Reference: 20150519

9 February 2016

[redacted]

Thank you for your Official Information Act request, received on 16 December 2015. You requested the following:

> *"What work, if any, has Treasury done on possible new capital or wealth taxes for New Zealand since January 2009? Can I please have copies of any work done, if any, and any estimations of costs and revenue resulting."*

On 22 December 2015 you clarified that you were not requesting information regarding the new bright-line test for sales of residential property and revised the scope of your request to read:

> *"Reports and briefing notes since 1 January 2009 to Ministers or Ministers' offices on new capital or wealth taxes, including capital gains taxes, risk free return method (RFRM), land taxes and other wealth taxes."*

Your refined request covered a number of joint reports that Inland Revenue was the lead agency for. This part of your request was transferred to Inland Revenue on 18 January 2016.

Information Being Released

Please find enclosed the following document:

Item	Date	Document Description	Decision
1.	22/11/2013	Treasury Report T2013/2924 – Economic Strategy: Issues and Options	Release in part

I have decided to release the relevant parts of the document listed above, subject to personal contact details of officials being withheld under section 9(2)(a) of the Official Information Act.

Information Publicly Available

The following information is also covered by your request and is publicly available on the Treasury website:

Item	Date	Document Description	Website Address
2.	18/12/2009	Treasury Report T2009/2714 – Where to From Here for Tax Reform?	http://www.treasury.govt.nz/publications/informationreleases/budget/2010/pdfs/b10-t2009-2714.pdf

Accordingly, I have refused your request for the document 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

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Economic Strategy: Issues and Options

Date:	22 November 2013	**Report No:**	T2013/2924

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Discuss** the assessment with Treasury on 3 December 2014	3 December 2014

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Mario Di Maio	Principal Advisor	04 917 6154 (wk)		✓
Chris Nees	Senior Analyst	04 917 6016 (wk)	s9(2)(a)	
Jane Frances	Manager	04 917 6056 (wk)		

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Refer a copy of this report to the Prime Minister and the Minister for Economic Development

Enclosure: No

Pages 2-29 deleted as not relevant to the request

A tax system for New Zealand's future

75. The tax system has a pervasive influence on economic decisions. Careful consideration is required in order to ensure that the tax system delivers on a range of objectives – from overall coherence, fairness and equity, integrity and sustainability over time, and simple to comply and administer. The underlying design of the New Zealand tax system has some attractive features and stacks up well internationally – in particular it has revenue integrity and it is comparatively simple.

76. In 2012 the tax system was shifted towards a more growth friendly mix. However, there are opportunities to improve current settings further. Concerns about the tax system have been summarised in other places but key issues remain around:

- Heavy reliance on those taxes that are most harmful to growth and that fall heavily on the mobile factors of production, including personal income and corporate taxes. Over time fiscal drag implies a greater proportion of tax revenue will come from income tax (see Chart 11). This reliance coexists with substantial gaps in terms of the tax base – namely the absence of tax on large part of capital gains or owner-occupied housing.

- Risks to the sustainability of the tax base that are getting larger over time. International mobility of capital and labour looks likely to increase in importance. There are concerns around the integrity of the corporate tax base, in response to profit shifting activities from multinational firms, and to the GST base, in response to growing levels of online purchases offshore. Over time, choices around adjustment to population aging may also imply higher taxation. Changes in Australia's approach to taxation, particularly its corporate tax choices, are particularly important given the degree of integration between the two economies.

- There remain differences in the tax treatment of different forms of investment (see Chart 12).[5] These differences can distort decisions about the type of assets in which to invest, which may have economic costs. One concern is that owner-occupied and rental housing are tax preferred over shares and debt instruments. This also creates scope to divert income and undermines integrity and fairness of the tax system.

Chart 11: Distribution of taxpayers if fiscal drag is not addressed until stated year

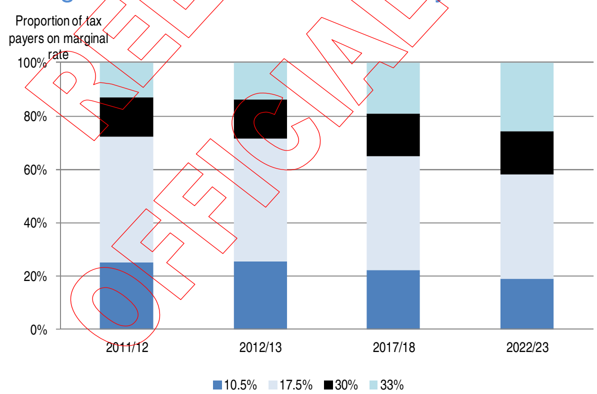
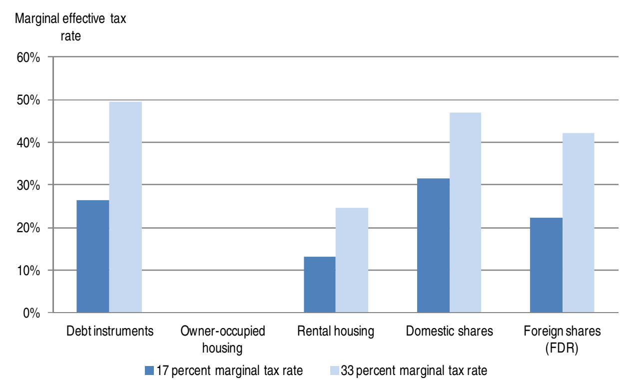


Chart 12: Effective marginal tax rates on different investment vehicles



Source: Treasury

[5] The real effective tax rates for rental housing shown are calculated on the basis of 100% equity investment. The presence of debt can reduce the real effective tax rate and in fact it could be negative with a high level of debt. If we assume the post-tax risk adjusted returns are equal, there should be no incentive to borrow to invest in additional housing, the distortion is best illustrated by comparing real effective tax rates on the equity portion.

77. Changes are needed to strengthen the tax system within the current design. Recent Treasury analysis suggests that changes within our current broad-base, low rate tax framework offer potentially larger improvements in growth than from fundamentally redesigning New Zealand's tax system.[6] More fundamental changes have material risks with associated integrity and increased complexity.

78. Within the current tax framework, the largest gains would come from further reductions on taxes on mobile factors of production through personal and corporate income tax reductions. The resulting loss in revenue would need to be offset by base broadening such as a capital gains tax, which would address weakness in current system and reduce the tax advantage towards housing. Alternatively this could be offset through new tax bases, such as a land tax and considering the merit for further environmental taxation over time, both of which would shift the tax burden away from mobile and more distorting tax bases.

79. Treasury modelling work has suggested that personal income tax cuts may have greater economic benefit than corporate income tax cuts in New Zealand. This is primarily because most of the benefits of personal tax cuts would accrue to residents, whereas a larger proportion of the benefits of corporate income tax cuts 'leak' overseas to non-residents given New Zealand's high level of foreign capital ownership. In contrast under our imputation system a personal income tax reduction would increase incentives for both savings and investment, and labour supply. But this choice is not cut and dried. An important influence on the corporate rate is Australia's approach to corporate tax. Most recently the new Coalition Government has indicated that they will lower effective corporate tax rates for smaller Australian companies.

80. It may be worth considering some smaller scale and second-best alternatives in the absence of an appetite for a more material shift in the direction of broadening the tax base and lowering taxes on capital and labour. One such focus for further work could be a tax switch to housing and land from other investment. The following options could be considered:

    a. While from first principles, the ideal reform would be to broaden the tax base through a more comprehensive capital gains tax, an alternative option worth considering would be the application of the Risk-Free Return Method to housing. This approach would approximate the taxation of economic income on rental housing and imputed rents for owner-occupied housing. The greatest improvement in investment efficiency would be to include owner-occupied housing in the tax base. However, there are some unattractive consequences to applying RFRM to owner-occupied housing as compared to a capital gains tax, including the probability of a larger windfall loss to homeowners. At a smaller scale we have recently advised on whether ring-fence housing investment losses being offset against income from other sources.

    b. Reducing tax on interest income may also be worth considering. Modelling suggests it would be likely to result in an increase in private savings and reduce pressure on domestic demand, similar to a personal tax reduction.[7] However,

[6] Fundamental reforms considered include a dual income tax, which taxes capital at a lower rate than labour, or an Allowance for Corporate Equity, which exempts normal returns to capital from tax.

the reduction in tax on interest income may also cause other distortions, not captured in modelling work (such as between debt and equity investments), so the overall efficiency impacts are unclear. There are also fiscal risks from tax arbitrage opportunities which would have to be managed or addressed with new anti-arbitrage rules, adding to complexity of the tax system.

c. The Tax Working Group recommended consideration of a land tax. From an economic efficiency point of view the tax has a number of desirable advantages, although it raises equity concerns in taxing one form of wealth differently than others. Further work suggested that a land tax could be levied on land values above a specific flat value per hectare as a means of ensuring some degree of progressivity and to account for difference in economic uses and values. Initial work has indicated that the imposition of a land tax at a flat rate will, on average, lead to tax payments that are a fairly constant proportion of income as income rises. The link with local government use of ratings as a tax base may also suggest some consideration of central-local government roles.

Remainder of document deleted as not relevant to the request