THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: 20170316

24 October 2017

[redacted]

Thank you for your Official Information Act request, received on 26 September 2017. You requested:

> *"all advice given to Ministers regarding the book 'Tax and Fairness' written by Deborah Russell and Terry Baucher, since its publication in May 2017"*

Information Being Released

Please find enclosed the following document:

Item	Date	Document Description	Decision
1.	29 May 2017	Aide Memoire: Tax and Fairness by Deborah Russell and Terry Baucher	Release in part

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

- staff direct telephone numbers, under section 9(2)(k) – to prevent the disclosure of official information for improper gain or improper advantage

Please note we have redacted the direct dial phone numbers of staff members in order to reduce the possibility of staff being exposed to phishing and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including the Treasury's own website.

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

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

1 The Terrace
PO Box 3724
Wellington
New Zealand

tel. 64-4-472 2733
fax. 64-4-473 0982
www.treasury.govt.nz

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

Yours sincerely

Mark Vink
Manager, Tax Strategy

THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: T2017/1461 SH-13-0

Date: 29 May 2017

To: Minister of Finance (Hon Steven Joyce)

Deadline: None
(if any)

Aide Memoire: Tax and Fairness by Deborah Russell and Terry Baucher

This aide memoire summarises the main points from *Tax and Fairness* by Deborah Russell and Terry Baucher.

Chapter 1. What does a good tax system look like

As suggested by the title, the book primarily analyses the tax system through the lens of fairness, while also acknowledging other criteria such as efficiency. Chapter 1 sets out a number of principles for a good tax system. These are:

- Equity (horizontal and vertical – everyone with the same income should pay the same tax; higher incomes may pay higher tax rates);
- Certainty (amount, time, and method of tax payment should be certain and not arbitrary);
- Convenience (compliance costs for taxpayers should be low and the rules for payments should be convenient, such as PAYE);
- Efficiency (tax system should not have high administrative costs; also, the tax system should be not impose high economic costs (deadweight costs));
- Neutrality (tax system should not influence private decisions (unless this is intended));
- Revenue (the tax system should raise sufficient revenue);
- Visibility (people should know how much tax they pay, and how the government spends its revenues);
- Coherence (tax measures should fit an overall structure, and not contribute to loopholes or unintended consequences);

Chapter 2. Nobody likes secondary tax

Secondary tax is a special PAYE rate for an employee's second and third jobs. The standard PAYE rates presume your first dollar of wage is your first dollar of total taxable income, so the total effective tax rate on your annual wage is calculated and apportioned to your fortnightly pay. It does a good job approximating the right amount of tax at the end of the year. The secondary tax rate presumes your first dollar of wage is starting at a higher marginal tax rate, so the rate of tax is higher. It makes it looks like the second job is being taxed at a higher tax rate (it's not, it's just the assumption of where it fits into your total annual income). It may be inaccurate and result in a large tax bill or tax refund at the end of the year. The authors think this should be fixed (presumably because it violates the "visibility" principle). They suggest some options – upgraded IT by IRD that could consider all income sources simultaneously and calculate the secondary tax withholding rate more accurately, renew annual tax return filing requirements (prompting the employee to pay more tax or get a refund) or tax second jobs at a new, flat rate (while conceding that this would be inconsistent with the equity principle).

Chapters 3 and 4. All savings are equal, but some are more equal than others; and The love affair with property

The authors describe the development of different regimes for taxing savings and how they resulted from different historical issues. However, they are all generally attempting to obtain comprehensive income tax (TTE) tax outcomes.

- Debt investments and New Zealand company investment is taxed on an accrual method (company investment by means of the company tax regime);
- Foreign shares are taxed on a deemed 5% return basis. The deemed return method is meant to overcome a number of issues (low dividend payout rates by foreign companies; lack of ability to tax the underlying company income). This has resulted in high and low effective tax rates compared to actual income in different years depending on the performance of the investments;
- Investment real property is taxed at a lower effective tax rate due to lack of a capital gains tax (although this is partly offset by the removal of building depreciation). Owner-occupied housing is generally not taxed at all (as is the case in almost all other countries).

The implication is that the tax system encourages people to invest in housing over other forms of savings. Our perspective is that we tax financial savings appropriately (TTE), in a way that is consistent with equity and efficiency outcomes. Housing investments are subject to lower effective tax rates for historical and methodological reasons and in a similar manner to other countries. These issues are discussed in *Private Savings and Taxation of Savings* (T2017/56 refers).

Chapter 5. Capital gains tax – the final frontier

The book goes through historical debates on the merits of a capital gains tax and land tax. It views as regrettable the frequent dismissals of a capital gains tax by official reviews which are followed by incremental changes to the "revenue account property" rules which tax capital gains taxes in particular circumstances (the most recent change was the addition of the two-year bright line rule for selling residential investment property). The authors appear sceptical of traditional arguments against a capital gains tax, such as it being complicated, given how common it is in other tax systems and the inclusion of other complex regimes in the tax system.

Chapter 6. Taxation of multinationals

The authors discuss recent reports about multinationals and what (reportedly) little tax they pay in New Zealand. They are supportive of the OECD-led BEPS proposals and also a unilateral diverted profits tax. In this case, they appear to agree with the government's move to adopt the most significant BEPS proposals on foreign hybrids and earnings stripping using interest. They should also be supportive of the proposal for an anti-avoidance rule on permanent establishment avoidance which is similar to the UK and Australia diverted profits tax (or Multinational Anti-Avoidance Law in the case of Australia).

They have a third approach, which is that multinationals should be encouraged to pay more tax in acknowledgment of the value of public services funded by government (a good citizen approach) and a more ethical approach by the professional tax community (lawyers and accountants) to steer clear of aggressive tax avoidance. This may be a somewhat naïve approach and, in fact, they acknowledge that the demands of investors for high returns may overwhelm any altruistic thoughts of management.

Chapter 7. Who writes tax law?

The book describes the tax policy development process (GTPP) and notes that IRD has the central role with the support of a small number of Treasury officials. They note that the dominant IRD role is now unusual internationally with Treasury departments usually having the dominant tax policy function in other countries. They note that Treasuries usually have to take account of wider economic issues and suggest this could be why Treasury has been more supportive of a capital gains tax than IRD.

They note that private sector participation in the policy development process is dominated by tax practitioners and large companies, suggesting their views may be given great weight, while others in the community who may have an interest tend not to participate, such as trade unions. They therefore support that New Zealand adopt something like the Australian Board of Taxation to review tax policy issues. This body would have permanent members that include not only tax practitioners (such as chartered accountants), but also other community representatives, such as unions and community support groups. Presumably they think this would provide a wider perspective to enter into the tax policy development process (although it's not clear how that would have changed the outcome of some recent policy reviews).

New Zealand has an extensive GTPP process which seeks advice from a wide range of stakeholders, including trade unions for policy issues where we think they would have an interest. We consider the case for a Board of Taxation is not strong in New Zealand, and it runs the risk of giving private sector groups a more formal role in the tax policy process which could slow it down and increase the risk of more self-interested perspectives gaining hold.

Chapter 8. Where to from here?

Conclusions from the book are:

- The tax system should be reviewed with an emphasis on reforming the taxation of savings, investment, and capital;
- We should set up a Board of Taxation; and
- We should engage in more public discussion of the morality of taxation.

Steve Mack, Principal Advisor, Tax Strategy, s9(2)(k)
Suzy Morrissey, Acting Manager, Tax Strategy, s9(2)(k)