THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: 20170125

18 May 2017

Thank you for your Official Information Act request, received on 4 April 2017. You requested:

> *"1. Any memos, reports or briefing notes, including drafts, prepared by officials between 1 January 2015 and 4 April 2017 relating to the viability of a tourist tax on international visitors to New Zealand."*

On 5 April 2017 you clarified that your request was for documents prepared for Ministers as well as for documents prepared for internal Treasury use.

Furthermore, on 27 April I extended the time limit for responding to your request by 10 working days.

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	25 July 2016	Draft internal Treasury paper noting tourism taxes as a potential response to tourism-related environmental pressures.	Release in part
2.	24 August 2016	Draft internal Treasury paper assessing tourism taxes against the Living Standards Framework.	Release in part
3.	21 October 2016	Minutes from internal Treasury meeting noting work being done on tourism taxes.	Release in part
4.	13 December 2016	Draft internal Treasury and Inland Revenue paper assessing tourism tax ideas proposed in industry report (1st draft).	Release in part

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5.	16 December 2016	Draft internal Treasury and Inland Revenue paper assessing tourism tax ideas proposed in industry report (2nd draft).	Release in full
6.	8 March 2017	Draft internal Treasury paper noting issues that would need to be considered in developing tourism taxes.	Release in full

I have decided to release the relevant parts of the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- names and contact details of junior officials and certain sensitive advice, under section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions, and
- advice still under consideration, section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials.

Please note that:

- some information has been redacted because it is not covered by the scope of your request,
- the documents being released are draft in nature and do not necessarily reflect the Treasury's and Inland Revenue's overall views, and
- document 3 contains an error – the cross-agency working party referred to in the minutes was not in fact led by DPMC.

Please also 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

Matt Cowan
Acting Manager, Tax Strategy

Information for Release 20170125

Natural Resources team – generation of policy ideas, August 2016

Area / topic	Previous first best advice	Reason for change or	Responsible team member

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Natural Resources team – generation of policy ideas, August 2016

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Tourism		Growing number of tourists putting pressure on the environment. Tourism tax?	s9(2)(g)(i)
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pages 1 - 7 not covered by request

TOURISM TAX

Policy proposal: [Not clear – is it (i) a tax on foreign visitors to NZ, (ii) a tax on foreign and domestic tourists in NZ, (iii) a tax on foreign and domestic tourists in specific parts of NZ, or something else?]

Problem definition: [Not clear]

Has this been our previous first-best advice? No.

LSF scores: *(from -2 to +2, with 2 = 'significant impact', 1 = 'moderate impact' and 0 = 'no or minor impact, or positives cancel out negatives')*

Flow / Stock	Score	Justification
Economic growth	**-2**	+ would capture some of the gap in the base from no GST on international flights – unlikely to accurately capture specific costs imposed by tourism; lower expenditure and employment
Sustainability	**+1**	+ revenue base expected to grow significantly in coming years
Increasing equity	**-2**	+ tourists don't contribute to some services provided by local govt, placing burden on residents – tourists already contribute to funding general public services through GST, and specific services through the border clearance levy, fuel excise/RUC, hut fees, car park charges
Social cohesion	**+1**	+ addresses public concerns about freeloading
Managing risks	**0**	
Economic capital	**+1**	+ shifts tax burden from residents onto non-residents
Natural, social & human capital	**+1**	+ funding could be spent on protecting the environment

Timing of benefits: *(short = 1-2 years, medium = 2-5, long = 5+)*

Confidence in impacts: *(low, medium, high)*

Ease of implementation: *(easy, medium, hard)*

page 9 not covered by request

Strategic Intention: An Internationally Connected and Competitive Business Environment

Monthly Steering Group Meeting, Thursday 20 October 2016
Room 10.1/10.2

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Tourism, McKinsey have been doing a report with Air NZ on a tourism tax. There is a cross-agency working party lead by DPMC on Tourism. s9(2)(f)(iv)

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Framework

1. Clear and coherent frameworks are very important for good tax policy. International tax reviews have cited the importance of deciding what ~~it is~~ a nation wants to tax and then doing so consistently.

2. There are two broad models that a government can adopt in determining what to ~~levy~~ tax ~~on~~. Tax can be levied on narrow bases with high tax rates, or~~; alternatively tax can be~~ levied on broad tax bases with low rates.

3. ~~New Zealand is very fortunate to have a clear and coherent broad-base, low-rate framework for taxation (BBLR).~~ Broad bases ~~help~~ ensure ~~that~~ taxes are fair and efficient, and do not distort investment decisions or economic activity (for example by favouring one industry at the expense of others). Broad bases also allow ~~the~~ government to collect the revenue that is necessary to fund its spending at as low rates as possible. Lower tax rates are less likely to discourage investment or additional economic activity; this in turn provides a second-round benefit in promoting fairness, efficiency and growth.

4. New Zealand is very fortunate to have a clear and coherent broad-base, low-rate framework for taxation (BBLR). This BBLR framework was introduced in the mid-1980s and has a lot of buy-in from the wider New Zealand public. ~~Consistent~~ R~~r~~eviews of taxation have consistently ~~suggested~~ stated ~~that~~ there should be a high burden of proof before moving away from BBLR principles.

Considerations for new tax bases

5. Under this framework, narrowly based taxes, such as a bed or border tax, can generally only be justified on externality grounds. This is that they are a "corrective tax" that is intended to change behaviour and ~~compensate~~ ensure consumers face the costs of~~for~~ the ~~social~~ harm they impose on society when~~of~~ consuming a product. As noted above, there should be a high burden of proof before adopting such taxes and moving away from BBLR principles.

6. For such a tax to be of net benefit it needs to be strongly targeted at the harm it ~~is~~ addresses, ~~ing~~ and at a rate corresponding to the harm. A poorly targeted corrective tax can result in ~~further~~ economic distortions, harming efficiency and equity, and would be contrary to the BBLR framework.

7. In addition, in considering whether to implement a new tax, the standard tax policy objectives of coherence, efficiency, equity, revenue integrity, fiscal cost, and compliance and administration costs must be considered. For corrective taxes in particular, it must be considered whether the administration and compliance costs imposed by a new tax type exceed the benefits of the tax (especially in situations where the additional revenue collected by the tax is low).

8. The majority of issues with external~~ity~~ costs in New Zealand tend to be localised in nature. As a result, taxes at a national level tend not to meet the criteria of being strongly targeted and it is likely that the compliance and administration costs of a new tax type would exceed the benefits of the tax. Instead, it is more likely that a

Commented [1] **:** Can we make this para specific to tourism rather than general?

[1] - s9(2)(g)(i)

carefully designed charge applied at the local level is more likely to be the more appropriate tool for these localised issues.

~~8.~~9. Tourists already contribute revenue through our existing, broad bases. It is important to consider whether imposing new taxes would reduce tourism expenditure, with corresponding reductions in GST and income tax.

Tax options raised in Tourism Leaders Report

~~9.~~10. The Tourism Leaders Report outlined two tax options for funding tourism related infrastructure~~ alongside a number of non tax options. These were~~:

- A bed tax of 2% of room rates for all accommodation providers; and
- An additional $5 departure tax to be placed on top of the existing border clearance levy.

~~10.~~11. The report estimated that the two taxes would raise revenue of $35 million and $30 million respectively.

Initial analysis of these options

~~11.~~12. In determining the effectiveness of the two tax options, it is important to be clear about ~~what~~ the purpose of ~~the~~ imposing such a tax~~es are~~. The tax could either be designed as a revenue raiser, or could be designed as a corrective tax. ~~What they are designed to do~~Identifying the purpose is important ~~in~~ for determining whether ~~they are~~the tax is effective or whether there are alternatives that could achieve the goals ~~in~~ more efficiently~~ ways~~.

~~12.~~13. Below is our initial analysis of the options based on the criteria outlined in the framework section. This analysis represents our ~~only a~~ very initial consideration of the measures.~~,~~ ~~i~~In particular, it has not been possible to fully cost all options in the time available.

Are bed and border taxes effective revenue raisers?

~~13.~~14. As outlined earlier, ~~under our BBLR framework,~~ narrowly based taxes are generally not justifiable on ~~pure~~ revenue raising grounds. This is because narrowly based taxes are inefficient and impose higher costs on society than our broader ~~based~~ income tax and GST bases. In addition, ~~such~~ narrowly -based taxes move away from our BBLR framework for taxation, and therefore are likely to decrease the coherence of the framework and the general buy-in from the private sector~~ to it~~.

~~14.~~15. Previous analysis o~~f~~n the border clearance levy ~~done in 2015 showed~~concluded that the border levy was likely to decrease tourism expenditure by approximately $56m and raise approximately $100m million in revenue. This indicates that tourism expenditure is sensitive to price changes.~~ in pricing and that t~~Border and bed~~he tax options raised in the Tourism Leaders Report~~ taxes would be relatively inefficient at raising revenue~~ and create economic distortions~~. R~~This r~~educted~~ion~~

~~in~~ tourism expenditure ~~in turn~~ would also likely result in reduced GST and income tax receipts.

Are bed and border taxes effective corrective taxes?

~~15.~~16. A~~To be effective a~~ corrective tax needs a ~~to be~~ strong~~ly~~ connection ~~linked~~ with the social harm it is intended to address.

~~16.~~17. T~~he social harm created by tourism raised by t~~he Tourism Leaders Report is suggests that the use of infrastructure by ~~the~~ tourists is a social harm~~.~~ Our initial view is ~~that we do not consider that~~ a bed or border tax is unlikely to be strongly targeted towards this harm. ~~The use of i~~Infrastructure use by tourists is highly variable and ~~is~~ generally localised in nature. A bed or border tax is likely to be a blunt tool that overcharges low infrastructure users and undercharges high infrastructure users. This over and undercharging creates further economic distortions and inefficiencies. It could also be considered inequitable to charge tourists for infrastructure they do not use.

18. As a result, a bed and border tax is likely to be an inefficient way of addressing infrastructure use by tourists. Instead, more ~~we consider that it is more likely that~~ localised solutions through targeted user charges and regulation would provide a more efficient and fair way of addressing infrastructure use.

Hypothecating revenues

19. Revenue raised through the proposed taxes would be hypothecated to tourism-related infrastructure.

20. The Budget process aims to ensure Government spending is directed to its highest value use. This is achieved through central prioritisation. Where revenues are hypothecated, the spending is not subject to the same level of scrutiny and trade-offs. This will result in lower value projects being funded ahead of higher value alternatives, and limit Government's ability to spend effectively. For this reason, the Treasury generally opposes hypothecation.

~~17.~~21. Some tagged taxes, such as user levies, have a clear legislated framework and cost-benefit model governing revenue collection and spending. There is a very strong link between the taxed activity and subsequent spending, as is the case for road user charges hypothecated to the National Land Transport Fund. Bed and border taxes are likely to be poor proxies for tourism-related infrastructure use, and as such, poor candidates for hypothecated revenues.

Administration and compliance costs

~~18.~~22. A~~The a~~dministration and compliance costs ~~of the taxes would~~ ultimately depend on the final design of taxes and choices regarding implementation. However, because of the relatively low amount of revenue raised from the taxes, it is likely that the two options would have disproportionate compliance and administrative costs relative to the revenue raised from them. This is particularly the case for the bed tax, which would require the creation of a new tax type.

Tax incidence

~~19.~~23. An argument commonly raised in support of tourism taxes is that they are of net benefit to a country because the incidence ~~of them~~ falls on non-residents. However, as outlined above, one significant effect of the tax is that it i~~'~~s likely to decrease tourism expenditure in New Zealand. This means ~~that~~ a significant amount of the

Commented [1] : What about GST on the levy?

Commented [1] : We might be better of referring to this as an external cost – I am not sure we want to refer to tourists as creating harm.

Commented [1] : Could we throw in some examples? The main distortion that springs to mind is low infrastructure users are priced out of the market, but this seems desirable when part of the point is to reduce pressure on assets

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[1] - s9(2)(g)(i)

incidence of the tax is likely to be borne by New Zealanders through reduced tourism receipts.

24. In addition a border ~~bed~~ or bed ~~border~~ tax ~~would also likely~~may be ~~charged on~~applied New Zealand residents travelling overseas or paying for temporary accommodation domestically. As a result, these New Zealanders will also bear some of the incidence of the tax. This could also be seen as unfair as ~~for~~ some New Zealanders may pay both general taxes and a specific bed or border tax to fund infrastructure they do not use~~who leave New Zealand permanently who will not use New Zealand infrastructure that the tax is paying for~~.

Conclusion

~~21.~~25. Maintaining a clear and coherent framework is very important for good tax policy. New Zealand is well served by its BBLR tax framework and we would caution against measures that are inconsistent with this. On our initial consideration we do not consider that a border or bed tax meets the burden of proof for ~~moving~~ departing from BBLR principles. The measures have the potential to reduce efficiency, productivity, and growth, and to erode the coherence of our BBLR framework.

~~22.~~26. If it is considered that there is a need to centrally fund additional infrastructure, we consider that existing tax bases would be a better source of funding rather than introducing new tax types. If there is concern about the overuse of infrastructure by tourists then we consider the better approach is likely to be charging them for the use of infrastructure directly or through targeted regulation.

Framework

1. Clear and coherent frameworks are very important for good tax policy. International tax reviews have cited the importance of deciding what a nation wants to tax and then doing so consistently.

2. There are two broad models that a government can adopt in determining what to tax. Tax can be levied on narrow bases with high tax rates, or levied on broad tax bases with low rates.

3. Broad bases ensure taxes are fair and efficient, and do not distort investment decisions or economic activity (for example by favouring one industry at the expense of others). Broad bases also allow government to collect the revenue that is necessary to fund its spending at as low rates as possible. Lower tax rates are less likely to discourage investment or additional economic activity; this in turn provides a second-round benefit in promoting fairness, efficiency and growth.

4. New Zealand is very fortunate to have a clear and coherent broad-base, low-rate framework for taxation (BBLR). This BBLR framework was introduced in the mid-1980s and has a lot of buy-in from the wider New Zealand public. Reviews of taxation have consistently stated there should be a high burden of proof before moving away from BBLR principles.

Considerations for new tax bases

5. Under this framework, narrowly based taxes, such as a bed or border tax, can generally only be justified on externality grounds. This is that they are a "corrective tax" that is intended to change behaviour and ensure consumers face the costs of the harm they impose on society when consuming a product. As noted above, there should be a high burden of proof before adopting such taxes and moving away from BBLR principles.

6. For such a tax to be of net benefit it needs to be strongly targeted at the harm it addresses, and at a rate corresponding to the harm. A poorly targeted corrective tax can result in economic distortions, harming efficiency and equity, and would be contrary to the BBLR framework.

7. In addition, in considering whether to implement a new tax, the standard tax policy objectives of coherence, efficiency, equity, revenue integrity, fiscal cost, and compliance and administration costs must be considered. For corrective taxes in particular, it must be considered whether the administration and compliance costs imposed by a new tax type exceed the benefits of the tax (especially in situations where the additional revenue collected by the tax is low).

8. The majority of issues with external costs associated with tourism in New Zealand tend to be localised in nature. As a result, taxes at a national level tend not to meet the criteria of being strongly targeted and it is likely that the compliance and administration costs of a new tax type would exceed the benefits of the tax. Instead, it is more likely that a carefully designed charge applied at the local level is more likely to be the more appropriate tool for these localised issues.

9. Tourists already contribute revenue through our existing, broad bases. It is important to consider whether imposing new taxes would reduce tourism expenditure, with corresponding reductions in GST and income tax.

Tax options raised in Tourism Leaders Report

10. The Tourism Leaders Report outlined two tax options for funding tourism related infrastructure:

- A bed tax of 2% of room rates for all accommodation providers; and

- An additional $5 departure tax to be placed on top of the existing border clearance levy.

11. The report estimated that the two taxes would raise revenue of $35 million and $30 million respectively.

Initial analysis of these options

12. In determining the effectiveness of the two tax options, it is important to be clear about the purpose of imposing such a tax. The tax could either be designed as a revenue raiser, or could be designed as a corrective tax. Identifying the purpose is important for determining whether the tax is effective or whether there are alternatives that could achieve the goals more efficiently.

13. Below is our initial analysis of the options based on the criteria outlined in the framework section. This analysis represents our very initial consideration of the measures. In particular, it has not been possible to fully cost all options in the time available.

Are bed and border taxes effective revenue raisers?

14. As outlined earlier, narrowly based taxes are generally not justifiable on revenue raising grounds. This is because narrowly based taxes are inefficient and impose higher costs on society than our broader income tax and GST bases. In addition, narrowly based taxes move away from our BBLR framework for taxation, and therefore are likely to decrease the coherence of the framework and the general buy-in from the private sector.

15. Previous analysis of the border clearance levy concluded that the border levy was likely to decrease tourism expenditure by approximately $50m and raise approximately $100m million in revenue. This indicates that tourism expenditure is sensitive to price changes. Border and bed taxes would be relatively inefficient at raising revenue. Reduced tourism expenditure would also likely result in reduced GST and income tax receipts.

Are bed and border taxes effective corrective taxes?

16. A corrective tax needs a strong connection with the social harm it is intended to address.

17. The Tourism Leaders Report suggests that the use of infrastructure by tourists is a social harm. Our initial view is a bed or border tax is unlikely to be strongly targeted towards this harm. Infrastructure use by tourists is highly variable and generally localised in nature. A bed or border tax is likely to be a blunt tool that overcharges low infrastructure users and undercharges high infrastructure users. This over and undercharging creates further economic distortions and inefficiencies. For example, a tourist with low infrastructure use in New Zealand could be deterred from visiting New Zealand due to them being charged for infrastructure they do not use. This would be inefficient and deter tourists whose visits may be of net benefit to New Zealand. It could also be considered inequitable to charge tourists for infrastructure they do not use.

18. As a result, a bed and border tax is likely to be an inefficient way of addressing infrastructure use by tourists. Instead, more localised solutions through targeted user charges and regulation would provide a more efficient and fair way of addressing infrastructure use.

Hypothecating revenues

19. Revenue raised through the proposed taxes would be hypothecated to tourism-related infrastructure.

20. The Budget process aims to ensure Government spending is directed to its highest value use. This is achieved through central prioritisation. Where revenues are hypothecated, the spending is not subject to the same level of scrutiny and trade-offs. This will result in lower value projects being funded ahead of higher value alternatives, and limit Government's ability to spend effectively. For this reason, the Treasury generally opposes hypothecation.

21. Some tagged taxes, such as user levies, have a clear legislated framework and cost-benefit model governing revenue collection and spending. There is a very strong link between the taxed activity and subsequent spending, as is the case for road user charges hypothecated to the National Land Transport Fund. Bed and border taxes are likely to be poor proxies for tourism-related infrastructure use, and as such, poor candidates for hypothecated revenues.

Administration and compliance costs

22. Administration and compliance costs ultimately depend on the final design of taxes and choices regarding implementation. However, because of the relatively low amount of revenue raised from the taxes, it is likely that the two options would have disproportionate compliance and administrative costs relative to the revenue raised from them. This is particularly the case for the bed tax, which would require the creation of a new tax type.

Tax incidence

23. An argument commonly raised in support of tourism taxes is that they are of net benefit to a country because the incidence falls on non-residents. However, as outlined above, one significant effect of the tax is that it is likely to decrease tourism expenditure in New Zealand. This means some of the incidence of the tax is likely to be borne by New Zealanders through reduced tourism receipts.

24. In addition a border or bed tax may be applied to New Zealand residents travelling overseas or paying for temporary accommodation domestically. As a result, these New Zealanders will also bear some of the incidence of the tax. This could also be seen as unfair as some New Zealanders may pay both general taxes and a specific bed or border tax to fund infrastructure they do not use.

Conclusion

25. Maintaining a clear and coherent framework is very important for good tax policy. New Zealand is well served by its BBLR tax framework and we would caution against measures that are inconsistent with this. On our initial consideration we do not consider that a border or bed tax meets the burden of proof for departing from BBLR principles. The measures have the potential to reduce efficiency, productivity, and growth, and to erode the coherence of our BBLR framework.

26. If it is considered that there is a need to centrally fund additional infrastructure, we consider that existing tax bases would be a better source of funding rather than introducing new tax types. If there is concern about the overuse of infrastructure by tourists then we consider the better approach is likely to be charging them for the use of infrastructure directly or through targeted regulation.

Tourism tax skeleton notes for Tax Strategy planning day 9/3/17

Background

Tourism Satellite Account 2016 statistics

Earnings from tourism overtook those from dairy last year, at $14.5 billion. Tourism directly employs 1 in every 13 people in New Zealand. Yearly growth in tourist numbers has increased from 5% in 2015 to 10% in 2016 for a total of 3.3 million. MBIE estimates further increases to 4.5 million in 2022.

Tourism expenditure was $35 billion contributing $2.8 billion in GST. Again, yearly growth is increasing, from 4% in 2014 to 12% in 2016.

Tourism will be significant, both in tourist volume and contribution to GDP.

Public interest

Recent media articles indicate a reasonable degree of public interest. Anecdotally, much of the interest is in making funds available to ensure sufficient infrastructure, or reducing congestion. The previous Prime Minister expressed interest in bed taxes or departure taxes as recently as November 2016.

Previous advice

Our previous advice on tourism taxes has tended to focus on avoiding hypothecation. We should ignore the funding side of the equation for today as I think that advice will stand.

More recently we/IR have provided quite generic advice to MBIE on the high bar for departing from BBLR. Given the level of public interest, we should consider having something more comprehensive to say.

Grounds for exploring tourism taxes

Revenue Strategy

The Government's revenue strategy is published on our website. The following appear most relevant to tourist taxes:

- Fair and efficient
- Responds to medium-term needs in a planned and coherent way
- Biases economic decisions as little as possible
- Low compliance and administrative costs.

Generally, the Government favours a broad-base, low-rate framework. Narrow taxes need to clear a high bar before we can recommend them. Why might we recommend a tourist tax?

IN-CONFIDENCE

Externalities

Externalities can warrant departing from BBLR. Where a cost is imposed on a party external to the transaction, taxes can be efficiency-enhancing.

Much of the infrastructure, such as toilets and carparks, near sites frequented by tourists is paid for by local councils, mainly through rates. The use of such infrastructure is often free. Tourists who use such infrastructure may impose costs on ratepayers, such as extra maintenance or congestion, which are external to the decision to use. There may be a case for exploring such taxes further.

Considerations for advice

Key question: What information would we want to have available to inform a policy position?

Conceptual considerations

For a tax to efficiency enhancing, policymakers need to establish a clear link between the activity and the external cost, and set the rate on that activity such that it reflects the external cost. For tourism taxes, that will be difficult. For example:

- Bed and border taxes will generally be only weakly associated with congestion and infrastructure use, and it is difficult to make a case for externalities associated with sleeping in a hotel or entering an airport
- The cost of congestion by definition varies with the number of users and so too should the tax if it is to be efficient
- If the externalities are caused by congestion, should it be a user charge rather than a tourist tax?

Do any tourism activities generate a clear externality that would be suitable for taxation?

Cost/benefit analysis

It will be important to estimate whether the revenue raised would outweigh the GST lost from discouraged tourists, and any impacts on employment and PAYE (would the tax break even?). To do this, we would need to know how price sensitive tourists are. This could vary among particular groups, so detailed demographic breakdowns would probably be useful, particularly if the demographic profile of tourists is changing in a particular way.

If it does break even, to what extent do we value deadweight costs imposed on other countries?

Administrative considerations

Would these taxes be easily enforced? The more targeted the tax the more difficult it would be to enforce, and the less targeted the tax the greater the risk of inefficiency.

IN-CONFIDENCE

Many of the externalities seem to be imposed in the remotest places (e.g, Tekapo toilets).

AirBnB collects and remits bed taxes. Other informal accommodation providers, along with the more traditional providers could likely withhold bed taxes too.