

# A TAX SYSTEM FOR NEW ZEALAND'S FUTURE

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## Morning Session 2

### GST

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# 1. Current NZ GST

- Broad base
  - Low rate
  - Revenue
- 96.4% Consumption-efficiency
  - 6<sup>th</sup> lowest in OECD
  - \$11.11 bil. (private sector, 2008)  
19.7% of total tax revenue

## 2. The issue

- Increase GST rate as:
  - i. a revenue positive input to broader package, and/or
  - ii. change in tax mix?
- Increase GST without special rates
- Revenue, equity, efficiency, integrity & compliance

**BUT** the key is these 5 effects for whole package

### 3. How much more revenue?

Two effects:

- *Mechanical effect*: 'Automatic' amount of additional revenue
- *Behavioural effect*: Reduced revenue caused by behavioural responses eg buy more non-GST items; decrease expenditure as proportion of disposable income; increased avoidance

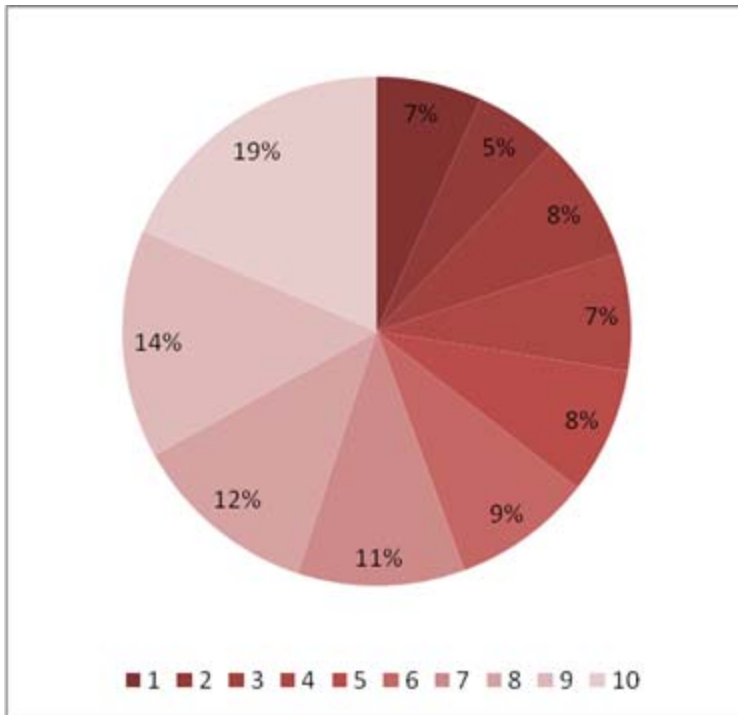
#### Mechanical effect of an increase (per year):

| ●<br>(\$ billion)             | 2007/08<br>GST | Estimated additional revenue at: |              |              |
|-------------------------------|----------------|----------------------------------|--------------|--------------|
| Rate                          | 12.5%          | 15%                              | 17.5%        | 20%          |
| <b>Private sector revenue</b> | <b>11.115</b>  | <b>2.150</b>                     | <b>4.200</b> | <b>6.170</b> |
| Automatic benefit adjustment  | N/A            | (0.250)                          | (0.480)      | (0.720)      |

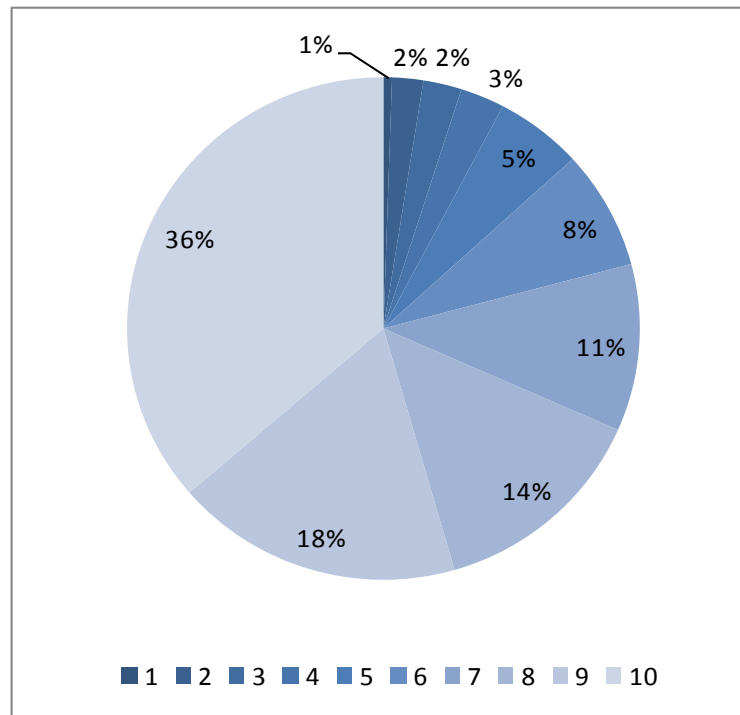
## 4. Equity effects; compensation?

- 94.5% of private GST revenue in 2006/07 paid by domestic households, 5.5% by non-residents
- cf GST & income tax paid by NZ domestic households

**GST paid by NZ households**



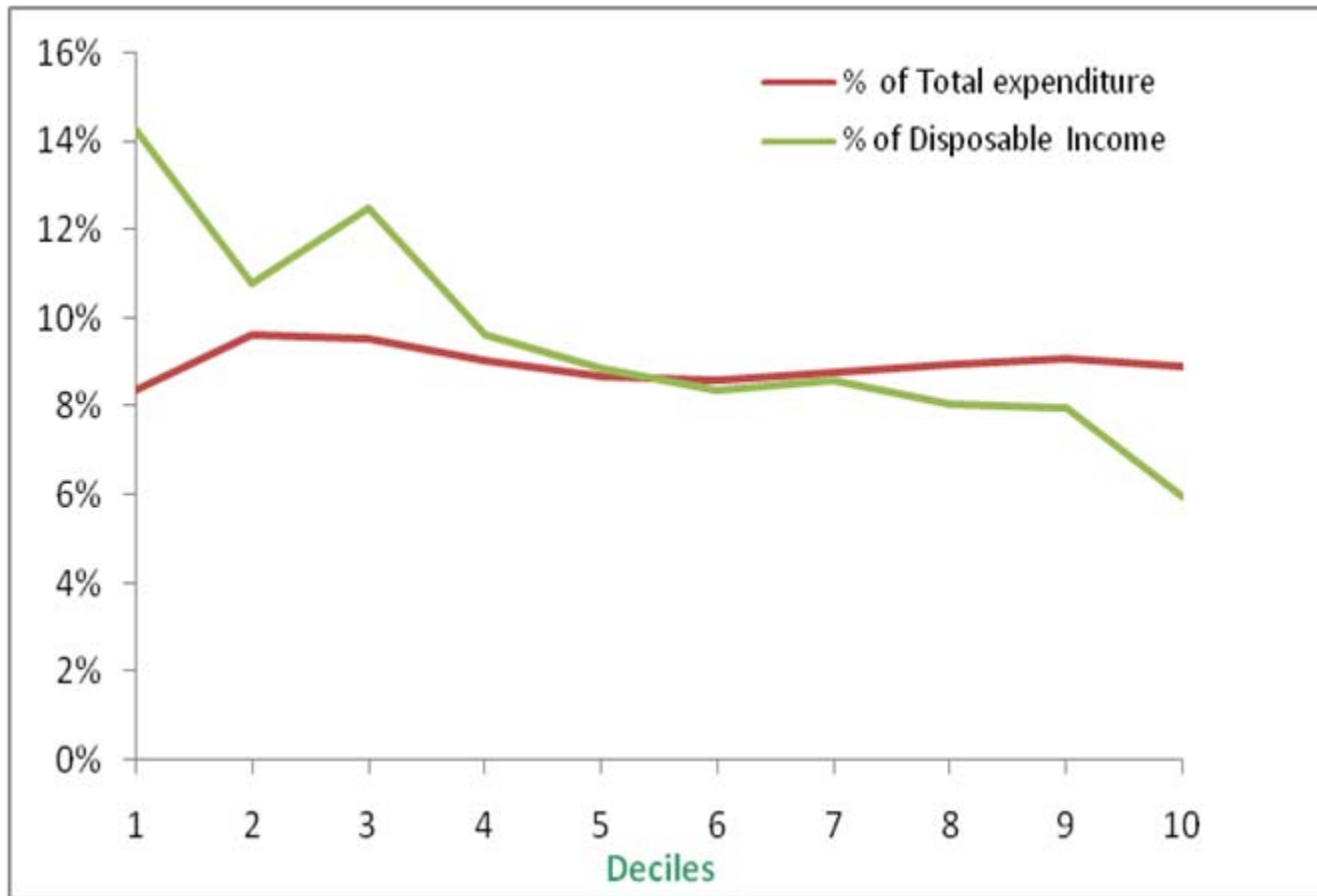
**Income tax paid by NZ households**



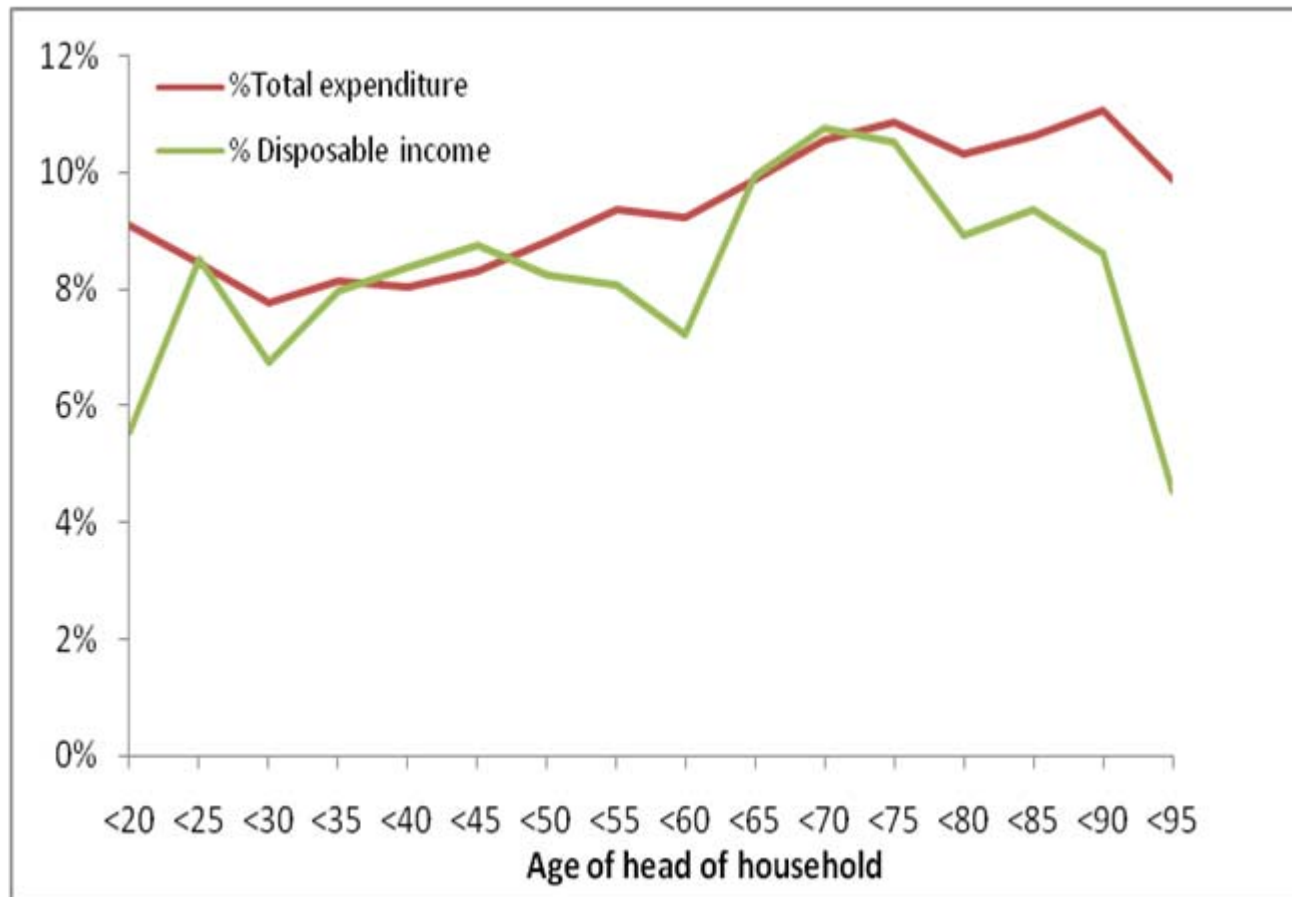
# Equity: (i) impact of GST on households

- Saving and borrowing mean that GST looks regressive if measured as a proportion of disposable income
- Measuring distribution by annual income overstates regressivity due to progressive tax rates on income
- Thus, need to measure GST as proportion of lifetime income, as well as by annual income. Ways to estimate impact include:
  - Annual expenditure - more stable across life times than income;
  - Age distribution of households.

# Average GST paid by deciles



# Impact of GST on different age groups





# Equity: (ii) Compensation for GST increase

- 1986 compensation for impact on low income families
- Many benefits automatically adjust for price changes
- Compensation may still be desirable because of:
  - Delay in increase in benefits
  - Non-uniform increases in prices
  - Households that do not receive an adjusted benefit
- **BUT** the key is the impact of whole package

## 5. Efficiency & growth

- Indirect labour tax (reduces the real effective wage)
- Indirect wealth tax (lowers real consumption)
- Relative to income taxes, broad-base GST:
  - Less progressive & not good redistributive tool
  - Less discouraging to savings and investment
  - Broad base GST reduces deadweight costs & increases efficiency of tax collection
  - Likely one-off increase in prices & temporary contraction of consumption
- **BUT** the key is impact of whole package

## 6. Integrity & compliance

- Incentivise
  - Fraud and avoidance behaviour
  - Substitution toward non-taxable providers
- Increase risks associated with GST refunds
- Relatively low implementation, administrative and compliance costs **BUT** tax fraction & payments basis more difficult for 15 & 17.5%
  - **BUT** the key is impact of whole package

## 7. Work to do includes

- Impact of behavioural response on revenue
- Compensation to whom? How? When?
- Nature of impact on:
  - Renters and on low-income earners
  - Those over 65, particularly retirees: benefit less from income tax reductions; higher GST expenditure; accumulated wealth faces higher indirect tax
  - Businesses: ability to raise prices to reflect increased tax and impact on margins; compliance costs
- **BUT** key is the 5 effects for whole package