Tax Reform in New Zealand: Current Developments

"Australia's Future Tax System: A Post-Henry Review" Conference
Sydney 21-23 June, 2010

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Outline

- The New Zealand Tax Reforms
  – what are they?
- The Case for Reform
  – What's wrong with the current tax system?
- The Key Arguments and Evidence
- The Reform Advice Process
  – The 'Tax Working Group' (New Zealand's "Henry Review")
- Evaluation: the final score …

Australia **2 : 2** New Zealand

(New Zealand win on penalties!)

The New Zealand context

- ‘Modest’ tax changes in 2008 & 2009
- Nov. 2008: Tax reform advice to in-coming government (‘BIMs’)
- Feb 2009: Tax conference - Treasury/Inland Revenue/Victoria University
- May 2009 – Jan 2010: Tax Working Group (TWG)
- Jan 2010: TWG Report
- Jan-May 2010: Officials’ Budget advice
- 20th May 2010: Budget

Budget tax changes 2010

		Before Budget 2010	After** Budget 2010
Income tax:			
Thresholds:	$0 - $14,000	12.5%	10.5%
	$14,001 - $48,000	21%	17.5%
	$48,001 - $70,000	33%	30%
	> $70,000	38%	33%
GST:		12.5%	15%
Corporate tax:			
Statutory rate		30%	28%
'Thin cap' rules for foreign-owned companies		75%	60%
QCs* & LAQCs*		No 'flow-through' for profits	Full 'flow-through'
Depreciation rules:			
Depreciation 'loading' on new plant/equip.		20%	0%
Depreciation on buildings (> 50 years)		3% (db)† or 2% (sl) †	0%
Savings:			
Trusts		33%	33%
Portfolio Investment Entities (PIEs)		30%	28%
Unit trusts, Superannuation Funds		30%	28%

Tax Changes & Recommendations, 2010

Budget 2010 changes

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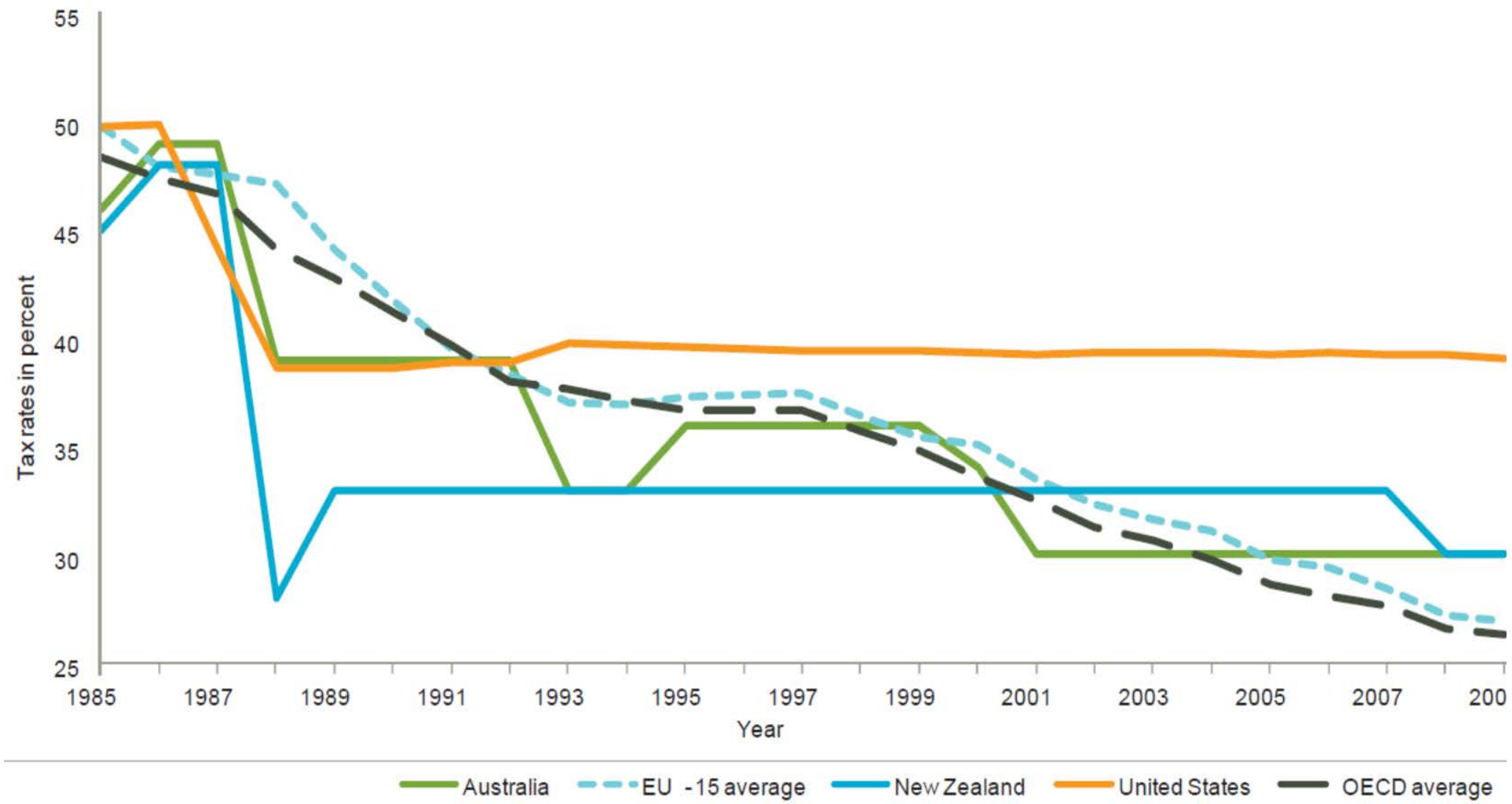
TWG recommendations

1. Align top personal, PIE, trust (& company?) tax rates
2. Consider cutting 30% statutory corporate tax rate
4. Retain imputation
5. Broaden tax base: either capital gains tax (minority?) or risk-free return method on residential investment properties (majority?)
6. Introduce a low-rate land tax; e.g. 0.5% (majority)
7. Depreciation: remove 20% loading and remove building depreciation if evidence confirms they do not depreciate
8. Reduce thin cap rule from 75% to 60%
9. Raise GST to 15%

The case for reform

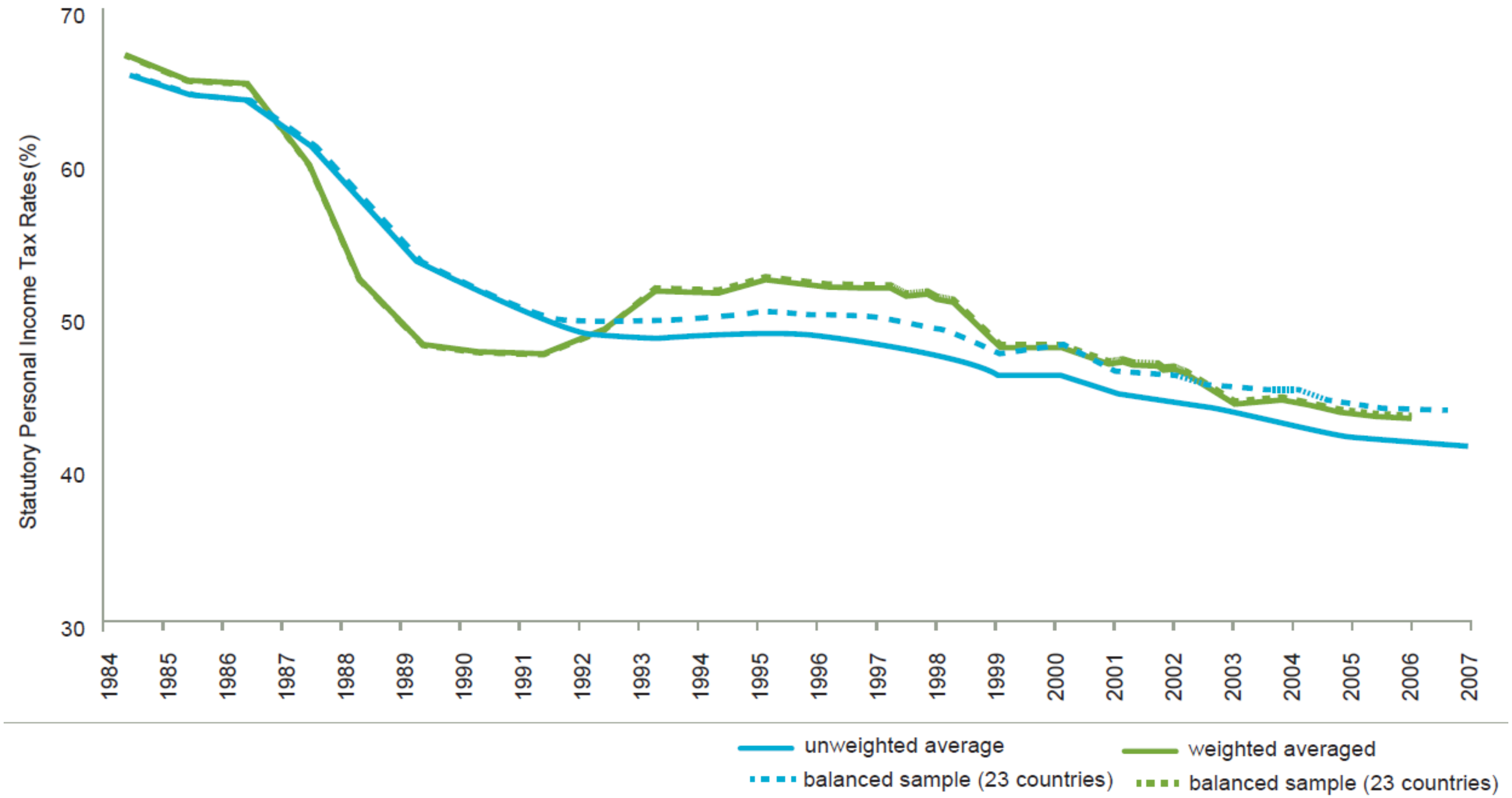
- **Global trends** in corporate & personal taxes are making New Zealand's system less internationally competitive.
- New Zealand - a **small open economy** with heavy dependence on net capital inflows; large outflows of human capital.
- Corporate & personal income tax and transfer settings moved tax system away from '**Broad-base, Low-Rate**' (removal of 'alignment'; high personal income tax EMTRs)
- **Disparate set of tax rates** on different income sources, investments, and entities $\Rightarrow$ adverse behavioural responses.
- Particular concern over response to **tax-favoured property**
- Overall system **less conducive to productivity growth** and more conducive to tax planning, arbitrage and avoidance.

Tends in statutory corporate tax rates OECD, 1985-2009



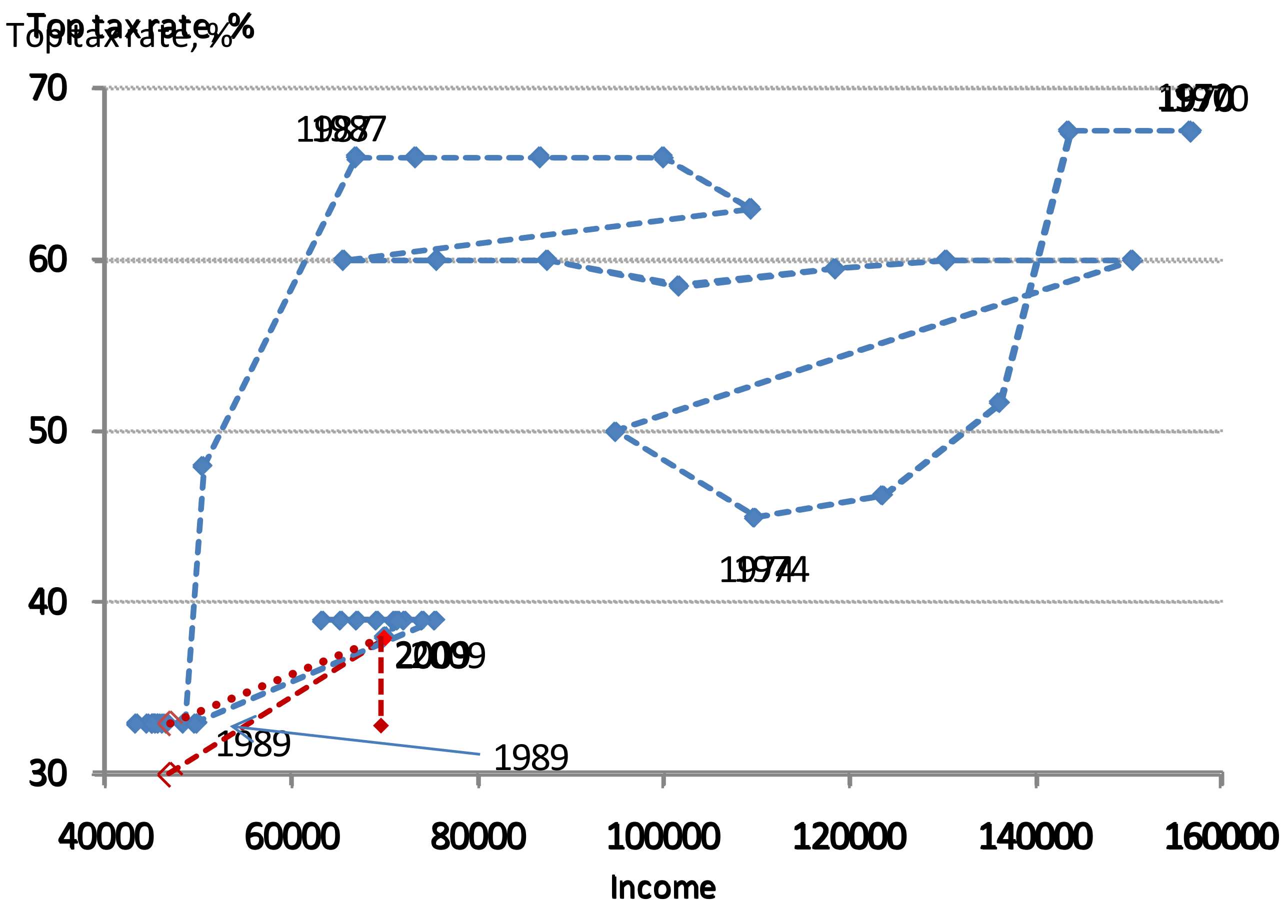
Source: OECD

Trends in Top Statutory Personal Income Tax Rates: OECD, 1984-2007

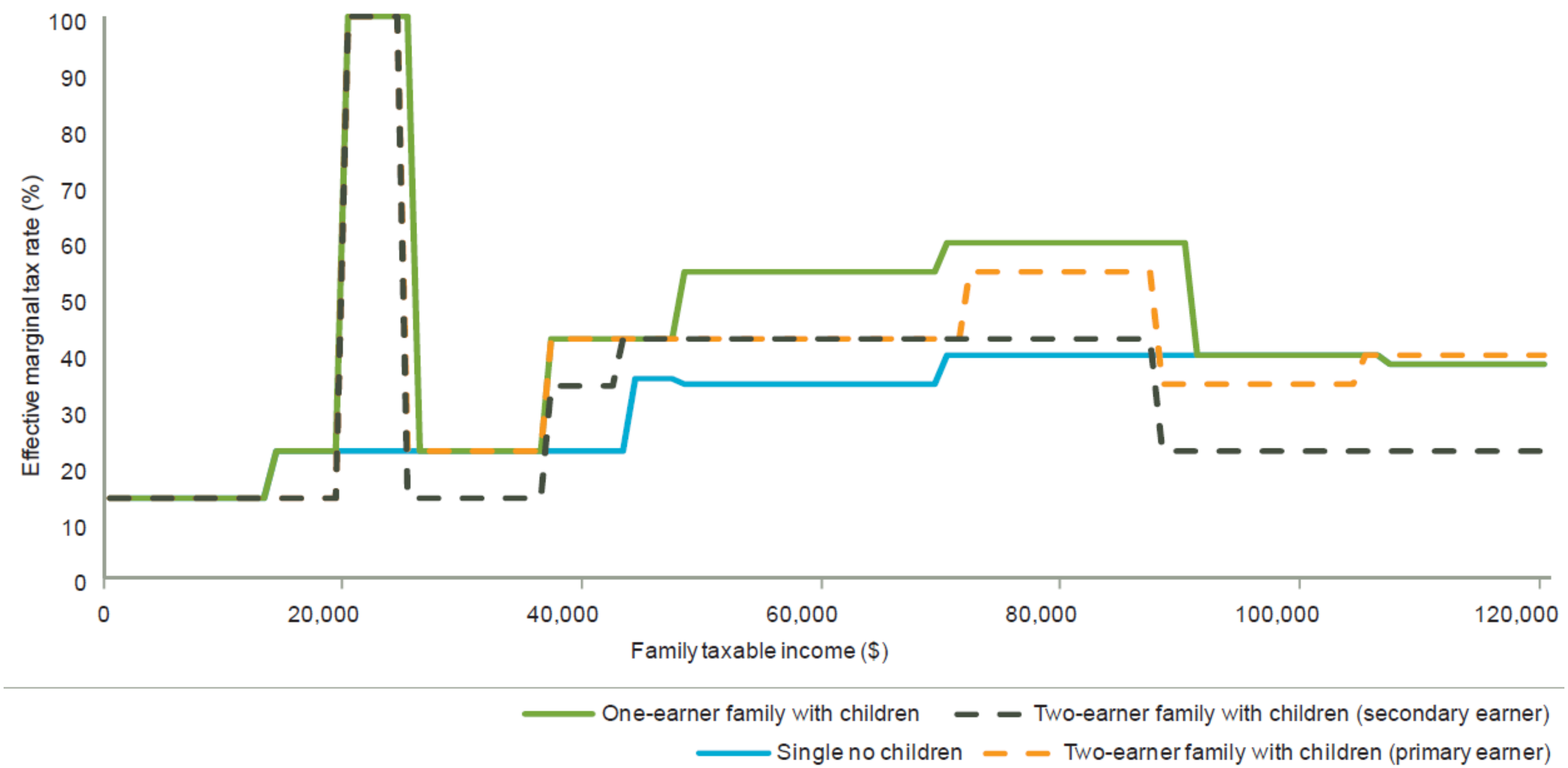


Source: Loretz (2008)

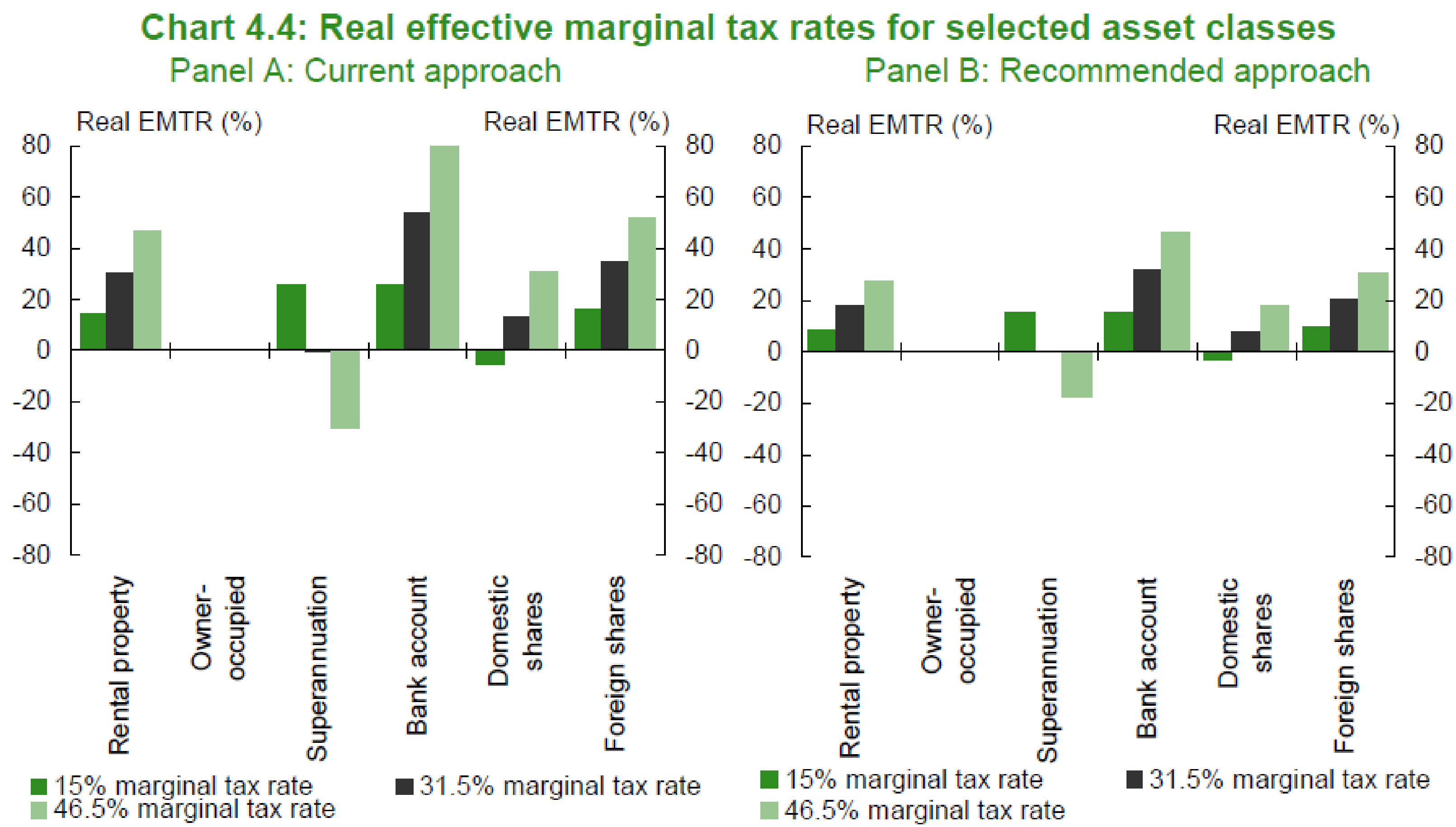
Trends in the Top Personal Tax Rate & Threshold



Effective Marginal Tax Rates on Personal Incomes New Zealand, 2009



Tax rates vary across assets & entities

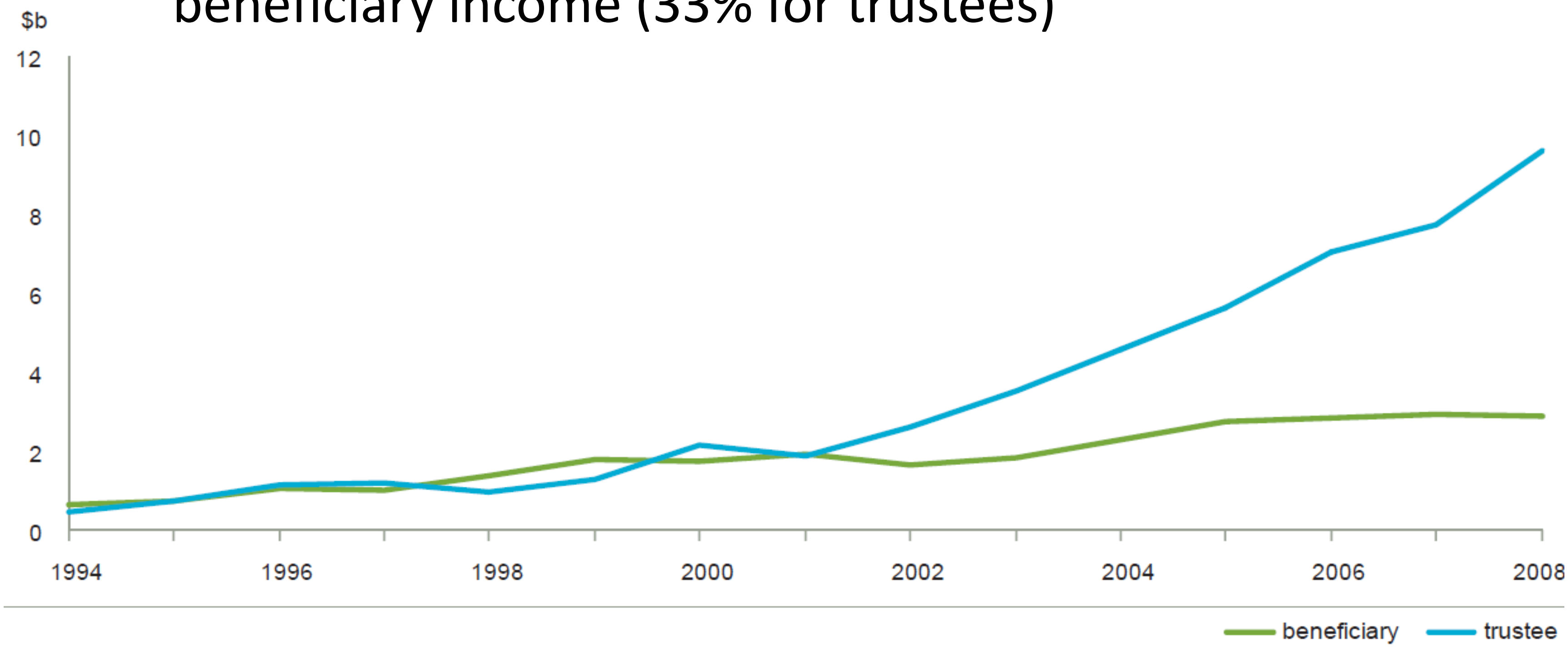


Australia

New Zealand

Trends in Trust Income

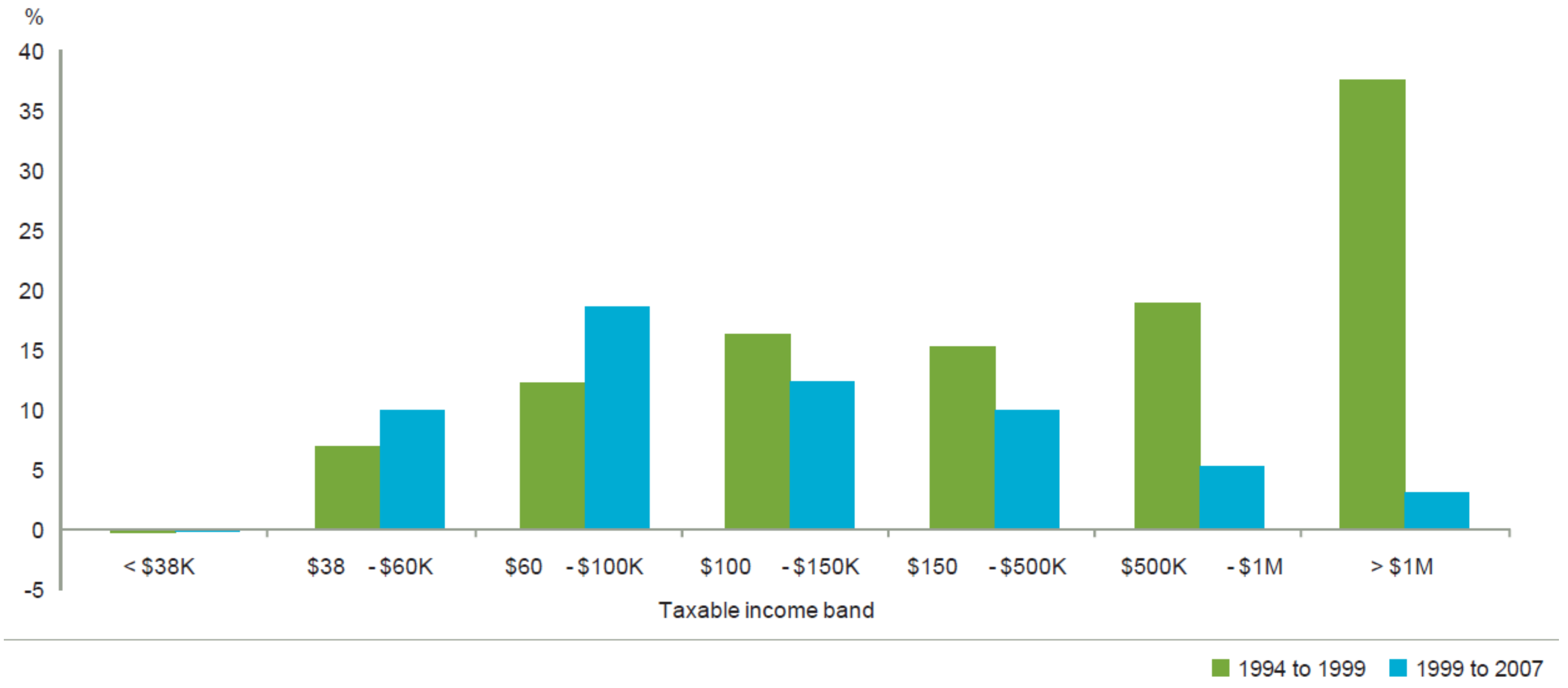
… Trustee income rises faster after 39% tax rate applies to beneficiary income (33% for trustees)



Note: The data for the year ended March 2008 is incomplete.

Average Annual Growth in Numbers of Individual Taxpayers at Different Income Levels

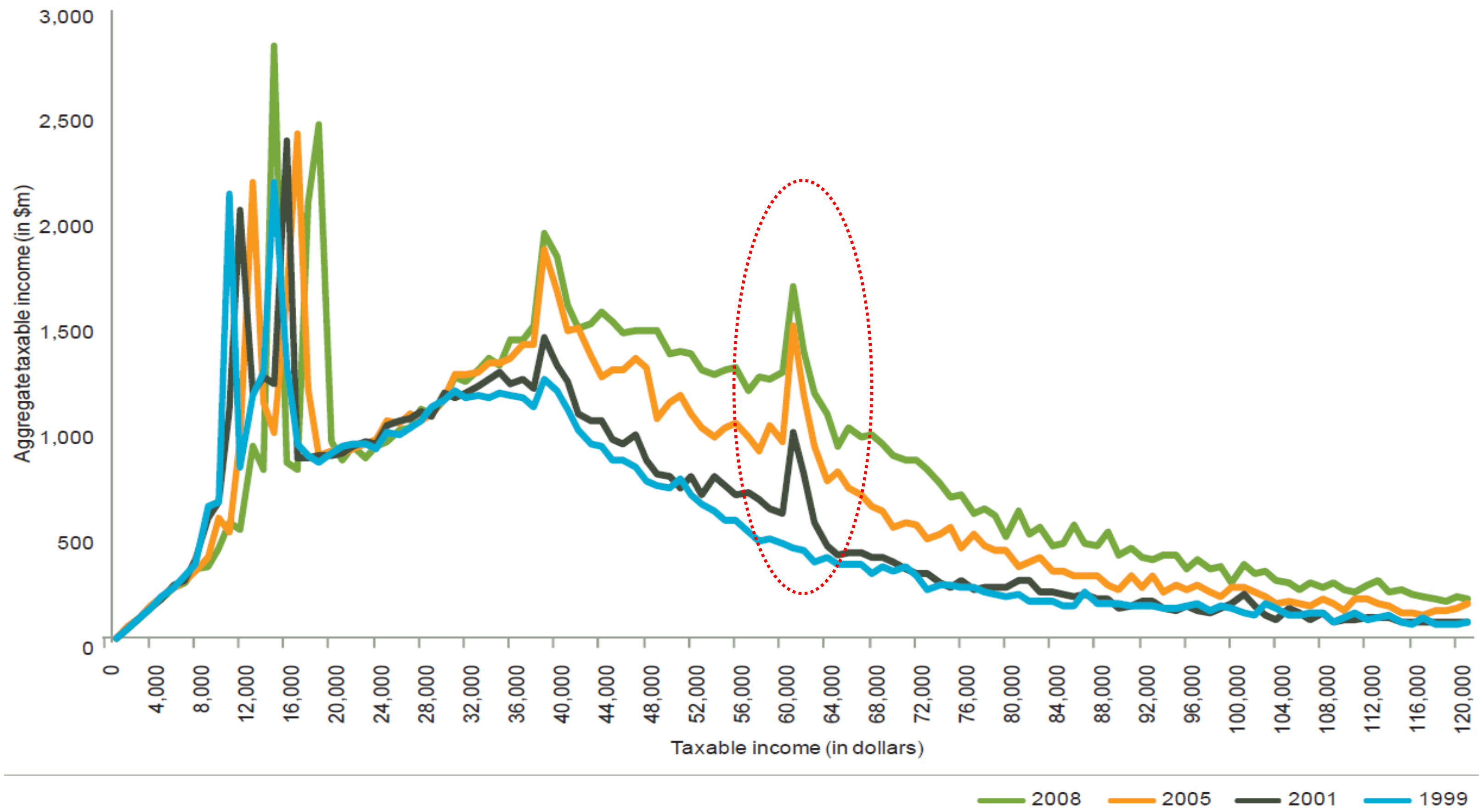
… apparently slower growth in high incomes after 1999



Note: The data for the year ended March 2007 is incomplete.

Taxpayers respond to MTR incentives

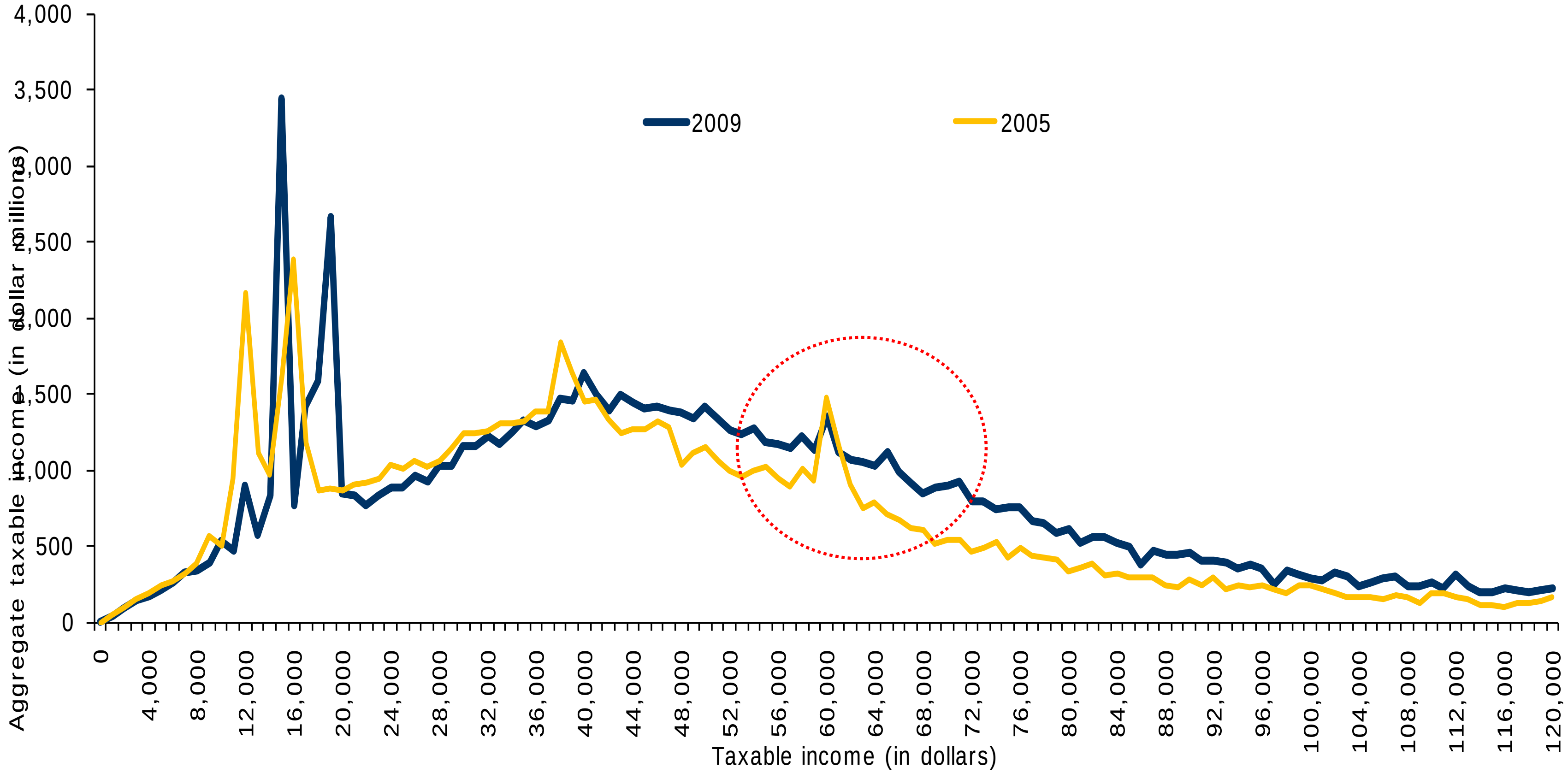
… 39% tax rate introduced after 1999 on incomes over $60,000



Note: The data for the year ended March 2008 is incomplete.

Taxpayers respond to MTR incentives

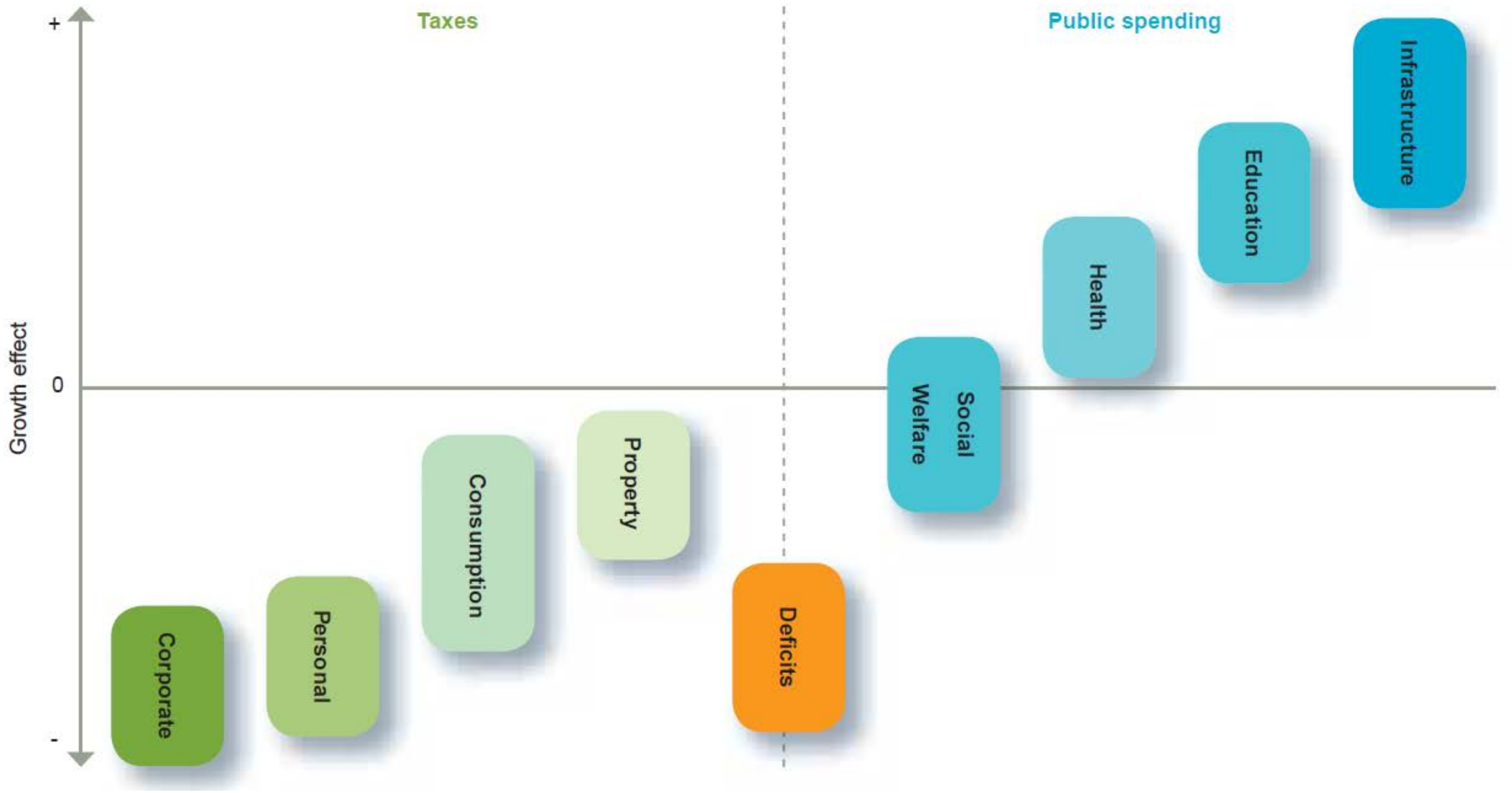
… 39% tax threshold raised to $70,000 in 2008



Note: The data for the year ended 2009 is at November 2009 and incomplete. The 2009 data is <u>substantially</u> incomplete
Source: Policy Advice Division, Inland Revenue

Macro effects of taxes and spending

… a schematic summary of the OECD evidence



2009-10 tax reform:

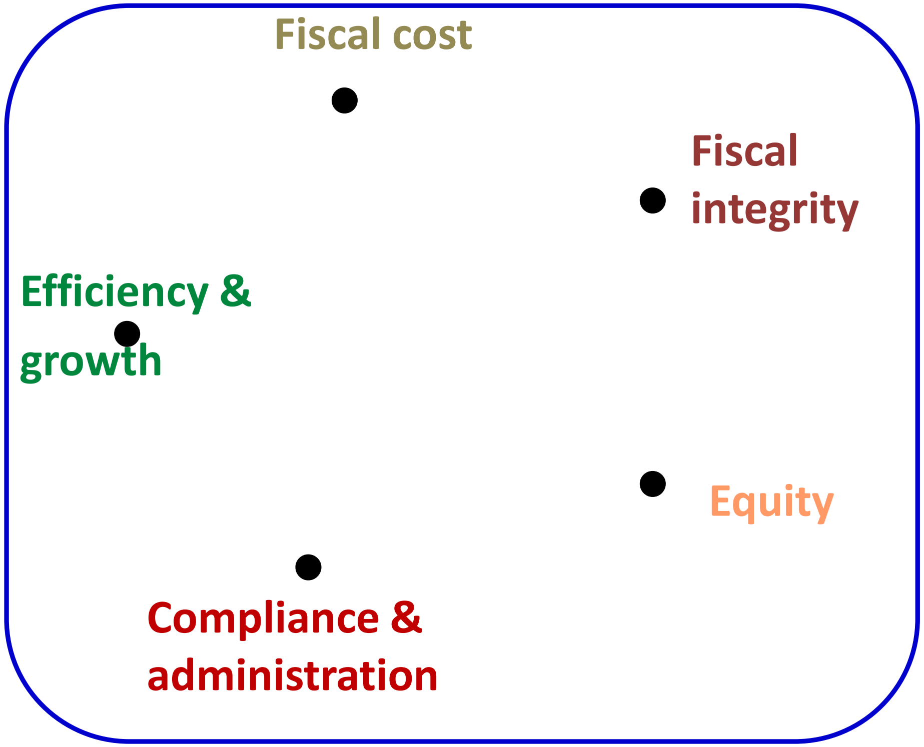
- objectives
- issues
- process

TWG tax reform objectives

Six properties or 'principles' of a good tax system:

1. Efficiency & growth
2. Equity
3. Fiscal integrity
4. Fiscal cost
5. Compliance cost & admin. efficiency

[6.] Overall Coherence



Tax reform issues in New Zealand

- Alignment versus non-alignment
- Consumption versus income taxation
- Base broadening via
  - a land tax and/or
  - changes to capital income taxation
    - … CGT or risk-free return method (RFRM) on rental property?
- Changes to depreciation rules
  - is 20% loading justified?
  - do buildings depreciate?

Tax reform *process* in New Zealand

Some lessons from the TWG process …

- A ‘phased approach’ helps build the case
- Real-time engagement and public debate
- Cooperative & multi-disciplinary process
- ‘Independence’ of government (TWG)
- The revenue-neutral constraint concentrates minds!
- Address ‘fairness’ issues (especially horizontal equity)

Conclusions

- Wide agreement in N.Z. over ‘the case for reform’
- General agreement among advisers over reform framework & options
- Legitimate differences of view from different value judgements and where evidence is limited
- 2010 reforms: move in right direction … and
- Key future choices over corporate/capital income taxation (and welfare reform?)
- Good analysis, evidence & political engagement – works best

Australian Vehicle FBT

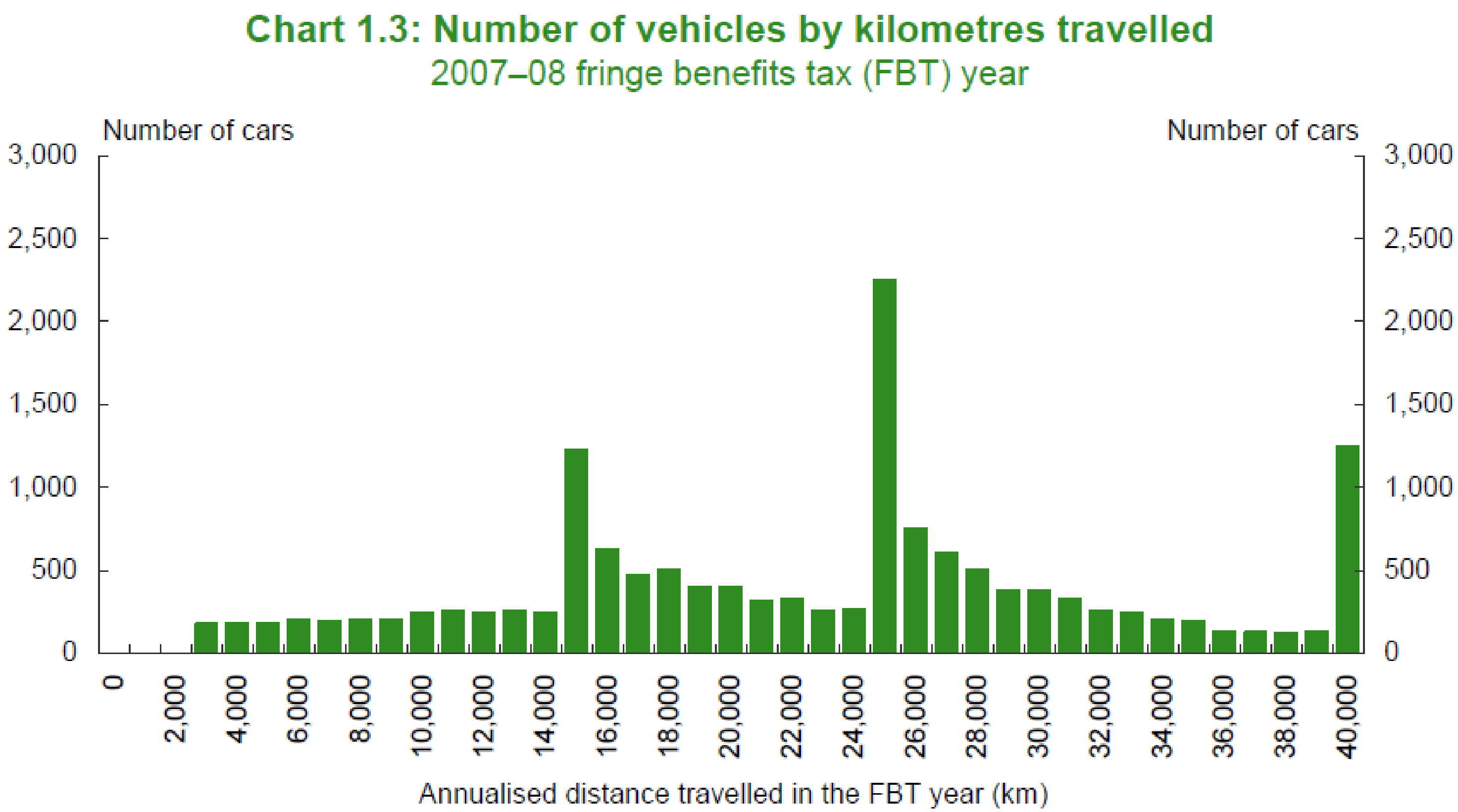
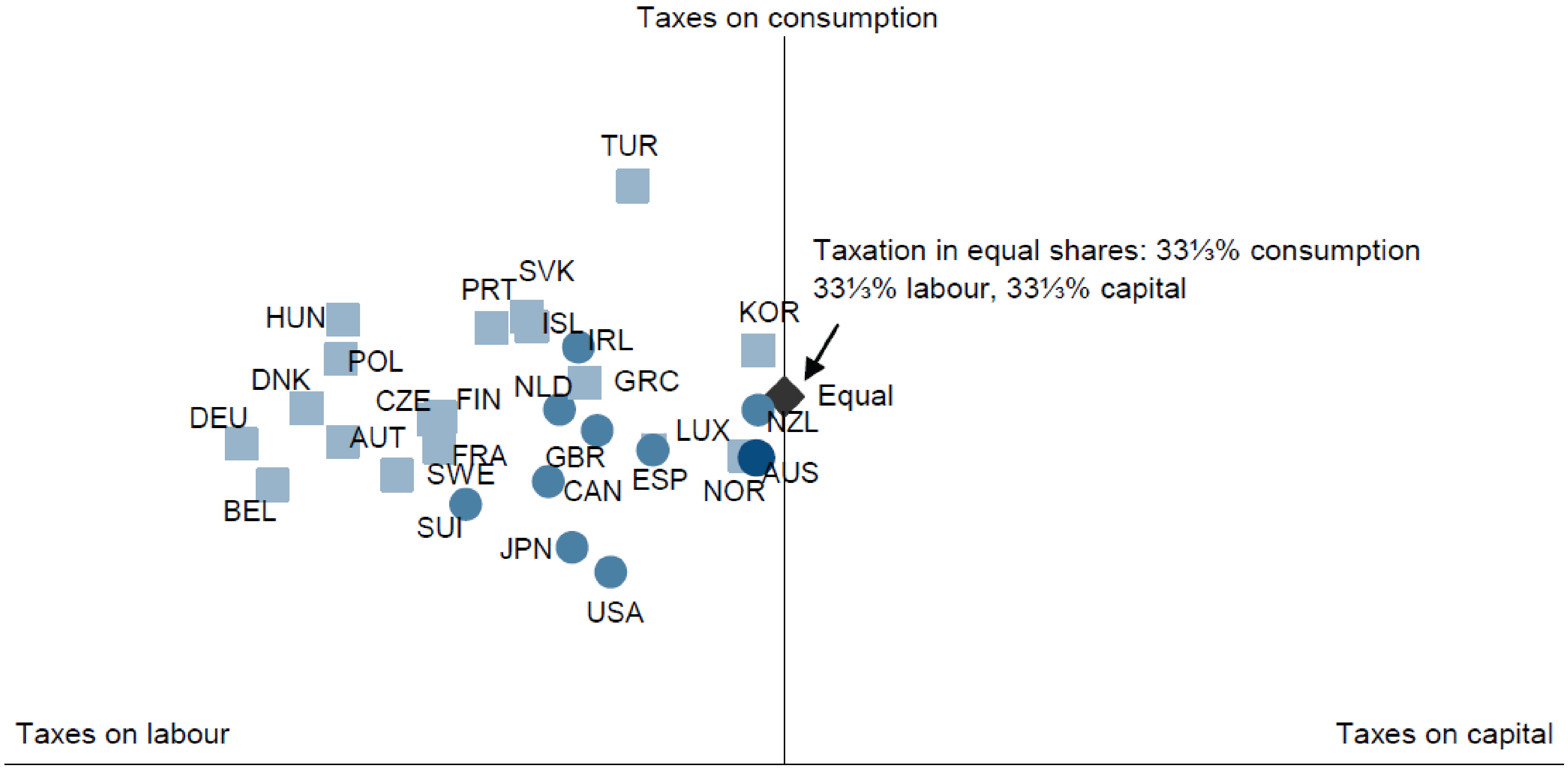


Chart 6.4: Estimated tax mix, Australia (dark dot), OECD-10 (light dots) and other OECD countries (squares) — 2005[a]



(a) Does not include Mexico. For Korea, Iceland, Switzerland and Turkey the share of personal income tax revenue derived from capital has been estimated using the average share of other OECD countries.

Source: OECD (2007a); Eurostat (2008), national governments; Australian Treasury estimates.

RadioNZ Morning Report, 21 May 2010

The Dominion Post says it was lollies for all, with some unexpected winners in Mr English's second budget.

The paper's lead article says the Finance Minister has pulled a rabbit out of the hat with $15 billion in tax cuts in the next four years and a plan to beat Australia out of the starting blocks.

It quotes Mr English as saying New Zealand is on track to a position most developed economies will envy but the paper goes on to say the price is a sharp rise in the cost of living.

A 2.5% increase in GST is tipped to increase inflation on the back of higher tobacco taxes, more expensive fuel and power prices, and a rise in ACC levies.

http://www.radionz.co.nz/news/regional/53820/morning-report-local-papers

(03 September 2010)