STRIVING FOR INTERGENERATIONAL WELLBEING

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ABSTRACT

New Zealand's most recent Tax Working Group ('the TWG') differs from previous tax review groups due to the unique frameworks upon which they based their assessments. The final report of the TWG used Treasury's Living Standards Framework ('LSF'), with its goal of 'intergenerational wellbeing', alongside both a traditional tax assessment framework and *Te Ao Māori* principles.

This article seeks to explore whether and how the frameworks used by tax review groups in New Zealand have influenced the conclusions they have reached and the recommendations they have made. In particular, this article considers how the LSF influenced the TWG to reach conclusions that previous groups considered but did not get 'over the line'. The conclusion is that the LSF was highly influential upon the outcomes of the TWG. The TWG placed greater weight upon equity, the environment and distributional outcomes. The result of this change in emphasis was recommendations that are weighted in favour of social and environmental issues over economic growth.

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I INTRODUCTION

Tax working groups have increased in their frequency in New Zealand, with each new government wanting a fresh approach to tax, seeking new ideas outside the confines of existing policymakers.[1] The 2019 Tax Working Group ('the TWG') are the latest to issue their recommendations on how New Zealand's tax system can be improved to meet the objectives given in their Terms of Reference.

Over the past (almost) 100 years, each tax review group has used a framework to assist them with assessing the current mix of taxes and recommending ideas for improvement. Most groups have employed relatively traditional criteria in their frameworks, based upon the four canons published in Adam Smith's 1776 treatise (equity, efficiency, certainty and convenience).[2] However, early in the TWG's formation, Treasury introduced them to the Living Standards Framework ('LSF').[3] Developed within Treasury, this framework is intended to provide a comprehensive and broad guide for government policy.

This article seeks to explore whether the frameworks used by tax working groups in New Zealand influenced the recommendations made by the groups. In particular, this article compares the frameworks used by the TWG with the frameworks adopted by previous tax reviews, and considers how these differences influenced the TWG's final recommendations.

After this introduction, the final recommendations of the TWG are outlined, followed by a discussion on the recommendations of previous tax review groups in New Zealand. The influence and impact of the use of the LSF and other frameworks by the TWG is analysed. The conclusion reached in this article is that the LSF has necessarily shifted the recommendations reached by the TWG away from a focus on economic growth policy objectives and toward more socially oriented goals. Because of this shift, the recommendations to introduce a capital gains tax ('CGT') and environmental taxes were inevitable outcomes.

This article undertakes exploratory research, using inductive techniques to reach conclusions. The author undertook a literature review of the tax review group reports identified in the article and the literature associated with the frameworks. The author has used observation techniques to see how the groups have linked the use of the frameworks with their recommendations made to the government. While the study is largely positivist in its approach, the conclusions reached are made from an interpretivist perspective. Interpretivism is a limitation of this research, as the research findings are necessarily viewed from the perspective of the author.

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[1] For a more generic study of New Zealand's tax reviews, see Adrian Sawyer, 'The Contributions of Tax Committees: A New Zealand Perspective' (Conference Paper, Tax Administration Research Centre Annual Conference, April 2018).

[2] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Strahan and Cadell, 1776).

[3] Treasury, *The Treasury Approach to the Living Standards Framework* (February 2018) <https://treasury.govt.nz/sites/default/files/2018-02/tp-approach-to-lsf.pdf> ('LSF').

II The 2019 TWG

The TWG, chaired by Sir Michael Cullen,[4] was formed by the incoming Labour-led government in 2017.

Both Labour's and the Green Party's 2017 election campaigns showed an openness to the introduction of a comprehensive CGT.[5] Therefore, after the successful formation of a coalition government between the Labour Party and New Zealand First, with the Greens offering 'confidence and supply', the political will for the introduction of a CGT appeared to be there. New Zealand First, while vague on its tax policy prior to the 2017 election, did not appear to support the introduction of a CGT.[6]

Under its Terms of Reference set out by the new government, the TWG was required to consider the 'structure, fairness and balance' of the current tax system.[7] Similar to previous tax reviews, economic sustainability and productivity, housing affordability, and efficiency and simplicity of the tax system were also included in the TWG's objectives.[8] Outside the scope of the review was any increase in income tax or GST rates, the introduction of an inheritance tax, any tax on gains from disposal of the family home, and recommendations surrounding the interface between the tax and transfer system.[9] The number of restrictions appeared to hamper efforts to recommend policy change in some areas. In particular, the carve out of the 'family home' in relation to tax on capital is widely regarded as an impediment to a sound CGT system.[10] Equally, the inability to consider inheritance tax or the interface with the transfer system restricted the TWG's ability to operate freely.

The TWG made two key recommendations: first, the introduction of a comprehensive CGT; and second, that environmental taxes should play a greater role in pricing negative externalities.[11] Both recommendations would increase the tax burden on investors, businesses and landowners (most notably, farmers).

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[4] Sir Michael Cullen is a former Deputy Prime Minister and Minister of Finance of the previous Labour government, under the Prime Ministership of the Rt Hon Helen Clark.

[5] James Shaw, 'Greens Will Finally Close Property Speculators' Tax Loophole' (Press Release, Green Party, 22 August 2017). The Labour Party failed to rule out a CGT, but placed reliance on the findings of the proposed tax review group: see 'Greens Target Capital Gains Tax But Labour Won't Budge', *Radio New Zealand* (Web Page, 17 September 2017) <https://www.rnz.co.nz/news/political/339581/greens-target-capital-gains-tax-but-labour-won-t-budge>.

[6] While no official policy appears to exist, the leader of New Zealand First, the Rt Hon Winston Peters, had told media that he did not support 'an extension of the capital gains tax': see Richard Harman, 'Peters Ready to Throw Spanner into Labour's Capital Gains Tax Plans', *Politik* (Web Page, 21 August 2017) <http://politik.co.nz/en/content/politics/1171/Peters-ready-to-throw-spanner-into-Labour's-capital-gains-tax-plans-Labour-capital-gains-tax-Grant-Robertson-Winston-Peters.htm>.

[7] 'Terms of Reference: Tax Working Group', *Tax Working Group* (Web Page, 8 March 2018) <https://taxworkinggroup.govt.nz/resources/terms-reference-tax-working-group> ('TOR').

[8] Ibid.

[9] Ibid.

[10] Alison Pavlovich and David Sutton, 'Implementation of Capital Gains Tax: How Should We Do This?' (2019) 25(1) *New Zealand Journal of Taxation Law and Policy* 31.

[11] Tax Working Group, New Zealand Government, *Future of Tax: Final Report — Volume I: Recommendations* (February 2019) 8–9 <https://taxworkinggroup.govt.nz/resources/future-tax-final-report> ('TWG').

Having found that taxpayers in higher income deciles typically earn a greater proportion of their income from capital gains,[12] which are often not taxed under the current system,[13] the TWG recommended the introduction of a comprehensive CGT levied at marginal income tax rates.[14] The TWG also recommended that additional revenue collected through a CGT be reapplied to reduce the income tax burden on the lowest step of the progressive tax scale — effectively a tax reduction for all individual taxpayers.[15]

The TWG recognised the role environmental taxes can play in influencing behaviour,[16] and recommended that taxes should play a role in modifying exploitation of the physical environment. The TWG recommended the use of positive incentives, but also the reduction of current concessions to undesirable activities.[17]

Despite the TWG's majority endorsement of a CGT, such a tax was unacceptable to New Zealand First, and the government has abandoned CGT as a policy objective for the foreseeable future.[18] Environmental taxes are included on the government's latest tax policy work programme, updated in August 2019.[19] This is discussed further in Section V.

III Previous Tax Review Groups' Frameworks and Recommendations

There have been six generic tax reviews commissioned prior to the TWG.[20] The focus of this article is only on the most recent reviews: the 2010 Victoria University of Wellington Tax Working Group, chaired by Bob Buckle ('VUW review');[21] the 2001 Tax Review, chaired by Robert McLeod ('McLeod review');[22] the 1982 Taskforce on Tax Reform, chaired by Malcolm

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[12] Ibid 61.

[13] Note that there are many capital gains that are subject to taxation in New Zealand, such as the proceeds from some sales of land (*Income Tax Act 2007* (NZ) ss CB 6-15), capital gains on financial arrangements (*Income Tax Act 2007* (NZ) sub-pt EW), and capital gains on portfolio holdings of foreign shares (*Income Tax Act 2007* (NZ) sub-pt EX). However, there are many gains that fall outside these provisions, with no comprehensive CGT to absorb them into the tax net.

[14] TWG (n 11) 8.

[15] Ibid 19.

[16] Ibid 39.

[17] Ibid 51.

[18] 'PM Jacinda Ardern on Capital Gains Tax: "I Could Not Get the Support of NZ First"', *Radio New Zealand* (Web Page, 30 April 2019) <https://www.radionz.co.nz/news/political/388067/pm-jacinda-ardern-on-capital-gains-tax-i-could-not-get-the-support-of-nz-first>. 'Shane Jones: New Zealand First Killed Off Capital Gains Tax', *New Zealand Herald* (online, 31 May 2019) <https://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=12236290?>.

[19] Hon Stuart Nash, Minister of Revenue, 'Work Programme Confirms Economic and Social Focus' (Press Release, New Zealand Government, 8 August 2019).

[20] There were two earlier reviews, but this article focuses only on those since the 1967 Ross review. In both 1922 and 1951, the governments commissioned independent tax reviews. These are explored in Sawyer (n 1).

[21] Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, January 2010) <https://www.victoria.ac.nz/sacl/centres-and-institutes/cagtr/pdf/tax-report-website.pdf> ('VUW review').

[22] Robert McLeod et al, *Tax Review 2001: Final Report* (October 2001) <https://treasury.govt.nz/sites/default/files/2007-11/taxreview2001-report.pdf> ('McLeod review').

McCaw ('McCaw review');[23] and the 1967 Taxation Review Committee, chaired by Lewis Ross ('Ross review').[24]

The reviews reflect the times in which they operated; for example, the Ross review reflected an era when policy focus was on traditional family roles and perspectives. Tax rates and exemptions depended on whether the taxpayer was a married man with two children, or a single man, or a dependent wife.[25] The McCaw review was commissioned at a time when incentives and concessions had led to a narrow tax base that was taxed at high marginal rates.[26] That review therefore focused on broadening the tax base so that rates could be reduced, and recommended that incentives and concessions should be eliminated unless the economic gains for New Zealand were proven.[27]

While the tax system may not have been 'perfect' by the turn of the 21st century, it was fairer than it had been in the past. Arguably, this allowed the McLeod review and the VUW review to think more strategically about the tax system as a whole. With a broad and comprehensive tax base already established, these reviews could focus on economic wellbeing to promote growth in the economy.[28]

The Ross, McCaw, McLeod and VUW reviews based their respective frameworks on 'traditional' principles of equity and efficiency, broadly derived from Adam Smith's four canons of taxation.[29] This differs from the 2019 TWG, who used the LSF and *Te Ao Māori* (a Māori worldview), alongside traditional principles. The TWG's recommendations evolved out of a greater focus on fairness and equity than the two immediately preceding reviews. The recommendations on introducing a CGT and enhancing environmental taxes were driven by concerns beyond economic growth.

The following sections looks at the frameworks adopted by each group and the resulting recommendations.

A *Ross Review (1967)*

The 1967 Ross review was mandated to 'carry out a comprehensive review of the rates, structure, and incidence of the whole field of central Government taxation'.[30] The review considered the future of the tax system in light of continued revenue needs and the desire to promote economic growth and stability. The review relied on Smith's canons of equity, efficiency, certainty and convenience, but repackaged convenience and certainty into

[23] Malcolm McCaw et al, *Report of the Task Force on Tax Reform* (April 1982) ('McCaw review').

[24] Lewis Ross et al, *Taxation in New Zealand: Report of the Taxation Review Committee* (October 1967) ('Ross review').

[25] Ibid 116–17.

[26] McCaw review (n 23) 80; McLeod review (n 22) II.

[27] McCaw review (n 23) 65.

[28] McLeod review (n 22) 5.

[29] That is, equity, efficiency, certainty and convenience: see Smith (n 2) Book V, ch II, pt II.

[30] Ross review (n 24) 8.

'administration and public acceptance'.[31] Public acceptance recognises that public opinion matters for voluntary compliance.

The Ross review's main recommendations were to reduce the impact of income taxation and substitute this tax revenue with increased sales taxes. They made a number of proposals over a wide range of tax issues, including: taxation of fringe benefits within the PAYE system; reduction of concessions; introduction of special tax rules for groups of companies; reduction in the number of steps in the income tax scale; and changes to the taxation of trusts.[32] Interesting and notable in a current context is the recommendation that estate duties be retained and a (reduced-rate) comprehensive realised CGT be introduced on the grounds of equity.[33] The incumbent government at the time failed to implement the recommendations.

B *McCaw Review (1982)*

Despite conducting a thorough analysis of New Zealand's tax law, the 1982 McCaw review did not identify an underpinning framework or guidelines until several chapters into their analysis.[34] The McCaw review referred to the traditional tax assessment criteria — fairness, simplicity, certainty and neutrality.[35] Simplicity, certainty and neutrality were not elaborated upon any further, but, given the reference to 'traditional principles of taxation', presumably these derive from Smith's canons of efficiency and certainty.[36] The group emphasised the importance of fairness in their assessment of the tax system as a whole. They noted that fairness and perceptions of fairness are essential to acceptability and relative permanence of the tax system. The group explored the 'ability-to-pay principle' in relation to fairness, and paid regard to the need for both horizontal and vertical equity.

Fairness was a focus for this review group because the tax system was considered by many as grossly unfair.[37] The tax base was dependent upon a narrow group of people paying very high rates of tax. The recommendations of the McCaw review focused upon ways to improve the fairness of the tax system, including: reducing the number of tax rates; introducing a fringe benefits tax; introducing a value added tax; reducing double taxation of company earned income; reducing the number of tax concessions for business; and indexing the company tax base to account for inflation. The incumbent government failed to implement any of the recommendations. However, all but the last recommendation was introduced by subsequent governments.

C *McLeod Review (2001)*

The 2001 McLeod review described its tax policy focus as being to 'enhance the overall economic well-being of New Zealanders'.[38] The review aimed to achieve this outcome by

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[31] Ibid 12–13.

[32] Ibid 433–53.

[33] Ibid 542.

[34] McCaw review (n 23).

[35] Ibid 69.

[36] Smith (n 2) Book V, ch II, pt II.

[37] McCaw review (n 23) 80; McLeod review (n 22) II.

[38] McLeod review (n 22) 5.

making the tax system itself more efficient — that is, reducing the cost of imposing taxes.[39] Alongside improved efficiency, the review expected the tax system to promote fairness, while also raising sufficient revenue.[40] The goals of fairness and efficiency dominated the framework used by the McLeod review.

The review considered fairness a subjective concept, but one that incorporates objective principles. These are: the ability-to-pay principle; even-handedness; the user-pays principle; and transitional fairness. Ability-to-pay or vertical equity describes the ideal that taxpayers should pay according to their ability. Even-handedness is more commonly referred to as horizontal equity — similarly situated taxpayers should be treated similarly.[41] User-pays or the benefit principle holds that tax should be paid by those who benefit from the associated government expenditure.[42] This aspect of the review's interpretation of 'equity' is interesting, as it diverges from objectives of redistribution or the ability-to-pay principle. Finally, transitional fairness refers to managing tax policy change fairly so that windfall gains or losses do not occur. Within the McLeod review's concept of equity are competing interests.

In terms of tax efficiency, the McLeod review recognised not only the administrative costs of tax payment and collection, but also the costs that can be incurred when taxes affect behaviour. If one activity is taxed more heavily than another, tax will influence the behaviour of a taxpayer to choose one activity over the other. The chosen activity may have a lesser tax cost but may not be the best decision in the absence of tax. In this case, tax has created an economic loss.[43]

The McLeod review had a strong focus on taxation of outbound investment. However, also included in their recommendations was the introduction of the risk-free return method to account for taxation of capital, recognising the potential of the untouched tax base.[44] They also suggested an increase in GST and, perhaps, a decrease in income taxes, to promote economic growth objectives.[45]

D *VUW Review (2010)*

Like the McLeod review, fairness (or equity) and efficiency featured in the framework used by the 2010 VUW review. The Terms of Reference for this review were broad — a complete review of tax policy in the medium term, with a view towards the government goal of aligning the top tax rates of trusts, companies and individuals.[46] The VUW review based its

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[39] Ibid.

[40] Ibid.

[41] Vertical and horizontal equity principles evolve out of Adam Smith's canon of equity: see Smith (n 2) Book V, ch II, pt II.

[42] This evolves from Adam Smith's equity principle (see Smith (n 2) Book V, ch II, pt II), but modern theorists largely reject the benefit principle in favour of a broader sacrifice principle. For more discussion, see Klaus Vogel, 'The Justification for Taxation: A Forgotten Question' (1988) 33(1) *American Journal of Jurisprudence* 19.

[43] This is consistent with the key elements of Smith's canon of efficiency: see Smith (n 2) Book V, ch II, pt II.

[44] McLeod review (n 22) III, IV.

[45] The recommendation was based upon research showing that economic decisions are less distorted by GST than by income taxes. The research relied upon is: WE Diewert and DA Lawrence, *The Marginal Costs of Taxation in New Zealand* (New Zealand Business Roundtable, 1994).

[46] Treasury, 'New Tax Working Group to Assist Government' (Press Release, 8 May 2009) <https://treasury.govt.nz/publications/media-statement/new-tax-working-group-assist-government>.

recommendations on the framework that a sound tax system must adhere to the principles of: efficiency and growth; equity and fairness; revenue integrity; fiscal cost; compliance and administration cost; and coherence.[47]

The VUW review was driven by the objective that tax policy should be efficient and fair. However, it also sought to minimise distortions to economic growth. Furthermore, the review considered how tax impacts changes in income and wealth over a lifetime, not just on an annual basis.

The emphasis upon efficiency and promotion of economic growth is evident in the recommendations made by the group. These included a reduction in the corporate tax rate and the highest individual income tax rate. They also recommended a low-rate land tax — recognising a gap in the tax base but reluctant to endorse the perceived 'inefficiency' of a comprehensive CGT. The VUW review also recommended an increase in the rate of GST.[48] Overall, the package of recommendations must be viewed as regressive in its effects.

E *The 2019 Tax Working Group*

A strong emphasis of the TWG's work was the frameworks guiding its review. Because of the long history of using the established principles set out by Smith and adapted by the VUW review (and previous tax review groups), the TWG considered it important to maintain these principles for consistency.[49] In addition, the long history and reliance on Smith's canons can hardly be overlooked or ignored by any group assessing a tax system with a view to tax reform. However, the TWG expanded the traditional frameworks considerably by incorporating the LSF and *Te Ao Māori*.[50]

The LSF and its effect on the TWG's recommendations are considered in the next section.

IV The Living Standards Framework and the TWG

In 2008, a small group of Treasury staff began working on a project to change the way public policy is made in New Zealand. Even as late as 2017, Treasury's stated main objective was to raise the living standards of New Zealanders through higher gross domestic product ('GDP') per capita.[51] However, by 2018, the LSF stepped into the forefront of policymaking when the Labour-led government announced it would deliver the first 'Wellbeing Budget' in 2019, based on the LSF. The impact of this announcement was that each Ministry was required to submit

[47] VUW review (n 21) 15.

[48] Ibid 22. The group referred to evidence that consumption taxes are better for economic growth. However, there is also evidence that subjective wellbeing is higher where taxation on income is higher and taxation on consumption is lower: see Arthur Grimes et al, 'Subjective Wellbeing Impacts of National and Subnational Fiscal Policies' (Working Paper No 16-05, Motu Economic and Public Policy Research, April 2016).

[49] TWG (n 11) 28.

[50] LSF (n 3).

[51] Treasury, New Zealand Government, *Statement of Intent: July 2017 — June 2021* (2017) 16 <https://treasury.govt.nz/publications/soi/statement-intent-2017-2021>.

their Budget bids to Treasury based upon the objectives of the LSF.[52] Treasury's LSF is illustrated in Figure 1.

Figure 1: Treasury's Living Standards Framework[53]

The overall goal of the LSF is 'to promote higher living standards and greater intergenerational wellbeing'. This is supported by sub-goals that involve balancing optimal current wellbeing with preservation and, ideally, growth of four capital stocks for the future. These capital stocks are social capital, natural capital, human capital, and financial and physical capital. Another dominant feature of the LSF is the focus on distribution of outcomes. Measurement of the best and worst cases are necessary to observe equality of distribution.

A *Global Conceptions of Wellbeing*

New Zealand is not the only nation to develop a new model for assessing wellbeing beyond neoclassical economic measures. Bhutan has measured wellbeing through its 'Gross Happiness

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[52] New Zealand Government, *The Wellbeing Budget* (30 May 2019) 7. Note that there were no significant tax changes announced in Budget 2019, so we still have little indication of how tax policy might be impacted by the LSF.

[53] 'Our Living Standards Framework', *The Treasury* (Web Page, 4 December 2018) <https://treasury.govt.nz/information-and-services/nz-economy/living-standards/our-living-standards-framework>.

Index' since 2008.[54] In the same year, then French President Nicolas Sarközy commissioned three economists, Jean-Paul Fitoussi, Amartya Sen and Joseph Stiglitz, to report on measuring economic and social progress beyond GDP ('the Fitoussi Commission').[55] The Fitoussi Commission produced a comprehensive set of measurements for assessing and monitoring peoples' wellbeing beyond GDP, and made observations around the importance of wealth distribution, measuring the wellbeing of households rather than whole economies, and focusing on income and expenditure rather than production. Beyond economics, the Fitoussi Commission recognised the importance of health, education, political voice, social connections and the environment.[56] The work performed by the Fitoussi Commission was adopted by the OECD and translated into a country-by-country analysis of wellbeing called 'How's Life?'.[57] This report has been published every second year since 2011 and provides an assessment of the wellbeing of each participating country using 11 dimensions of current wellbeing and four resources for future wellbeing. Measures of current wellbeing include housing, education, health, safety and civic engagement, as well as measures of income and employment. Measures of future wellbeing include four stocks of capital: natural, human, economic and social.

B *New Zealand's Adaptation of 'Wellbeing' into the Living Standards Framework*

The LSF identifies multidimensional factors that contribute toward current wellbeing. Underlying the LSF is a range of measures taking into account areas such as health, knowledge and skills, civic engagement, and cultural identity. The first draft of these measures came out in late 2018 and they are still being developed. Therefore, the TWG had to work with little to no guidance on underlying measurements.

A broader concept of wellbeing includes measures such as adequacy and quality of housing. The LSF includes measures of dampness and mould in people's homes as a contributor to overall wellbeing. It also includes measures of mental health and the amount of leisure time available to people. These factors are measured alongside people's incomes to contribute toward an assessment of current wellbeing.[58] To accommodate the LSF, tax policy should factor in more than economic wellbeing or maximising GDP per capita. The impact of taxes on housing cost and quality, or on an individual's ability to participate in the workforce, requires consideration.

As well as measures of current wellbeing, the LSF measures stocks for future wellbeing. The objective of policymaking should manage and enhance stocks of natural, human, social, and financial and physical capital for the future. The model recognises that the four capitals support each other and, when all are strong, the result is a greater synergistic impact. This is represented by the *whāriki* (woven mat), showing each stock of capital as an individual strand of *harakeke*

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[54] *Constitution of the Kingdom of Bhutan 2008* (Bhutan) art 9.2.

[55] Joseph E Stiglitz, Amartya Sen and Jean-Paul Fitoussi, *Report by the Commission on the Measurement of Economic Performance and Social Progress* (European Commission, 2009) <https://ec.europa.eu/eurostat/documents/118025/118123/Fitoussi+Commission+report>.

[56] Ibid 14.

[57] OECD, *How's Life? 2017: Measuring Well-Being* (OECD Publishing, 15 November 2017).

[58] For the detail on the latest measurements for living standards, see Anita King, 'Living Standards Analysis Model: The First Prototype' (Working Paper No 18/05, Treasury, December 2018). Note that Statistics New Zealand has yet to finalise which indicators will be used.

(flax) (see Figure 1 above). Because each stock is important, policymaking should consider the impact it has on other stocks.

Natural capital is the natural environment, including the quality of resources and the availability of natural resources able to support human activity. Measurement of natural capital as a stock is under development.[59] There are currently some basic measures included in the measurement 'dashboard', but this is recognised as an area that still needs significant further development, mainly due to its complexity.

Financial and physical capital include assets such as buildings, roads, money and brands. These are the assets that have a direct role in wealth creation. Measurement of this capital is well developed already.[60]

Human capital is the stock of human ability to participate in work, study, recreation and society in general. Aspects such as mental health, education, physical wellness and skills will contribute to the strength of this capital.[61]

Finally, social capital measures overall societal wellbeing. Contributions toward this wellbeing measure include an individual's participation in civic matters, sense of belonging and trust in institutions.[62]

By adopting the LSF as a framework, the TWG significantly increased the complexity of its task by having to consider the impact of policy recommendations on such a broad range of factors. However, the LSF may also have given the TWG licence to look at tax in ways unavailable to previous reviews.

C *Further Development of the LSF to Incorporate Te Ao Māori*

The TWG adapted the LSF to incorporate a Māori perspective. By integrating *Te Ao Māori* with the LSF, a further framework was developed that pays greater heed to Māori concepts of *waiora* (wellbeing).[63] This development may be taken up by Treasury to inform future development of the LSF. The TWG's integrated framework, named He Ara Waiora (A Pathway towards Wellbeing), combined aspects of *Te Ao Māori* and the LSF and is illustrated in Figure 2.

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[59] Treasury will develop the measurements further with reference to external sources being developed internationally. For reference to indicators being developed by the European Environment Agency, see Treasury, 'Our People, Our Country, Our Future — Living Standards Framework: Background and Future Work' (Treasury Paper, 4 December 2018) 14 <https://treasury.govt.nz/sites/default/files/2018-12/lsf-background-future-work.pdf>.

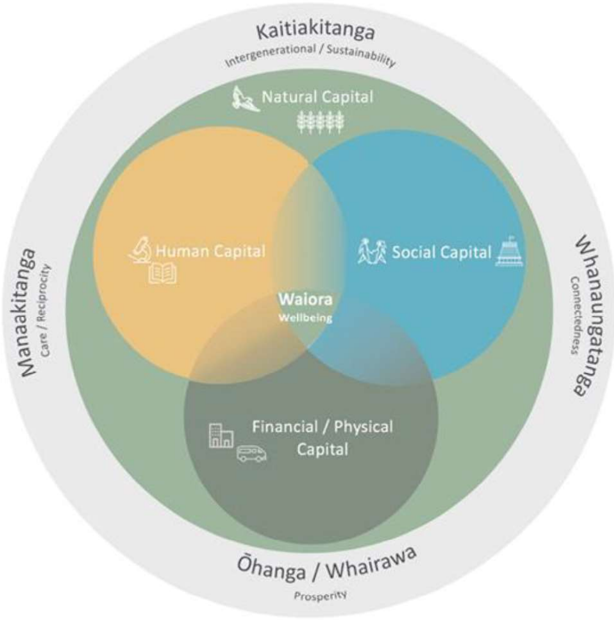
[60] John Janssen, 'The Start of a Conversation on the Value of New Zealand's Financial/Physical Capital' (Discussion Paper No 18/07, Treasury, July 2018). In the summary is stated: 'Compared to the capitals covered in the February papers — human, natural and social — financial/physical capital is relatively more straight-forward given existing measurement frameworks such as the national accounts.'

[61] See 'Human Capital', *Living Standards Framework — Dashboard* (Web Page) <https://lsfdashboard.treasury.govt.nz/wellbeing>.

[62] See 'Social Capital', *Living Standards Framework — Dashboard* (Web Page) <https://lsfdashboard.treasury.govt.nz/wellbeing>.

[63] For a discussion of *Te Ao Māori* and the TWG, see Matthew Scobie and Tyron Love, 'The Treaty and the Tax Working Group: *Tikanga* or Tokenistic Gestures?' (2019) (NZ special edition) *Journal of Australian Taxation* 1.

Figure 2: He Ara Waiora — A Pathway towards Wellbeing[64]



As well as using He Ara Waiora to consider the performance of the tax system as a whole, the TWG used the established traditional principles to assess individual reform options.[65] The LSF and He Ara Waiora include economic wellbeing within their objectives, but it is limited to a partial role rather than being a dominant objective. Economic wellbeing objectives are relevant in respect of maintaining and growing financial and physical capital, and contribute to assessment of current national wellbeing.

Before considering the TWG's recommendations, its consultation process should be noted. The submission period for comments on the TWG's scope was open for six months and they received 6,711 submissions from individuals, organisations and academics. The TWG ran polls and participated in numerous discussions around the country, with a range of people.[66] The results discussed in its final report indicate a variety of views were received, with little consensus among them.[67] This extensive consultation supports the principles of the LSF. In order to consider the implications of tax reform on areas as diverse as housing affordability, clean rivers and mental health, consultation with a wide and diverse group of people is essential.

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[64] TWG (n 11) 27, Figure 2.1.

[65] Inland Revenue and Treasury, 'Tax Working Group Assessment Framework: Decision Paper for Session 3 of the Tax Working Group' (Decision Paper, prepared for the Tax Working Group, February 2018) 4 <https://taxworkinggroup.govt.nz/resources/twg-bg-tax-working-group-assessment-framework> ('Tax Working Group Assessment Framework').

[66] 'Key Documents: Engagement', *Tax Working Group* (Web Page, 11 March 2018) <https://taxworkinggroup.govt.nz/key-documents>.

[67] TWG (n 11) 5.

V 2019 TWG RECOMMENDATIONS

Two main recommendations were made by the TWG: the introduction of a comprehensive CGT and the introduction of environmental taxes.

A *Comprehensive Capital Gains Tax*

A recommendation that New Zealand should implement a comprehensive CGT has finally been made, after previous reviews recognised the untapped tax base but dismissed a comprehensive tax as too cumbersome, inefficient and administratively awkward.[68] The McLeod review recommended a risk-free return model to tax *some* capital gains,[69] while the VUW review recommended a low-rate land tax.[70] Both groups rejected a CGT based on concerns around administrative efficiency, and fairness issues about owner-occupied properties. The TWG identified the crux of the debate: 'In broad terms, will the fairness, integrity, revenue and efficiency benefits from reform outweigh the administrative complexity, compliance costs and efficiency costs arising from the extension of capital gains taxation?'[71]

The government requested the TWG to consider, within parameters, the 'structure, fairness and balance of the tax system'.[72] The TWG concluded that 'the current treatment of capital gains reduces the fairness, progressivity and integrity of the tax system'.[73] The lack of fairness is attributable to a failure in both horizontal and vertical equity. People in a similar financial position are treated differently depending on how their income is derived (horizontal inequity).[74] A capital gain may be free of tax, whereas wages are always taxable.[75] The TWG also identified the regressive nature of New Zealand's tax system, as tax-free capital gains benefit the wealthiest members of society (vertical inequity).[76] The TWG also concluded that this lack of fairness erodes the sense of equity, essential to public acceptance of taxation and voluntary compliance.[77]

The TWG's recommendation of a CGT was cognisant of three particular areas of the LSF — the impact on social capital, inequality (current wellbeing), and financial and physical capital.

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[68] The VUW review (n 21) concluded that 'most members of the TWG have significant concerns over the practical challenges … and potential distortions and other efficiency implications that may arise from a partial CGT': at 11. The McLeod review (n 22) rejected a comprehensive CGT as 'such a tax would increase the complexity and costs of our system': at III.

[69] McLeod review (n 22) III, IV.

[70] VUW review (n 21) 11.

[71] Ibid 60.

[72] TOR (n 7).

[73] TWG (n 11) 35.

[74] Ibid 31.

[75] Ibid.

[76] Ibid 32.

[77] Ibid 33.

1 *Social Capital*

Perceptions of fairness are affected by deterioration of social capital, including trust in government institutions.[78] Data used to measure social capital has been sourced from a survey conducted by the State Services Commission.[79] The survey asked people whether they have trust in government institutions. Trust in government institutions is essential for taxation, especially given the voluntary compliance nature of New Zealand's tax system.[80]

How the tax burden is shared is another contributor to social capital identified by the TWG.[81] The LSF dashboard does not refer to inequality as a contributor to social capital — inequality is linked with current wellbeing measures. However, the TWG linked perceptions of fairness, good administration and sustainability of the tax base with building public trust and confidence in the system.[82] They indicated that treating gains from capital differently to other forms of income risks undermining perceptions of fairness and public acceptance of the tax system.[83]

2 *Current Wellbeing*

Another aspect of the LSF that is evident in the TWG's recommendation of a CGT is the objective of greater equality of outcomes. The LSF measures the dispersion of outcomes — whether it is income or housing or any other measurement of current wellbeing.[84] Consequently, current wellbeing is measured not only by average outcomes but also by the distribution of those outcomes.

The TWG noted that the absence of a CGT affects inequality by reducing the progressivity of the tax system. They noted that the wealthiest 20 per cent of New Zealand society hold around 75 per cent of the wealth.[85] The TWG also provided evidence that the current tax system is not particularly progressive and relies mainly upon transfers, such as Working for Families, to deliver equity.[86] They also observed the deterioration in effectiveness of the tax and transfer system in reducing inequality.[87]

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[78] See 'Social Capital' (n 62).

[79] State Services Commission, New Zealand Government, *New Zealanders' Satisfaction with Public Services: Kiwis Count — December 2017 Annual Report* (June 2018) <http://ssc.govt.nz/sites/all/files/2017-kiwiscount-ar.pdf>.

[80] TWG (n 11) 33. The TWG acknowledged this issue. *Tax Administration Act 1994* (NZ) s 92 requires each taxpayer to assess their own income tax liability.

[81] Tax Working Group Assessment Framework (n 65) 6.

[82] TWG (n 11) 7.

[83] Ibid 71.

[84] 'Social Capital' (n 62).

[85] TWG (n 11) 33, Figure 3.4.

[86] Ibid 30–1.

[87] Ibid 30. The TWG referred to economic research by Matt Nolan: 'Did Tax–Transfer Policy Change New Zealand Disposable Income Inequality between 1988 and 2013?' (Working Paper in Public Finance No 12/2018, Victoria University of Wellington, August 2018).

Introduction of a CGT is linked to better progressivity in the tax system.[88] Tax progressivity is a key tool for redistribution of wealth to achieve greater equality.

3 *Financial and Physical Capital*

Efficiency and productivity relate to the production and growth of financial and physical capital. The TWG identified the failure to tax capital gains as reducing productivity and, therefore, negatively impacting on financial and physical capital.[89] The TWG addressed the impact on productivity as being a tension between positive results of better allocation of resources versus negative consequences of higher taxation, greater administration and possible 'lock-in' effects.[90]

The TWG suggested that not taxing capital gains reduces productivity, because it 'distorts investment into less productive — tax-favoured — sectors and industries'.[91] They argued the tax system should be neutral and one type of investment should not be favoured over another.[92] This line of reasoning follows Smith's canon of efficiency: that taxes should not 'take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury'.[93] This inefficiency 'loss' refers not only to administration costs but also to distortions in investment decisions based upon tax preferential choices. According to the TWG, a CGT is likely to rebalance the economy through resource reallocation.[94]

The TWG also acknowledged there could be negative effects from a CGT upon productivity. The additional tax costs on a business add to the cost of doing business, effectively amounting to an increase in savings and investment.[95] Also potentially negating the growth of financial and physical capital is the distortionary impact of lock-in — this is where taxpayers choose not to realise their assets due to the impact of taxation. The additional administration costs associated with the additional taxation are almost certain and unavoidable. The TWG included this consideration in their assessment.[96]

It is not certain how a CGT affects productivity and efficiency.[97]

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[88] Ibid 61.

[89] Ibid 34.

[90] Ibid 67. Lock-in effects refer to the potential that taxpayers will not dispose of their assets due to the effects of taxation on gains.

[91] Ibid.

[92] Ibid.

[93] Smith (n 2) Book V, ch II, pt II.

[94] TWG (n 11) 67.

[95] Ibid.

[96] Ibid 68–9.

[97] See the discussion in Inland Revenue and Treasury, 'Extending the Taxation of Capital Income: Discussion Paper for Session 8 of the Tax Working Group' (Discussion Paper, prepared for the Tax Working Group, May 2018). See also Maithm Khaghaany and David Sutton, 'A Capitalist Argument for Capital Gains Tax' (2019) 25(3) *New Zealand Journal of Taxation Law and Policy* 235.

The TWG's recommendation to introduce a CGT was not unanimous — 3 of the 11 proposed ad hoc inclusion of types of gains within the income tax net.[98] However, the majority concluded that:[99]

> … extending capital gains taxation would involve an increase in compliance and efficiency costs but … these costs would be outweighed by reductions in investment biases, as well as improvements to the fairness, integrity and fiscal sustainability of the tax system.

The three members of the TWG who did not support the recommendation to implement a broad-based CGT favoured an incremental approach to increase the tax base over time.[100]

B *Environmental Taxes*

The TWG's recommendations on environmental taxes directly supported enhancement of natural capital,[101] and acknowledged the impact of the environment on human, social, and financial and physical capital.[102] The TWG described natural capital as 'a profound and non-substitutable basis for the economy',[103] and recognised that the environment has 'intrinsic value that goes beyond utility' and is essential to 'support life and human activity'.[104] Its recommendations were founded on the idea that building and protecting natural capital is not a goal in itself, but essential to preserving and growing the other three capitals.

Managing natural capital determines the 'sustainability and wellbeing of our people over time'.[105] This statement points to natural capital being essential not only to the wellbeing of people today but also into the future — this is the essence of wellbeing being intergenerational.

The relationship between natural capital and human capital is often made in relation to health. Without a healthy natural environment, human health will deteriorate. Therefore, a deterioration in natural capital diminishes human capital. However, links have also been made to the substitutability of human capital and natural capital.[106] Sometimes, highly skilled human capital may replace the use of natural capital in order to provide more sustainable contributions to financial and physical capitals.

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[98] TWG (n 11) 71.

[99] Ibid.

[100] Ibid 56.

[101] For reference to the role of taxation in enhancing natural capital, see ibid 41.

[102] Ibid 37.

[103] Ibid 35.

[104] Ibid 37.

[105] Ibid.

[106] Robert L Ayres et al, 'Natural Capital, Human-Made Capital, Economic Growth, and Sustainability' (Report from 'Assessing the Role of Human and Natural Capital in Economic Production' workshop, Center for Energy and Environmental Studies, Boston University, 1996) <https://www.researchgate.net/publication/255646529_Natural_Capital_Human_Capital_and_Sustainable_Economic_Growth>.

Natural, financial and physical capitals are intertwined. Without sustainable use of natural capital, which is a basis for the economy, future economic wellbeing will decline.[107]

The concept of 'sustainability' was reiterated with regard to natural capital. While social, human, and financial and physical capitals may fluctuate over time, natural capital can be, in some cases, permanently lost. The TWG acknowledged the immediate environmental crisis facing humanity,[108] and the role taxes can have as an instrument to achieving policy goals.[109]

Because of the connection between policymaking and natural capital when applying the LSF, the TWG considered it essential that tax reform should introduce instruments to manage sustainable behaviour. They developed a framework for determining when a tax could enhance natural capital,[110] and identified areas where taxes could address negative externalities. The TWG also observed that current rules around farming-specific deductions should be reviewed to determine whether they are inconsistent with the objective of enhancing natural capital.[111]

C *Intergenerational Wellbeing*

The concept of intergenerational wellbeing informed the TWG's recommendations on a CGT and environmental taxes. In particular, there are two points of difference between the focus of the TWG and the two most recent reviews. First, the TWG had a framework for determining wellbeing that went beyond economic wellbeing. Second, the requirement to consider the wellbeing of both current and future generations changed the tenor of its recommendations.

The discussion on CGT had not significantly changed since the Ross review. All reviews recognised capital gains as an untapped tax base. However, while New Zealand's level of inequality is debatable,[112] concentration of wealth is clear.[113] Reducing inequality underpins every measure of current wellbeing in the LSF, and so, having adopted this framework, the TWG could not ignore wealth inequality. To conclude that the administrative burden of a CGT would outweigh redistribution of wealth would run counter to one of the foundations of measuring current wellbeing. Adoption of the LSF made the CGT recommendation inevitable in the absence of a wealth or inheritance tax.

Likewise, adoption of the LSF made environmental tax recommendations inevitable. Since LSF-observant policymakers must protect and accumulate natural capital, the TWG could not ignore the impact taxes can have on behavioural change. Also impossible to ignore was the 'intergenerational' focus in all wellbeing measures. Like equality of outcomes, future wellbeing is an LSF foundational principle. The wellbeing for future generations is as important as the wellbeing for people today.

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[107] Ibid.

[108] TWG (n 11) 38.

[109] Ibid 39.

[110] Ibid 41.

[111] Ibid 51.

[112] Movements in New Zealand's income gini coefficient from the mid-1990s to today are not clear: see Ministry of Social Development, *The Social Report 2016: Te Pūrongo Oranga Tangata* (June 2016) 133.

[113] Distribution of wealth is highly concentrated within the top 20 per cent of households: see Statistics New Zealand, 'Wealth of Top 20 Percent Rises by $394,000' (Press Release, 14 December 2018).

D *Government Response to the TWG's Recommendations*

Despite the government commissioning the review and campaigning on the potential introduction of a CGT, they rejected the TWG's recommendation to implement one. Not only did they reject the recommendation, but the Rt Hon Prime Minister Ardern stated the government would not consider it again while she is leader.[114] This is surprising, given that a CGT has been a Labour Party policy for a sustained period, and there is potential for a future Labour government that won't need to rely upon New Zealand First as coalition partner. Nevertheless, the Prime Minister concluded that the government did not have the mandate for a CGT.[115]

While the CGT was rejected, the government made announcements that they would review (again) the rules around taxation of land.[116] In particular, included in the tax policy work programme is a review of taxation 'in relation to investment property and speculators, land banking, and vacant land'.

The recommendation that the government should consider using taxation as a tool to achieve behavioural change in respect to use of natural resources has been taken up in the tax policy work programme.[117] The recommendations of the TWG were unspecific — the author speculates this may reflect the specialisation and complexity around these issues. The work programme will consider the framework offered by the TWG in more depth, and also look at tax reforms in the areas of greenhouse gases (emissions trading scheme), solid waste (waste disposal levy), water pollution, and congestion (in Auckland).

VI CONCLUSION

The five tax reviews considered in this article contemplated a CGT, and broadly agreed on the advantages and disadvantages. They identified efficiency and equity issues, and acknowledged the additional administrative costs for both Inland Revenue and taxpayers, and the extra tax cost for taxpayers that might deter investment in productive activity. All the tax review groups acknowledged similar benefits and limitations of a CGT. However, only the TWG and the 1967 Ross review concluded that the costs would be outweighed by the improvements to fairness of the tax system — in particular, helping to address social inequalities by increasing the progressivity of the tax system.

Given the broad agreement of the groups on the benefits and costs of CGT, the different conclusion reached by the TWG, compared with more recent reviews, is due to their increased emphasis upon equity objectives — particularly the progressivity of the tax system.

In the same way, the TWG was not the first tax review to consider greater use of environmental taxes but, given its adoption of the LSF, which recognises the importance of providing for the

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114 Rt Hon Jacinda Ardern, 'Government Will Not Implement a Capital Gains Tax' (Press Release, New Zealand Government, 17 June 2019) <https://www.beehive.govt.nz/release/government-will-not-implement-capital-gains-tax>.

115 Ibid.

116 Nash (n 19).

117 Ibid.

wellbeing of future generations and the preservation of natural capital, environmental taxes necessarily became a key consideration.

Previous reviews have considered tax reform in light of current wellbeing; the LSF broadens and deepens the objective of public policy to intergenerational wellbeing. It also emphasises the interwoven value of all four capitals, with no one capital dominating the others. With the LSF as the underpinning framework for the TWG's review of the tax system, the final recommendations to adopt a comprehensive CGT and use of environmental taxes were a natural conclusion.

Observing the TWG using the principles of the LSF and He Ara Waiora shows us that a multidimensional wellbeing framework results in outcomes that place less weight upon economic growth objectives. Future research may be warranted on how tax policy develops with regard to the LSF.