wage rose.) .

⁵ <https://www.union.org.nz/wp-content/uploads/2016/12/NZCTU-Alternative-Economic-Strategy.pdf>

⁶ Statistics New Zealand, Infoshare table QEX008AA.

- 5.8. On incomes more than three times the average wage (that is, over \$160,000 p.a.) a 45 percent tax rate could apply
- 5.9. The frequently-heard claim that high top tax rates are a check on economic growth, and that therefore tax cuts for high income earners are a way to trigger higher economic growth, is not supported by solid evidence. Piketty, Saez and Stantcheva⁷ used cross-country data to compare changes in the top marginal tax rate with growth of per capita GDP over the period from 1975-9 to 2006-10. They found that “the correlation is virtually zero and insignificant suggesting that cuts in top tax rates do not lead to higher economic growth”.⁸ Their scatter plot for GDP growth adjusted for initial income levels is reproduced below.

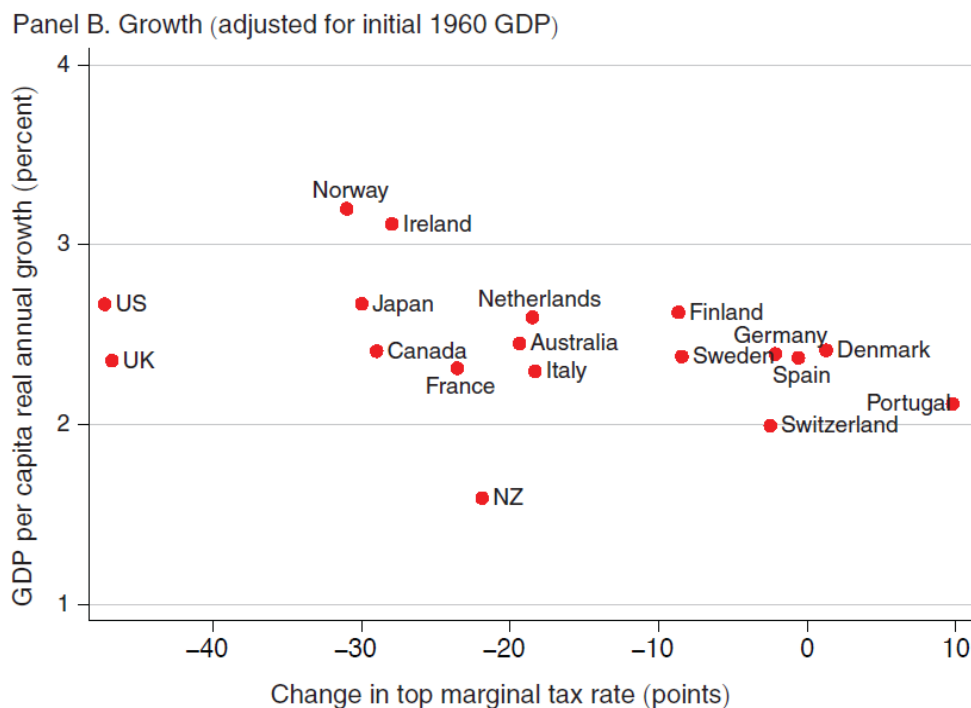


FIGURE 4. TOP MARGINAL TAX RATES AND GROWTH FROM 1960–1964 TO 2006–2010

- 5.10. The same study gathered cross-country evidence to show how low tax rates on top incomes contribute powerfully to income inequality of both post-tax and pre-tax income.⁹ Post-tax income inequality obviously is reduced by high top rates and worsened by low ones. But in addition, there is a clear empirical link between top tax rates and inequality of pre-tax income. Two mechanisms explain this. First, low top tax rates increase the incentive for CEOs and other top management to bargain hard for the pay increases that have driven CEO

⁷ Thomas Piketty, Emmanuel Saez and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities” *American Economic Journal: Economic Policy* 6(1): 230-271, February 2014.

⁸ Thomas Piketty, Emmanuel Saez and Stefan Stantcheva, *Taxing the 1%: why the top tax rate could be over 80%*, 8 December 2011, <https://voxeu.org/article/taxing-1-why-top-tax-rate-could-be-over-80> page 4.

⁹ These results are summarised in Facundo Alvaredo, Lucas Chancel, Thomas Piketty, Emmanuel Saez and Gabriel Zucman, *World inequality report 2018*, World Inequality Lab 2017, <http://wir2018.wid.world/files/download/wir2018-summary-english.pdf> , pages 257-260.

compensation to absurd heights, unrelated to their productivity, in recent decades. Second, high top tax rates limit the amount of money received by top income earners and thereby slow down their rate of wealth accumulation, reducing inequality of pre-tax income in subsequent years.¹⁰

- 5.11. Two observations in the Piketty-Saez-Stantcheva study are especially striking. First, they point out that in their data set, “no country experiences a significant increase in top income shares without large top rate tax cuts” (page 254). Their chart showing this, using data from 1960-64 to 2005-09, is reproduced below :

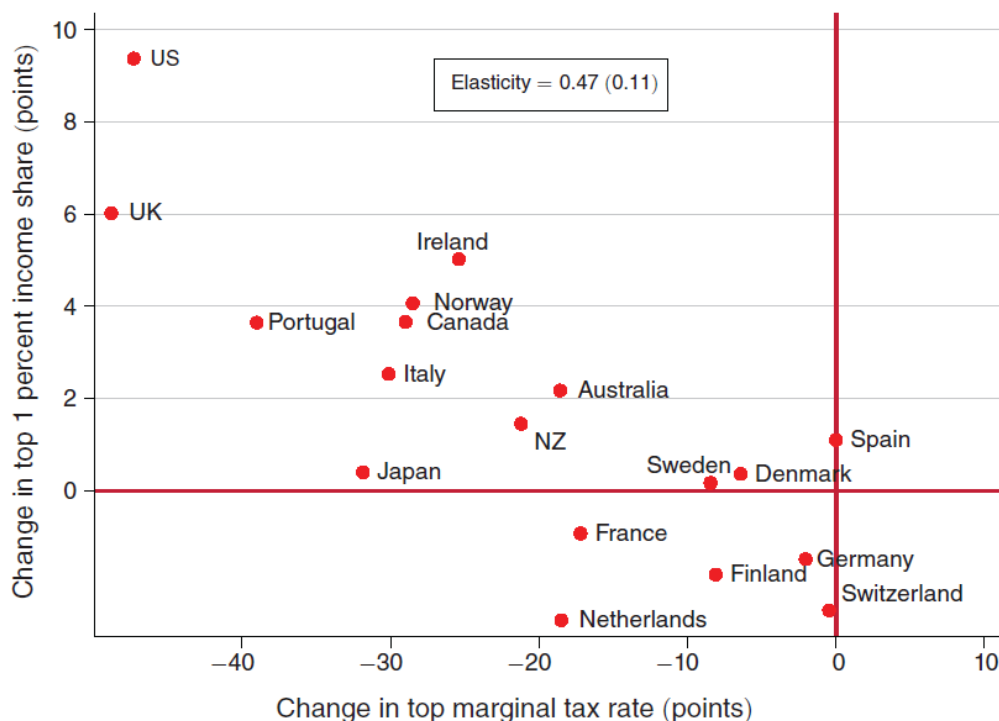


FIGURE 3. CHANGES IN TOP INCOME SHARES AND TOP MARGINAL TAX RATES

- 5.12. Secondly, “a striking feature of the evidence is that, in all countries that experience both a large top tax rate cut and a large increase in top income shares, the surge in top incomes tends to follow the top tax rate cuts” (page 256). In other words, the tax cuts led to the rise in inequality, not *vice versa*.
- 5.13. The growth effects of cuts in personal taxes have been overstated in much recent policy discourse in New Zealand as elsewhere. As Gale and Samwick warn¹¹,

While there is no doubt that tax policy can influence economic choices, it is by no means obvious, on an *ex ante* basis, that tax rate cuts will ultimately lead to a larger economy in the long run. ...

¹⁰ For discussion of these effects see Thomas Piketty, Emmanuel Saez and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities” *American Economic Journal: Economic Policy* 6(1): 230-271, February 2014.

¹¹ William G. Gale and Andrew A. Samwick, Effects of income tax changes on economic growth, Brookings Institution, February 2016 p.2 and p.27.

The argument that income tax cuts raise growth is repeated so often that it is sometimes taken as gospel. However, theory, evidence, and simulation studies tell a different and more complicated story. Tax cuts offer the potential to raise economic growth by improving incentives to work, save, and invest. But they also create income effects that reduce the need to engage in productive economic activity, and they may subsidize old capital, which provides windfall gains to asset holders that undermine incentives for new activity. In addition, tax cuts as a stand-alone policy (that is, not accompanied by spending cuts) will typically raise the [government] budget deficit. The increase in the deficit will reduce national saving -- and with it, the capital stock ... and future national income -- and raise interest rates, which will negatively affect investment. The net effect of the tax cuts on growth is thus theoretically uncertain and depends on both the structure of the tax cut itself and the timing and structure of its financing.

- 5.14. Recent micro-level research in Australia has thrown up the intriguing finding that firms with lower effective tax rates create fewer jobs than those facing higher rates.¹² This again cautions against accepting facile *a priori* arguments about the relationship of tax rates to economic growth.
- 5.15. Progressive taxes are not the sole instrument for reducing inequality, and should be promoted together with other policies that could reduce the inequality of pre-tax income and thereby lessen the pressure on Government spending when tackling child poverty and low wages. While arguing strongly the case for a more progressive tax system, the NZCTU gives equal emphasis to policies that improve the bargaining power of labour, raise the minimum wage, and force the passing-through of productivity gains to wages and salaries.

6. Interface with the benefit system

- 6.1. The NZCTU strongly agrees with the comment in the Background Paper (page 20) that “it is best to think of the tax and transfer system overall, rather than individual taxes in isolation”. It is therefore unfortunate that income support through transfers lies outside the Tax Working Group’s terms of reference.
- 6.2. Taxes impact on benefits and tax credits (and vice-versa). The highest effective marginal tax rates are currently on middle income families receiving Working for Families tax credits.
- 6.3. The Tax Working Group should investigate improvements to the welfare system that can be achieved through the tax system, including at least partially replacing Working for Families with a tax free threshold on personal income, as in Australia.
- 6.4. The tax/benefit system is not a substitute for the wage system and should not be used as a means of sustaining a low-wage economy.

¹² Andrew Leigh, “Do firms that pay less company tax create more jobs?”, *Economic Analysis and Policy* 59 (2018):25-28.

7. Reducing the rate of GST

- 7.1. While undeniably efficient as a revenue-raising instrument, GST is strongly regressive in its impact on lower-income groups in the community. The NZCTU considers that the GST rate should be reduced immediately to 12.5 percent and GST should be progressively replaced with other forms of taxation including income taxes on high incomes, asset taxes, an international Financial Transaction Tax, the FAT tax explained below, and taxes or increased royalties on commercial use of resources.
- 7.2. Regarding the suggestion on page 50 of the Background Paper that GST might be removed from some goods and services, this is superficially attractive but would raise difficult administrative issues at the boundaries of the exemptions, and would probably be less effective in providing relief to low-income households than a reduction in the general GST rate.

8. Tax avoidance by multinationals

- 8.1. The loss of revenue from tax avoidance and evasion has a direct impact on our members by reducing the revenue available to fund public services which we value, and by loading higher taxes than otherwise necessary on working people.
- 8.2. Preventing corporate tax evasion or avoidance encourages business responsibility. It ensures that responsible companies and investors are not undercut by the irresponsible behaviour of others.
- 8.3. Aggressive tax avoidance and evasion by international investors and multinational corporations is best combatted by international cooperation, and so we welcome the work being done in the OECD on Base Erosion and Profit Shifting.. It is important that New Zealand acts promptly to take advantage of any agreements emerging from that work programme, both to protect our own revenue and to support other countries that are acting or considering acting to do the same. We would not like to see New Zealand lagging in these important matters.
- 8.4. That does not mean that New Zealand should not act unilaterally (or in concert with Australia or a small number of like-minded countries) when it is able to do so. We recognise that some matters will not find international agreement or will take many years to find agreement. That should not stop New Zealand from taking what action it can.
- 8.5. New Zealand should not be swayed by threats of disinvestment by multinational companies. If investors' presence in New Zealand depends on tax avoidance then it is questionable what value they add to New Zealand and whether their character should be welcomed, let alone encouraged by weak tax laws.
- 8.6. Diverted Profits Tax should be on the agenda. They are a penal rate of tax aimed to provide an incentive on multinationals to pay the right tax under the standard rules, and have been implemented in Australia and the U.K.

- 8.7. The avoidance of tax by multinational internet-based corporations such as Google and Facebook puts local carriers of advertising such as newspapers and broadcast television and radio at a competitive disadvantage. The business model of conventional news media is already severely weakened by changes in technology working through the internet and other forms of digital media and communications. The advertising revenue on which the conventional media depend is undermined by these new technologies and forms of business, which they are struggling to respond to. It makes it even more difficult if their competition can lower their costs by avoiding paying tax on their activities.
- 8.8. This is a matter of public interest: the conventional media are still the principal originators of the content on which we largely depend for reliable news, and particularly for news about New Zealand. The steady loss of capacity through lay-offs of journalists and other media staff is creating a major failure in the news media market.
- 8.9. There is therefore a strong public interest case to ensure that provision of advertising services and platforms is tax neutral. Tax avoidance by Google, Facebook and others which have significant activity in New Zealand but do not have a tax presence in New Zealand is a growing issue that will affect more than just the media industry. We urge action to address this.
- 8.10. We are aware that some other countries including France, Hungary, India, Israel and Italy are taking various types of action.¹³ We also understand that the field of possible options is limited on the one hand by double taxation treaties and on the other by rules in the WTO and other trade and investment treaties such as the 'Comprehensive and Progressive Transpacific Partnership' (CPTPP)¹⁴.
- 8.11. We submit that the Tax Working Group should provide clear advice on these limitations and on the position New Zealand should take in negotiations of international treaties and agreements to protect New Zealand's options in taxing activities such as those above. While it is difficult to anticipate what other organisational and technological forms will present challenges to the taxation system in the future, it is important that New Zealand maintain as wide as possible options to address them, unilaterally if necessary.
- 8.12. In particular we note that Article 10.6 of the CPTPP states that in relation to local presence, "No Party shall require a service supplier of another Party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border supply of a service." The Tax Working Group should seek reassurance that this and other provisions of the CPTPP will not create any difficulties in deeming or requiring tax presence or permanent establishment by multinationals.
- 8.13. Inland Revenue have informed us that "the CPTPP should not limit New Zealand's taxation options for these entities [without physical presence],

¹³ See Chapter 4 of Organisation for Economic Co-operation and Development. (2018). *Tax Challenges Arising from Digitalisation – Interim Report 2018 Inclusive Framework on BEPS*. Paris: OECD Publishing. Retrieved from <http://dx.doi.org/10.1787/9789264293083-en>.

¹⁴ See section 6.3.1 *ibid*.

except to the extent we wanted to tax them more harshly than New Zealand residents”. Given that the form of tax used may have to be different from a conventional income tax (e.g. a revenue tax), it will be difficult to be sure that in some circumstances the tax will not be more harsh – despite being more lenient in other circumstances – than the tax on New Zealand residents. New Zealand could therefore be accused of actions contrary to the provisions of the CPTPP despite there being no intention to be more harsh overall.

9. Broadening the GST tax base: financial services

- 9.1. The NZCTU submits that financial services ought not to be exempted from tax on their value-added. If they 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.
- 9.2. A FAT levied on the sum of the profits and remuneration of financial institutions would effectively be a tax on the sector’s value added, and thus could fill the gap in the GST tax base.
- 9.3. We note the comment on page 6 of the Background Paper that the exemption from GST of financial services “reflect[s] past administrative judgments that it would be too administratively complex to include financial services”.
- 9.4. In the course of the debates that led to the 1985 decision to exempt financial services from New Zealand’s GST, a crucial problem was perceived to be that the credit-invoice arrangement through which GST was implemented was unsuited to financial services because of the difficulty of excluding pure interest (the time value of money)¹⁵. Consequently, a different approach would have to be used for financial services. After considering various options the Government of the day concluded that “no ideal solution existed because of the compliance and measurement difficulties associated with each of the options proposed”¹⁶.
- 9.5. Among the options considered but rejected in 1985 was one that would have taxed financial services on “the sum of salary and wages, other labour expenses, rates, levies (and other indirect taxes) and the net operating surplus, less depreciation incurred. This method correctly measures the tax base, but does not directly identify the tax charged on supplies.”¹⁷
- 9.6. There thus exists a way to target the GST tax base – value added – for financial services by taxing the sector’s profits and remuneration, but that approach would have to be implemented by a separate tax rather than

¹⁵ White Paper on Goods and Services Tax: Proposals for the Administration of the Goods and Services Tax; New Zealand government, March 1985. For a summary of the debate and its outcome see GST and Financial Services: a Government Discussion Document Inland Revenue Department, October 2002, <https://taxpolicy.ird.govt.nz/sites/default/files/2002-dd-gst-financial-services.doc>, Chapters 2 and 3. The point is repeated on page 30 of the TWG Background Paper.

¹⁶ *GST and Financial Services* Page 10.

¹⁷ *GST and Financial Services* page 9.

through GST's credit-invoice method. Such a tax on financial sector value added is now referred to internationally as a Financial Activities Tax (FAT).

9.7. A detailed 2010 IMF report on financial sector taxation noted that¹⁸

For technical reasons, financial services are commonly VAT-exempt—which means that, purely for tax reasons, the financial sector may be under-taxed and hence perhaps 'too big'. Taxing value-added in the financial sector directly would mitigate this.

9.8. The IMF staff considered two possible means of taxing the financial sector: a Financial Transactions Tax (FTT, often called 'Tobin tax') and a Financial Activities Tax (FAT). They identified a number of reasons why a FAT would be a better instrument than a FTT insofar as the objective is to tax value added.

9.9. The IMF study then outlined two possible forms of FAT¹⁹. If the tax were to be levied on all remuneration and profits, it would approximate a value-added tax. Alternatively, if levied only on the rent component of profits and remuneration (that is, on all returns above a normal return to capital and the reservation price of labour) it would be akin to a direct tax targeting excess returns.

9.10. In the present context of widening the GST net, the relevant option is the first of these. However, before recommending a FAT on finance, the Working Group should revisit the question of whether the existing GST system can be at least partially extended to financial services.

9.11. Several other countries have now applied GST to various financial services in relation to activities where invoiced services are supplied. India, for example, in 2017 imposed its new GST regime on banks, insurance and other financial institutions, replacing an earlier financial transactions tax.²⁰ Malaysia brought in GST on some financial services (not including loan interest) in 2015.²¹ The argument that taxing financial services is "too hard" has worn thin.

9.12. If indeed it is possible to extend the GST credit-invoice arrangement to some financial services, then if a FAT is applied in New Zealand to the sector's value added as measured by each firm's wages and profits, any GST paid could be made deductible against the FAT.

¹⁸ IMF Staff, "A fair and substantial contribution by the financial sector", Chapter 1 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>, page 20

¹⁹ For detail see pages 20-21, and Appendix 6 "The Financial Activities Tax: design issues and revenue potential", in *Ibid*. See also Michael Keen, Russell Krellove and John Norregard, "The Financial Activities Tax", Chapter 7 in *Financial Sector Taxation: the IMF's Report to the G-20 and Background Material*.

²⁰ *How GST rollout will affect financial services* <https://www.businesstoday.in/current/economy-politics/gst-rollout-will-affect-financial-services/story/255655.html> ; *How will the GST Impact Financial Services Sector in India?* <https://blog.capitalfloat.com/will-gst-impact-financial-services-sector-india/>; *Impact of GST on banks and NBFCs* <https://cleartax.in/s/impact-gst-banks-nbfc>.

²¹ *GST in the financial sector*, <https://www.pwc.com/my/en/assets/press/150330-theedge-special-pullout-gst-in-the-financial-sector.pdf>.

- 9.13. We submit that the Tax Working Group should recommend the adoption of a Financial Activities Tax to correct for the current under-taxation of financial services due to their exclusion from GST.

10. Financial Transactions Tax

- 10.1. While the FAT is preferable to the FTT for the purpose of domestic revenue raising and to correct for the distortions arising from the GST-exempt status of financial services, a strong case remains for imposing a Financial Transactions Tax (Tobin tax) on international financial flows, for the purpose of restraining toxic hot money movements and stabilising the exchange rate.²²
- 10.2. An FTT ought to be on the Working Party's agenda as an important tool of macroeconomic policy, whether implemented as a permanent levy on cross-border flows or held in reserve to be used at times of international financial turmoil.
- 10.3. The most common argument made against an FTT is that it is indiscriminate and so penalises "good" as well as "bad" transactions²³. Examples of "good" cross-border transactions are offshore purchases by New Zealand households, payment for overseas travel, and Government debt transactions. However, the appropriate rate for an FTT on cross-border flows would be very low and would make only a relatively minor difference in the cost of many of these items.
- 10.4. The thorough review of FTT by Burman *et al* notes that while an FTT is a second-best response to financial-market imperfections, "it would deter some forms of inefficient rent seeking by making many high-frequency trading strategies unprofitable".²⁴
- 10.5. The rate for an FTT on cross-border flows in and out of New Zealand would be a fraction of one percent of the value of each transaction, and the motivation would be not revenue but economic stabilisation, by deterring speculative hot-money transactions
- 10.6. Simplicity dictates that an FTT be levied on all transactions, rather than attempting to ring-fence out "good" transactions such as those involving Government debt. Exempting any class of transactions provides an incentive for avoidance activity that attempts to reclassify other transactions into the exempt category.

²² Tobin, James, 1978. "A Proposal for International Monetary Reform." *Eastern Economic Journal* 4 (3–4), 153–159.

²³ See e.g. Geoff Simmons, "Is a Financial Transactions Tax a silver bullet?", *National Business Review* 12 August 2016.

²⁴ Leonard E. Burman, William G. Gale, Sarah Gault, Bryan Kim, Jim Nunns, and Steve Rosenthal "Financial Transaction Taxes in Theory and Practice" *National Tax Journal*, March 2016, 69 (1), 171–216, p.187..

11. Broadening the income tax base: capital gains and wealth transfers

- 11.1. As the Background Paper notes (page 5) the current review is “an opportunity to explore whether there is a case to broaden the [tax] base further”. One obvious gap in the income tax base at present is that capital gains and wealth transfers (such as gifts and inheritances) are not treated as income.
- 11.2. The economic definition of income was laid out as follows by J.R. Hicks in his *Value and Capital* (Oxford: Clarendon Press, 1939, Chapter 14 pages 172 and 179):

The purpose of income calculations in practical affairs is to give people an indication of the amount which they can consume without impoverishing themselves. Following out this idea, it would seem that we ought to define a man's income as the maximum value which he can consume during a week, and still expect to be as well off at the end of the week as he was at the beginning.

...

The capital value of the individual's property at the beginning of the week is an assessable figure; so is the capital value of his property at the end of the week; thus, if we assume that we can measure his consumption, his income *ex post* can be directly calculated.

- 11.3. Income therefore includes windfall gains in the value of assets held by the individual. It is a striking anomaly in New Zealand's system of taxes and transfers that whereas this principle 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.

Capital gains

- 11.4. Introduction of a capital gains tax is well overdue in New Zealand. As the Background Paper notes on page 48, the absence of a capital gains tax favours investment by the rich in assets such as shares, land, and rental properties. The NZCTU supports removal of this anomaly, provided that the family home remains exempt.
- 11.5. Applying the Hicksian definition of income set out above, the best way to bring it in is to treat capital gains as income and tax them accordingly, rather than to introduce an entirely separate tax.
- 11.6. This raises a tricky transition issue in relation to allowing deductibility of capital losses. 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.

11.7. Comment on a range of issues has been invited in Appendix 2 of the Working Paper. Responses to some of these are as follows:

- Should the CGT be a separate tax or part of the income tax? In line with the income definition above, the income tax base would be broadened to include capital gains, so that no separate CGT would be necessary.
- Should capital gains be taxed on an accrual basis or only when realised? In the long run, as discussed below in relation to wealth taxation, New Zealand will ideally have created a comprehensive register of wealth holdings valued at current market values. This would make possible the imposition of CGT on accrued capital gains, but would leave several problems with the accrual approach. For one thing, accrued capital gains do not translate to cash in the hand with which to pay tax obligations. For another, the accrual approach would make more difficult the issue of taking account of short-run gains and losses of value over the period an asset is held. The realisation approach is therefore a better way to bring in taxation of capital gains.
- What assets should be covered given that the terms of reference exclude any tax on the family home? Assets such as rental properties, shares, collectibles, and cars all fall within the ambit of a CGT in principle, but avoidance of undue complexity in the tax affairs of ordinary households points to a *de minimis* rule.
- Should assets held by KiwiSaver and other savings schemes be taxed? Consistency with the inclusion of capital gains along with other forms of income seems to require that capital gains on pension-fund assets should be taxed, as is currently the case with the capital income received by those funds.
- Should assets held offshore be subject to tax? In principle, the realisation approach ought to apply to assets held offshore. In practice there are obvious difficulties, given that the funds from realisation will not always be returned to New Zealand and will be extremely hard to trace in the face of foreseeable avoidance behaviour. If however they are not taxed, there is an incentive to “hide” wealth and capital gains offshore. We therefore support the inclusion of offshore assets.
- When should non-residents be subject to tax? Whenever they realise a capital gain on assets held in New Zealand.
- Should capital losses be ring-fenced to be offset only against capital gains income or should they be offset against any income? 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.

Wealth transfers: gifts and inheritance

11.8. In the past, wealth transfers used to be taxed by specific taxes such as estate duty and gift duty which were charged to the donor (or the donor’s estate), giving rise to perceptions of unfairness. These taxes have been abolished in

New Zealand and there is no intention of reviving them (as witnessed by the explicit exclusion of “inheritance tax” from the TWG’s Terms of Reference).

- 11.9. However, the fact remains that wealth transfers are clearly income in the hands of the recipient and ought to be included in any proper accounting of the recipient’s income for tax purposes²⁵.
- 11.10. Clearly there would need to be carefully-designed limits to the levels at which gifts are taxed. If a tax-free threshold on the value of gifts is established, then this would remove the problem of small gifts being liable for tax, while at the same time removing a major inequity and inconsistency of treatment in the current benefit system (which abates benefits when gifts are received).

12. Wealth taxes

- 12.1. A common argument against wealth taxes is that taxing “capital” deters savings and hence capital accumulation. However, in their work for the Mirrlees tax review in the UK, Banks and Diamond²⁶ critically dissected the conventional argument and concluded that capital income should be taxed, opening the way to taxes on wealth.
- 12.2. The publication in 2014 of Thomas Piketty’s *Capital in the twenty-first century*, which recommended a wealth tax as a means of checking the concentration of income and wealth at the top of the distribution, has resulted in a revival of debate about the practicalities of wealth taxes, after a period in which many OECD countries phased them out.
- 12.3. A wealth tax designed primarily to put a brake on extreme inequality would apply to the top few percentiles of the population and so would not affect the vast bulk of the population. It would include property wealth, but should exclude the family home.
- 12.4. Denmark until 1997 imposed a flat-rate wealth tax on portfolios above an exemption threshold set above the 97th percentile²⁷. The rate was 2.2% until 1989, then 1% until the tax was abolished in 1999. The evidence suggests that this tax was effective in limiting the top-1% wealth share in Denmark.

²⁵ See Jennifer Bird-Pollan, “Unseating privilege: Rawls, equality of opportunity and wealth transfer taxation” 59 *Wayne Law Review* 713 (2013); Henry J Aaron and Aliocia H. Munnell “Reassessing the role for wealth transfer taxes *National Tax Journal* 45(2): 119-143, June 1992; Dean Machin *If you want a fair inheritance tax, make it a tax on income*, <https://theconversation.com/if-you-want-a-fair-inheritance-tax-make-it-a-tax-on-income-33654>.

²⁶ James Banks and Peter Diamond, *The Base for Direct Taxation*, London: Institute for Fiscal Studies, 2008,

²⁷ Katrine Jakobsen, Kristian Jakobsen, Henrik Kleven and Gabriel Zucman, *Wealth taxation and wealth accumulation: theory and evidence from Denmark*, NBER Working Paper 24371, March 2018, p.10.

- 12.5. To administer the tax, the Danish authorities built, and still maintain, a register of individual wealth holdings, described as follows by Jakobsen *et al*²⁸:

The wealth registry includes detailed information on end-of-year financial assets, non-financial assets, and debts. As a rule, these assets are recorded in the registry at their prevailing market prices. Most of these assets and liabilities are reported by third-parties to the Danish government, which makes the data very reliable. For instance, the value of bank deposits is reported by banks; the value of listed stocks and bonds is reported by the financial institutions (banks, mutual funds, and insurance companies) who hold these securities on behalf of their clients; and the value of mortgages is reported by mortgage lenders (banks or specialized mortgage institutions). Non-financial assets are recorded using land and real estate registries. Moreover, before the wealth tax was abolished in 1997, all assets other than those reported by third parties had to be self-reported by households. This included cash, large durables (such as cars, boats, and private planes), non-corporate business assets, unlisted securities (i.e., bearer bonds, unlisted equities, and shares of housing cooperatives), assets held abroad (foreign real estate and foreign bank accounts), and inter-personal debts. The Danish wealth data are considered of a very high quality,

- 12.6. In Sweden, from 1910 until 2007 a wealth tax at the rate of 1.5% applied to a broader segment of the population than was the case in Denmark: eight percent in 2000, falling to three percent in 2007.²⁹ The Swedish register seems to have been more open to manipulation than the Danish one; Seim finds evidence of widespread avoidance and evasion. He nevertheless concludes from his analysis of behavioural effects that³⁰

The small behavioral effects and lack of real responses to the wealth tax that I find imply that wealth taxation may be an efficient redistributive tool. A comparison to income taxation ... suggests that wealth taxation can be a more efficient way to redistribute resources compared to income taxation if the behavioural responses to wealth taxes are smaller than those of income taxes. This is true in the paper at hand because wealth taxpayers tend to locate in the upper end of the income distribution, where taxable income elasticities are largest. Such a suggestive normative exercise, comparing the welfare effects of wealth taxes to those of progressive income taxes, suggests that the social surplus is 24 percent higher when redistribution is accomplished by wealth taxation.

- 12.7. Switzerland has the most wide-ranging wealth tax which is targeted at revenue-raising, though Brühlhart *et al*³¹ find that the tax rate is well below the revenue-maximising level.
- 12.8. Clearly in order to implement a wealth tax, an important pre-requisite is adequate information in the form of a register of wealth holdings of individuals such as the Danish one³². Development of a similar wealth register in New

²⁸ Jakobsen *et al* p.6.

²⁹ David Seim, "Behavioral Responses to Wealth Taxes: Evidence from Sweden", *American Economic Journal: Economic Policy* 2017, 9(4): 395–421.

³⁰ Seim 2017 p.419.

³¹ Marius Brühlhart, Jonathan Gruber, Matthias Krapf and Kurt Schmidheiny, *Taxing Wealth: Evidence From Switzerland* NBER Working Paper 22376, June 2016.

³² Ellen R. McGrattan *Taxing Wealth*, Federal Reserve Bank of Minneapolis Economic Policy Paper 15-4, March 2015, argues strongly that it would be premature to introduce wealth tax in the USA given the lack of the necessary consistent database.

Zealand should be a priority, not merely to enable introduction of a wealth tax if this option were to be pursued, but also to provide valuable information on key variables such as savings rates across the wealth distribution. We submit that the Working Group should recommend a study of the Danish register with a view to adoption of a matching system in New Zealand.

- 12.9. A New Zealand tax targeted at the goal of curbing inequality could appropriately be targeted at the top percentile (or possibly top 5%) of the wealth distribution, should include property wealth, but should exempt the family home (which in any case is usually only a small fraction of top-percentile wealth).
- 12.10. The issue of whether a wealth tax applying to the top percentiles would have significant effects on aggregate economy-wide saving and investment behaviour clearly requires consideration. Behavioural response to wealth taxation is currently the subject of a rapidly-growing international literature. For the most part this literature has addressed the question of the tax elasticity of wealth holdings within a target group. The issue of how changes in top-percentile savings behaviour and wealth holdings affects the economy-wide savings rate remains open and is probably best tackled by looking at cross-country empirical evidence of the relationship between taxes and long-run growth performance. There appears to be no compelling evidence that either wealth taxes or high top marginal rates have held back economic growth over the past century, but the Working Group will no doubt wish to review the literature for itself.

13. Land tax

- 13.1. A land tax was canvassed by the 2010 Tax Working Group³³ and is among the options mentioned in the TWG Background Paper.
- 13.2. In the event of a comprehensive wealth tax being introduced, land would be included as one form of wealth – probably the easiest to tax, given its inelastic supply and the existence of a set of valuations.
- 13.3. However, if a wealth tax is confined to the top percentiles of the distribution, there is a case for implementing a land tax more broadly, for revenue purposes.
- 13.4. If such a land tax is contemplated, it should exclude land under the family home and should have a value-per-hectare threshold below which no land tax is payable, to shield low-income groups, iwi and other parties holding extensive areas of low-productivity land.

³³

A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group, January 2010, pp.50-51. Also Andrew Coleman and Arthur Grimes, *Fiscal, Distributional and Efficiency Impacts of Land and Property Taxes*, http://www.victoria.ac.nz/sacl/cagtr/twg/Publications/3-impacts-land-property-taxes-coleman_grimes.pdf.

14. Company tax

- 14.1. The company tax rate should be returned to 30%. Comparisons with rates in other countries that do not take account of imputation (as in the left-hand column of page 28, and Figure 8 on page 29 in the Background Paper) give a false impression. As the Background Paper goes on to state, “when factoring in imputation, New Zealand’s tax rate on domestic shareholders is the sixth lowest in the OECD”. Loose comparisons with other countries, and the restriction imposed by the Terms of Reference, should not deter the Working Group from at least recommending further review aimed at an increase in the New Zealand rate.
- 14.2. We note that the Terms of Reference direct the TWG to consider “whether a progressive company tax rate (with a lower rate for small companies) would improve the tax system and the business environment”. Faced with the Terms of Reference prohibition on increasing any income tax rate, the Background Paper on page 49 has looked only at the option of a lower rate for small companies.
- 14.3. Applying different tax rates to companies on the basis simply of size or ownership opens up difficult avoidance issues, as the Background Paper notes on page 49.
- 14.4. There is an argument for making the company tax system progressive in a different sense: by taxing profits up to the risk-free rate of return (or some similar measure of the user cost of capital) and applying a higher rate to profits over this threshold. Insofar as it is possible to identify “rents” (pure profit) these should be targeted for higher tax rates (see discussion of excess profits in section 13).
- 14.5. Tax deductibility of interest on related party borrowing opens the way to avoidance of tax and should be ended.
- 14.6. The taxation of excess profits resulting from market dominance deserves the Working Party’s attention and is discussed in section 13.

15. Tax on excess profits

- 15.1. While the case outlined in section 7 above for the introduction of a Financial Activities Tax to fix the gap in GST resulting from the exemption of financial services was specific to that sector, it is of interest that the IMF’s 2010 report included a more generally applicable model for taxing excess profits. The IMF’s “FAT2” model, under the heading “taxing rents on capital and labour”, noted the wide discrepancy between remuneration and profits in the financial

sector on the one hand relative to those paid in other sectors of the economy, and suggested that the gap could be treated as excess returns³⁴.

15.2. Keen *et al* pointed out that³⁵

Taxing rents is an economically efficient way to collect revenue. In a closed economy, a tax on pure rents (i.e. income in excess of normal returns) is non-distortionary because economic agents have no incentive to change their behavior in response to the tax: to maximize their aftertax earnings they will take the same decisions as needed to maximize their before tax earnings. The same would apply in an open economy when the source of rents is specific to a particular location. When rents are not tied to particular locations, a similar result will still broadly apply if there is some degree of international coordination (e.g. on tax bases and minimum tax rates), and/or the tax is levied at sufficiently low rates so as not to significantly alter incentives for location.

15.3. Those comments apply not simply to the financial sector, but across the economy as a whole. Comparing financial-sector earnings and profits to those in the rest of the economy, as the IMF authors did, will provide an underestimate of financial-sector rents insofar as excess profits are prevalent in other sectors as well.

15.4. There has been growing international concern over the rapid increase in inequality of incomes and wealth in the advanced economies, mirrored in the falling labour share of national income and rising profit share. Recent analyses have focussed on the evidence that these trends are the product of an underlying rise in the exercise of market power by the owners of capital.

15.5. Simcha Barkhai found that in the USA, the shares of both labour and capital have been falling (if the latter is defined as the value of the capital stock multiplied by its required rate of return) while pure profits have been rising³⁶ due to a rise in markups (proxied by industry concentration).

15.6. De Loecker and Eeckhout³⁷ measured markups directly for all publicly traded firms across all sectors of the US economy over the period 1950-2014, using a well established methodology³⁸. They found average markups to have risen from 18% in 1980 to 67% in 2014, and demonstrated that the increase was closely reflected in the trend of dividends (a measure of profit). They show that the rise in markups has given rise to a decrease of both the labour share, and the capital share (when this is understood as the normal rate of return applied to the capital stock).

³⁴ Keen *et al* 2010 pages 131-134.

³⁵ Keen *et al* 2010 page 133.

³⁶ Simcha Barkhai, *Declining labor and capital shares*, University of Chicago Booth School of Business, New Working Papers Series No 2, November 2016.

³⁷ Jan De Loecker and Jan Eeckhout, *The rise of market power and the macroeconomic implications*, CEPR Discussion paper 12221, 2017.

³⁸ R. Hall, "The Relation between Price and Marginal Cost in U.S. Industry", *Journal of Political Economy*, 96(5), 921-947, 1988.

- 15.7. Eggertson *et al*³⁹ have recently argued that in the USA, “an increase in the financial wealth to output ratio,... an increase in measured Tobin’s Q, and a divergence between the marginal and the average return on capital ... can be explained by an increase in market power and pure profits in the US economy, i.e. the emergence of a non-zero-rent economy”. The combination of increasing market power and falling interest rates has shifted a rising share of the economy’s total output into the hands of a rentier class.
- 15.8. The same trends as those discussed in the overseas literature have been evident in New Zealand⁴⁰, which means that the option of introducing a tax on excess profits (rents) is due for consideration. While a wealth tax and/or land tax, as discussed elsewhere in this submission, would make some inroads into profits and rent in general, neither of these would be targeted at particular companies’ excess profits.
- 15.9. We recommend that the Tax Working Group initiate a programme of research into the design of an excess profits tax in the New Zealand setting.

16. Tax avoidance

- 16.1. The first essential requirement in addressing avoidance is to ensure that IRD is adequately resourced to police the tax system effectively, track down evasion, and ensure that everyone pays their fair share.
- 16.2. There is a need to ensure that Trusts other than registered Charitable Trusts cannot be used for tax avoidance.
- 16.3. Income taxation of closely held companies needs review to make it difficult to use them for tax avoidance. A capital gains tax would assist in this by removing the ability to avoid tax on company income by leaving it within the company and realising it by sale of the company (perhaps to a related entity) at a raised value.
- 16.4. Victoria University academic, Lisa Marriott has pointed out starkly different approaches to tax and benefit “cheats” with the latter being treated much more harshly for much smaller sums.⁴¹ Processes should be reviewed to ensure this apparent double standard does not continue.

³⁹ Gauti Eggertsson, Jacob A. Robbins and Ella Getz Wold, *Kaldor and Piketty’s facts: The rise of monopoly power in the United States* Washington Center for Equitable Growth Working Paper Series February 2018 <http://equitablegrowth.org/working-papers/kaldor-piketty-monopoly-power/> .

⁴⁰ Max Rashbrooke (ed) *Inequality: a New Zealand Crisis* Wellington, Bridget Williams Books, 2013; *The Piketty phenomenon: New Zealand perspectives* Wellington, Bridget Williams Books 2014;

⁴¹ See for example Marriott, L, ‘Unpaid Tax and Overpaid Welfare: A comparison of debt recovery approaches in New Zealand’, *New Zealand Journal of Taxation, Law and Policy*, (2014), 20(1), pp.46-70.

- 16.5. Tax avoidance in New Zealand is most conspicuous at the top of the income and wealth distribution and in certain sectors whose characteristics favour the maximisation of deductible expenses.
- 16.6. However there is also the suspicion of widespread evasion by the self-employed through cash jobs and treating the stock and assets of closely held companies as personal property. This reduces respect for the fairness of the tax system and its enforcement.
- 16.7. Below, we recommend that consideration should be given to publishing tax statistics on all companies in the interests of transparency. This would increase public confidence in the tax system, and better inform debate on tax avoidance and evasion.

17. Pollution taxes

- 17.1. Polluters should face taxes on their emissions, including greenhouse gas emissions, with the aim of incentivising them to reduce emissions or obliging them to pay the costs of all significant “externalities” (side effects such as pollution and global warming). However this should be done in a way that ensures people on lower incomes do not end up paying an unfair share of the burden.
- 17.2. We support a price on greenhouse gas emissions so that a clear signal is sent to emitters. However this needs to be strengthened with a major programme to transform the economy. It should include allocation of credits or other forms of protection for firms that are “competitiveness at risk” and facing a price for emissions. This should be monitored to ensure this assistance is not misallocated or too generous, or there is insufficient change of behaviour.
- 17.3. While pollution taxes are desirable in their own right, they can be regressive, creating a disproportionate burden for lower income people. In those cases, the Tax Working Group should make those effects clear and recommend explicit counteracting measures to ensure that their recommendations do not increase real disposable income or wealth inequality, nor have disproportionate effects on already disadvantaged New Zealanders. That could be achieved by for example reduced taxes of other kinds, or increased income support.
- 17.4. It is important not to treat pollution taxes in isolation from other policy elements required in order to address externalities effectively without creating unwanted collateral effects. We recognise that a more comprehensive approach than taxes alone is required, including policies that assist people through change to ensure a just transition to a more sustainable society.

18. Resource taxes and royalties

- 18.1. Taxes and royalties are the means to provide a fair return to New Zealanders from the exploitation of natural resources by private enterprise, and to incentivise efficient use of those resources.
- 18.2. The Background Paper discusses these taxes only in passing on page 41, and they are not mentioned in the Terms of Reference. Nevertheless, the issue of a possible tax on fresh water bottled for export has been prominent in public debate recently, and the wider issue of water taxation is clearly on the policy agenda.
- 18.3. The level of existing resource levies, taxes and royalties should be reviewed to ensure that they are at similar levels to other countries to ensure New Zealand is not unnecessarily missing out on revenue from the consumption of our (often unrenewable) resources.

19. Need for better tax statistics

- 19.1. The statistics currently available on tax are not sufficiently detailed or well presented to give members of the public access to high-quality information on the tax system.
- 19.2. Reflecting this, the Background Paper produced by the Tax Working Group conveys a false impression of progressivity by presenting (in Figure 10) data for tax by decile in terms of the percentage of total tax received, rather than as percentages of the relevant decile's income. While it is true that the top decile pays 35% of total tax, this outcome is due to its much greater income – not to dramatically greater tax effort. The public consultation process would have been assisted by inclusion of estimates of average tax rates at various income levels.
- 19.3. The absence from the Background Paper of any calculation of effective *ex post* average tax rates by decile is a major shortcoming that reflects the inadequacy of publicly-available statistics.
- 19.4. Reliance on a chart reproduced from Bryan Perry's 2017 report on household income inequality is an unsatisfactory substitute for genuine research by the TWG staff. What is needed is the total figure for income tax paid by decile, divided by total income for that decile, and hence showing the average tax rate at each income level with and without netting off benefits received. It would be useful also to have estimates of the average incidence of all taxes including GST by decile. The TWG staff should be asked to carry out the necessary research to produce these estimates, or Statistics New Zealand should be asked to produce them.
- 19.5. Looking ahead it should be the task of some designated Government agency – whether IRD, Treasury, or Statistics New Zealand – to publish timely and

detailed tax statistics on all forms of tax, including for example effective rates of company tax collected by industry.

- 19.6. Consideration should be given to publishing tax statistics on all companies in the interests of transparency.