Reference: 20150050

7 May 2015

Thank you for your Official Information Act request, received on 24 February 2015. You requested the following:

> *Any reports, briefings, analysis or opinions undertaken, held or created by Treasury since 2011 on the potential impact of a Capital Gains tax on wealth inequality.*

On 25 March 2015 I wrote to you advising that I was extending the time limit for deciding on your request by an additional 30 working days.

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	November 2011	Treasury forum note: capital gains tax	Release in full
2.	4 February 2014	IRD policy report: Benefits and drawbacks of a capital gains tax	Release in part

I have decided to release the documents listed above, subject to information being withheld under the following section of the Official Information Act:

- section 9(2)(a) – to protect the privacy of natural persons, including deceased people.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Information Publicly Available

The information listed in the table below is also covered by your request and available on the Treasury and OECD websites.

Item	Date	Document Description	Website Address
1.	27 April 2011	OECD Economic Surveys: New Zealand 2011	http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2011/adjusting-towards-a-sustainable-growth-path_eco_surveys-nzl-2011-4-en
2.	[July 2013]	Long term fiscal statement paper: The role of tax in maintaining a sustainable fiscal position	http://www.treasury.govt.nz/government/longterm/fiscalposition/2013/pdfs/ltfs-13-bg-rtmsfp.pdf

Accordingly, I have refused your request for the documents listed in the above table under section 18(d) of the Official Information Act – the information requested is publicly available.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Suzy Morrissey
Team Leader, Tax Strategy

Information Being Released
OIA 20150050

Doc 1	Page 1
Doc 2	Page 4

IN-CONFIDENCE

Reform scenario 1: Capital Gains Tax

A capital gains tax (CGT) would be a tax on realised capital gains imposed at normal income tax rates. A CGT was considered but not recommended by the Tax Working Group. A CGT was modelled by both Diamond and Zodrow and Andrew Coleman. The modelling was based on an accrual capital gains tax (as this is simpler to model) and Diamond and Zodrow used a CGT rate of 83% of normal income tax rates to account for the benefit of tax deferral. A CGT was modelled both including and excluding owner-occupied housing.

Assessment

Economic growth	***[Brief summary label]***
	DZ model showed almost no GDP improvement from a CGT that excluded owner-occupied property and modest GDP improvement (0.6% long-term) if the CGT included owner-occupied property. However, we discount this result because the methodology does not reflect the empirical evidence of the economy in New Zealand (the model assumes no inflation and no relative price changes – it assumed most of the burden of a CGT would be borne by the non-competitive corporate sector as a tax on retained earnings. In contrast, empirical evidence shows most of the burden of a CGT would fall on investment in real property, and historical sharemarket data for NZ shows little burden from a CGT on share investments). The Coleman model shows a reduction in housing prices from a CGT and more domestic savings invested in assets other than housing compared to current policy settings. Unfortunately the Coleman model does not attempt to quantify economic growth implications from this but a CGT funding a reduction in tax burden on non-real property investments and labour should lead to an improvement in GDP.
Welfare	***[Brief summary label]***
	For the reasons mentioned above the DZ model is unlikely to capture welfare changes from introduction of a CGT. However, the funding of a reduction in personal tax rates and improvement in economic performance is likely to improve welfare.
Macro imbalances	***[Brief summary label]***

Reference: 20150050

7 May 2015

Thank you for your Official Information Act request, received on 24 February 2015. You requested the following:

> *Any reports, briefings, analysis or opinions undertaken, held or created by Treasury since 2011 on the potential impact of a Capital Gains tax on wealth inequality.*

On 25 March 2015 I wrote to you advising that I was extending the time limit for deciding on your request by an additional 30 working days.

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	November 2011	Treasury forum note: capital gains tax	Release in full
2.	4 February 2014	IRD policy report: Benefits and drawbacks of a capital gains tax	Release in part

I have decided to release the documents listed above, subject to information being withheld under the following section of the Official Information Act:

- section 9(2)(a) – to protect the privacy of natural persons, including deceased people.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Information Publicly Available

The information listed in the table below is also covered by your request and available on the Treasury and OECD websites.

Item	Date	Document Description	Website Address
1.	27 April 2011	OECD Economic Surveys: New Zealand 2011	http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2011/adjusting-towards-a-sustainable-growth-path_eco_surveys-nzl-2011-4-en
2.	[July 2013]	Long term fiscal statement paper: The role of tax in maintaining a sustainable fiscal position	http://www.treasury.govt.nz/government/longterm/fiscalposition/2013/pdfs/ltfs-13-bg-rtmsfp.pdf

Accordingly, I have refused your request for the documents listed in the above table under section 18(d) of the Official Information Act – the information requested is publicly available.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Suzy Morrissey
Team Leader, Tax Strategy

IN-CONFIDENCE

	The Coleman model shows an increase in net foreign assets (reduction in net foreign borrowing) from a CGT due to a reduction in land values. Since a CGT would fund a reduction in personal tax rates it seems likely a CGT/income tax rate reduction should improve private savings. However, the DZ model showed a decrease in private savings for a business assets CGT [need to understand this] but an increase in private savings if the CGT included owner-occupied property.

Equity	***[Brief summary label]*** A CGT would improve horizontal equity. Distributional analysis done for the Tax Working Group shows that a CGT which did not include owner-occupied property would increase vertical equity (progressivity) of the personal tax system. However, if owner-occupied property is included in the CGT base the impact is fairly distributionally neutral.
Fiscal cost	***[Brief summary label]*** We estimated the revenue from a realised CGT, excluding owner-occupied housing, under Australian transition (CGT applies only to sales of property acquired after the effective date) would rise from less than $100 million the first year to about $1 billion pa after 5 years to over $2.5 billion pa after 10 years and increasing. However, year-to-year volatility is likely to be significant and dependent on the rate of property price appreciation.
Compliance/ complexity	***[Brief summary label]*** Although a CGT would have the benefit of removing the capital/revenue distinction in many cases, it would also add complexity depending on its design. Some features adding complexity would include - a special tax rate, inflation indexing, ringfencing capital losses, and providing rollover relief for particular transactions.

Overall comment

IN-CONFIDENCE

Treasury has previously recommended a CGT on the basis that it is consistent with BBLR, may provide first order allocative efficiency benefits, and provides revenue which could be used to fund income tax rate reductions. Although the DZ modelling shows weak GDP or welfare effects, this seems related to its methodology which doesn't reflect how a real CGT would operate in NZ. The modelling doesn't seem to give any reason to change our position that a CGT would be a beneficial reform for NZ.

Could the reform delivered on a smaller/more incremental scale?
There is already a capital/revenue boundary so the option here would appear to be to move the boundary so more transactions are captured on revenue account. An example would be a "bright line" test for sales (ie, all sales within, say, 10 years of acquisition are on revenue account). An advantage of this approach would be that many more sales would be subject to tax. A downside of this approach would be creating distortions at the margins, eg, deferring sales in order to avoid the tax.

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Policy report: Benefits and drawbacks of a Capital Gains Tax

Date:	4 February 2014	**Priority:**	Medium
Security level:	**Sensitive**	**Report no:**	IRD 2014/36

Action sought

	Action sought	**Deadline**
Minister of Revenue	**Discuss** this report with officials	Wednesday, 5 February 2014

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
Hamish Slack	Senior Policy Analyst	*[Withheld under s9(2)(a)]*
Matt Benge	Chief Economist	

Sensitive

National Office

Level 8
55 Featherston Street
PO Box 2198
Wellington 6140
New Zealand

Telephone 04-890 1500
Facsimile 04-903 2413

POLICY AND STRATEGY
Te Wāhanga o te Rautaki me te Kaupapa

4 February 2014

Minister of Revenue

Benefits and drawbacks of a Capital Gains Tax

Executive summary

Late last week you asked Inland Revenue for a report covering the benefits and drawbacks of a Capital Gains Tax (CGT). This report has been drawn together quickly. After discussion we could provide further information on any issues where you think that more explanation is required.

As drawn out in the discussion in this paper, a CGT has some positives and some drawbacks. Moreover, the particular design of the CGT being analysed is critical. Many of the most important effects of a CGT will depend on how well it integrates with and supports the rest of the tax system.

A recommendation on whether or not a CGT would improve the status quo ultimately depends upon the specific design chosen.

Recommended action

We recommend you **discuss** this report with officials on Wednesday, 5 February 2014.

Discussed/Not discussed

Matt Benge
Chief Economist
Policy and Strategy

Hon Todd McClay
Minister of Revenue

Background

1. Late last week you asked Inland Revenue for a report covering the benefits and drawbacks of a Capital Gains Tax (CGT). This report has been drawn together quickly. After discussion we could provide further information on any issues where you think that more explanation is required.

2. There is substantial debate about whether New Zealand should adopt a CGT. For example, the Victoria University of Wellington Tax Working Group (TWG) considered the tax but the majority of its members did not recommend its adoption. On the other hand, the New Zealand Treasury has consistently recommended a CGT.

3. This debate is not about a CGT in principle. Increases in asset values, just like regular income, increase a person's net wealth and ability to consume. A capital gain is income. A comprehensive income tax system would therefore include a tax on capital gains as they accrue (that is, the tax is due each year based on value increases during that year). However, such a tax is very difficult to implement. Increases in asset values can be difficult to ascertain in the absence of a sale and people may lack the funds to pay.

4. The design of a CGT is critical as many of the most important effects of a CGT will depend on how well it integrates with and supports the rest of the tax system. It has not been possible to discuss these issues in much depth in this paper. However, it should not be thought that a real world CGT will be unproblematic so long as "it is designed well". There will be some important drawbacks and pressures created by the best possible real-world capital gains tax.

5. The question at issue in this on-going debate is whether the sort of CGT that could be implemented in practice would be better for New Zealand than the status quo. Many of the compromises made in other countries in implementing a CGT weaken many of the arguments for such taxation, while introducing important drawbacks. A recommendation on whether or not to introduce a CGT therefore depends upon the ultimate design chosen.

A workable CGT

6. The pros and cons of a CGT depend on the design of the tax. For the purposes of this report, we assume it:

- applies on realisation (that is, when assets are sold or otherwise disposed of),
- is applied at a person's marginal tax rate, so there is no special lower tax rate applied to capital gains,
- has limited exemptions or deferrals of taxation such as rollovers,
- does not apply to owner-occupied housing, and

- ring-fences capital losses, so they can be only used to offset capital gains (and not other income such as salaries and wages).

A CGT and the principles of a good tax system

7. The TWG identified six key principles of a good tax system:
- efficiency,
- equity,
- revenue integrity,
- fiscal cost,
- compliance and administration costs, and
- coherence.

8. The discussion below sets out how well the CGT described above fits into this framework. In some instances it has a positive impact, in some a negative impact, and others the overall impact is unclear.

9. The model CGT described above features capital gains taxed at full tax rates. Note that if the tax applied at a lower rate, it would reduce the impact of the reform. That is, it would reduce all of the benefits and increase some of the drawbacks described below. For example, it would reduce the efficiency improvements of the tax as, while assets that generate capital gains would be taxed more heavily than at present, they would still be tax advantaged compared to other assets. On the other hand, it would reduce the lock-in effect of the tax as the tax liability resulting from a sale would be smaller. Importantly, a lower tax rate for capital gains would also potentially increase the complexity of the tax.

Efficiency

10. The overall efficiency impact of the CGT with the design features we have suggested is unclear. Some elements would improve efficiency while others would decrease it.

Improvements to efficiency

11. In the absence of a CGT, there will be incentives to invest too much in assets which are expected to rise in value and too little in fully-taxed assets. A CGT substantially reduces these incentives. Some tax benefit remains as the tax is deferred until the asset is disposed of.

12. A CGT will also tend to improve efficiency as it allows other tax rates to be lower than they would otherwise need to be. A CGT would raise a substantial amount of revenue, which could be used to lower other taxes or reduce the need to increase taxes in the future (for example, to close the fiscal gap caused by New Zealand's ageing population).

13. The efficiency impact of a CGT can be overstated because a key asset that is generally expected to rise in value is land, but land is in fixed supply. Applying a CGT to land

therefore has no efficiency impact (except to the extent the CGT revenue from land allows other distorting taxes to be lowered as described above). Indeed, land use is likely to be distorted by the model CGT because it will apply unevenly (i.e. owner-occupied housing is excluded). On its own, this will have a negative impact on efficiency.

14. Nevertheless, a CGT will have efficiency benefits from its application to other assets. For example, at present that lack of a CGT may encourage companies to put too much effort into activities which provide capital gains rather than immediate taxable income through building up its business (e.g. customer loyalty, brand names).[1]

15. This is an especially large concern if the taxpayer can claim deductions for expenses while building up the asset but is not taxed on the asset's sale. A CGT can provide a backstop which reduces investment distortions when deductions are allowed early.

16. Finally, a CGT would discourage individuals putting too much effort into fixing up a rental property rather than earning immediately taxed income, as at present any increase in the property's value due to their effort is untaxed. Of course, even if a capital gains tax were introduced, there would be a tax bias encouraging people to put too much effort into fixing up their own houses so long as owner-occupied housing is exempt from the CGT. This may be the bigger bias.

Negative impacts on efficiency

17. While some aspects of the model CGT improve efficiency, others will decrease it. A CGT that applies when assets are sold creates the incentive to defer selling assets that have increased in value to avoid paying the tax.[2] This effect is known as "lock in". In theory, what the sale proceeds are used for (either consumption or another investment) must be valued more highly by some reasonably significant margin in order for the sale to be worthwhile.

18. The tax similarly creates the incentive to bring forward the sale of an asset that has fallen in value. Both of these effects have a significant negative impact on efficiency. The lock-in, for example, can discourage businesses from expanding when it otherwise would be in their best interest to do so.

---

[1] Of course, a realisation-based CGT will only offset this bias to the extent that assets are sold. It does not, for example, discourage a business from devoting an inefficiently large amount of effort to building up customer loyalty or brand name if the aim is for the current owner to enjoy the higher income stream rather than selling the business on to someone else.

[2] To illustrate: say a taxpayer faces a 30 percent tax rate which applies to both ordinary income and realised capital gains. Our taxpayer purchased a share for $100 that is now worth $200. No further value appreciation is expected. The share yields a 10% return or $20, paid at the end of the year.

Our taxpayer wants to sell this share. If he waits until the end of the year he will have $184 after tax ($220 revenue less $36 in tax). If instead he sells immediately to invest somewhere else he will have $170 after tax to invest ($200 revenue less $30 tax). But in order for this immediate sale option to be attractive the alternative investment needs to have a higher return – otherwise our taxpayer would end up with less than the $184 after tax he could have by holding on to his existing share. In this case the alternate investment would need to provide a return of 11.8% (or $20).

19. A CGT designed as suggested would also impact incentives for taxpayers to engage in risky projects, which also has negative efficiency consequences. Our suggested CGT features loss ring-fencing, meaning capital losses can only be used to offset tax on capital gains. This is to protect taxpayers bringing forward the sale of assets that have fallen in value but not selling assets that have increased in value. It also protects against tax fraud and the impact of property downturns on the revenue. Loss ring-fencing is standard among countries with capital gains taxes.

20. This ring-fencing would have little impact on someone with a large and well diversified portfolio of capital assets. Such a person would be readily able to utilise any capital losses. However, numerous taxpayers have neither a large or well diversified portfolio of capital assets – such as small business owners and landlords. They may struggle to utilise any capital tax loss. Risky capital projects will therefore likely be less attractive to smaller taxpayers, where success will be fully taxed but failure brings only partially-valued deductions.

21. It may be possible to ameliorate some of the negative effect of loss ring-fencing rules with more targeted provisions; however, we have not had the time to consider the practicality of such rules.

Impact of rollover provisions

22. We have suggested that any CGT be implemented with limited rollover relief provisions. Even if rollover relief is provided, however, a CGT will have some unattractive biases.

23. Rollover provisions are often aimed at reducing the "lock-in" effect described above; the biases discouraging taxpayers from selling an asset that has risen in value and purchasing a replacement asset (for example, if they sell a farm to purchase a larger farm). In the absence of this type of rollover there can be efficient commercial transactions that do not take place. For this reason several countries with a CGT provide this type of rollover relief.

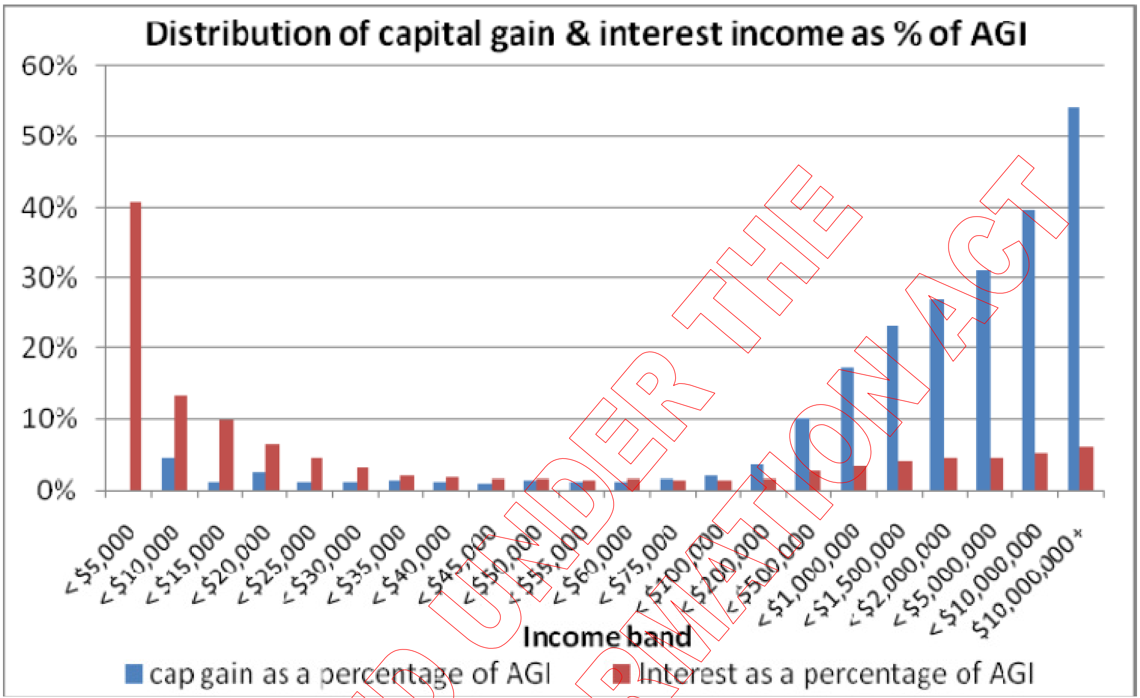
24. However, rollover relief comes with its own inefficiencies. It creates artificial barriers to taxpayers changing industries or how they carry out their business. For example, it would encourage farmers who sell a farm to purchase another farm rather than a business in town. For this reason, we suspect that it would probably be best to keep rollover relief provisions as confined as possible.

Equity

25. Taxing capital gains would increase progressivity and horizontal equity. What constitutes a fair degree of progressivity in a tax system is open to debate and ultimately a political decision. Nevertheless, increasing horizontal equity would generally be considered to improve fairness.

26. International evidence indicates that taxing capital gains would be highly progressive. As shown in the graph below, in the United States capital gain income is generally low for

those on lower incomes but rises sharply at higher incomes. If New Zealand is similar this suggests that current settings, where most capital gains are untaxed, favour the wealthy.



AGI: adjusted gross income, data is for 2006.

27. Horizontal equity is the notion that taxpayers in similar situations should have a similar tax obligation. There is no obvious reason why a person who derives $100,000 in interest income should be taxed differently to a person who derives $100,000 in capital gains. Taxing capital gains is therefore consistent with horizontal equity.

Revenue integrity

28. Revenue integrity is the idea that the tax system should minimise opportunities for tax avoidance and arbitrage. A CGT should improve the revenue integrity of the tax system.

29. At present, taxpayers can have incentives to enter into artificial arrangements to transform taxable income into untaxed capital gains. One example of this arises with taxpayers who develop IP in New Zealand. If the IP is developed in a subsidiary of a foreign firm, there can be incentives for the IP to be sold to entities based in low-tax countries overseas and leased back. Many countries struggle with sort of issue. A CGT would reduce this incentive. It would mean the sale of IP offshore would be taxable.

30. The current lack of CGT may also provide other opportunities for tax arbitrage. For example, we have seen cases where taxpayers have sold assets, ostensibly to increase the asset's carrying value, and therefore provide for higher depreciation deductions. A CGT would reduce incentives to perform such a sale.

31. At the same time, a CGT may encourage people to migrate out of New Zealand in order to avoid the tax, reducing its revenue integrity. It is difficult to apply a CGT to people once they have left New Zealand– especially for intangible assets such as shares. It would be difficult to know that such a sale had occurred, yet alone tax it.

32. Our understanding is that Australia initially attempted to tax people leaving Australia on their unrealised capital gains when they left the country but then abandoned this approach. Canada does have rules that create a CGT liability when someone emigrates, but we do not know how successfully the rules are applied.

Fiscal cost

33. A CGT could become a significant source of revenue over time. It would provide one way of helping bridge the fiscal gap that is likely to emerge over time because of New Zealand's ageing population. Treasury estimates presented for the Long Term Fiscal Strategy (LFTS) suggest an eventual estimated revenue gain for a realisation-based CGT excluding owner-occupied housing of 0.8% of GDP after it is fully transitioned (approximately $1.6 billion based on current GDP). This was based on an assumption of a 1% per annum gain in the real value of land and 2% per annum inflation.

34. The revenue gain from the tax would be lower initially and rise over time, with this profile being highly dependent on how the tax is brought in (see the discussion under *Transition*). CGT revenues tend to also be highly volatile and move with the business cycle; that is, high during economic booms and low during economic downturns.

35. Due to its cyclical nature, the revenue obtained from the CGT is therefore likely to be less valuable than a less risky revenue stream of a similar amount. This is because that a CGT will tend to produce most revenue in states of the world where New Zealand is doing particularly well and the Government is less in need of revenue. On the other hand, this feature means a CGT helps to maintain macroeconomic stability, as it is a counter-cyclical automatic stabiliser.

36. Finally, introducing a CGT may place pressure on other policies. This may reduce the aggregate fiscal gain. For example, implementing a CGT may bolster calls for depreciation to be reintroduced for buildings (which would have a fiscal cost of around $690m per year).

Compliance and administration cost

37. Capital gains taxes are complex with a high compliance burden. Not only do taxpayers have to come to grips with a complex additional law, but filing requirements will likely increase and taxpayers will be required to keep records about the purchase of, and improvements to, assets. These records will need to be kept for at least as long as the taxpayer holds an asset – which could be a very long time.

38. The complexity of the tax is very dependent upon the design chosen. Applying full tax rates to capital gains would allow the tax to be (potentially considerably) simpler than if

preferential tax rates were applied. Provisions to narrow the ambit of the tax can introduce significant complexity.

39. Although in aggregate a CGT will likely increase compliance costs, in some situations it may reduce them. New Zealand does tax capital gains in some situations – such as when a person purchased the property with the intention of resale. This is very difficult to apply and may discourage people from buying and selling assets regularly (such as shares) out of concern this activity will constitute an intention of resale.

40. Reliance on the so-called revenue account rules, which are also difficult to comply with, will also be reduced (assuming full taxation of capital gains). These rules determine whether expenditure on an asset is "on revenue account" (and therefore deductible) or "on capital account" (and therefore non-deductible). As a general rule of thumb, expenditure to repair an asset is on revenue account while expenditure that improves an asset is on capital account. However, this boundary can be unclear and therefore the source of disputes. A CGT would reduce pressures on this boundary to some extent as a consequence of a CGT is that expenditure on capital account can (essentially) be deducted against capital gains. However, ring-fencing capital losses may mean this boundary is not entirely removed.

41. In the time available, it has not been possible to work through the likely systems issues associated with introducing a CGT. However, some changes to Inland Revenue's computer systems would likely be required. This is likely to be complex. Managing these changes would also draw resources away from Inland Revenue's business transformation programme. This could delay the transformation programme and increase its cost.

42. More generally, Inland Revenue would require additional resources to administer the tax. As noted above, CGTs are very complex taxes. International experience is that they require frequent amendments to address problems that arise in their application. As a completely new tax base, it is also likely to require additional audit resources to ensure people are complying with their CGT obligations.

Coherence

43. A coherent tax system is one where the different components of the tax system make sense when viewed as a whole. A CGT is consistent with the fundamental basis of our tax system – one with broad tax bases and low rates. A CGT should therefore be seen as a coherent addition to the current tax system.

44. It is instructive to ask how New Zealand has been able to sustain a tax system without capital gains taxation when almost all other OECD countries have such taxation. From a structural point of view, capital gains taxation plays a role in co-ordinating the taxation of companies and their shareholders. Since selling shares can be a substitute for extracting dividends, pressures can arise when dividends are subject to a higher tax rate than capital gains. New Zealand's policy framework, with a broad company tax base, relative alignment between the top personal and company tax rate, and imputation, greatly mitigates the structural necessity of a CGT. Under current policy settings, a CGT in New Zealand is a

choice, rather than a structural imperative. If settings where to change, such as an increase in the top personal tax rate, the structural case for a CGT would be increased.

Other issues

Transition

45. How to transition to a system with a CGT is an important issue. There are two broad approaches: where all assets are valued on the day the CGT first applies and immediately subject to the tax (a so-called "Canadian transition"), or where the tax applies to an asset only after it has been sold subsequent to the CGT's application date (a so-called "Australian transition).

46. An Australian transition is much simpler but has significant lock-in effects. Owners of assets at the time the tax comes into force have strong incentives not to sell, as any replacement asset they purchase will have the tax. Revenue arising from an Australian transition will also take a long time to build up, as initially very few assets will be subject to the tax.

47. A Canadian transition avoids the lock-in effect of an Australian transition, and the tax's revenues build up faster. However, valuing all assets on the day the CGT first applies is very difficult. While it may be possible to use proxies for some type of asset (e.g. property rating valuations for rental properties), these may not be accurate. To the extent they are not accurate it will create a lock-in similar to that under an Australian transition and also weaken the fairness of the tax.

Interaction with social assistance policies

48. Another issue is whether capital gains should count for social assistance purposes. There are good arguments that they should, as someone deriving capital gains has less need for Government assistance. However, it may result in large fluctuations in entitlement (for example, a person may have an entitlement to Working for Families in years 1 and 3, but sell a property in year 2 for a capital gain so have no entitlement in that year). In addition, most social assistance programmes are not wealth tested, so a person can own a significant portfolio of assets generating capital gains and still be entitled to assistance – provided they do not sell the assets.

Impact on housing

49. A CGT is unlikely to affect the rate that land increases in value, but is likely to result in a one-off reduction in land values. In addition, a CGT that did not apply to owner-occupied housing will likely result in a small increase in the proportion of owner-occupied homes. Housing affordability should increase for owner-occupiers.

50. However, we would also expect rental prices to increase as landlords may try pass on some the cost of the tax onto tenants. So housing affordability is likely to reduce for tenants.

Consultation

51. This report reflects Inland Revenue's views about the pros and cons of a capital gains tax. Treasury has been advised about this report.