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A Capital Gains Tax is Not the Answer

Monday, 21 September 2009, 9:46 am

Article: NZ Centre For Political Research

THIS WEEK...

A Capital Gains Tax is Not the Answer

Former Prime Minister David Lange is reputed to have described a capital gains tax as the sort of tax you introduce if you want to lose not just one election, but the next three! And he should know since the Fourth Labour Government considered a capital gains tax back in 1988, eventually rejecting it as being too difficult. Sadly, they also rejected the flat tax proposed by then Finance Minister Roger Douglas, which would have aligned personal income and company tax at around 23 percent. The introduction of a low flat tax - in conjunction with a low GST consumption tax - would have transformed New Zealand into a first world economy instead of the third world economy with first world spending habits that we are today.



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As a result of the present economic recession – and reckless spending by the Labour administration– the government’s income and expenditure are now seriously out of kilter. Income taxes, which make up almost a half of the government’s tax revenue, are falling as wages come under pressure and unemployment rises. GST, which accounts for around 22 percent of government tax revenue is also down as families tighten their belts and spend less. And company tax, which contributes around 15 percent of government tax revenues, has had its bottom line squeezed between rising costs and falling sales.

However, instead of reducing spending to match their lower income (as most households and businesses are having to do), the government is looking for new ways to increase tax revenue. They started by cancelling our promised tax cuts, saving an estimated \$1 billion. And the proposed emissions trading scheme, which puts a price on carbon across the economy, is being described by many as yet another tax grab.

Earlier this year a high level group of private and public sector tax experts were appointed by the government to a Tax Working Group to review New Zealand's tax system. Their principle objective is to find ways of broadening the tax base so the government can meet its medium term objective of aligning the top rate of income tax, trustee tax, and company tax at no more than 30 percent.[1]

It is most unfortunate that the mandate of the Tax Working Group excludes examining the quality of government spending. This is especially the case since the Secretary of the Treasury has been so outspoken about the fact that around \$40 billion of the Government's \$62 billion budget could be better spent.[2] The fact that 65 percent of all government spending is deemed to be of poor quality is a disgrace, especially as total government spending (which includes local government) is forecast to rise from 40.3 percent of GDP in 2007 to 46.4 percent in 2010.[3] In other words, almost half of the country's wealth created each year is consumed by the government sector. This places New Zealand in the upper echelon of state controlled economies.

In comparison, public expenditure in Hong Kong is expected to be only 19.4 percent of GDP in 2010, falling to 18.9 percent in 2014. The small size of their government is the key reason why Hong Kong is now a very wealthy country, while New Zealand, with its ever-expanding government, is so poor.

In fact, convention places a 20 percent of GDP cap on government spending in Hong Kong. Article 107 of the Hong Kong Basic Law requires the Hong Kong government to "keep the budget commensurate with the growth rate of its gross domestic product". Over the years this has been interpreted as meaning that public spending should remain at 20 percent of GDP - a figure has now assumed de facto constitutional status.[4]

Given the excessive rate of growth of the public sector in New Zealand, surely a cap on government spending is the sort of restriction on the administration that needs to be considered here? It is unfortunate that such initiatives are outside the scope of the Tax Working Group, whose brief is instead limited to various tax gathering possibilities.

One such scheme that is presently being considered is a capital gains tax. Although the Tax Working Group is looking at the proposal as a means of broadening the tax collection base, the Labour and Green parties are using it as an opportunity to push for higher taxes by claiming it will make housing more affordable.

This week's Guest Commentator, property investment specialist Frank Newman, points out the fallacy of that argument, explaining that New Zealand already has a capital gains tax for investment traders - including property investors - and that homes have become less affordable, largely because of local and central government policy:

"It may come as a surprise to many that there is in fact a capital gains tax regime in New Zealand; its application is far from clear and therefore not widely understood. Put very simply, a taxpayer is liable for income tax on capital gains if they are a dealer or trader, or if they bought the investment with the intention of reselling at a profit. It's the latter that causes the difficulty. The IRD as the all-powerful arbiters must look at the circumstances of each case to come to a view on the investor's intention at the time the purchase was made. With the onus on the taxpayer to prove their innocence, that lack of legal clarity puts the taxpayer at risk of an unexpected and potentially ruinous tax liability.

"Property investors face further challenges because there are additional and more specific rules applying to gains on the sale of property. These include for example a minimum ten year holding rule for a builder's private home and onerous rules about "tainting". The tainting rules state that should a long-term property investor with an existing portfolio of properties buy another property with the intention of selling it for a quick profit, then the capital gains on ALL of their properties in their portfolio would become taxable. They all become "tainted" by the one transaction. This is not the case for sharemarket investors who can own shares in a trading account and shares in a portfolio account, without one tainting the other.

"It is therefore incorrect to say New Zealand does not have a capital gains regime, (but fair to say it lacks the clarity of capital gains regimes in other countries). It's also bogus to claim property is New Zealanders most preferred investment because of tax advantages. It is popular for a number of other reasons". To read Frank's full article, click the sidebar link>>>

Although the government's objective of aligning income, trust and property taxes at 30 percent is commendable, unfortunately for New Zealand the world has already progressed beyond that target. At the present time, the OECD average company tax is under 27 percent and falling, with South Korea, one of our key trading partners planning to introduce a company tax of 20 percent by 2010, and another of our trading partners, Canada, intending to implement a federal corporate tax of 15.9 percent by 2012. If New Zealand is to remain competitive in the global marketplace, aligning the tax rate nearer to 20 percent - not 30 percent - would seem the prudent way to go, especially as it is now well known that lower, flatter taxes drive faster economic growth, generating extra tax revenue from higher wages and greater company profits.

Dr Daniel J. Mitchell, a Senior Fellow with the Cato Institute and a top international tax reform expert believes that the benefits of lower, flatter taxes cannot be over-stated: "Thanks largely to tax competition, governments are dramatically improving tax policy. Over the past 30 years, tax rates on productive activity have been sharply reduced. Personal and corporate income tax rates have been slashed. Capital gains tax rates, wealth taxes, and death taxes have been lowered or eliminated. These pro-growth reforms have boosted the global economy, lowered poverty, and improved living standards."

He believes that the "flat tax revolution" is the most exciting of all tax reforms with some 24 countries having adopted some form of single-rate tax regime - many of the more recent 'conversions' opting for flat 15 percent or 10 percent tax rates. The result has been faster growth, more jobs, and increased competitiveness. And while politicians are usually extremely concerned about losing their tax revenue, the results show that flat tax systems invariably generate higher tax revenues because of more income and better compliance.

Dr Mitchell also makes a point that is especially relevant to New Zealand, and that is that because labour and capital can cross national borders to escape punitive tax rates, it no longer makes sense to discriminate against highly-productive taxpayers.[5] With an astonishing 24 percent of New Zealanders living overseas (compared with only 4 percent of Australians who live overseas) finding ways to improve the incentives to work, invest and save in New Zealand has to be a critical objective of the Tax Working Group.

The OECD estimates that a 5 percent fall in people's marginal tax rate increases GDP by 1 percent over the medium term as taxpayers respond to incentive effects. Imagine the boost to the economy if the government changed the tax mix by collecting more of its revenue from the non-distortionary consumption tax (if GST was raised to 15 percent, it would bring in an additional \$2.15 billion in revenue), so it could reduce income and company tax rates to levels that would stimulate entrepreneurial activity, boost productivity and economic growth, and significantly raise living standards. By carefully managing transitional issues to prevent hardship, a prosperous future could be the reality for all New Zealanders.

Whether this government has the vision, the commitment, and the courage to do what would be needed, will be a crucial test.

All articles can be found on the NZCPR RESEARCH PAGE - click [here>>>](#)

1. Victoria University, Tax Working Group
2. John Whitehead, Public Sector Performance
3. Roger Kerr, Trend to Bigger Government Must be Reversed
4. Prof Michael Littlewood, The Hong Kong Tax System
5. Dr Daniel J. Mitchell, The Global Flat Tax Revolution: Lessons for Policy Makers

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Corrections: Most. Prisoners. Ever.

The number of prisoners behind bars in New Zealand is at its highest level ever, and underlines the urgent need to create extra prison capacity, Corrections Minister Judith Collins said today.

At Monday unlock this week – where prisoners throughout the country are counted - there were 8509 people in prisons or police stations. [More>>](#)

ALSO:

- NZ Govt - [Government has zero tolerance for crims](#)
- NZ Govt - [Address to Sensible Sentencing Trust Conference](#)
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- Sensible Sentencing Trust - [Right To Silence Should Be Scrapped, Say Victims](#)
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- Sensible Sentencing Trust - [Three Strikes & You're Out Top Of List For Victims](#)
- Sensible Sentencing Trust - [Devices To Stop Repeat Drunk Drivers A Must](#)

- Sensible Sentencing Trust - [Minister Of Courts Snubs Victims Conference](#)
- TV3 Video - [Current drink-driving laws 'pathetic' - lobby group](#)
- TV3 Video - [Neighbours of 'murder house' say fire was inevitable](#)
- Justice For Robin Bain - [Petition Opposing Compensation Bid](#)
- NZ Police - [Zero tolerance for 'boy racers' in Rotorua](#)

[Climate Change: 'John Key' Gets The Global Climate Wake Up Call](#)

Today is the Global Wake Up Call on climate change, with over 2300 events in 130 countries urging Heads of State to show leadership at the UN General Assembly climate summit in New York. [More>>](#)

ALSO:

- 350 Dunedin - [Dunedin Public Sends Climate Wake-Up Call To Govt](#)
- 350 Aotearoa - [Be part of something big - and quite loud!](#)
- TV3 Video - [Climate change flash mobs to demand wake up call](#)

[Pay-Equi-Tea: Protesting Does Not Call For Subtle-Tea](#)

The Pay Equity Challenge coalition was officially launched on the steps of Parliament today, the eve of Suffrage Day, by campaigners dressed in the fashions worn by Kate Sheppard when New Zealand women became the first in the world to win the right to vote. [More>>](#)

ALSO:

- NZ Govt - [Suffrage movement transcends boundaries](#)
- National Council of Women - [From Suffrage to Sufferance](#)
- TV3 Video - [Pay equity campaigners mark suffrage day outside Parliament](#)

[Dropped Aitches: Nobody Tells Michael Laws How To Spell!](#)

"I have a constitutional responsibility to fight this decision until there is no fight left in my body. It is not simply that the decision is wrong - it is that an entire community has had its views, feelings, history and heritage swept aside." [More>>](#)

ALSO:

- NZ Geographic Board - [Board Accepts 'Whanganui' Place Name Proposal](#)
- NZ Geographic Board - [Whanganui summary report \(PDF\)](#)
- NZ Govt - [NZ Geographic Board Determination](#)
- NZ Govt - [Look for unity, Sharples urges Whanganui](#)
- Maori Party - [Turia welcomes board's decision](#)
- Wanganui District Council - [Prime Minister on Wanganui 'H' issue](#)
- Wanganui Chronicle - [Chronicle Considers The H Word](#)
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- Television NZ - [Q+A Panel: Wyatt Creech and Kate Gainsford](#)
- TV3 Video - [Board recommends Wanganui be spelled with an 'h'](#)
- TV3 Video - [Geographic Board says Wanganui should be spelt with an 'h'](#)
- TV3 Video - [Iwi happy over 'Whanganui' decision](#)
- TV3 Video - [Laws on Campbell Live](#)
- [Out-Link - Hard News - Friday Gold: An email exchange with Michael Laws](#)
- [Out-Link - Random Play: Racial's coming home ... to roost](#)
- [Out-Link - Reading the Maps: W\(h\)anganui: why Laws and Turia are both wrong](#)

[Palm Trees: English "Looks Forward" To Supermarket Pickets](#)

John Key's Government today admitted that production of palm kernel animal feed is helping destroy Indonesian and Malaysian rainforests... Mr English also sought to deflect attention from Fonterra's use of palm kernel by twice challenging Greenpeace to picket the nation's supermarkets. [More>>](#)

ALSO:



- [Questions and Answers - 17 Sept 2009](#)

More Bill English news:

- TV3 Video - [English haunted by housing allowance arrangement](#)
- Tom Frewen - [Today In Parliament - 17.09.09](#)

[Super City: Auckland Council Bill Passes, Still No Maori Seats](#)

Te Ururoa Flavell: We know, obviously, that the Māori seats, or mana whenua seats, are an issue for this Parliament, and I want to continue the theme around that and perhaps put some questions to the Minister in the chair, Rodney Hide, as I thought that his kōrero earlier this morning at least gave an overview as to where he is at. [More>>](#)



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- EMA - [Passage of super city law historic](#)
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- North Shore City - ['Frankenstein' super city let loose on Aucklanders](#)
- Labour - [Govt cannot assure funding for Auckland arts](#)
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- Labour - [Super City Fails Diverse Communities](#)
- Grassroots Action Group - [Government Gets Its Way](#)
- *Out-Link* - [Hard News: Rodney on the Road](#)
- Scoop Full Coverage - [Report Calls For Auckland Super City](#)

[Militaria: Kiwi Troops To Subdue Taliban With Utility Belts](#)

New Zealand Defence Force (NZDF) troops deploying to Afghanistan this October will be equipped with the latest, battle tested body armour and protective equipment. [More>>](#)



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- TV3 Video - [New combat gear for NZ soldiers in Afghanistan](#)
- NZ Defence Force - [Soldiers To Return To NZ After Security Breach](#)

[Orderly Behaviour: Future Undies Are Off](#)

The Engineering Society of Canterbury (ENSOC) has today advised the University of Canterbury that, in light of events at the weekend, the Undie 500 Charity Drive will not be returning to Dunedin in the foreseeable future. [More>>](#)



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- NZ Police - [Undie 500 arrest and charge details](#)

[ETS: Benefit Rise On/Off Table In Maori-Nat Negotiations](#)

Paula Bennett has given the public two different answers as to whether she supports increases to benefits and she should get her story straight, says Labour's Social Development spokesperson Annette King. [More>>](#)



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- Scoop Business - [SMELLIE SNIFFS THE BREEZE: A stinky climate deal](#)
- NZ Govt - [Government's ETS strikes a balance to protect jobs](#)
- Labour - [Maori Party ETS 'wins' as clear as mud](#)
- Scoop Business - [No ETS deal with Maori on Treaty forests](#)
- Libertarianz - [PM's Clumsy Bribe Insults Dignity Of Maori](#)
- Carbon News - [World listening to NZ on climate deal changes](#)
- 95bfm - [95bFM: Deady & Sharples - Benefits of the ETS](#)
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[**Gordon Campbell: Putting The SAS Back Into Afghanistan**](#)

Who has stolen John Key's brain? The Prime Minister who only a couple of months ago was demanding to see a viable exit strategy before he would put New Zealand combat troops back into Afghanistan, has been replaced by a John Key impersonator for whom the vaguest of goals – combatting global terrorism – now seems like a darn good reason for doing so. [More >>](#)

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