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New Zealand's Tax Working Group recommends a capital gains tax and more

The Tax Working Group ("**Group**"), set up by the New Zealand Government to make recommendations on the fairness, balance and structure of the tax system, has released its final report. The issue to have received the most focus throughout the Group's deliberations has been the question of how far the Group would go in recommending a tax on capital gains ("**CGT**") but that is by no means the only recommendation that will be of interest to businesses.

Introducing a capital gains tax

The Group has (by an 8 to 3 majority) recommended a comprehensive CGT under which capital gains would be taxed at the same rates as ordinary income, with no discount or allowance for inflation. The family home, along with certain other personal use assets (including art, motor vehicles, jewellery and other collectibles) would be exempt.

Assets held on the commencement date of the CGT would not be excluded from the CGT, but only the gain attributable to the period from the commencement date would be subject to the CGT. This would require the cost base of assets to be determined as at the commencement date (referred to in the final report as 'valuation day').

The Group recommends that with some exceptions, capital gains should be taxed on a realisation basis. The exceptions include certain foreign portfolio share investments that are currently (and would continue to be, subject to some recommended changes) taxed on a deemed return basis, and portfolio share investments in New Zealand and most Australian listed companies that are held by certain managed funds, which would be taxed on an accrual basis. The recommendation would therefore result in an inconsistent treatment of gains in respect of New Zealand and Australian shares: interests held through managed funds would be taxed on an accrual basis while interests held directly would be taxed on a realisation basis.

Regarding non-residents, the Group has stated that the existing source rules should apply to the CGT. For example, the Group suggests that non-residents should be taxed on the realisation of interests in New Zealand land. The Group has noted that taxing non-residents in respect of assets other than interests in New Zealand land (and in land-rich companies) or assets forming part of the business property of a New Zealand permanent establishment, would "be inconsistent with some of New Zealand's tax treaties".

Business tax reforms

At the core of the Group's recommendations are four tax reform packages that are "illustrative" of how the estimated $8.3 billion (over five years) from implementing a capital gains tax could be applied. All four packages include an increase in the threshold at which the personal income tax rate increases from 10.5% to 17.5%.

The Group does not recommend a reduction in the corporate tax rate (which is currently 28%) despite a trend towards corporate tax rate reductions internationally. Nor is it recommended that New Zealand's system of dividend imputation be altered.

The remaining measures in each package are targeted at particular outcomes: "increasing progressivity through reductions in personal income tax", "business and housing focus", "saving focus" and "diversified focus". For example, the business and housing package includes measures such as reinstating depreciation deductions for buildings, allowing deductions for certain expenditure that is currently neither depreciable nor deductible, and less restrictive rules for carrying-forward losses.

International tax

While the Group did not recommend specific international tax changes, the Group did note its support for "New Zealand's continued participation at the OECD" and recommended that "the Government stand ready to implement a digital services tax if a critical mass of other countries move in that direction". The Government appears to have already acted on that recommendation by announcing, prior to the release of the Group's report, that New Zealand will proceed with a digital services tax, with public consultation to commence in May this year.

Interestingly, the Group's final report acknowledges the potential dangers to the New Zealand economy of a digital services tax. The Group recommends that such a tax be implemented "only if it is reasonably certain that New Zealand's export industries will not be materially impacted by any retaliatory measures".

The Group also acknowledged that New Zealand's implementation of the anti-hybrid mismatch rules has created "some unintended compliance issues for small businesses". The Group therefore recommends a review of whether the rules should apply to "small businesses or simple business transactions (such as the transfer of trading stock and utilisation of losses)".

Environmental taxes

The Group's consideration of environmental taxes included the existing waste disposal levy (applicable to certain landfills) and Emissions Trading Scheme as well as potential new taxes to address water pollution and water abstraction, possible congestion charging and "input-based tax instruments" (including on fertiliser).

The Group has stated that it supports an increase to the current $10 (plus GST) per tonne rate of the waste disposal levy after an expansion of the levy's coverage to prevent leakage to unlevied landfills. The Group recognises, however, that such taxes on waste might not be a sustainable source of revenue because an increased rate of the levy should result in reduced volumes of waste disposal.

In addition, the Group has recommended the Emissions Trading Scheme be made more "tax-like – specifically, by providing greater guidance on price and auctioning emissions units to raise revenue". The Group also considered taxes in relation to water pollution and water abstraction, acknowledging that tax instruments could have a greater role in addressing water quality and the efficiency of water use. The Group acknowledged that the use of tax instruments in relation to water would, however, be dependent on whether Māori rights and interests could be adequately addressed.

Government response and implementation

The Government response to the recommendations is expected in April this year, with any required legislation to implement its decisions expected to be introduced in November 2019. The Minister of Finance has stated that "no changes arising from the report will be implemented this term [of Government]". On this basis, 1 April 2021 would likely be the earliest commencement date for a CGT.

It is by no means clear whether the Government will proceed with a comprehensive CGT. To date, it has been thought that a CGT is politically unpalatable. And the junior coalition partner in the Government (the New Zealand First Party) whose support would be required to implement any of the recommendations, has previously been understood to oppose a CGT. The opposition National Party has already vowed to repeal a CGT if one were enacted into law, meaning tax policy may feature prominently in the run-up to the 2020 election.

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