Executive summary

The New Zealand Government created the Tax Working Group (the Group) to provide recommendations to improve the fairness, balance and structure of the New Zealand tax system over the next 10 years. (The Terms of Reference can be accessed [here](#))

On 21 February 2019, the Tax Working Group released its final recommendations on the fairness, balance and structure of the New Zealand tax system over the next 5 to 10 years.

The Group’s recommendations will be reviewed by the Government and a full response is expected in April 2019. Finance Minister Grant Robertson and Revenue Minister Stuart Nash gave an initial response, emphasizing that the Government is not bound to accept all the recommendations put forward and that it is highly unlikely that all recommendations will be implemented. If some, or all of the recommendations are implemented, changes to New Zealand’s tax regime will become effective on 1 April 2021 at the earliest.

The remainder of this Alert summarizes the Group’s recommendations as outlined below. A subsequent Alert will provide the Government’s response.
Capital Gains Tax: The Group recommended the introduction of a comprehensive Capital Gains Tax (CGT) by an 8:3 majority. This would involve a realization-based tax that applies to capital gains on a broad range of assets, at full rates, with no allowance for inflation and limited rollover relief. Capital gains would be taxed within the existing tax system.

Taxation of Businesses: The Group found that the current approach to taxation of business is largely sound but that, fiscal conditions allowing, measures should be introduced to help businesses grow, be more productive and lower what they spend complying with New Zealand's tax rules.

Environmental and ecological outcomes: The Group developed a framework for deciding when environmental taxes can be best applied. It recommended a better use of taxes to discourage activities that cause negative impacts.

Further recommendations: The Group also provided recommendations on international income taxation, retirement savings, personal income tax, the future of work, charities, Good and Services Tax (GST) and financial transaction taxes, corrective taxes, housing and the integrity and administration of the New Zealand tax system.

Detailed discussion

Capital Gains Tax

New Zealand is unusual in not having a comprehensive CGT. A CGT, if well designed, could ensure that the tax system is fairer and more sustainable over the long-term. However, it will increase compliance costs and may affect the productivity of the economy negatively by reducing investment returns.

Included assets for capital gains purposes

The Group recommended that the taxation of capital gains should extend to the following, pre-defined, assets (included assets):

- Land, including improvements to land (other than the excluded, or family, home)
- Shares
- Intangible property
- Business assets

Personal-use assets, such as cars, boats or other household durables would not be included assets.

Income calculation

The Group recommended that capital gains should be taxed on a realization basis in most cases within the current income tax system. Therefore, capital gains would be taxed at a person's marginal income tax rate when the asset is disposed of. There would be no discount for capital gains and no adjustment for inflation.

Expenditure incurred in acquiring an asset would be deductible at the time of sale and costs incurred on improvements would be deductible from sale proceeds. A taxpayer would generally be able to offset losses arising from the disposal of capital assets against ordinarily taxable income (and not just against capital gains). However, capital losses would be ring-fenced or denied entirely for some assets.

Limited rollover relief proposed

Rollover relief would apply in some circumstances, including but not limited to the following:

- Death
- Certain involuntary events (e.g., compulsory Crown acquisition)
- Business transactions that result in a realization of assets but no change in ownership substance

However, the rollover reliefs recommended would be significantly narrower than in most countries with a CGT. The Group recommends no general rollover relief for businesses that sell assets and reinvest the proceeds in replacement assets, although it does support a targeted measure for small businesses with an average turnover of less than NZ$5 million. Businesses that frequently acquire and sell assets, or that are capital intensive (e.g., private equity, venture capital, listed property trusts and primary sector ventures) in particular would be impacted.

Transitional rules – Valuation Day

The Group recommended that tax should be calculated on the gains and losses that arise after implementation date (Valuation Day). Taxpayers would have five years from Valuation Day (or to the time of sale if that is earlier) to determine the value of their included assets as at Valuation Day. If the asset has not been valued, a default method would apply (such as the straight-line method).

The Group favors a valuation regime that provides the taxpayer with a choice between simplicity (lower compliance costs) and accuracy. The Government and New Zealand's revenue authority Inland Revenue would develop tools and guidance to assist taxpayers throughout the valuation process.
Minority Report – Taxation of real property
A minority of the group considered the benefits of a CGT on businesses and shares to be outweighed by the efficiency, compliance and administrative costs of such modifications. They considered that the potential double taxation and inconsistency risks will adversely impact New Zealand's equity markets. Therefore, the minority only saw merit in broadening the currently narrow capital gains tax base to residential investment properties, and potentially to holiday homes, through extending current rules.

Changes to business taxation
The Group considered that the current approach to the taxation of businesses is largely sound and did not recommend any change to the corporate tax rate in New Zealand (28%) or to move away from the current imputation system (which avoids economic double taxation by conferring a credit on the shareholder for the tax already paid by the company). The Group recommended that developments in company tax rates around the world, particularly in Australia, should be monitored.

Largely depending on the implementation of a CGT, the Group also recommended a number of tax measures to enhance productivity and reduce compliance costs:

- Change the loss-continuity rules to support the growth of innovative start-up firms
- Reform the treatment of black-hole expenditure (expenditure that results in an economic cost to a taxpayer, but for which neither immediate deductions nor depreciation deductions are available, for example, when an asset is abandoned before its completion):
  - Include a new rule (where the Income Tax Act 2007 does not apply) to recognize deductions for back-hole expenditure over a period of five years
  - If the assets are subsequently restored, any corresponding tax deductions would be clawed back
  - Introduce a safe-harbor threshold of $10,000 to allow upfront deductions for low levels of feasibility expenditure (to reduce compliance costs)
- Restore depreciation deductions for buildings either fully, if fiscally feasible, or partially, limiting deductions to:
  - Seismic strengthening only
  - Multi-unit residential buildings (e.g., an apartment block)
  - Industrial, commercial and multi-unit residential buildings
- Implement certain immediate changes that lower compliance cost, such as increasing the threshold for provisional tax from $2,500 to $5,000 of residual income tax

Environmental taxes
The Group noted the threat that climate change is posing to both New Zealand and the globe. It developed a framework to guide the Government’s decision-making in respect of taxing negative environmental externalities (NEE), outlining:

- Favorable attributes of NEE taxes (if satisfied, the case for taxation is stronger)
- Essential attributes of NEE taxes (should be satisfied)
- Principles for designing externality taxes

The Group also noted that New Zealand has limited institutional capabilities to design and implement environmental taxes and, therefore, recommended that the Government strengthen its capability to use tax to enhance environmental and ecological outcomes.

Others
International income taxation
The Group endorsed New Zealand's continued participation in discussions at the Organisation for Economic Co-operation and Development on the future of the international income tax framework. The Government should monitor developments in, and collaborate with, other countries. The Group recommended that if a critical mass of other countries introduces a digital services tax, New Zealand should be ready to move in the same direction, unless export industries will be materially impacted by retaliatory measures.

Retirement savings
The Group recommended that the Government considers encouraging the savings of low-income earners through measures focused on New Zealand's KiwiSaver scheme (a voluntary work-based savings scheme). A possible measure to achieve this would be to refund the employer’s superannuation contribution tax (ESCT) for KiwiSaver members earning up to $48,000 per annum.

Future of work
The Group recommended that the Government supports Inland Revenue's efforts to increase the compliance of self-employed through measures, such as:

- Expanding the use of withholding tax as far as possible
Supporting the facilitation of technology platforms to assist the self-employed to meet their tax obligations (e.g., smart accounts)

Using data analytics to identify under-reporting of income

Reviewing the current GST requirements for contractors who are akin to employees

Aligning the legal definitions of employee and dependent contractor

Integrity and administration of the tax system

The Group noted that currently there are integrity risks associated with closely held companies as the company and top personal tax rates are not aligned. Therefore, Inland Revenue needs to strengthen the enforcement of the rules for closely held companies.

The Group also recommended the introduction of further measures to fight the “hidden economy” (undeclared and cash-in-hand transactions). Tax collection could also be enhanced by increasing the remedies available to the Commissioner and establishing a single Crown debt collection agency.

The Group and the private sector question whether Inland Revenue has sufficient resources to effectively administer a comprehensive CGT. In the event of a CGT as recommended, Inland Revenue would need to significantly advance its tax technical capabilities and invest heavily in new technologies to improve data analytics and overall efficiency as well as enforcement to preserve the integrity of the New Zealand tax system.

Charities

The Group noted that the underlying issue regarding the taxation of charities is the extent to which charitable entities are accumulating surpluses rather than distributing or applying those surpluses for the benefit of their charitable activities.

It recommended that the Government consider the following measures:

- Whether to amend (sharpen) deregistration tax rules to keep assets in the sector and ensure there is no deferral benefit.
- Whether not-for-profit organizations should be treated as if they were final consumers or, in the alternative, to limit GST concessions to a smaller group of not-for-profit bodies.

Illustrative packages

The Group was instructed by the Government to produce revenue neutral packages. The Group suggested four alternative packages targeted at different outcomes; this work is at an early stage and whether such packages will be introduced depends entirely on the implementation of a CGT. The packages aim to promote fairness across the tax system.

Possible revenue-reducing measures would include:

- Incentivizing private savings (e.g., see section on retirement savings)
- Introducing supporting measures for businesses (see section on taxation of businesses)
- Reducing taxation of personal income (e.g., increase in bottom threshold to support those on lower incomes and improve the progressivity of the tax system)
- Diversifying revenue-reducing measures across the above areas

The above measures are aimed at improving the progressivity of New Zealand’s tax system and attracting businesses to New Zealand.

Next steps

Although subject to change, a possible timeline is:

- April 2019 - The Government responds on whether to proceed with some, or all, of the Group’s recommendations
- April to late 2019 - Release of a public consultation document covering detailed design
- Late 2019 - Tax bill introduced to Parliament
- Mid 2020 - Government aims to pass legislation before the 2020 election
- 1 April 2021 - CGT commences only if a Labour-led Government is re-elected. The opposition center-right New Zealand National Party is on record as opposing CGT and plans to repeal it prior to implementation date if elected.

Endnote

1. Currency references in this Alert are to NZ$. 

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Global Tax Alert
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