

Tax Working Group needs to keep working

The Tax Working Group delivered its final report to the government today, with much anticipation as to the redesign of the tax system, given universal agreement that it is not currently sustainable.

Unfortunately, and not unexpectedly, there is no clear outcome to the report with a range of partial solutions to identified problems, caveated with all the issues that each of these solutions present.

The government's response to the paper is the best indication of its usefulness. It is not the panacea of our tax woes that some thought it to be, rather simply, just one of several reviews (most notably including an identical one being considered by the Australian government) that will be considered in the lead up to this year's budget. Take this as meaning no significant change is forecast given the constraint placed on the Tax Working Group of fiscal neutrality; no tax changes that would result in the government receiving less revenue.

So what are the problems with the current system?

- A reliance on personal and corporate taxes which inhibit growth and adversely impact on savings, investment and productivity
- Demographic changes in the population and tax-base placing a greater reliance on a smaller proportion of the population for the tax take
- Fiscal drag pushing more income earners into the higher tax brackets
- Lack of international competitiveness of our personal and corporate tax rates
- Very high marginal tax rates for many on working for families
- Major hole in our tax base regarding the taxation of capital

The Tax Working Group has made several recommendations which can effectively be grouped, as the likely outcomes of the report:

- Some technical tinkering
 - for land owners, the introduction of some form of land tax and the removal of depreciation on buildings
 - for business people, the removal of the 20% loading on depreciation of plant and equipment
 - for foreign investors, a change to the thin capitalisation rate (less interest deductions, so theoretically more tax paid here)

- further thought on the introduction of a "risk-free rate of return" for the taxation of rental properties, which would mean that instead of taxing rental properties on the basis of rental income and allowable deductions, a deemed amount of taxable income would be included in the tax return (meaning the end of rental losses).
- More thought on interaction of welfare design and the tax system to deal with the problems Working for Families has created
- Consider Capital Gains Tax for the future
- A more radical approach suggested for the government would be to move to align top tax rates across all taxpayers, funded by an increase in GST to 15%. They consider this is the most appealing to deal with the inefficiencies of our tax system, but in our view is likely to face the hurdles of timing. How quickly can this be put in place given a 2011 election year, the negative impact on low income earners who would need to be compensated, and the negative impact on middle income New Zealand who are always forgotten?.

Clearly the Tax Working Group have been hamstrung by the fiscal neutrality constraint, but have fallen into the trap of so many other reviews and failed to think outside the square when it comes to tax design - what could we do differently rather than how do we tweak what we already have.

Fundamentally, the government needs to stop the tail wagging the dog when it comes to tax policy design, and take a fundamental look at New Zealand in the context of the world economy and decide what our role should be. As Australia moves closer towards becoming a regional headquarters for Asia Pacific, with resulting capital flows and job growth, New Zealand is still heavily reliant on traditional exports, domestic services, and imported consumables. Once we determine New Zealand's role, given our aging population, changing world demand, and mobility of human capital, then we can strike sustainable policies for the future, of which tax will be but one of many to consider.

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