A comprehensive capital gains tax in New Zealand – no longer political hari-kari? A consideration of the Labour Party proposal of 2011

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Abstract

Political commentators have long said that the enactment of a comprehensive capital gains tax (CGT) in New Zealand would be “[a] sure-fire path to political suicide”. (Edlin, 2008) However, in more recent times there may be a change in the mood of the nation – or at least in the Boardroom – to the adoption of a CGT: “The Herald’s Fran O’Sullivan said this year’s Mood of the Boardroom survey showed support was building in the business community for a tax on capital gains”. (Chapman-Smith, 2013) Deloitte New Zealand Chief Executive Thomas Pippos, also writing in The New Zealand Herald, similarly observes: “Even for certain traditional naysayers there is an acceptance that a CGT is an inevitable part of our future tax landscape that once enacted will not, like the short-lived R&D regime, ever be removed.” (Pippos, 2013)

In the 2011 General Election the centre-left Labour Party campaigned on inter alia introducing a comprehensive CGT levied at a rate of 15 per cent. The Labour Party was unsuccessful in the 2011 General Election. However, in the current mixed member proportional (MMP) electoral system, it is certainly possible that the 2014 General Election could see the Labour Party forming a government with the Green Party of Aotearoa New Zealand and the consequent introduction of a CGT.

This paper considers the CGT proposed by the Labour Party in 2011. It notes that aspects are consistent with CGT regimes generally, such as it being realisation-based with exclusions for the principal private residence and personal assets and collectibles. However, other aspects, including the rate and retention of existing provisions that tax gains from dealers at their marginal tax rates, could provide definitional issues and arbitrage opportunities between income tax and the CGT.
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1.0 INTRODUCTION

Political commentators have long said that the enactment of a comprehensive capital gains tax (CGT) in New Zealand (NZ) would be “[a] sure-fire path to political suicide”. Indeed, former Prime Minister, the Rt Hon David Lange is reputed to have characterised “a capital gains tax policy as one likely to lose you not merely the next election, but the next three”. When the NZ Treasury Secretary John Whitehead in 2009 suggested it was time for NZ to address the issue of taxing capital gains from property investment, a newspaper report quoted Whitehead as stating that his comments were made “[a]t the risk of being chased down by an angry crowd with pitchforks and flaming torches”.

However, there may be a change in the mood of the nation – or at least in the Boardroom – to the adoption of a CGT: “The Herald’s Fran O’Sullivan said this year’s Mood of the Boardroom survey showed support was building in the business community for a tax on capital gains”. Deloitte New Zealand Chief Executive Thomas Pippos, also writing in The New Zealand Herald, similarly observes: “Even for certain traditional naysayers there is an acceptance that a CGT is an inevitable part of our future tax landscape that once enacted will not, like the short-lived R&D regime, ever be removed.” Support for a CGT is also evident among the wider community.

On 14 July 2011, as part of its tax policy for the 2011 General Election, the centre-left Labour Party (Labour) proposed introducing a capital gains tax (CGT) levied at 15 per cent with effect from 1 April 2013 (ie 18 months after the 2011 General Election). Its other key

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1 Bob Edlin “A sure-fire path to political suicide” The Independent (New Zealand, 5 February 2008) at 14.
2 Barrett and Veal, referring to overseas experiences, conclude “Memorable as Lange’s aphorism may have been, its plausibility is dubious”: see Jonathan Barrett and John Veal “Equity versus Political Suicide: Framing the Capital Gains Tax Debate in the New Zealand Print Media” (2013) 19 New Zealand Journal of Taxation Law and Policy 91 at 94 (fn 25).
3 “Capital gains tax promoted” The Press (Christchurch, 4 June 2009) at B4.
5 Thomas Pippos “Capital gains tax an inevitable part of the future landscape” The New Zealand Herald (online ed, New Zealand, 23 July 2013).
6 A poll undertaken in October 2013 found 52.3 per cent believed a CGT on investment properties would help control rising house prices, up from 37.1 per cent in an August poll. This result came on the back on the introduction by the Reserve Bank of its loan to value ratio (LVR) restrictions which limit low deposit loans aimed at inter alia easing house price inflation: Michael Fox “Kiwis ‘ready’ for capital gains tax” The Press (Christchurch, 12 November 2013) at A5.
tax policies included a new marginal tax rate of 39 per cent on incomes above $150,000; a tax-free threshold of $5,000, and the removal of GST on fresh fruit and vegetables.  

It is debateable whether Labour (the major NZ opposition party) sensed a change in the electorate toward a CGT, or was simply looking to clearly differentiate themselves from the incumbent centre-right National-led coalition government. On the face of it, the inclusion of such a policy may not be surprising for a centre-left party – indeed other left-of-centre parties such as the Green Party of Aotearoa New Zealand (Greens) also have had such a policy for a number of years. What was unusual for NZ politics, given the previous (apparent) public disdain for a CGT, was that a major political party would campaign on such a policy.

The Labour Party was unsuccessful in the 2011 General Election. At the time of writing Labour remains committed to implementing a capital gains tax should it form the next government after the 2014 General Election, albeit the details of its policy (and how similar it is to its 2011 proposal) is unclear at this stage. On the basis that the Mixed Member Proportional (MMP) electoral system produces coalition-based governments and the Greens and Labour are likely coalition partners, it is possible that the 2014 General Election could see a Labour-Greens coalition elected to the front-benches and the possible introduction of a CGT.

This paper considers Labour’s CGT proposal which is contained in the document “Labour’s Fairer Tax System Explained …” (hereafter the policy statement), and identifies potential issues that may need consideration if it was to be fully developed and ultimately

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8 Barrett and Veal observe that the 2011 Labour CGT policy was introduced “at a time when public opinion appeared to be turning favourably towards a CGT.” Barrett and Veal, above n 2, at 94.
9 The National Party firmly opposes a comprehensive CGT: see for example Fox, above n 6, at A5.
10 See “Green Taxation and Monetary Policy Summary” <www.greens.org.nz/policysummary/green-taxation-and-monetary-policy-summary>. The Greens website states that they “will enhance the progressivity of the tax system by introducing an income-tax-free threshold of $10,000 and a comprehensive capital gains tax (excluding the family home).” These policies, along with new ecological taxes and better enforcement of current tax law would broaden the tax base and make it more resilient. In the 2011 General Election the Mana Party also campaigned on introducing a CGT on all assets except the family home and Maori land, see for example <mana.net.nz/wp-content/uploads/2011/06/Final-for-release-Economic-Justice-25-September-2011.pdf>.
11 As to the role of the CGT policy in Labour’s election defeat, Barrett and Veal (above n 2, at 94 fn 28) cite Colin James who observes “Whether the capital gains tax was the cause, or just opened the trapdoor through which Labour was destined to fall, is debateable. Judging by subsequent ratings in the polls, I think it was probably the latter.” Colin James “On a Wing and a Smile: Political Transition in National’s Business-as-Usual Re-Election” in Jon Johansson and Stephen Levine (eds) Kicking the Tyres: The New Zealand General Election and Electoral Referendum of 2011 (Victoria University Press, Wellington, 2012) 65 at 66 n 1. Barrett and Veal’s article contains an interesting discussion on the framing of the CGT debate in the media between 1993 and up to the 2011 General Election: Barrett and J Veal, above n 2, at 91.
13 Labour Party, above n 7.
implemented. The paper also includes comment from commentators and media. It notes that aspects are consistent with CGT regimes generally, such as it being realisation-based with exclusions for the principal private residence and personal assets and collectibles. However, other aspects, such as the CGT rate and retention of existing provisions that tax gains from dealers as income, could provide definitional issues and arbitrage opportunities between income and capital gains.

The Greens 2011 CGT policy was not selected for consideration in this paper as it was less detailed than that of Labour’s. This paper does not consider the merits of a CGT and the disadvantages of such a tax or the merits of alternative taxes such as a land tax. Further, the paper does not aim to undertake an in-depth comparison with Labour’s policy with the CGT regimes of other countries such as Australia or the United Kingdom, although the experiences of other jurisdictions are drawn on as relevant in the discussion. It is not the purpose of this paper to consider CGT ‘best practice’, nor to evaluate Labour’s policy using Adam Smith’s canons of a good tax. The likely impact of a CGT on, for example, house inflation and taxpayer behaviour is not considered in this paper. The history of the CGT


16 For a discussion of what should be key principles in the design of a CGT see Chris Evans and Cedric Sandford “Capital Gains Tax – The Unprincipled Tax?” [1999] 5 British Tax Review 387.


18 The impact of a CGT in New Zealand are considered in Andrew Coleman, “The long term effects of capital gains taxes in New Zealand” (Paper presented for Session Three of the Victoria University of Wellington Tax
debate, including the findings of previous committees which have looked into a CGT for NZ, is also beyond the scope of this paper. Rather, as already indicated the focus of this paper is on Labour’s CGT proposal and identifying potential issues that may need consideration if it was to be ultimately implemented. This paper has a number of limitations, the most noteworthy being, as Labour’s policy statement is simply that, a broad statement of intent rather than a highly detailed and fully formulated proposal, there are aspects absent from the policy statement which limits analysis of it.

Section 2 of this paper outlines the background to Labour’s CGT proposal. Sections 3 and 4 contain an analysis of the proposal and identify issues requiring further consideration, respectively. Concluding observations are made in Section 5.

2.0 LABOUR’S CGT POLICY INTRODUCED

Not unexpectedly the purpose of Labour’s CGT proposal was couched in somewhat political and populist rhetoric:

It’s not fair for people to have to pay tax on every dollar they earn from wages or interest on their money in the bank while others are making huge profits buying and selling assets without paying any tax … This tax switch is about creating a fairer tax system. In fact, under Labour, the overwhelming majority of Kiwis will wind up paying less tax not more.

Reference to the CGT “creating a fairer tax system” in Labour’s policy statement resonates with commentators, such as Evans and Sandford, and groups such as the Organisation for Economic Co-operation and Development (OECD).

The proposed CGT will be broad based and comprehensive, aimed at avoiding high compliance costs associated with a large number of significant exemptions and will follow the same approach as adopted in Australia and other jurisdictions. With respect to arguments of complexity and administrative costs, Labour would draw on the experiences of

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20 Labour Party, above n 7.
21 Evans and Sandford, above n 16, at 403.
22 In its June 2013 economic survey of New Zealand, the OECD highlighted the lack of a capital gains tax as a weakness in the New Zealand tax policy framework and stated that a CGT could, along with other tax changes, “facilitate a more efficient and equitable tax structure”: OECD OECD Economic Surveys: New Zealand (OECD Publishing, Paris, 2013) at 24.
23 The policy statement lists a broad range of assets to which the CGT will apply: Labour Party, above n 7, at 9.
24 At 9.
other countries. The policy statement also acknowledges the complexity inherent in the current NZ tax system due to the absence of a comprehensive CGT: “some tax experts have said that the lack of a CGT in NZ has caused considerable complexity, requiring arbitrary and ad hoc tax rules to limit the exploitation of this exemption.”

The policy statement itself, after a three-page media statement, outlines some high-level details of the regime and how it could operate. It also contains a useful “Questions and Answers” section (with 26 questions covering the rationale for the CGT and practical operational issues) followed by a table covering five pages titled “When will the Capital Gains Tax Apply?”

The CGT proposal was costed by independent experts BERL to generate $78 million in its first year, rising to $2.27 billion in year 10; or $26 billion over 15 years. How realistic these amounts are is dependent on favourable asset price movements and the impact the CGT may have on taxpayer behaviour. Krever observes that estimates of CGT revenues have generally been conservative and that the extra revenue raised can be traced to the fact that significant avoidance had occurred due to the conversion of items of ordinary income into capital gains.

Along with paying off debt, some of the revenue raised by the CGT would be used to offset the loss of revenue from the introduction of the $5,000 tax free threshold and removing GST

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25 At 18.
26 At 18. In their article considering inter alia the South African CGT regime, Huang and Elliffe (above n 19, at 287) refer to the South African National Treasury’s acknowledgement that CGTs are complex but “it did not accept that a realisation-based CGT would be any more complex than the pre-existing capital-revenue boundary”. The South African National Treasury also refer to Robin Oliver’s observation that “simplicity has not been the outcome of the lack of a capital gains tax in New Zealand”: National Treasury (South Africa), above n 15, at 12 citing Robin Oliver “Capital Gains Tax – The New Zealand Case” (Paper prepared for the Fraser Institute’s 2000 Symposium on the CGT, Vancouver, 15-17 September 2000) at 3. For a discussion of problems with the New Zealand income tax base see also Elliffe, above n 14, at 184-197.
27 Labour Party, above n 7, at 6 – 14.
28 At 15 - 18
29 At 19-23.
30 At 15. Estimates of Labour’s CGT ultimately raising $2.8bn per annum by 2025 if the CGT was introduced in 2013 is approximately half Treasury’s estimate of revenue from a realised CGT (excluding the family home): KPMG “Labour’s tax policy for the 2011 general election” Taxmail (online ed, New Zealand, 15 July 2011) at 3. The Treasury in 2013 estimate a CGT could raise around 1 per cent of extra tax: The Treasury Affording Our Future – Statement on New Zealand’s Long-Term Fiscal Position (Wellington, July 2013) at 48 <www.treasury.govt.nz/government/longterm/fiscalposition/2013/affordingourfuture/ltps-13-aof.pdf>. The assumptions underlying the Treasury’s 2013 calculation are not stated, other than that it would be levied at income tax rates.
31 Rick Krever “A Capital Gains Tax for South Africa” (Draft notes for a presentation to the Portfolio Committee on Finance and the Select Committee on Finance) Section 6, at 8. He observes that in Australia’s case within a short period after introduction the revenue collected from the tax was almost tenfold more than predicted (at 7).
from fresh fruit and vegetables. While the revenue from the tax would be used in part to reduce income tax, Tarrant posits that Labour’s policy is arguably not the optimal option in the OECD’s view on the basis that not all the revenue raised will be used “to fund growth-enhancing tax rate reductions”, ie, the company tax rate would remain unchanged and the top individual tax rate would in fact increase. Hosking similarly observes:

The reason Treasury, the OECD and the IMF all talk of New Zealand having a capital gains tax is to broaden the tax base and to cover off an area of income not currently taxed. Crucially, the idea is emphatically not to increase overall taxation: it is to allow tax reductions in other areas. (paragraph break removed)

The policy statement estimates, based on Australia’s experience, that the CGT would impact in any one year less than 10 per cent of taxpayers (or 267,000 people). An Expert Panel would initially be appointed to “provide top level advice to guide the design of the CGT” before proceeding through the generic tax policy process (GTPP) to enactment.

Reaction from the other political parties was predictably mixed. For example, as indicated the Greens have been supporters of a CGT for some time on the basis that its absence has significantly affected housing affordability, led to widening inequalities in wealth and a disproportionate investment in a largely unproductive sector of the economy (ie housing).

The Prime Minister and National Party leader John Key described it as “baking a tax cake in hell’s kitchen” and in his view, to be effective, the CGT would have to apply to everything. Peter Dunne, Revenue Minister at the time of the policy’s launch and United Future leader described the tax as a “bureaucratic nightmare” and “a massive attack on personal achievement and success” which satisfied “entrenched envy within the Labour left”.

32 Labour Party, above n 7, at 16. The removal of GST from fresh fruit and vegetables was dropped as Labour policy following the 2011 General Election. In addition, it has been hinted the tax-free threshold proposal will also not be part of its 2014 election policy: Alex Tarrant “Labour’s second best, politically palatable capital gains tax stance; Why not actually do what the IMF and OECD recommend? (2012) interest.co.nz at 2 <www.interest.co.nz>.
33 Tarrant, above n 32, at 1.
35 Labour Party, above n 7, at 16.
36 At 18.
37 The GTPP incorporates consultation and public submissions to a select committee: see Adrian J Sawyer “Reviewing tax policy development in New Zealand: lessons from a delicate balancing of law and politics” (2013) 28 Australian Tax Forum 401.
38 Lloyd Burr “Labour’s tax policy: capital gains, tax-free produce” (14 July 2011) 3News at 3 <www.3news.co.nz).
39 At 3.
40 At 2.
right-wing ACT Party criticised the policy on the basis that taxpayers are “clobbered twice: once when you create or earn wealth, the second time when you dispose of it.”

3.0 THE PROPOSED CAPITAL GAINS TAX

This section considers key aspects of Labour’s CGT policy derived from their policy statement and includes comment along with each key aspect. Labour’s policy and its discussion is presented in the future tense on the assumption that, if elected, the implemented regime would be based on or at least reflect the policy statement.

3.1 Capital Gains Tax Rate

The CGT will be levied on the net gain (after allowing for costs associated with buying and selling the asset) at the flat rate of 15 per cent at the individual level. This rate compares favourably with individual income tax rates which range from 10.5 per cent to 33 per cent and “makes some allowance for inflation”. The policy statement comments that the tax base is not indexed for inflation due to the practical difficulties of indexation, as evidenced by the abandonment of indexing in the Australian and the United Kingdom CGT regimes. In addition, the low CGT rate will reduce the risk of taxpayers holding onto assets, ie “lock-in” effects.

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41 At 4.
42 In contrast, capital gains in Australia are subject to tax at the individuals marginal tax rate, ie potentially at 45 per cent, although there is a concession for individuals and family trusts whereby only 50 per cent of the capital gain is taxed if the asset is held for more than 12 months, thus halving the effective tax rate on the gain. In South Africa natural persons are only subject to CGT on 25 per cent of the net profit on capital assets, also referred to as the “low inclusion rate”: Huang and Elliffe, above n 19, at 280. At the current marginal tax rates the maximum effective tax rate for an individual is 10 per cent on capital gains: at 280. For corporations in South Africa the proportion of any capital gain subject to CGT is 50 per cent, which converts to a 15 per cent maximum effective tax rate: at 280.
43 The income tax rates for individuals are:

<table>
<thead>
<tr>
<th>Income bracket</th>
<th>Tax rate</th>
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<tbody>
<tr>
<td>$0 - $14,000</td>
<td>10.5%</td>
</tr>
<tr>
<td>$14,001 - $48,000</td>
<td>17.5%</td>
</tr>
<tr>
<td>$48,001 - $70,000</td>
<td>30.0%</td>
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<tr>
<td>$70,001 and over</td>
<td>33.0%</td>
</tr>
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44 Labour Party, above n 7, at 7. With respect to compensating for inflation, then Labour Finance spokesperson (and now Labour leader) David Cunliffe defended the adoption of the 15 per cent rate on the basis: “You can do that [account for inflation] in two ways. You can either say 50% of it, which is a proxy for inflation, is taxed, and it’s all taxed at the marginal tax rate as it were income. Or you can say all of the gain will be taxed at a lower rate. It’s a similar answer.”: Tarrant, above n 32, at 2.
45 Labour Party, above n 7, at 7. Evans and Sandford also argue against indexation on the basis it does not exist for capital or income and there is no need in a low inflation environment: Evans and Sandford, above n 16, at 404.
46 Labour Party, above n 7, at 7. This view is supported by Burman and White: Burman and White “Taxing Capital Gains in New Zealand: Assessment and Recommendations”, above n 14, at 20.
Cadelis criticises as strange the argument for a lower CGT rate based on inflation grounds as “the rate charged on the capital gains is unrelated to the inflation rate.” As the CGT rate bears no reference to the inflation rate, she argues short-term capital gains are over compensated for.”

Further, as Labour’s proposal taxes capital gains on realisation, taxpayers acquire a deferral advantage not available under an accruals-based CGT. “According to economic literature, this ability to defer tax compensates for the effects of inflation because over time the base cost of the asset becomes a smaller percentage of the asset’s market value.” The assets after-tax return therefore increases the longer the asset is held. In light of the benign inflation environment in NZ, she concludes the deferral advantage compensates for the effects of inflation. Finally, with respect to compensating for inflation, the tax system does not compensate taxpayers for such effects presently, whether it be adjustments to the income tax thresholds or depositors who are subject to tax on the nominal interest derived.

While there is some rationale for the 15 per cent CGT rate (albeit subject to certain criticisms), the low rate “negates many of the benefits of introducing the tax”. The reality is that as it is lower than three of the present four tax brackets for individual taxpayers it will affect the neutrality of the tax and, an arbitrage opportunity will exist between income from capital and income from labour (especially if, as Labour propose, the top marginal tax rate is increased to 39 per cent). Thus the practice that currently exists, of taxpayers restructuring their other income into capital gains to minimise their tax liability will continue under the Labour proposal. This “preferential treatment of capital gains undermines the neutrality of the tax system, promoting the diversion of resources into capital appreciating assets, rather than

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48 Cadelis, above n 47, at 4-5 provides an example based on the Canadian approach where only 50 per cent of the capital gains are taxed at the taxpayer’s marginal tax rate. In respect of an asset acquired for Can$100 which is sold one year later for Can$200, only Can$50 of the capital gain will be included in the taxpayer’s taxable income. If instead the capital gain were indexed at the relevant inflation rate (2 per cent is the figure provided), the asset’s cost base would be inflation-adjusted to Can$102; thus the taxpayer would have made a capital gain in real terms of Can$98 which would be included in their taxable income. In this example they would have been overcompensated for inflation by Can$48.
49 Neil Brooks “Taxing Capital gains is Good for the Tax System” (paper prepared for the Portfolio Committee on Finance, Parliament of the Republic of South Africa, 26 January 2001) 8; and National Treasury (South Africa), above n 15, at 21.
51 Cadelis, Labour Party, above n 7, at above n 47, at 5.
52 Cassidy and Alley, above n 15, at 120.
income producing sources."\(^5^3\) In fact, the “concessionary treatment of capital gains does not free up resources in the tax planning and administration community, … transaction costs are not adequately reduced as complex anti-avoidance measures need to be designed in order to arrest new avoidance schemes.”\(^5^4\) As Cadelis also observes\(^5^5\) “[t]he preferential treatment of capital gains is said to be ‘the single most important tax loophole that is responsible for turning a generation of dedicated law and accounting graduates into the greatest masters of needlepoint in the history of the law.”\(^5^6\) The current difficulties in “differentiating between income and capital will continue to be perpetuated despite the introduction of a CGT.”\(^5^7\)

Not only would taxation of capital gains at the individual’s marginal tax rate eliminate these arbitrage opportunities, according to Cadelis it is the simpler option compared with the Australian approach, for example, where due to the lower effective tax rate on capital gains, anti-avoidance provisions that specifically target tax planning have had to be implemented.\(^5^8\) These provisions are both complex and difficult to understand.\(^5^9\)

Cassidy and Alley make it clear that “[e]quity is also undermined by the concessional treatment of capital gains.”\(^6^0\) Cadelis passionately argues for a CGT set at the taxpayer’s marginal income tax rate on the basis of equity.\(^6^1\) She observes that horizontal equity\(^6^2\) is undermined under Labour’s proposal as taxpayers earning their income from assets that produce capital gains will face a lower tax rate than those earning the equivalent in the form of employment income for example. This discrepancy is unfair because both taxpayers have the same ability to pay. Labour’s proposal means vertical equity\(^6^3\) is also compromised:\(^6^4\)

\(^5^3\) At 99.
\(^5^4\) National Treasury (South Africa), above n 15, at 14
\(^5^5\) Cadelis, above n 47, at 4.
\(^5^6\) Cadelis attributes the quote to an American commentator in Brooks, above n 49, at 8. Similarly, the National Treasury (South Africa) commented that a CGT which treats capital gains preferentially will not eliminate the complexities of the capital-revenue distinction; rather it “will still create the same opportunities for tax arbitrage and avoidance which will be fully exploited by the well-advised and wealthy taxpayers in South Africa.”: National Treasury (South Africa), above n 15, at 14.
\(^5^7\) Cassidy and Alley, above n 47, at 120.
\(^5^8\) Cadelis above n 47, at 4.
\(^5^9\) At 4.
\(^6^0\) Cassidy and Alley, above n 15, at 99.
\(^6^1\) Cadelis, above n 47, at 3-6.
\(^6^2\) James defines horizontal equity as “[t]he idea that it is fair to treat people in similar circumstances in the similar way with respect to taxation”: Simon James A Dictionary of Taxation, Second Edition (Edward Elgar Publishing Ltd, Cheltenham, 2102) at 73. Thus “[h]orizontal equity exists when people with the same ability to pay tax are taxed equally.”: Cadelis, above n 47, at 3.
\(^6^3\) James defines vertical equity as “[t]he fairness of the tax treatment of individuals in different circumstances. For example, it might be thought fair that individuals receiving higher incomes should pay more tax than those receiving lower incomes.”: James, above n 62, at 287.
\(^6^4\) Cadelis, above n 47, at 4.
High-income earners are more likely to hold capital assets than low-income taxpayers.\textsuperscript{65} Since mainly taxpayers in the high income tax brackets hold capital assets, they would obtain the most benefit from a low CGT. In fact, the main source of income for less wealthy taxpayers is employment income, which is comprehensively taxed through pay as you earn (‘PAYE’) and fringe benefits tax (‘FBT’).

A CGT levied at the individuals marginal tax rate would see wealthier individuals taxed at a higher rate as they have the greater ability to pay based on their capital assets. Accordingly stronger vertical equity would result as this group would bear more of the tax burden. The New Zealand Treasury in July 2013 observed that a CGT could have (positive) implications for both horizontal and vertical equity; with respect to the latter probably making the tax system more progressive.\textsuperscript{66}

In “Capital Gains Tax – the Unprincipled Tax”, Evans and Sandford examine the differences that exist between the CGT regimes of six-English speaking countries\textsuperscript{67} by reference to three major structural considerations – tax base, the tax rate and the degree to which preferences have been included.\textsuperscript{68} Evans and Sandford’s first and most important principle with respect to the structure of a CGT is “that capital gains are income and need to be taxed as such. … [therefore] so far as possible, a capital gain should not be treated any differently to the treatment meted out to other forms of income.” \textsuperscript{69} (emphasis in original) As a consequence they suggest that capital gains are taxed at prevailing income tax rates.\textsuperscript{70}

3.2 Point of taxation

Somewhat predictably, based on overseas practice, the CGT will be applied on realisation (typically the point of sale) rather than as the gain accrues,\textsuperscript{71} although what constitutes realisation is not detailed. Cassidy and Alley raise issues which will require consideration by

\textsuperscript{65} Cadelis (at 4) cites in support of this observation: National Treasury (South Africa), above n 15, at 24; and Kenny, above n 14, 272. The South African National Treasury similarly note that the nature of a CGT is such that its economic and administrative burden falls most heavily on wealthy and sophisticated taxpayers and accordingly “compliance burdens therefore fall where they are most able to be borne”: Huang and Elliffe, above 19, at 284-285.

\textsuperscript{66} The Treasury, above n 30, at 27.

\textsuperscript{67} The United Kingdom, Ireland, the USA, Canada, Australia and New Zealand (which is not included in the main discussion due to its absence of a CGT).

\textsuperscript{68} Evans and Sandford, above n 16, at 387.

\textsuperscript{69} At 403.

\textsuperscript{70} At 404. The tax teachers surveyed by Cheng, Davey and Hooper held the same view: Alvin Cheng, Howard Davey and Keith Hooper “The Perceptions of Tax Teachers on Taxing Capital Gains in New Zealand” (2010) 16 New Zealand Journal of Taxation Law and Policy 217 at 236. This article contains a useful discussion of tax teachers views on taxing capital gains in New Zealand and the design of such a tax (including indexation, tax rates and capital losses).

\textsuperscript{71} Labour Party, above n 7, at 11.
the Expert Panel. For example, if the CGT is triggered on “disposal”.72 “What is a ‘disposal’? Is it confined to sales or do transactions that merely impact on an asset also attract liability?”73

The policy statement does single out two cases requiring specific rules. First, and with the exception of inheritance on death, gifting will be considered a CGT ‘event’, essentially to ensure gifting could not be used as a means of avoiding CGT.74 The donor will be subject to CGT on the market value of the asset. Following the Australian example, the policy statement provides that capital gains on inheritance will be rolled over to the heir and subject to CGT based on the gain since valuation day (see the next section of this paper) on the realisation of the asset by the heir.75

Second, capital gains on assets transferred between a couple after the breakdown of a relationship will be rolled over and only payable upon the subsequent realisation of the asset.

3.3 Valuation day

The CGT will only apply to gains accrued from a specific date, labelled “valuation day” or “v-day” by the policy statement.76 The approaches adopted in Canada, the United Kingdom and more recently, South Africa, are acknowledged as the basis for this policy.77 This approach is favoured in the policy statement for the following reasons:78

(1) it will not penalise taxpayers for investment decisions made prior to the introduction of the CGT;

(2) it does not disadvantage other taxpayers, especially young. The policy statement does not elaborate on this point but presumably has in mind that a blanket exclusion for all assets owned before the introduction of the CGT would unfairly advantage asset-rich taxpayers;

(3) it would not create ‘lock-in’ incentives or avoidance opportunities (which could occur if pre-CGT held assets were entirely exempt from future CGT).

72 Cassidy and Alley, above n 15, at 100; 111-113.
73 To avoid issues that have arisen in Australia (at 111-113), Cassidy and Alley recommend a definition limited to changes in ownership (at 113).
74 Labour Party, above n 7, at 11.
75 At 11. For a discussion of the Australian experience of rollover relief on death see Cassidy and Alley, above n 15, at 122-123.
76 Labour Party, above n 7, at 10.
77 At 10.
78 At 10.
The policy statement is critical of the grand-parenting approach adopted in Australia, where CGT only applies to assets acquired after the implementation of the regime, on the basis that it “increases ‘lock - in’ and complexity by creating avoidance opportunities through shifting value from post-CGT to pre-CGT assets. This has in turn increased the complexity of the Australian scheme.” Thompson similarly observes that the exclusion of pre-CGT regime assets (along with certain rollover relief) could “distort the normal impacts of the market. A large group of assets become locked up as people hold on to their assets with protected status.” KPMG observe: “While well intentioned, this policy may trigger unintended economic consequences, if landlords are incentivised to sell to avoid any tax impost.” While acknowledging the issues with grandparenting, Deloitte counter such criticism by noting that it “has the benefit of taking the political heat off a CGT because it doesn’t adversely impact historic investment decisions.”

Another reason for adopting the “valuation day” approach is that it will generate revenue earlier than a grand-parenting approach, which would be crucial if the GST exemption and tax-free threshold included in Labour’s policy were also implemented (with their consequential negative impact on tax revenue).

An issue that will require consideration by the Expert Panel and which is flagged by the policy statement is how to treat assets whose v-day value is below their present value. While offering no solutions, the policy statement observes that taxpayers in Canada are permitted to use “the median rule” whereby they can:

- take the middle value out of the purchase price, the v-day value and the sale price as the base cost from which capital gains are calculated. This means that if the purchase price is in the middle, i.e. the asset is sold for more than its purchase price but less than its v-day value then no capital gain (or loss) is assessed.

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79 At 10. Cassidy and Alley, discuss examples of how a post-CGT asset can be disguised as a pre-CGT asset: Cassidy and Alley, above n 15, at 105.
81 KPMG, above n 30, at 4.
82 Patrick McCalman A 10-step guide to a potential capital gains tax Deloitte (online ed, New Zealand, undated) at 1.
83 Labour’s tax policy would only become revenue positive from 2018/2019 when the forecast CGT revenue starts to significantly increase: at 1.
84 Labour Party, above n 7, at 13.
85 At 13.
Other operational issues, such as the valuation methods for assets which are not easily valued, will be included within the Expert Panels purview.\(^{86}\) In these cases the policy statement favours following the South African approach of providing taxpayers with a choice of valuation methods, some of which are relatively simple proxies of a full market valuation.\(^{87}\) No further detail on this issue is provided. Labour’s policy statement is also silent on options for determining the base cost of assets before ‘v-day’.\(^{88}\) In addition, Cassidy and Alley observe that in the South African context, where the CGT applies to gains on assets from 1 October 2001, “there is really no definition or guidance about how to determine if an asset is a pre-valuation asset beyond the obvious; that is, whether it was acquired before 1 October 2001.”\(^{89}\)

### 3.4 Exemptions

#### 3.4.1 The main residence

In line with other CGT regimes, the main residence will be exempt. While not specifically defined in the policy statement, it refers to the main residence as “the residence where you live most of the time.”\(^{90}\) Baches will be included as part of the CGT regime as to exempt would lead to loopholes, as well as definitional and administrative issues.\(^{91}\) However, CGT will not apply while the family bach is passed down through the generations.\(^{92}\)

Where the primary residence is also used for business purposes, there will be a partial exemption from the CGT for that portion of the property used as the family home.\(^{93}\) Similarly, in respect of farms, the primary farm residence and surrounding land used for domestic purposes (the curtilage) will be exempt from CGT.\(^{94}\) The wider land used in the farming business will be subject to the CGT and will be determined using the same basis used for GST purposes.\(^{95}\)

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86 At 13.
87 At 10.
88 Huang and Elliffe briefly outlines the three valuation methods adopted in South Africa for establishing the base cost of assets acquired before the implementation date of the CGT: Huang and Elliffe, above n 19, at 286 (fn 121). See also Cassidy and Alley, above n 15, at 106.
89 Cassidy and Alley, above n 15, at 106.
90 Labour Party, above n 7, at 7. The Australia regime provides that where the property upon which main residence is located is larger than two hectares, the gain on the area that exceeds two hectares is subject to the CGT: Cassidy and Alley, above n 15, at 121. A similar rule is found in South Africa: Huang and Elliffe, above n 19, at 285.
91 Labour Party, above n 7, at 9.
92 At 16.
93 At 10.
94 At 9.
95 At 21.
In recommending a realisation-based CGT regime for NZ, the OECD commented: 96 “Excluding primary residences from taxation would diminish the effectiveness of such a tax, but partial exemption or rollover relief could act as a ‘second best’ solution so as to facilitate public acceptance.” 97 Neither of these OECD options is itself without its own issues. Rollover relief will still lead to potential “lock in” behaviours while partial exemption may favour residential investment over other forms of investment (and be contrary to the CGT’s purpose).

While exempting the primary residence is a political necessity, it reduces the revenue to be raised from the tax and creates complexity. 98 With respect to the first issue, Huang and Elliffe note that the unlimited (in terms of dollar amount) exemption from the CGT for capital gains from the sale of the primary residence in Australia “has caused significant loss to the CGT base 99 and tax-induced investment in housing.” 100 While seeing no principled reason for exempting the primary residence, Evans and Sandford also acknowledge the political necessity of doing so. 101 However, they recommend the impact of the exemption be minimised by capping the exemption (as utilised in the US, at least at the time of their article), 102 or permitting deferral through rollover, potentially with built-in age based concessions (as was the US practice prior to 1997). 103 They note while the first recommendation has the advantage of simplicity, it would not cope with greatly differing house prices across a country. The second option introduces greater equity but at the cost of simplicity. 104

97 Cunliffe acknowledged criticism of the family home exemption: “All of the economic purists say that the family home ought to be included in a capital gains tax. But virtually no country does it, because its politically untenable, and we’re of the same view”: Tarrant, above n 32, at 2.
98 Estimates are that owner occupied housing accounts for two-thirds of the property market: Rob Hosking “Officials raise land tax idea again” The National Business Review (online ed, New Zealand, 10 December 2012).
99 See Peter Abelson and Roselyne Joyeux “Price and Efficiency Effects of Taxes and Subsidies for Australian Housing”, (2007) 26 Economic Papers: A Journal of Applied Economics and Policy 147 at 150, as cited in Huang and Elliffe, above n 19, at 296. Abelson and Joyeux are reported as “estimating the static loss to the tax base to be between A$7.2 and A$10 billion per year, depending on assumptions about gains growth.”: Huang and Elliffe, above n 19, at 296.
100 Huang and Elliffe, above n 19, at 296.
101 Evans and Sandford, above n 16, at 404.
102 South Africa’s regime exempts gains of primary residences up to ZAR1.5 million: Huang and Elliffe, above n 19, at 296. At the time of writing, ZAR1.5 million is equivalent to NZ$178,680.62 (20 November 2013).
103 Evans and Sandford, above n 16, at 404.
104 Evans and Sandford, above n 16, at 404.
The exemption also opens the door to manipulation and the definition of primary residence will therefore need to be precise.\(^{105}\) The concession may lead to wealthier taxpayers investing in bigger and grander family homes (the “mansion effect”)\(^ {106}\) and thus undermine vertical equity. The exemption will also need to accommodate a variety of situations including, for example, a taxpayer who is changing residence and for a period owns two residences.

An exemption for the primary residence can be abused in at least two ways. First, a family which owns more than one property could list the properties under different names and thereby each property could qualify for the exemption, e.g., the husband and wife separately, or alternatively including a family trust. With respect to properties owned by different individuals, Cadelis comments that Canada have resolved this issue by providing that a family can only assign one property as its principal residence in a tax year.\(^ {107}\) This approach is reliant on a very robust definition of “family”.\(^ {108}\) Where another entity such as a trust or company is used to purchase a second property and thereby circumvent the primary residence rules, Cadelis notes that to prevent such manipulation South Africa provides that only natural persons and one special trust (set up for those suffering from a mental illness or physical disability) qualify for the primary residence exemption. Companies and trusts are unable to claim the exemption even if the subject property is genuinely the primary residence of the shareholders or beneficiaries.\(^ {109}\)

If Labour ultimately decided to adopt this approach, due to the large number of family trusts in New Zealand,\(^ {110}\) many of which will own the primary residence, not to mention residences owned by companies, a period would be required in order for primary residences to be transferred back into individual’s names to qualify for the exemption. This approach, which was adopted in South Africa,\(^ {111}\) would be controversial as it would impose significant, albeit one-off, compliance costs on trusts and companies. It would also strike at the heart of one of the very legitimate reasons for the establishment of a trust. Depending on how the residence

\(^{105}\) Cassidy and Alley outline issues faced by Australia with respect to exempting the main residence: Cassidy and Alley, above n 15, at 121-122.


\(^{107}\) Cadellis, above n 47, at 5 referring to Income Tax Act RSC 1985 c 1 (5th Supp.), s 54.

\(^{108}\) Cadellis briefly outlines the Canadian definition: at 5.

\(^{109}\) At 6.

\(^{110}\) The Law Commission estimates that NZ has 300,000 to 500,000 trusts used for a variety of purposes ranging from owning the family home, through to use in business, by charities, and by many, including Māori, to collectively hold land and other assets: Law Commission Review of the Law of Trusts – A Trusts Act for New Zealand (Wellington, 2013) at 6.

\(^{111}\) Cadellis, above n 47, at 6. Individuals who owned their primary residence in a trust or company were given a until 31 December 2012 to undertake the transfer (ie a little over 11 years)
has been treated for tax purposes by the trust or company, there could also be tax consequences on the transfer into an individual’s name, for example the crystallisation of depreciation recovery on chattels and the house (see also the discussion in section 3.9(iii) of this paper).\textsuperscript{112} As an alternative, through the use of broad associated persons provisions, the CGT regime houses owned by other entities could be encompassed within the definition of primary residence.

3.4.2 Personal property

In addition, in an endeavour to reduce unnecessary compliance costs personal property including boats, furniture, electrical goods and household items will be exempt from the CGT.\textsuperscript{113} For these purposes personal property is defined as “used or kept mainly for the personal use or enjoyment of yourself or your associates”.\textsuperscript{114} It is clear from the “Questions and Answers” section of the policy statement that the exemption will apply to “luxury” items such as “the millionaire’s super yacht”, on the basis such assets depreciate over time and to levy the CGT on such items would provide a tax incentive due to the ability to write off capital losses (against capital gains).\textsuperscript{115}

3.4.3 Collectables

The policy statement also exempts “collectables” such as jewellery, antiques, artwork, rare folios or stamp collections.\textsuperscript{116} The stated rationale for exempting this category is threefold – first, a CGT on these items would be intrusive, second it would result in high compliance costs and, finally it would not raise significant revenue.\textsuperscript{117} However, the policy statement makes it clear that the current tax position for taxpayers who regularly trade in these items (and personal property)\textsuperscript{118} will continue, ie they will be subject to income tax at their marginal tax rate.\textsuperscript{119}

Cognisant of potential avoidance concerns, the policy statement notes that the Expert Panel will be asked to consider how to control any such issues.

\textsuperscript{112} Buildings were able to be depreciated up until (and including) the 2010/2011 income year.
\textsuperscript{113} Labour Party, above n 7, at 8.
\textsuperscript{114} At 8.
\textsuperscript{115} At 17 (Question 18).
\textsuperscript{116} At 8. South Africa excludes most personal use assets such as motor vehicles, certain types of boats, caravans, artwork, postage stamp collections, furniture and household appliances: Huang and Elliffe, above n 19, at 285.
\textsuperscript{117} Labour Party, above n 7, at 8.
\textsuperscript{118} See “Questions and Answers” (Question 17): at 17.
\textsuperscript{119} Section CB 5 of the Income Tax Act 2007 (ITA 2007) provides that amounts derived from the disposal of personal property is income if the person ‘s business is to deal in that kind of property.
This category of exemption may influence behaviour in favour of these forms of investment compared with others, such as shares, which will be subject to the CGT. For this reason the definition of collectables will need to be clear and robust.

3.4.4 Other exemptions

The CGT will also not apply to withdrawals from retirement savings schemes, such as KiwiSaver; lump sum compensation such as for redundancy, ACC or court costs, a life insurance policy which is surrendered or sold, winnings or losses from gambling and medals.120

At present, KiwiSaver funds that are constituted as Portfolio Investment Entities or PIEs are exempted from tax on the sale of certain NZ and Australian equities. If the CGT were implemented and this benefit removed it could impact on incentives to save for retirement using KiwiSaver and other equivalent superannuation funds. KPMG121 observe that in Australia there is a CGT discount for superannuation funds. Further, “[a]t a practical level, a CGT regime for managed funds will require further consideration, as the CGT will apply on realisation but PIEs generally allocate income/losses each year or even daily to their investors.”122

Labour’s policy is also silent on the tax treatment of PIEs generally. “Any differential treatment in this area needs to be considered carefully, weighing up the cohesiveness of the application of the CGT versus the impact on savings. On the face of it, however, CGT would seemingly apply to such investments.”123

KPMG describe the four categories of concessions outlined in Section 3.4 as “reasonably broad based”,124 noting they are “consistent with similar exemptions from CGTs around the world”125 but the home-office carve-out will create complexity. The apportionment rules for farms may also create some complexity; although for those GST-registered farms (which presumably is most farms except non GST-registered ‘hobby farms’) the curtilage calculation will already have been made.

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120 At 9.
121 KPMG, above n 30, at 4.
122 At 4.
123 McCalmann, above n 82, at 1.
124 KPMG above n 30, at 3.
125 At 3.
3.5 Small Businesses

The policy statement proposes the exemption of “[s]mall business assets, up to a maximum of $250,000, sold for retirement, where the owner is above a certain age (e.g. 55) has held the business for 15 years and has been working in the business”. The term “small business” is not defined – this and other details will be considered by the Expert Panel in consultation with the small business community. The exemption is to ensure that those who have saved through investing in a small business are not disadvantaged on their return. The concession will also apply to the sale of farming businesses.

The exemption is laudable and recognises the reality that NZ is a nation of small businesses and the CGT should not penalise investment and those making provision for their retirement. However, it will create additional complexity, irrespective of how the term “small business” is concerned and will lead to taxpayers attempting to structure into the provision. A specific anti-avoidance provision will be required to prevent this. It is also questionable whether the threshold is too low (or even if there should be a threshold at all) – a point that no doubt would be reflected in consultation with the sector. In addition, any threshold will require monitoring by future governments to ensure it retains its currency and the policy goals of the concession continue to be met.

3.6 Capital losses

As is the practice under most CGT regimes, capital losses will be ‘ring fenced’ and therefore will only be able to be offset against an existing or future CGT liability. The Expert Panel will be tasked with deciding whether there should be an upper limit against which capital losses can be offset against capital gains. The tax teachers surveyed by Cheng, Davey and Hooper believed that in line with taxing capital gains at the same level of income tax rates, capital losses should in fact be deductible against gross income. Similarly, one consequence of Evans and Sandford’s view that capital gains are charged to tax at prevailing
income tax rates is that, subject to certain anti-avoidance provisions to prevent taxpayers taking advantage of timing differences, capital losses should be available to set off against all income.\textsuperscript{133}

Issues that will require the Expert Panels consideration include whether business trading losses will be able to be offset against capital gains. In addition, will the current continuity of shareholding requirements for carry forward of company trading losses apply with respect to a capital loss? KPMG observe that a combination of shareholding continuity and a same business test are utilised in Australia in this respect.\textsuperscript{134}

3.7 Treatment of traders

As indicated, s CB 5 ITA 2007 provides that amounts derived by a person who is in the business of dealing in personal property are subject to income tax at the individual’s marginal tax rate (or entity rate if undertaken through an alternative structure). Taxpayers who occasionally buy and sell personal property, i.e. the level of their activity means that they do not constitute dealers, are therefore not subject to tax under this provision.\textsuperscript{135} The policy statement proposes to retain this distinction, with amounts derived by dealers continuing to be treated as income and subject to the relevant income tax rate(s): “[t]here is no intention for traders in capital assets to be taxed less than at present once a CGT is in force.”\textsuperscript{136} The Expert Panel will be tasked with ensuring this does not occur.

The proposed retention of s CB 5 ITA 2007 will create a tension with the CGT regime, especially if, as Labour proposes, the top marginal tax rate for individuals is increased from 33 per cent to 39 per cent; creating a 24 per cent differential between the CGT rate and top marginal tax rate for income. This differential will “create strong incentives to characterise amounts as a capital gain to pay less tax. Conversely, the incentive will be to characterise losses as being on revenue account.”\textsuperscript{137}

\begin{itemize}
\item \textsuperscript{133} Evans and Sandford, above n 16, at 404. The tax teachers surveyed by Cheng, Davey and Hooper held the same view: Cheng, Davey and Hooper, above n 70, at 236.
\item \textsuperscript{134} KPMG, above n 30, at 4.
\item \textsuperscript{135} However, depending on their purpose at the time of acquiring personal property, the taxpayers may be subject to tax on amounts derived under s CB 4 ITA 2007, even in respect of a one-off transaction. While the policy statement is silent with respect to the future status of s CB ITA 2007, presumably under Labour’s proposal they would be subject to CGT on any capital gains.
\item \textsuperscript{136} Labour Party, above n 7, at 12.
\item \textsuperscript{137} KPMG, above n 30, at 3.
\end{itemize}
3.8 Treatment of Property in Canterbury

Due to the fact that the 2010 and 2011 Christchurch earthquakes destroyed a great deal of wealth in the region and led to the decline in underlying land values, a different v-day is proposed for real estate in Canterbury to avoid additional hardship for those in the region. Recognising a property’s value at the original v-day used for the CGT could be lower than its pre-quake levels and establishing a reliable valuation in affected parts of Canterbury could be problematic, real estate (both residential and commercial) in greater Christchurch (as defined by the Canterbury Earthquake Recovery Act 2011) will not be liable for CGT for an initial 5 year period from the commencement of the CGT, ie at the earliest 2018. At that point this would be reviewed and ultimately a separate Canterbury v-day for this real estate will be set.

At the time of writing (December 2013) the question arises whether such an exemption would still be required. While real estate prices have increased in the region significantly, due in part to a supply shortage following the destruction of in excess of 12,200 houses, there are still areas Christchurch, in particular in the eastern suburbs where the state of the land is underdetermined with potentially significant loss of value depending on the ultimate classification of such land, especially if it cannot be built on. Further, anecdotally the price of land classified under The Canterbury Earthquake Recovery Authority (CERA) Residential green zone technical category TC3, whereby potentially significant and expensive foundations will be required for new houses, has also fallen.

3.9 Alternative entities

As indicated NZ has a large number of family trusts. To ensure trusts cannot be used to avoid CGT the policy statement provides that the CGT will apply to capital gains derived from assets held in a trust. In addition, transfers of assets into a trust will generally be regarded as a CGT ‘event’.

The policy statement highlights issues that will require consideration by the Expert Panel, in conjunction with the Law Commission as appropriate, including:

1. Whether CGT applies “to distributions to a beneficiary or unit holder or upon realisation even if that occurs within a trust structure”;

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138 Lois Cairns “Council, Cera pledge joint housing action” The Press (Christchurch, 27 November 2013) at A5.  
139 <cera.govt.nz/residential-green-zone-technical-categories>.  
141 Labour Party, above n 7, at 11.  
142 At 12.
whether technical issues relating to the Trans-Tasman treatment of assets exist;
(3) ensuring a family home can be protected from CGT liability without giving up the main residence exemption (however, also see the comments in Section 3.4.1).

On this issue the policy statement observes that there are reasons taxpayers have their main residence in a trust which are unrelated to minimising their tax liability including protecting assets from business or creditor. Labour’s view in these cases “is that people who wish to protect their main residence from legal liability (and have no other tax implications) should be able to benefit from the family home exemption.” (emphasis added)

The emphasised phrase indicates a narrow exemption is envisaged. With respect to other entities, the Expert Panel will be directed to consider the Australian approach. For example, the policy statement observes that each individual within a partnership calculates their capital gain or loss according to the portion of their legal interest in the asset.

3.10 Other matters

The policy statement briefly identifies additional issues consequent upon the possible adoption of a CGT; some of which will require consideration by the Expert Panel:

3.10.1 Treatment on Non-residents

In principle, non-residents will subject to CGT in the same way as NZ resident taxpayers. The Expert Panel will be tasked with considering complexities and technical issues that may arise as a consequence – the impact on double tax agreements is specifically mentioned.

3.10.2 Emigrating from New Zealand

In line with the approach adopted in Australia emigrating from NZ will constitute a CGT event in respect of assets except land, buildings and business assets. The Expert Panel’s advice on the above three listed asset classes will be sought.

143 At 12.
144 At 12.
145 At 14.
146 This recognises that from a tax perspective general partnerships are transparent: s HG 2(1) ITA 2007.
147 At 14. McCalman notes that in Australia non-resident investors generally are only subject to CGT when they have invested into a ‘land rich’ asset: McCalman, above n 82, at 1.
149 Evans and Sandford similarly recommend that CGT apply where the taxpayer is leaving the revenue authorities “fiscal net”: Evans and Sandford, above n 16, at 403.
3.10.3 Treatment of Insolvent Companies and Companies in Liquidation

Upon the declaration by a liquidator that they expect no distribution, shareholders may claim a loss on the shares if they were disposed of for nil consideration. Any subsequent liquidation distribution will be treated as a capital gain.

3.10.4 Treatment of foreign currency gains and losses

The policy statement makes a distinction between currency gains and losses made in connection with a trade or business or with the management or administration of investment assets and those currency gains or losses incurred in connection with the purchase of an investment. In the former case, the current treatment remains, i.e. the gain is treated as income and the losses a deductible expense. The currency movement in respect of the realisation in the latter case will be a capital gain or loss and included as part of the overall gain or loss on the investment.

3.11 Issues for the Expert Panel

In addition to the matters highlighted in the above discussion as requiring specific input from the Expert Panel, the policy statement adds the following matters:

3.11.1 Māori Land

As Māori customary land passes upon death to the next generation, rather than being sold, the rollover on death provisions mean that no CGT will be payable. By contrast, ordinary assets owned by Māori business entities will be subject to the same CGT treatment as for other taxpayers. Any complexities arising from Māori land or assets will be referred to the expert panel.

3.11.2 Rollover provisions

The Expert Panel will be tasked with considering whether there should be any other rollover provisions in addition to those already referred to above, i.e. inheritance on death and relationship breakups. The policy statement suggests rollover provisions could potentially be relevant where an asset class is transferred between taxpayer entities, for example “from one arm of a business to another”. While not entirely clear presumably this is referring only to

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150 Labour Party, above n 7, at 14.
151 At 14.
152 At 13.
153 At 13.
related party transfers. Rollover relief could potentially also apply when a taxpayer disposes of one asset and replaces it with a similar asset.\textsuperscript{154}

Evans and Sandford argue on equitable grounds that rollover “provisions need to exist where involuntary disposals occur (compulsory acquisitions, corporate takeovers and mergers, destruction of assets through natural disasters, etc).”\textsuperscript{155} Similarly, on efficiency grounds they argue “for deferral of the capital gain where taxpayers are rolling the proceeds of the disposal of one asset into a bigger asset, in order to grow a business.”\textsuperscript{156}

KPMG also list as other potential areas for rollover relief\textsuperscript{157} the transfer of business assets on consolidation; and involuntary disposal of assets (such as following a natural disaster similar to the Christchurch earthquakes).

Cassidy and Alley sound a cautionary note with respect to rollovers and exemptions generally:\textsuperscript{158}

\begin{quote}
Political pressures often see such CGT carve-outs and preferences increase over time; sometimes to the extent that the tax effectively implodes.\textsuperscript{159} Thus care must be taken when introducing concessions lest they erode the benefits of a CGT. These carve-outs and preferences undermine the neutrality of the taxation regime\textsuperscript{160} and necessitate the introduction of anti-avoidance measures which add to complexity of the provisions. Again equity is undermined as it is wealthier New Zealanders who have the ability to restructure their affairs and invest in tax-free capital assets.
\end{quote}

3.11.3 Venture capital

Venture capital investment is exempt from CGT in Australia.\textsuperscript{161} Accordingly, the Expert Panel will be required to consider whether a similar exemption apply in NZ to avoid a Trans-Tasman tax differential, or to ensure simplicity, asset neutrality and anti-avoidance venture capital should be treated no differently to other investments.\textsuperscript{162}

\begin{flushright}
\textsuperscript{154} At 13. \\
\textsuperscript{155} Evans and Sandford, above n 16, at 404. \\
\textsuperscript{156} At 404. \\
\textsuperscript{157} KPMG, above n 30, at 4. \\
\textsuperscript{158} Cassidy and Alley, above n 15, at 99. \\
\textsuperscript{159} Tax Review 2001 Final Report (Wellington, 12 October 2001) at 34. \\
\textsuperscript{160} New Zealand Planning Council For Richer or Poorer: Income and Wealth in New Zealand – The First Report of the Income Distribution Group (Wellington, June 1988) at 80. \\
\textsuperscript{161} Labour Party, above n 7, at 13. \\
\textsuperscript{162} At 13.
\end{flushright}
4.0 ISSUES FOR LABOUR TO PONDER

There are a number of issues that are not addressed in Labour’s policy statement and which will need to be considered if it, or a variation, is implemented. These include:

1. A number of terms and concepts will need to be defined. For example, “What is an ‘asset’? Must it be proprietary in nature?”

2. How would the CGT regime apply to the financial arrangements regime and offshore foreign investment fund (FIF) investments subject to the Fair Dividend Rate (FDR) tax regime, both of which tax gains on an accrued basis. It is not stated whether these regimes would be replaced by the realisations-based CGT, or as is the view of KPMG based on overseas experience, they would remain separate from the CGT which would lead to additional complexity.

3. Related to (2), and as previously noted, while New Zealand does not have a comprehensive CGT regime, it does have “a multitude of different CGTs embedded in the tax rules” including sections CB 3 and 4 ITA 2007 which bring to tax certain gains from the sale of personal property as well as the financial arrangements rules and FDR tax regime. “One positive of bringing in a comprehensive CGT regime is that the need for the retention of ‘micro regimes’ such as the FDR is brought starkly into focus, with the potential for such to be eventually removed from the Tax Act.” It remains to be seen to what extent the current the present ‘micro’ CGT regimes are removed. Labour’s policy does not refer to the operation of s CB 4 but presumably this section would be repealed with effect from “v-day” and such gains subject to CGT. Unfortunately, at least with respect to section CB 5, which taxes the income of dealers, it appears that provision will run in tandem with the CGT meaning the current boundary issue of what is dealing remains.

163 Cassidy and Alley, above n 15, at 100; 107-110.
164 At 114-117. The authors comment that the definition of “cost” in the depreciation provisions (ss EE 57 ITA 2007) is an example where the term has been effectively defined: at 117.
165 KPMG, above n 30, at 4.
166 McCalman, above n 82, at 1.
167 At 1.
(4) Should the CGT regime include an annual exemption for individuals? Evans and Sandford recommend a tax-free threshold for individuals on the basis that it “has the advantage of significantly reducing the operating (administration and compliance) costs related to the CGT, by eliminating the ‘minnows and tiddlers’ from the CGT net, without impugning the overall integrity of the regime.”\textsuperscript{168} They also recommend any such threshold be indexed for inflation.\textsuperscript{169}

(5) Labour’s policy does not indicate whether a distinction will be made between short term and long term gains, for example by tapering relief.\textsuperscript{170} To maintain equity and efficiency considerations, Evans and Sandford strongly argue for minimising all preferences and concessional treatments.\textsuperscript{171} Accordingly,\textsuperscript{172}

\begin{quote}
[t]here should not be any distinction between short term and long term capital gains as different treatment of such gains causes difficulties at the margin, encourages the ‘lock-in’ effect, significantly adds to the complexity of the regime and undermines the fundamental principle that all gains are income and should be treated as such.
\end{quote}

(6) Is the CGT a separate tax or part of the income tax code? Cassidy and Alley suggest it is likely that Labour’s CGT would be integrated into the existing income tax legislation, the ITA 2007 – the approach adopted in Australia and South Africa.\textsuperscript{173} This approach has considerable tax benefits for the revenue authority and taxpayers as the CGT forms part of the existing tax administration system.\textsuperscript{174}

5.0 CONCLUSION AND A PLEA FROM THE AUTHOR

In the context of being an election document, Labour are to be congratulated on producing what appears to be a well-researched policy statement which is informative and illustrates the\textsuperscript{168} Evans and Sandford, above n 16, at 404.
\textsuperscript{169} At 404. The (indexed) tax-free threshold in the United Kingdom for individuals, personal representatives and trustees for disabled people is £10,600 (2012-13) rising to £10,900 for 2013-14. For other trustees the tax-free threshold is £5,300 and £5,450 for 2012-2013 and 2013-2014, respectively: HMRC Capital Gains Tax rates and annual tax-free allowances <www.hmrc.gov.uk/rates/cgt.htm>.
\textsuperscript{170} Tapering relief reduces the percentage of the capital gain that is chargeable with CGT for assets held for a longer period. In Australia, for example, a 50 per cent discount on capital gains is available in some cases to individuals and certain trusts for assets held for more than 12 months: Evans, above n 15, at 124, 127; Cassidy and Alley, above n 15, at 119. Evans is highly critical of the 50 per cent discount arguing it: “savagely offends both the horizontal and vertical aspects of equity.”: Evans, above n 15, at 127.
\textsuperscript{171} Evans and Sandford, above n 16, at 404.
\textsuperscript{172} At 404.
\textsuperscript{173} Cassidy and Alley, above n 15, at 99.
\textsuperscript{174} At 99.
application of the CGT. However, as a statement prepared for the 2011 General Election it obviously lacks some detail which limits a comprehensive analysis.

Overall Labour appears to be proposing a fairly ‘standard’ CGT – it is a realisation-based CGT which exempts the family home and quarantines capital losses. As a consequence certain outcomes are likely; including the mansion effect, ‘lock-in’ of assets and the discouragement of risk taking as capital losses cannot be offset against gross income. In recent times NZ has adopted a broad-based low rate tax structure. Ideally a CGT should complement this approach. This will be a challenge and there will necessarily also be a trade-off between principles of equity and neutrality with complexity. On this point, Deloitte sound a note of warning:

while a capital gains tax can be made to work, there is no denying that it would introduce significant additional complexity into the tax system. Complexity will arise from the rule design and the various exemptions being mooted as well as the fact that at this stage it appears that any CGT will simply add to the existing plethora of quasi CGTs that exist within the Income Tax Act.

A capital gains tax that contains minimal exemptions and a tax-free threshold for capital gains (which is indexed) for example, could reduce the complexity of the CGT.

When debating and evaluating the introduction of a CGT, it is important that politicians, policymakers and taxpayers are clear as to its purpose. For example, a CGT should not be seen as a panacea for the housing crisis and related house-inflation (especially in Auckland and Christchurch) – a crisis which is largely due to a shortage of supply caused by a confluence of factors including population growth, migration, restrictive planning rules and scarcity of (appropriately-zoned) land. Some have questioned Labour’s motivation for

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175 Inland Revenue Department Briefing for the Incoming Minister of Revenue - 2013 (Inland Revenue Department, Wellington, June 2013).

176 McCalman, above n 82, at 1.

177 The Prime Minister John Key, who opposes a CGT, is quick to point out that countries with a CGT have still suffered from house price inflation: Fox, above n 6, at A5. The Treasury in fact suggest a CGT could cause real property process to be lower: The Treasury, above n 30, at 48. Interestingly, UK finance minister George Osborne has announced that from 2015 Britain will impose CGT on foreign investors selling homes that are not their primary residence to curb soaring house prices: “Britain to tax foreign property investors from 2015 – Osborne” Reuters.com (online ed, 5 December 2013).

178 Jason Krupp “Housing promises risk an Irish solution”, (New Zealand, 11 November 2013) <nzinitiative.org.nz/Media/Opinion+and+commentary/Housing+promises+risk+an+Irish+solution.html>. Hosking also comments that “There is no reason to think a capital gains tax would stop any future property bubble: it certainly didn’t in Australia or the United States: Hosking, above n 34, at 2.
proposing the tax. For example, Hosking cautions against the reasons put forward by Labour.\(^{179}\)

In fact, they plan to increase, rather than decrease, income taxes, with the return of a 39% top tax rate imposed by the last Labour government. In short, the policy is a tax grab under the guise of a concern about the current property bubble in Auckland.\(^{180}\) (paragraph break removed)

The success of a CGT, or any tax, will depend on a clear policy rationale which informs the design, consultation and implementation phases. A failure to clearly articulate its purpose and adhere to it will potentially lead to a poorly designed and functioning CGT. Further, policymakers can expect to face heavy lobbying with any such future tax. Keeping a clear focus of the object(s) of the tax will ensure that pressure from lobby groups do not derail the tax. Assuming that a CGT is an issue in the 2014 General Election it would be a shame if the debate for a CGT was overtaken by election rhetoric and hype and for the issues such as equity, neutrality and complexity to be lost under a sea of compromise. The final word is best left to Gammie who sounds a warning shot to any future government looking to introduce a CGT, “[a CGT] is a compromise, and, as is so often the case with a compromise, it functions badly and pleases no one.”\(^{181}\)

\(^{179}\) At 2.

\(^{180}\) This view is reinforced by Labour’s web page headed “Affordable and healthy homes” which states the party will “[i]ntroduce a capital gains tax to take pressure off house prices”: Labour Party, above n 12.