SPEAKMAN LAW

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Issue 27

What's inside

Briefly – Special Interest/Law

- Residential land "sensitive" and subject to Overseas Investment Office consent from October 22.
- Mainzeal directors in court facing claim against them for reckless trading. Includes Jenny Shipley being sued for more than $47m.
- CBL Insurance interim liquidation continues, whilst directors establish solvency, plan for recovery.
- Eric Watson ordered to pay Sir Owen Glenn $49.4m, who says he is determined to take Watson to the ends of the earth. Meanwhile Eric Watson's Cullen Group recently in court fighting IRD $60m claim.
- Stairway to Heaven retrial ordered over copyright claims.

Briefly – Sport

- Europe retain Ryder Cup despite 11 of US team ranking in Top 17 world rankings. Team culture? At least one US legend, Phil Mickelson, now at the end of the road. Celebrate his success, not condemn his frailties.
- ABs retain Rugby Championship with wins over Australia and Argentina. Recent loss to South Africa taken well but Steve Hansen rightly says it won't be if we keep losing.
- Alistair Cook retires with century in his last test match, to book end his test career after a century in his first test. Good on him, he has been the perfect role model in a game that has needed one.

Tax Working Group (TWG) – Preliminary Report…

The TWG appointed by the Government primarily to assess whether or not New Zealand should introduce a capital gains tax appears to be unconvinced as to its merits. This newsletter summarises key findings in the TWG's preliminary report.

Taxation of Capital Gains

The TWG, in its preliminary report, offers no firm conclusion on introduction or otherwise of a capital gains tax. Instead the group is considering two main options: an extension of the existing tax net (through the taxation of gains on assets that are not already taxed); and the taxation of deemed returns from certain assets (known as the risk-free rate of return method of taxation). I discuss these further below.

GST

No reduction in the rate of GST is proposed. Nor are increased exemptions likely. It is recognised that GST disproportionately hits low income households, however, it is thought that the better means of improving their income is wealth transfers and changes to personal income rates.

A problematic aspect of the GST system is the treatment of financial services. Currently they are exempt from GST net for the reason, for example, that the service element of an interest bearing loan is so difficult to measure. On what amount would GST be charged on provision of such a loan?

The difficulties in these respects have led the TWG to recommend against bringing financial services within the GST net.

Taxation of Business

The TWG does not see a case to reduce the company rate and it recommends retaining the flat rate of company tax (instead of a progressive rate which we have for personal income).

Other aspects are to be retained, notably:

a. the imputation system; and

b. carry forward rules for tax losses.

Wealth Taxes, Inheritance Tax, Land Tax

None of these are proposed. New Zealand formerly had a wealth tax in the form of estate duty. This was repealed in 1988. The TWG note that wealth taxes tend to suffer from high levels of evasion and avoidance. They comment that taxpayers respond to wealth taxes by shifting their investments into untaxed assets and in any event are difficult to apply.

Land taxes suffer from major disadvantages, mainly their disproportionate (ie unfair) impact on certain groups and industries that hold a greater share of their wealth in land.

Inheritance taxes were at all times outside the scope of the TWG's report.

Specific Housing Market Measures

It is recognised that the tax system interacts with housing; the absence of taxing either the homeowner's equity in his or her home or gains on sale (other than for traders or where the "brightline" rule applies) actively encourages housing investment. On the other hand, the TWG is not convinced on the extent to which taxation impacts the housing market pointing to supply and demand and building costs as key causative features). Nevertheless three measures appear to be favoured by the TWG. These are:

a. restoration of depreciation on multi-unit residential buildings (which would support greater intensification in urban areas);

b. introduction of a tax on vacant residential land or on empty homes in residential areas; and

c. removal of the "ten year rule" related to changes in zoning, which would reduce the incentive to land-bank on city fringes.

Capital Gains Tax – Specific Considerations

The absence of a capital gains tax has an inherent unfairness. It means that people with the same amount of income are being taxed at different rates depending on the source of the income. A tax on capital gains, however, carries with it the converse (available deductions) for capital losses. As a revenue collection means there is therefore some risk for the Government in introducing a capital gains tax. This risk does not exist with the risk-free return method.

If a capital gains tax is to be introduced, there is the question whether it is to be targeted at specific assets or broader based. Under a targeted approach, for example, tax might be limited to land sales and gains from financial arrangements. But this may just drive investment into other assets that are excluded from the tax.

If a broad based approach is adopted, with it comes complexity of compliance and administration. A further issue is whether to tax gains on an accrued basis or on a realisation basis only. Rollover relief would be inevitable in a realisation based regime. This would be needed where, for example, a share is exchanged for another share, ie share swaps.

An example of a risk free return method is to take the rate applied to a "risk free" government bond rate, reducing it for inflation and applying it to the market value of the asset. The resulting amount (notional yield) would then be taxed at ordinary income tax rates.

The principal obstacle here is establishing market value of the asset each year. Further, where a bach is bought within the rules for example, there will be no cash to shelter the tax liability.

Conclusions

We must await the final report in February next year to know what the TWG recommends. My pick is a capital gains tax system that targets:

- Interests in land (other than the family home).
- Intangible property, including goodwill.
- Business assets.
- Shares in companies.

I suspect it will be on a realisation basis only, and with rollover relief where like assets are exchanged, rather than traded for cash or liquid assets. In addition, it seems a tax on vacant residential land/empty houses will be introduced.

Our Website…

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