Taylor Farrell

Question 2.

What is the most pressing intergenerational challenge facing our tax system?

Treasury University Challenge 2018

New Zealand's Generation Gap: Addressing Intergenerational Equity through the Tax System

Issues of intergenerational equity are gaining traction in the media and public discourse. New Zealand's news media bandy about such phrases as 'generation gap' or 'generation battle' to describe the perceived lack of equity between the generations.[1] Disparities in homeownership rates, and financial capital between generations has created tensions and threatens to undermine younger generation's ability to achieve key life milestones at a similar age as their parents had. Wellbeing inequality between generations of New Zealanders damage social cohesion and reduce people's trust in their government and public institutions. This essay will argue that achieving and maintaining intergenerational equity is the most pressing challenge facing our tax system. This essay will discuss the importance of generational equity for New Zealand based on Treasury's Living Standards Framework and the 'Four Capitals' before identifying housing unaffordability as a major driver of intergenerational inequality. The tax settings related to homeownership and capital gains are likely to be contributing to housing affordability for younger generations. Tax policy recommendations to address intergenerational inequality include rethinking the non-taxation of imputed income and introducing a capital gains tax.

What is Equity?

Intergenerational equity is the concept of fairness or justice between generations of people. Determining what is fair relies on value judgements and there is not always universal

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[1] Munro. "The Big Read: Reality of New Zealand's generation gap." and Wright. "Special report: NZ's generation battle - who's getting the roughest deal?"

agreement.[2] However, the general principle of fairness in a tax system is that people who have a higher ability to pay should pay a greater amount of tax.[3] So people who have accrued wealth throughout their lives may be required to pay more tax than those who are still starting out. People also view fairness in a tax system as the condition in which everyone meets their social obligation by paying a fair share. Fairness matters because people value fairness in and of itself. People believe that fairness is a key component of a well-functioning society. When residents believe that tax settings are fair they feel encouraged to voluntarily comply and are more likely to have trust in public institutions.[4] Many New Zealanders view our society as an egalitarian paradise where everyone is afforded a 'fair go.' We need our tax system to reflect our core values and to help to support fairness and equity into the future.

Why is Equity Between Generations Important?

People from different generations tend to agree on what it means to live a good and fulfilling life. It is important that New Zealanders of all ages have the opportunity to lead a meaningful life and reach the milestones that they value. However, rising house prices, the need to pay ever higher fees for tertiary education and difficulties starting out in the job market are hindering younger generations ability to reach key milestones. A 2016 British quantitative study commissioned by PricewaterhouseCoopers revealed that people of all generations tend to have a similar view of when the key milestones (such as buying a home or starting a family) should take place in an 'ideal life journey.'[5] When comparing the lived

[2] New Zealand Treasury and Inland Revenue Department. *Tax and fairness: Background Paper for Session 2 of the Tax Working Group,* 4.
[3] Ibid., 5.
[4] Ibid.
[5] Britain Think and PricewaterhouseCoopers. *Intergenerational Fairness: A citizens' view Report from a Citizens' Jury to look at intergenerational fairness in England, 5.*

experiences of participants, the study found that younger members felt that they would be unable to achieve key milestones at the same age as their parents or grandparents had.[6] Younger generations are finding it more difficult to be able to support themselves financially, leave the family home, buy their first home or work towards being financially secure enough to retire at a similar age as their predecessors.[7] This demonstrates a decline in the level of wellbeing of younger generations relative to their parents and grandparents at the same age.

How Does this Apply to Treasury's Living Standards Framework?

Treasury's vision is focussed on higher living standards for all New Zealanders.[8] Achieving higher living standards and improving intergenerational wellbeing relies on the growth, sustainability and equal distribution of economic capital.[9] New Zealand's economic capital is made up of four sectors - natural, human, social and physical/financial capital.[10] Future policy action must be structed around growing these four capitals in a way that is equitable for present and future generations. Intergenerational equity and notions of fairness are related to our social capital through its impact on trust and social cohesion. Social capital describes the norms and values that underpin society.[11] It includes the level of trust that people feel for each other and institutions, the rule of law, cultural identity and connections between people and communities.[12] Inequality, be it between different generations, within the same generation or between races and sexes is detrimental to social connectedness and

[6] Ibid.
[7] Ibid.
[8] The Treasury. "Living Standards," 8.
[9] The Treasury. "Living Standards."
[10] Smith. *Treasury Living Standards Dashboard: Monitoring Intergenerational Wellbeing.*
[11] Ibid., 4.
[12] Ibid.

the level of trust that people have for each other and their government.[13] This affects people's wellbeing by reducing society's level of social capital and making everyone worse off.

Human Capital

Equity is also linked with human capital outcomes as a certain level skills, knowledge and physical and mental health relative to the general population is required to fully participate in society. In terms of human capital, inequality exists when groups or individuals do not have the knowledge, health or skills to participate fully in work, study and recreation. [14] The 2013 census revealed that people who were 55 or over were less likely than people aged 54 – 20 to have formal qualifications.[15] Of those with formal qualification, the 30-34 age group were most likely to hold a bachelor's degree or above at 38.8%.[16] Trends suggest that university uptake is increasing, and younger generations will continue to increase their human capital relative to older generations. Therefore, younger generations possess higher levels of human capital relative to their parents and grandparents, and should be better off for it, particularly in their careers. However, the 2016 PwC study found that, while fewer baby boomers attended university compared to younger generations, they did not feel that their career paths had suffered for it.[17] For younger generations, university education has come at a cost, with the average student loan balance in 2017 being $21,467.[18] Tax settings need to support all generations to train and retrain in order to allow New Zealanders to maintain and increase their wellbeing through work, study and recreation.

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[13] Wilkinson & Pickett. *The Spirit Level: Why Greater Equality Makes Societies Stronger*
[14] Smith., 5.
[15] Statistics NZ, "2013 Census QuickStats about education and training"
[16] Ibid.
[17] Britain Think and PWC, 13.
[18] Education Counts, "Student Loan Scheme Annual Report 2017"

Physical and Financial Capital

Unequal distribution of physical/financial capital means that individuals or groups do not have access to houses, roads, buildings, hospitals, factories, equipment and vehicles which make up the country's physical and financial resources. These assets have a direct role in supporting incomes and material living conditions that are vital for wellbeing.[19] The Treasury has identified housing (along with income and wealth, and jobs and earnings) as a key material condition for material wellbeing. [20] However, those who rent their homes are far more likely to live in substandard conditions. The Building Research Association of New Zealand's 2015 *Housing Condition Survey* found that rental homes are twice as likely to have poor maintained features than owner occupied houses.[21] Those rentals were also twice as likely to smell musty, three times more likely to feel damp and twice as likely to have large patches of visible mould.[22] Poor rental housing stock and declining levels of home ownership disproportionately affect more recent generations of New Zealanders. In 2013, 49.8% of people aged over fifteen owned their own home, down from 53.2 percent in 2006. [23] Home ownership rates have fallen for all age groups, but the largest declines have been felt by those below 49 years of age.[24] This is evidence of intergenerational inequality in home ownership rates which has flow on effects for material wellbeing and quality of life. In order to increase the material wellbeing of individuals, the tax system needs to be geared to providing quality housing for all renters and owners.

Housing and the Tax System

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[19] The Treasury, 8.
[20] Ibid.
[21] White et al. *BRANZ 2015 House Condition Survey: Comparison of House condition by tenure.*
[22] Ibid.
[23] Statistics New Zealand, "2013 Census Quickstats about Housing."
[24] Ibid.

Taxation affects the attractiveness and affordability of investing in housing. Two categories of our current tax system need to be considered in relation to housing: Income tax and Goods and Services tax. Goods and Services tax applies only to new houses which make up a relatively small proportion of sales each year so is unlikely to contribute to the affordability of houses in the market as a whole. Income tax applies to the housing market in broadly the same way as the other sectors of the economy, however, there are some elements that are not captured.[25] One issue is that the imputed income from an owner's equity in their own house is not taxed. This creates inequality in the tax system between owner-occupied housing and rental housing and other forms of market investment such as shares, bonds, bank deposits and commercial property.[26] Capital gains and losses that arise on housing are not taxable or deductible unlike many other investments and economic activities such as earning wages and salary or investing in the stock market. The non-taxation of income from capital gains can be considered as a gap in our tax base that disproportionality benefits some generations, who were able to buy houses when they were more affordable, over more recent generations.

Do tax settings impact housing affordability for younger generations? And if so, how can the tax system change to address intergenerational equity? New Zealand's tax system has allowed market conditions to make large quantities of home owners into on-paper millionaires. Current tax settings appear to make housing a profitable investment and the rational choice economic activity for those who can afford it. The extent to which these settings impact housing affordability in comparison to other considerations such as under-supply, global low interest rates and population growth requires further investigation. This

[25] New Zealand Productivity Commission. *Housing Affordability Inquiry,* 85.
[26] Ibid.

essay has suggested two aspects of the tax system that can be considered to mitigate the trend towards rising house unaffordability for younger generations. The non-taxation of imputed income and capital gains are gaps in our tax system that could be closed to reduce the attractiveness of investing in housing. This would have flow on effects to reduce property speculation, promote investment in other activities, and increase the tax base. This increase in government revenue from the new taxes could be used to reduce lower brackets of income tax to make workers better off. Younger generations, who have yet to earn their highest salary from their jobs, will benefit most from lower income taxes. While older generations, who have become wealthy through home ownership, will retain the capital gains they have already accrued but will be taxed on any future gains and any imputed income. These changes in the tax system should be considered as possible policy solutions to promote and maintain intergenerational wellbeing and equity into the future.

Conclusion

Intergenerational inequality locks certain generations out of the standard of living that they should otherwise expect. The tax system is one of the levers we can turn to for remedial action on intergenerational fairness. Addressing intergenerational equity can promote the growth of social capital in New Zealand as a whole by increasing social connectedness and trust between generations. Intergenerational fairness can and should be addressed in ways that will work for all generations, and not penalise the successes of older generations. Policy analysts and policy makers must consider New Zealand’s tax settings as a lever to turn to for action.

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