

A TAX SYSTEM FOR NEW ZEALAND'S FUTURE

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Afternoon Session 1

Base broadening – taxation of capital income

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Background

- Tax theory holds most economically efficient income tax is a poll tax – provides incentive to work at least to extent to pay tax. Trouble is it's inequitable
- A poll tax on capital can be similarly considered – yet we seldom do. Yet under-utilisation of capital is common.
- Proposition is to consider tax base broadening via impost of Comprehensive Capital Tax (CCT) – on land, buildings, plant & equipment
- CCT would be additional to (a lower) tax on income from capital + profits

- Base broadening enables 3 improvements
 1. fundamental tax & benefit reform, integration
 2. alignment and reduction of income tax rates
 3. raises marginal efficiency of capital by lifting its price
- CCT is most significant base-broadening measure; land tax = selective alternative
- If capital stock is \$1,500 bn, a 1.25% tax would raise \$19bn (personal income tax is \$27bn)
- Concept is that capital does/should generate income in some form – cash, imputed rent, or capital gain. CCT taxes it comprehensively – dependant on rate

CCT enables two major reforms

1. Alignment - single flat income tax rate of 25% say, whether personal, companies, trusts – efficiency gains.

2. Integration - of welfare + income tax via Guaranteed Minimum Income, delivering efficiency & neutrality gains

Guaranteed Minimum Income

- All adults receive \$10,000 from government
- At 25% flat tax rate implies first \$40,000 of earned income is tax-free
- No need for sickness, NZ Super, unemployment, DPB etc benefits
- Total cost = 3m @ \$10,000 less \$16bn = \$14bn (plus cost of alignment of company, trust rate at 25% of \$3bn = \$19bn)
- Can dismantle machinery that decides & monitors eligibility for benefits

Rationale for CCT

1. encourages utilisation of capital
2. captures non-cash forms of capital remuneration

Effects of rise in price of Capital

1. encourage greater utilisation of capital – income effect
2. encourages labour-intensive production – substitution effect

Miscellanea on CCT

- Accrued basis tax – payers can defer part or all but face cost of money – avoids lock-in
- Valuation – link to value indexes of asset class – avoids costly valuation compliance
- Own home – vital it's not exempted totally, at most average value of house, not one house each – avoids mansions as tax shelters
- No deduction for interest – that deductibility remains for generation of taxable cash income only

Comprehensive Capital Tax

- Is the most significant base-broadening measure
- Base broadening holds key to 4 outcomes:
 1. fundamental tax & benefit reform, integration – reduces high EMTRs, benefit fraud
 2. alignment and reduction of income tax rates – removes use of different legal structures to minimise tax
 3. raises marginal efficiency of capital through lifting its price – critical to an economy that aspires to “pass Australia” but is destined to “fall below South Korea” on the OECD scale
 4. progressivity in income rates goes, CCT does it