THE TAX WORKING GROUP AND CAPITAL GAINS TAX IN NEW ZEALAND — A MISSED OPPORTUNITY?

ANDREW MAPLES* AND SUE YONG†

ABSTRACT

There has been much debate in New Zealand concerning the need for a separate and comprehensive capital gains tax ('CGT'), especially after the appointment of the Tax Working Group ('TWG') in 2017. The arguments for a CGT include equity, base broadening, certainty, additional tax revenues and remedying the housing affordability crisis. On the other hand, counter-arguments such as tax complexity (in the design of the CGT), overstatement of projected tax revenues, and high tax compliance and administrative costs have been raised by opponents of the tax. The TWG identified three socio-economic challenges facing New Zealand (among others) — housing affordability, income/wealth inequality and fiscal sustainability — all of which it is argued have a link to the tax system. Ultimately, for political reasons the government decided not to pursue the TWG's recommendation for a CGT. This paper considers whether this is a lost opportunity to address these three challenges.

* Associate Professor, UC Business School, University of Canterbury. Corresponding author: andrew.maples@canterbury.ac.nz.

† Senior Lecturer in Tax and Accounting, Auckland University of Technology.

I Introduction

> The taxation of capital gains has been traditionally the site of the most important battle-ground between those who feel on ideological grounds that the tax system should be more progressive and those who feel that the tax system already unfairly and unwisely oppresses the rich.[1]

The above statement best reflects the debate surrounding the taxation of capital gains in New Zealand for over five decades — a debate that was given fresh impetus in 2017 with the appointment of the Tax Working Group ('TWG'). The TWG was given a strong mandate to consider taxing capital gains (taking into account wellbeing considerations). Reviewing the TWG working papers, it is clear that New Zealand faces several socio-economic challenges. This paper focuses on three of those challenges, each of which is argued to be linked to the lack of a comprehensive capital gains tax ('CGT') in New Zealand. The first challenge is housing affordability.[2] Increasing property prices throughout New Zealand have prevented many first-home buyers (and others) from owning their property.[3] The perception is that, without a comprehensive CGT, residential property investment is tax-favoured — as often sizeable capital gains on sale remain untaxed — which increases demand (and the price) for this asset class. Second, levels of poverty in New Zealand continue to rise, while income/wealth inequality continues to grow,[4] again due in part, it is argued, to the greater opportunity for wealthier individuals to derive tax-free capital income (often through property investment).[5] Finally, the tax base is narrow and relies heavily on the taxation of individuals (including self-employed and wage/salary earners). The ageing population will impose tremendous pressure on the finances of future governments through potentially lower tax revenue growth as individuals retire, and also through higher government expenditure on health and New Zealand superannuation. The tax base will need to broaden, requiring alternative tax revenue streams by future governments.[6]

After considerable deliberation, many public submissions and much research, in early 2019 the TWG (majority) recommended New Zealand should comprehensively tax capital income. Despite this recommendation, due to a lack of support from coalition partner New Zealand First, the government decided not to pursue a CGT any further. Focusing on the TWG's CGT proposal, the authors consider whether the rejection of a CGT has meant that New Zealand has

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[1] Rick Krever and Neil Brooks, *A Capital Gains Tax for New Zealand* (Victoria University Press, 1990) 1, 1.

[2] See, for example, Tax Working Group, New Zealand Government, *Future of Tax: Interim Report* (September 2018) 6 <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-interim-report-sep18.pdf> ('Interim Report').

[3] Ben Chapman-Smith, 'Capital Gains Tax Not Good Unless Comprehensive', *New Zealand Herald* (online, 25 July 2013).

[4] See, for example, Interim Report (n 2) 21.

[5] Christian notes: 'A 2014 OECD report found that in the two decades from 1985 onwards, New Zealand had the biggest increase in income gaps of any developed country. … New Zealand's Gini coefficient rose rapidly in the 1980s and 1990s as [various] economic reforms took effect. It then fell a little in the 2000s, which is sometimes credited to the then-Government's Working for Families package and a higher minimum wage. Since the global financial crisis it has started rising again.' Harrison Christian, 'Once Were Warriors 25 Years On: Gangs and Being Poor, Then and Now', *Stuff* (online, 9 June 2019) <https://www.stuff.co.nz/national/111969648/once-were-warriors-25-years-on-gangs-and-being-poor-then-and-now>.

[6] See, for example, Interim Report (n 2) 28.

lost a significant opportunity to use the tax system to address (at least in part) the three socio-economic issues mentioned above, and make a positive impact on the welfare of New Zealand society.

This paper is organised as follows. Section II briefly summarises the work of the TWG. The three issues referred to above (housing affordability, income/wealth inequality and fiscal sustainability) are considered in Sections III, IV and V, respectively. Concluding comments and observations are made in Section VI.

II The Tax Working Group 2019

A *Background*

In 2017, the New Zealand government created the TWG to consider the future of tax,[7] and to 'provide recommendations to Government that would improve the fairness, balance and structure of the tax system over the next ten years'.[8] The TWG's approach of evaluating the tax system was extended beyond the established principles of tax policy design (that is, efficiency, equity, revenue, integrity, fiscal adequacy, compliance and administration costs, and coherence) to include Treasury's broader Living Standards Framework ('LSF').[9] The LSF identifies four capital stocks that are crucial to wellbeing — financial and physical capital, human capital, social capital, and natural capital[10] — and encourages policymakers to explore how policy change affects the four capital stocks and widens the scope of analysis to include a more comprehensive range of factors, distributional perspectives, and dynamic considerations.[11]

In March 2018, the TWG published 'Future of Tax — Submissions Background Paper', which sought submissions on several issues on the future of tax in New Zealand through a two-month public consultation period, 1 March to 30 April 2018.[12] Some 6,700 submissions were received.[13] September 2018 saw the TWG release an interim report summarising its views as

[7] For information on the TWG, reports and submissions, see 'What Is the Tax Working Group?', *Tax Working Group* (Web Page) <https://taxworkinggroup.govt.nz/what-is-the-tax-working-group>.

[8] Ibid.

[9] Interim Report (n 2). The framework was developed by Treasury to assist it to advise governments about how the policy trade-offs they make are likely to affect living standards: '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>.

[10] Ibid 12.

[11] Ibid.

[12] Tax Working Group, New Zealand Government, 'Future of Tax — Submissions Background Paper' (Background Paper, 14 March 2018) <https://taxworkinggroup.govt.nz/sites/default/files/2018-03/twg-subm-bgrd-paper-mar18.pdf>.

[13] Tax Working Group, New Zealand Government, '6,700 Submissions Received in Tax Working Group Consultation' (Press Release, 1 May 2018) <https://taxworkinggroup.govt.nz/resources/6700-submissions-received-tax-working-group-consultation>.

informed by the submissions.[14] The interim report considered two options for extending the taxation of capital income.[15]

The TWG released its final report in February 2019,[16] with the majority of the TWG recommending a broad extension of capital gains taxation based on the notion that it would increase the fairness, integrity and fiscal sustainability of the tax system.[17] Three members of the TWG rejected the proposed CGT on the basis that efficiency and compliance cost concerns 'would not be outweighed by the increased revenue, fairness perceptions, and possible integrity benefits of the broader approach',[18] instead preferring the current incremental approach of extending the tax base over time.[19]

Before the release of the final report, the government had indicated an intention to introduce draft legislation into Parliament in 2019 incorporating a CGT (subject to the TWG's recommendations and support of the coalition partners). In a move that surprised many, in April 2019 Prime Minister Rt Hon Jacinda Ardern announced that the government would not be pursuing a CGT and, also, it would not be on the Labour Party's agenda while she is the party leader.[20] Subsequently, Associate Finance Minister (and New Zealand First Member of Parliament) Hon Shane Jones claimed that 'NZ First was responsible for killing off the capital gains tax'.[21]

B *The Proposal — Summary*

The TWG (majority) proposed a broad-based CGT on realised gains and most losses from all types of land and improvements (with the exclusion of the family home), shares, intangible property and business assets. Collectables (including art and memorabilia) and personal assets such as cars, boats and jewellery were excluded. As widely expected, the TWG adopted a valuation day ('V-day') approach, with gains arising on or after the implementation date (V-day) to be taxed at the taxpayer's marginal tax rate. A five-year transitional period from the date of implementation was recommended for taxpayers to seek valuations concerning assets owned at V-day. The TWG did not recommend any adjustment for inflation, nor provide a

[14] Interim Report (n 2).

[15] The two options outlined in the interim report were: (i) taxing realised gains that are not already taxed; or (ii) taxing certain assets on a deemed return basis, such as a risk-free rate of return method: ibid ch 6, [43]–[95].

[16] Tax Working Group, New Zealand Government, *Future of Tax: Final Report — Volume I: Recommendations* (February 2019) <https://taxworkinggroup.govt.nz/resources/future-tax-final-report> ('TWG Volume I'); Tax Working Group, New Zealand Government, *Future of Tax: Final Report — Volume II: Design Details of the Proposed Extension of Capital Gains Taxation* (February 2019) <https://taxworkinggroup.govt.nz/resources/future-tax-final-report> ('TWG Volume II').

[17] TWG Volume I (n 16) 71. Chapter 5 sets out the main issues considered by the TWG in reaching the respective views.

[18] Robin Oliver, Joanne Hodge and Kirk Hope, 'Extending the Taxation of Capital Gains' (Background Paper, 18 December 2018) <https://taxworkinggroup.govt.nz/sites/default/files/2019-02/twg-bg-4050912-extending-the-taxation-of-capital-gains-minority-view.pdf>.

[19] Ibid.

[20] Stacey Kirk, 'Ardern "Done Talking" CGT', *The Press* (Christchurch, 18 April 2019) 1.

[21] John Anthony, 'NZ First Put an End to Capital Gains Tax, Shane Jones Claims in Post-Budget Speech', *Stuff* (online, 31 May 2019) <https://www.stuff.co.nz/business/industries/113143586/nz-first-put-an-end-to-capital-gains-tax-shane-jones-says-in-postbudget-speech>.

discount for capital gains. Rollover treatment for certain life events (such as death and relationship separations), business reorganisations and small business reinvestment was proposed. The existing rules would continue to apply to foreign shares that are currently taxed under the foreign investment fund regime (including the fair dividend rate method), as well as anything taxed under the financial arrangement rules.

The adoption of a V-day approach, while preferable to the grandfathering approach adopted in Australia, would lead to a significant burden on both taxpayers and the valuation industry, even with the transitional period.[22] The family home exemption had the potential to increase investment in the family home, known as the 'mansion effect'.[23] It was also narrow and would have been complex to apply where, for example, the family home was also used for business purposes (such as for an Airbnb or a home office).[24] The exemption for collectables is contrary to the approach adopted in other jurisdictions,[25] and somewhat surprising given that it would create a bias toward this asset class, one which is already favoured by the wealthy.[26] The absence of any allowance for inflation (through indexation of the cost base) is in line with other jurisdictions, due to its inherent complexity and the fact indexation does not exist for capital or other income; indeed, the UK and Australia abolished indexation for CGT purposes in the late 1990s for these reasons.[27] The lack of an indexed tax-free threshold to eliminate the 'minnows and tiddlers' was surprising,[28] as it would have reduced the number of taxpayers subject to the tax and arguably made the tax easier to 'sell' to the public (many of whom would never be required to pay it). The tax-free threshold would also reduce overall compliance and administrative costs.[29] The CGT proposal made no distinction between short- and long-term

[22] Troy Bowker, 'Capital Gains Tax "Valuation Day" Will Cost Kiwi Businesses Billions of Dollars', *Stuff* (online, 23 November 2018) <https://www.stuff.co.nz/business/108796278/capital-gains-tax-valuation-day-will-cost-kiwi-businesses-billions-of-dollars>.

[23] 'Westpac: With No CGT, Housing Market Could Rebound Next Year', *Mike Hosking Breakfast* (Newstalk ZB, 13 June 2019) <https://www.newstalkzb.co.nz/on-air/mike-hosking-breakfast/audio/dominick-stephens-housing-market-could-rebound-next-year-thanks-to-capital-gains-tax-cancellation>.

[24] Maggie Jaques, *Capital Gains Tax Review 2019* (Nexia New Zealand, 2019) <https://www.nexia.co.nz/capital-gains-tax-review-2019.php>. Further, the exclusion was limited to a maximum of 4,500 square metres (the house and curtilage) for those living on a lifestyle block or farm, even if a larger area was used for the enjoyment of the family home.

[25] See, for example, Chris Evans and Richard Krever, 'Taxing Capital Gains: A Comparative Analysis and Lessons for New Zealand' (2017) 23 *New Zealand Journal of Taxation Law and Policy* 486, 513.

[26] Nevil Gibson, 'Analysis: Super-Rich Push Collectables to New Highs', *National Business Review* (online, 17 March 2019).

[27] Chris Evans and Cedric Sandford, 'Capital Gains Tax — The Unprincipled Tax' (1999) 5 *British Tax Review* 387, 389; Shaleshni Sharma and Howard Davey, 'Characteristics of a Preferred Capital Gains Tax Regime in New Zealand' (2015) 21 *New Zealand Journal of Taxation Law and Policy* 113, 121.

[28] Evans and Sandford (n 27) 404. Evans and Krever note, for example, South Africa, Turkey and the UK all have tax-free thresholds: Evans and Krever (n 25) 511. Australian research shows that a tax-free threshold of AUD10,000 has the potential to remove up to 70 per cent of taxpayers from the need to interact with the tax, with little loss of revenue: at 508.

[29] Tova O'Brien, 'Large Majority of New Zealanders Don't Want Capital Gains Tax — Poll', *Newshub* (online, 8 April 2019) <https://www.newshub.co.nz/home/politics/2019/04/large-majority-of-new-zealanders-don-t-want-capital-gains-tax-poll.html>.

gains, such as providing a discount for the latter.[30] The CGT proposal would have created 'lock-in', whereby owners defer selling assets to avoid triggering a CGT liability.[31]

The TWG focused on a very comprehensive CGT with comparatively few exemptions, in an attempt to reduce complexity and the costs that flow as a consequence. However, the absence of 'discounts, concessions or allowance for inflation and very little in the way of exemptions, exceptions and roll-overs',[32] in combination with gains potentially taxed at the top marginal rate of 33 per cent (for some taxpayers), led to a CGT proposal described by some critics as 'one of the "harshest" in the world',[33] and one that would ultimately prove impossible to sell to coalition partner New Zealand First.

III Housing Affordability

A *The Importance of Homeownership*

Homeownership and the related issue of housing (un)affordability is a significant issue for many New Zealanders; indeed, public opinion has placed it at 'the top of the policy agenda in the last three national elections'.[34] In November 2018, the Prime Minister stated that the government 'would be measured by its success in fixing the housing crisis'.[35] Given the public's concerns over this issue it is not surprising that the Terms of Reference directed the TWG to have special regard to housing affordability (as well as whether 'a system of taxing capital gains or land … or other housing tax measures, would improve the tax system').[36] While the TWG does not define the term, the Ministry of Business, Innovation and Employment ('MBIE') defines 'housing affordability' as 'being able to meet housing costs (either of owning or renting) out of income without adversely impacting on the ability to afford the basic requirements for living and prospering in New Zealand society'.[37]

Housing affordability impacts significantly on the economy and society as the high cost of housing affects rates of homeownership, rents, wealth equality, social cohesion, social capital and wellbeing.[38] Homeownership 'benefits society because it encourages stable, more law-

[30] See, for example, Evans and Krever (n 25) 511.

[31] David Snell, 'A Capital Gains Tax for NZ?', *Stuff* (online, 25 August 2014) <http://www.stuff.co.nz/business/10419849/A-capital-gains-tax-for-NZ>.

[32] Jaques (n 24).

[33] Ibid.

[34] Anne Gibson, 'Tauranga Beats Auckland as NZ's Least Affordable for Housing: Global Study', *New Zealand Herald* (online, 22 January 2018) <https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11978019>.

[35] Tracey Watkins, 'Surprise Warm-Up Act for Jacinda Ardern's Star Turn at Labour Conference', *Stuff* (online, 4 November 2018) <https://www.stuff.co.nz/national/politics/108345619/surprise-warmup-act-for-jacinda-arderns-star-turn-at-labour-conference>.

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

[37] Ministry of Business, Innovation and Employment ('MBIE'), New Zealand Government, *Briefing for the Incoming Minister of Housing & Urban Development* (25 October 2017) 8.

[38] Interim Report (n 2) 6, 53.

abiding communities … it benefits future generations … the children of homeowners do better at school and have fewer behavioural problems than children of renters'.[39] The Australian Productivity Commission claims that access to affordable and quality housing provides a foundation for family and social stability, as well as contributing to improved health, educational outcomes and productivity of the workforce.[40] Overall, it enhances economic performance and 'social capital'.

As noted, due to high and rising house prices, housing affordability is now a significant public concern. The 2018 14th Annual Demographia International Housing Affordability Survey claimed that in 2017, despite some improvements, New Zealand housing was still 'severely unaffordable', and Auckland was the world's fourth least affordable city.[41] The patterns of housing tenure and housing stress are also prejudiced against lower-income groups, Pasifika and Māori. In 2017, 54 per cent of households in the lowest income decile lived in their own homes, compared to 78 per cent of households in the highest income decile. In 2013, only 33 per cent of Pasifika and 43 per cent of Māori owned their own homes, compared to 70 per cent of Europeans. Māori were also dependent on social housing, with nearly 50 per cent receiving emergency housing grants in 2017.[42] As well as affecting first-home buyers, rising house prices (and the lack of affordable housing) have consequential impacts on renters, as rents have risen faster than wages and house prices since 2014.[43]

Media reports have focused the public's attention on the (apparent) impact of the tax system on the housing market. For example, there are reportedly thousands of 'ghost houses',[44] which are vacant for long periods because, with rising house prices and significant tax-free gains, there is no incentive to rent out these properties.[45] Also, practices of 'land banking', with vacant sections remaining underdeveloped for lengthy periods, have caused rising house prices, especially near Auckland.[46] Motivated by the tax-free capital gain, '[t]he classic purchaser is just there to land bank till the land is zoned residential'.[47]

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[39] 'Shelter, or Burden?', *The Economist* (online, 16 April 2009) <http://www.economist.com/node/13491933>.

[40] Productivity Commission, Australian Government, *First Home Ownership* (Inquiry Report No 28, 31 March 2004) <https://www.pc.gov.au/inquiries/completed/first-home-ownership/report/housing.pdf>.

[41] Demographia, *14th Annual Demographia International Housing Affordability Survey: 2018 — Rating Middle-Income Housing Affordability* (2018) <http://www.demographia.com/dhi2018.pdf>.

[42] Interim Report (n 2) 21.

[43] Inland Revenue and Treasury, New Zealand Government, 'Tax and Housing: Discussion Paper for Session 5 of the Tax Working Group' (Discussion Paper, prepared for the Tax Working Group, March 2018) 8 <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-tax-and-housing.pdf>.

[44] According to Hawkes, in 2016 over 33,000 houses in Auckland were officially classified as empty: Colleen Hawkes, 'Is It Time to Address the Question of Empty "Ghost Houses"?', *Stuff* (online, 16 May 2018) <https://www.stuff.co.nz/life-style/homed/latest/103024164/is-it-time-to-address-the-question-of-empty-ghost-houses>.

[45] Ibid.

[46] Ross Linklater, 'Wealth Divide Issue NZ Must Address', *Otago Daily Times* (online, 7 March 2018) <https://www.odt.co.nz/opinion/wealth-divide-issue-nz-must-address>.

[47] Hawkes (n 44).

B *Affordability and the Tax System*

1 *Views of the Public*

The TWG requested submissions on the following questions:[48] 'How do you think the tax system affects housing affordability for owners and renters?' and 'Is there a case to make changes to promote greater housing affordability?' On the basis that it was not permitted to consider taxing the family home, the TWG also asked: 'Should New Zealand have a capital gains tax for other types of housing?' and 'What features should it have?' They received 739 online submissions from the public, with a wide spectrum of views expressed, including support for a (realised or unrealised) CGT and a land tax on undeveloped residentially zoned land.[49] In response to the question 'Can tax make housing more affordable?' (which received 3,124 responses), 47 per cent believed that 'it's not the responsibility of the tax system', while 33 per cent agreed that tax could 'help make housing more affordable'.[50] The results indicate that New Zealanders were divided in their views regarding the tax system's role in tackling housing affordability (and the housing crisis).

2 *Views of Researchers*

While, generally, researchers' views on the impact of the taxation system on housing affordability are mixed, the consensus indicates that it is not 'the primary cause of high house prices',[51] rather it is a contributing, secondary factor. In 2011, the Organisation for Economic Co-operation and Development ('OECD') concluded that favourable tax treatment of housing exaggerated the surge in house prices.[52] In 2013, it noted that the lack of a CGT in New Zealand exacerbates inequality, undermines housing affordability and motivates speculative housing investments.[53] In its submission to the New Zealand Productivity Commission's *Housing Affordability Inquiry*, the Reserve Bank of New Zealand's view was that, even though taxation regimes can affect house price movements and cycles, 'they have not been of decisive importance compared to supply factors, migration factors or fiscal and monetary policy'.[54] The Productivity Commission likewise confirmed that '[t]axation affects the attractiveness of investing in housing and its affordability, although the impacts are difficult to quantify and

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[48] Tax Working Group, New Zealand Government, *Can Tax Make Housing More Affordable?* (2018) <https://taxworkinggroup.govt.nz/sites/default/files/2018-03/twg-fact-housing-affordable-v2.pdf>.

[49] See Tax Working Group, New Zealand Government, 'Website Submissions Responding to the Question: Can Tax Make Housing More Affordable?' (Information Release, August 2018) <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-subm-3982424-can-tax-make-housing-more-affordable-website-submissions-incl-cover-sheet.pdf>. Submissions are short, ranging from the very brief ('It [CGT] hasn't worked elsewhere eg Australia!!!!!': at 12) to longer pieces of approximately 150 words, as well as detailed submissions by organisations and academics on this and other issues, which are separately available.

[50] 'Background Material: Quick Poll Results', *Tax Working Group* (Web Page, 1 May 2018) <https://taxworkinggroup.govt.nz/resources/quick-poll-results>.

[51] Inland Revenue and Treasury (n 43) 19.

[52] OECD, *OECD Economic Surveys: New Zealand 2011* (OECD Publishing, April 2011) 9 (emphasis in original).

[53] David Parker, 'OECD Says CGT Would Address Inequality and Grow the Economy' (Press Release, New Zealand Labour Party, 5 June 2013) <https://www.scoop.co.nz/stories/PA1306/S00050/oecd-says-cgt-would-address-inequality-and-grow-the-economy.htm?from-mobile=bottom-link-01>.

[54] Reserve Bank of New Zealand, New Zealand Government, 'Submission to the Productivity Commission Inquiry on Housing Affordability' (September 2011) 74(3) *Bulletin* 30, 31.

depend on factors such as tax design and key features of the housing markets'.[55] Inland Revenue and Treasury claimed that, while tax may not be a dominant driver of high house prices, 'tax policy has exacerbated the house price cycle in New Zealand over the past two decades'.[56]

In terms of the potential impact on housing affordability of a CGT in New Zealand, submitters to the New Zealand Productivity Commission in 2012 were split on whether taxing capital gains on houses would suppress house prices and improve housing affordability.[57] The Productivity Commission report concluded that the impacts of a tax (for example, a CGT) depend

> on the tax design: most importantly, whether the tax would apply to nominal or real changes in value; whether losses would be deductible; whether it would apply only to houses, or possibly just rental houses, or to all asset classes … and whether it would be an accruals or realisation based tax.[58]

In their background paper prepared for the TWG, Inland Revenue and Treasury noted that '[t]here has been relatively little modelling in New Zealand of the likely effects on the housing market of extending the taxation of capital income',[59] and '[t]here are few empirical studies to draw upon'.[60] They then cautioned:

> These models help us to understand channels of impacts and possible general directions of trends, but indications of precise outcomes should be taken with a high level of caution given the inherent oversimplification of models and the interaction of many real influences that cannot be incorporated into a workable model.[61]

Indeed, with owner-occupied homes accounting for 63 per cent of all homes, there are doubts as to how much influence a CGT that excludes owner-occupied homes will have on improving the housing market as a whole.[62] Snell argues that a CGT will only temporarily slow down the

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[55] New Zealand Productivity Commission, New Zealand Government, *Housing Affordability Inquiry* (March 2012) 15. The report also contains a brief discussion of the income tax influences on housing affordability during the housing boom of the early–mid 2000s: at 88–9.

[56] Inland Revenue and Treasury (n 43) 19, 83.

[57] New Zealand Productivity Commission (n 55) 14. In particular, the Auckland Catholic Diocese Justice and Peace Commission, Habitat Auckland and the New Zealand Council of Trade Unions supported the introduction of a CGT to dampen speculation. Submitters noted in the report who disagreed with this view were The Centre for Straight Thinking, the Reserve Bank of New Zealand, the Business Roundtable and the New Zealand Property Investors' Federation.

[58] New Zealand Productivity Commission (n 55) 15.

[59] Inland Revenue and Treasury, New Zealand Government, 'Potential High-Level Effects of Proposals to Extend the Taxation of Capital Income: Background Paper for Session 15 of the Tax Working Group' (Background Paper, prepared for the Tax Working Group, August 2018) 22 <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3998517-potential-high-level-effects-of-proposals-to-extend-the-taxation-of-capital-income.pdf>.

[60] Ibid 5. In addition, while noting that there is 'considerable international modelling of the effects of taxes on housing decisions', the studies mentioned in the background paper focused on the effect of different tax rules on owner-occupied as well as rental housing, and therefore the application was limited: at 22.

[61] Ibid 22, 36.

[62] Inland Revenue and Treasury, 'Tax and Housing' (n 43) 18.

housing market and the prices will increase after some time.[63] Leung and Zhang indicate that in the long term, if the inflation rate is moderate, a CGT will lead to an increase in rents and housing prices, and a decrease in house investment.[64] Property investors would be motivated to preserve their real rates of return on investments by increasing rents on tenants.[65]

Similarly, in 2009 Coleman, using different taxing models, revealed that house prices could increase (and not decrease) with CGT.[66] The price of large houses was predicted to drop (by about 0.5 per cent) in only one of the modelled scenarios. In the other modelled scenarios, house prices were predicted to rise by 0.6–0.8 per cent,[67] to 4–5 per cent.[68]

The TWG Secretariat commissioned Coleman and Binning to model the impact of extending the taxation of capital income to non-owner-occupied housing.[69] They concluded that house prices would increase slightly with a CGT.[70] Conversely, Westpac Chief Economist Dominick Stephens, using a single equation model, estimated that an extension to the taxation of capital income ('ETCI') applied at a 10 per cent rate would reduce house prices by 10.9 per cent (and increase rents by 5.5 per cent).[71] His model indicates, among other things, that the extra expense from a CGT would decrease the amount an investor could pay for a property while still realising a profit, thus putting downward pressure on house prices.[72]

Due to the highly stylised nature of these models, the TWG Secretariat did not consider that the models by Coleman/Binning and Stephens could be relied on for precise estimates of the changes in rents and house prices that are likely to occur if ETCI is introduced in New Zealand.[73] The Inland Revenue and Treasury background paper, therefore, also considered the impact on house prices in Australia, Canada and South Africa following the introduction of a CGT. In Canada, house prices initially increased for two years before levelling off.[74] In Australia, there was no noticeable change in house prices until two years after the CGT became

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[63] Snell (n 31).

[64] Charles Ka Yui Leung and Guang-Jia Zhang, 'Inflation and Capital Gains Taxes in a Small Open Economy' (2000) 9(3) *International Review of Economics and Finance* 195.

[65] 'Effect of Capital Gains Tax Played Down', *Otago Daily Times* (online, 9 July 2011) <https://www.odt.co.nz/business/effect-capital-gains-tax-played-down>.

[66] Andrew Coleman, *The Long Term Effects of Capital Gains Taxes in New Zealand* (Motu Working Paper No 09-13, Motu Economic and Public Policy Research, August 2009) 7–8.

[67] Ibid 13.

[68] Ibid 15.

[69] Inland Revenue and Treasury, 'Potential High-Level Effects of Proposals to Extend the Taxation of Capital Income' (n 59) 22.

[70] Ibid 23.

[71] Dominick Stephens, *Tax and House Prices* (Westpac Bulletin, 19 June 2018) 2 <https://www.westpac.co.nz/assets/Business/Economic-Updates/2018/Bulletins-2018/Tax-and-House-Prices-June-2018.pdf>.

[72] Ibid 2.

[73] Inland Revenue and Treasury, 'Potential High-Level Effects of Proposals to Extend the Taxation of Capital Income' (n 59) 26.

[74] Ibid 28.

effective in 1985. Instead, in 1987 there were increases in house prices.[75] The grandfathering of pre-CGT assets may have also meant the tax was slow to take effect.[76] In South Africa, following the 2001 introduction of a CGT, there was a steady appreciation in the real price of housing (until 2003), and then (due to other factors) a period of more significant price appreciation (until 2007).[77] According to Inland Revenue and Treasury, while the results are somewhat muddied by other factors, the implementation of a CGT did not have a large impact on the overall trend in house prices in those countries.[78]

Overall, therefore, the consensus is that the introduction of a CGT would have minimal effect on house prices — though it may initially lead to a modest increase, thus negatively impacting housing affordability.

3 *The Impact of the Current Tax System on Housing*

In the last decade there have been three major changes to the taxation treatment of rental housing, all of which have reduced its appeal as an investment (from a tax perspective), yet with apparently little impact on housing affordability and homeownership rates. First, in 2010 the ability to claim depreciation on the building was removed.[79] Second, initially introduced in 2015, the bright-line rule taxes profits from residential rental properties sold within two years of the purchase date.[80] The holding period was extended to five years from 29 March 2018.[81] Third, from the 2019–20 tax year, tax losses derived by residential landlords are 'ring-fenced', that is, not able to be offset against other income of the taxpayer.[82]

Also, New Zealand has very comprehensive provisions in the *Income Tax Act 2007* (NZ) (ss CB 6A–CB 15), which tax amounts derived from land transactions that would otherwise be classified as capital amounts according to general principles. These provisions (and the equivalent provisions, which trace their origins to 1900) cast a wide net on taxpayers who: acquire land for the purpose of sale; have a scheme; or are in a business (building, developing, dealing) in respect of the land. The associated person's provisions and recent bright-line test

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[75] Ibid 28–9.

[76] Ibid.

[77] Ibid 29.

[78] Ibid 7.

[79] In Budget 2010 it was announced that the depreciation rate of buildings with long estimated useful lives was to be changed to 0 per cent: 'Technical Tax Area: Changes to Building Depreciation', *Inland Revenue* (Web Page, 2019) <https://www.ird.govt.nz/technical-tax/legislation/2010/2010-27/leg-2010-27-building-depreciation/leg-2010-27-changes-building-depreciation.html>. A background paper prepared for the TWG concluded that the impact of the removal of building depreciation and the reduction in tax rates from 2011 should have seen house prices either falling or rising slightly, neither of which happened (at least initially): Inland Revenue and Treasury, 'Potential High-Level Effects of Proposals to Extend the Taxation of Capital Income' (n 59) 29. In fact, real house prices began a period of significant increase in 2012 (until 2017): at 30.

[80] The two-year bright-line period was introduced in the *Taxation (Bright-Line Test for Residential Land) Act 2015* (NZ).

[81] For further information, see 'Bright-Line Property Tax', *Inland Revenue* (Web Page, 2019) <https://www.ird.govt.nz/campaigns/2018/brightline.html>.

[82] See Inland Revenue, New Zealand Government, *Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill — Commentary on the Bill* (December 2018) <https://taxpolicy.ird.govt.nz/sites/default/files/2018-commentary-argosrrm-bill.pdf>.

(in s CB 6A) ensure a very comprehensive legislative reach. It would appear these provisions have done little to moderate house inflation; in fact, their presence may have increased section prices as developers seek a specific after-tax return. Rather, in more recent times house prices in Auckland and other centres have levelled off,[83] which may be in response to non-tax policies such as the restrictions on foreign buyers[84] and tightened credit conditions (including the high loan-to-value ratio).[85]

In conclusion, while views differ on the impact of the tax system on house prices, there is agreement that '[w]hen the tax system is considered as a whole, it is likely to create bias in decision-making towards investment in housing',[86] thereby having a secondary role in influencing house prices. What is less clear is the impact that a CGT would have on housing affordability, especially given that the TWG's proposal excluded the family home. The limited evidence indicates that a CGT may actually lead to an increase in house prices and therefore exacerbate the housing crisis. In reality, the potential scope for a CGT to significantly positively influence housing affordability is limited due to the fact that the housing crisis is caused primarily by non-tax factors, such as the substantial constraints on the supply of housing[87] (including excessive land use regulation,[88] inadequate infrastructure provision, and poor productivity in the building sector[89]), immigration,[90] and foreign buyers. At best, a CGT may impact on housing affordability at the margins by discouraging some residential investors/speculators. The greatest impact of a CGT may be on perceptions — the public's belief that property investment is tax-favoured (and that this is driving up demand and house

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[83] Greg Ninness, 'QV Figures Show Property Values on a Long Slow Decline in Auckland, Starting to Head Downwards in Several Other Regions', *interest.co.nz* (Web Page, 7 August 2019) <https://www.interest.co.nz/property/101060/qv-figures-show-property-values-long-slow-decline-auckland-starting-head-downwards>.

[84] Anuja Nadkarni, 'Foreign Buyer Ban Sees Drop in House Sales to Overseas Buyers', *Stuff* (online, 2 May 2019) <https://www.stuff.co.nz/business/112403763/foreign-buyer-ban-sees-drop-in-house-sales-to-overseas-buyers>.

[85] Rebecca Howard, 'LVR Restrictions Effective but Have Some Drawbacks — RBNZ', *New Zealand Herald* (online, 22 May 2019) <https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=12233340>. Other measures, such as requirements for landlords under the *Healthy Homes Guarantee Act 2017* (NZ), will make rental property ownership more costly for property investors and lead to investors exiting the property sector (possibly reducing house prices): Susan Edmunds, 'Capital Gains Tax Could Mean Higher Rents, Lower House Prices', *Stuff* (online, 22 February 2019) <https://www.stuff.co.nz/business/110793492/capital-gains-tax-could-mean-higher-rents-lower-house-prices>.

[86] Inland Revenue and Treasury, 'Tax and Housing' (n 43) 22.

[87] The TWG's interim report notes that a cause of unaffordable housing is New Zealand's inability to build enough houses to satisfy increased demand due to high rates of population growth: Interim Report (n 2) 53.

[88] Auckland City Council states that the average two-lot subdivision can cost around NZD120,000–150,000 for an approved consent, a new certificate of title, professional fees and other requirements. These costs will likely include: consent, processing costs and development contribution fees. See 'Check If You Can Subdivide Your Property', *Auckland Council* (Web Page, 2019) <https://www.aucklandcouncil.govt.nz/building-and-consents/types-resource-consents/subdivision-of-property/check-subdivide-property/Pages/default.aspx>.

[89] Inland Revenue and Treasury, 'Tax and Housing' (n 43) 19, 83.

[90] See, for example, Chris McDonald, 'Migration and the Housing Market' (Analytical Notes No AN2013/10, Reserve Bank of New Zealand, December 2013) 2. The Reserve Bank of New Zealand has claimed that net migration changes are consistent with large housing effects: Andrew Coleman and John Landon-Lane, 'Housing Markets and Migration in New Zealand 1962–2006' (Discussion Paper No DP2007/12, Reserve Bank of New Zealand, December 2007).

prices). For example, a poll by Fairfax Media-Ipsos 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 (although not stated, presumably also conducted by Fairfax Media-Ipsos).[91] Regular media reports of sizeable capital gains made on housing also imply rising house levels are driven by the lack of a CGT.[92] Thus, the taxing of capital gains (including rental housing) could be seen as a 'political' solution to current housing problems (that is, 'the government is taking action'), but in practice is likely to have minimal impact on the issue.

IV Housing Affordability, Income/Wealth Inequality and Tax

A *The Rise of Income and Wealth Inequality*

Rising house prices and the consequential decline in house affordability is an issue policymakers need to address because of the link between access to housing and income/wealth inequality. In their 2017 briefing to the incoming minister, MBIE officials stated:[93]

> The substantial increase in house prices over past decades appears to be the major cause of the observed increase in wealth inequality in developed countries, and the ongoing effect is one of restricting access to opportunity for the young and less well off. This flows into wider social costs, including overcrowding and homelessness, health problems, and poor educational and labour market outcomes.

Wealth inequality has increased since the 1980s with a steady decline in homeownership rates.[94] Headlines such as 'Wealthiest Cream $360 a Day for Three Years', referring to the net worth of the wealthiest 20 per cent of New Zealand households (caused primarily by the change in the value of residential property), demonstrates the impact of the fall in homeownership rates.[95] Statistics New Zealand's labour market and household statistics senior manager, Jason Attewell comments, 'changes to the value of the residential property has a big impact on household net worth'.[96] In their submission to the TWG, the Child Poverty Action Group exhorted that '[t]he taxation of housing must be radically reformed to improve affordability and reverse trends to growing wealth inequality. Housing-related poverty is a significant and growing cause of child poverty.' [97] They noted that, if child poverty continues to exist, it will

[91] Michael Fox, 'Kiwis "Ready" for Capital Gains Tax', *The Press* (Christchurch, 12 November 2013) A5.

[92] Susan Edwards, 'Properties Give Their Owners a Tax-Free Windfall — Is That Fair?', *Stuff* (online, 4 September 2018) <https://www.stuff.co.nz/business/106811474/properties-give-their-owners-a-taxfree-windfall--is-that-fair>. The author writes that Kate Hawkesby and Mike Hosking 'banked about $4.1 million in capital gains' when they sold their Remuera home. 'The Arney Rd property was bought in 2015 for $5.5m and sold this year for $9.6m.That means the property made $1.3m a year, on average, for each year they owned it, or $3561 a day.'

[93] MBIE (n 37) 3.

[94] Linklater (n 46).

[95] 'Wealthiest Cream $360 a Day for Three Years', *The Press* (Christchurch, 15 December 2018) C18.

[96] Ibid.

[97] Alan Johnson and Susan St John, Child Poverty Action Group, 'Taking a Child-Focused Lens to Tax' (Submission to the Tax Working Group, 30 April 2018) 2 <https://www.cpag.org.nz/assets/180425%20CPAG%20TWG%20Submission%20FINAL_2.pdf>.

'further undermine the efficiency of the economy and social stability'.[98] An online submission to the TWG succinctly captured the concerns of many:

> Housing in our metropolitan areas is now the preserve of the rich, with others forced into substandard conditions that are bad for them and cost our society more in bad health, education and social outcomes. This should be a PRIORITY in taxation reform as it cuts to the heart of the issues facing our country overall.[99]

B *Inequality and Residential Property Investment*

Inland Revenue and Treasury estimate that property investors pay only 29.4 per cent of their after-inflation return in tax, whereas bank depositors and owners of dividend-paying shares pay 55.7 per cent.[100] This bias in favour of property investment arises because, while income from any investment is taxable, due to the ability to deduct property-related expenses, landlords often derive limited income (or even a tax loss) from their investment, yet are more than compensated by the potentially significant untaxed capital gains. Indeed, some landlords have chosen to negatively gear, meaning that they fund the rental property purchase with significant debt and minimal personal equity and (until recently) have offset the consequential tax loss due to substantial interest (and other) deductions against their other income. This has led to people buying rental property for the capital gain, rather than for the yields on rental income that boost the demand for — and the price of — rental property. It is argued that, with a CGT, the tax system will be more equitable by taxing capital gains made from property investments. The CGT would dampen investor (and speculative) demand, thus lowering house prices and improving housing affordability and reducing income/wealth inequality.

There are two responses to these arguments. First, due to the above tax measures enacted in the last decade (abolition of depreciation, the bright-line rule and the recently introduced ring-fencing of losses), the tax advantages of residential investment have significantly diminished.[101] The after-inflation tax return figure for property investment referred to above will not take into account the impact of the extended bright-line rule or recent ring-fencing of losses. Second, as noted earlier, the limited evidence indicates a CGT will have minimal impact on house prices — in fact they may rise, albeit modestly, following its introduction (especially if the family home is exempt). The potential of CGT to materially influence house prices (and after-tax yields) is therefore very questionable. The executive director for the New Zealand

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[98] Ibid 4.

[99] Submission by Lloyd Meiklejohn, quoted in Tax Working Group, 'Website Submissions Responding to the Question: Can Tax Make Housing More Affordable?' (n 49) (emphasis in original).

[100] Jamie Gray, 'NZ Capital Gains Tax Would Lift Rate of Home Ownership — Bank', *New Zealand Herald* (online, 19 June 2018) <https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=12073159>. There are views that a CGT should not be implemented, as the wealthy are already unfairly taxed with the current system. The TWG acknowledges that households in the top income decile pay around 35 per cent of all income tax, whereas households in the lowest five income deciles collectively pay less than 20 per cent of all income tax: Interim Report (n 2) 6.

[101] Non-tax changes, such as the *Healthy Homes Guarantee Act 2017* (NZ), similarly have or will reduce the attractiveness of rental housing investment.

Taxpayers' Union scathingly commented that 'Labour is misleading taxpayers if they think a CGT will be a panacea for the housing market'.[102]

Overall, the taxation of capital gains (on rental investments) may have only a comparatively minor impact on the level of income/wealth inequality, due to the limited influence of a CGT on housing affordability. Non-tax measures mentioned earlier are more likely to be successful at suppressing house price inflation and the consequential income/wealth divide.

V Fiscal Sustainability and the New Zealand Ageing Population

A *The Issue*

There is a growing awareness of the increased government spending on health and retirement with the ageing population. The periodic debate on lifting the retirement age also raises the public consciousness on these matters.[103] Noted among the challenges facing New Zealand, the TWG has included the ageing population and the associated fiscal pressures (or the impact on 'fiscal sustainability') for proposing a CGT.[104] Buckle and Cruickshank define 'fiscal sustainability' as 'the ability of the government to meet its current and future financial obligations and can be expressed concerning the government living within its budget constraint over time'.[105] The government financial obligations are

> determined by its taxation, spending, and borrowing decisions. Therefore, fiscal sustainability can refer to whether the government can maintain its policies without major adjustments in the future, or whether its policies would lead to excessive accumulation of debt that the government would eventually need to take action to address.[106]

Treasury's projections in 2006 and 2009 'suggest that New Zealand's prevailing fiscal programmes are unsustainable over the longer term'.[107]

New Zealand's tax revenue is predominantly collected from personal income tax (both of self-employed and salary/wage earners), corporate income tax and GST.[108] Personal income tax revenue will come under pressure as the ageing population leads to slower revenue growth, while at the same time increasing government expenditure on health and superannuation. Statistics New Zealand projects that the 2010 median age of 35.8 years will be lifted to 43.0

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[102] 'Labour's CGT Will Make Housing Affordability Worse', *Scoop Independent News* (online, 3 September 2014).

[103] See, for example, Jordan Bowler, Philip Gunby and Kelly Tonkin, 'Raising the Retirement Age to 67 Not Enough to Support Ageing Population', *Stuff* (online, 13 March 2017) <https://www.stuff.co.nz/national/politics/opinion/90321320/raising-the-retirement-age-to-67-not-enough-to-support-ageing-population>.

[104] Interim Report (n 2) 22.

[105] Bob Buckle and Amy Cruickshank, 'The Requirements for Long-Run Fiscal Sustainability' (Conference Paper, 'Affording Our Future' Conference, Victoria University of Wellington, 10–11 December 2012) 4.

[106] Ibid.

[107] Ibid, citing Treasury, New Zealand Government, *New Zealand's Long-Term Fiscal Position* (27 June 2006) and Treasury, New Zealand Government, *Challenges and Choices: New Zealand's Long-Term Fiscal Statement* (October 2009).

[108] Interim Report (n 2) 41.

years by 2060.[109] The number of dependent persons (under 15 or over 64) per 100 people of working age (15–64) is projected to rise by 44 per cent, from 50 in 2010 to 72 in 2060.[110] New Zealand's 2010 median age is comparable to that in Australia, China and the US. Outliers include Japan and Germany, where (in 2010) the median age already exceeded 43 years, and India with a (2010) median age of only 26 years. Due to the ageing population alone, government spending on social welfare, including health and education, is projected to rise from 24.6 per cent to 28.2 per cent of gross domestic product ('GDP') between 2011 and 2061, with the peak effect occurring around 2040.[111] Table 1 outlines the long-term fiscal projections and expected cost pressures in New Zealand from 2010 to 2060.

Table 1: New Zealand Long-Term Fiscal Projections and Cost Pressures, 2010–60[112]

% of nominal GDP	2010	2020	2030	2040	2050	2060	Change (% points)
Health	6.9	6.9	7.9	9.1	10.1	11.1	4.1%
Superannuation ('NZS')	4.4	5.3	6.5	7.2	7.3	8.0	3.6%
Education	6.2	5.2	5.1	5.1	5.1	5.2	-1.0%
Other op. allowance covered (eg, Justice)	8.3	7.4	7.4	7.5	7.5	7.6	-0.7%
Non-NZS welfare	6.8	4.9	4.6	4.3	4.1	3.9	-2.9%
Debt-financial costs ('DFC')	1.2	1.9	2.6	4.3	7.1	11.4	10.2%
Total expenses ('E')	33.9	31.6	34.1	37.5	41.2	47.2	13.4%
Revenue (majority tax) ('R')	30.2	32.3	32.6	32.5	32.5	32.6	2.4%
Operating balance (R-E)	-3.7	0.7	-1.6	-5.0	-8.7	-14.7	-10.9%

[109] Bryce Wilkinson and Khyaati Acharya, 'Guarding the Public Purse: Faster Growth, Greater Fiscal Discipline', *The New Zealand Initiative* (Web Page, 24 November 2014) <https://nzinitiative.org.nz/reports-and-media/reports/guarding-the-public-purse>.

[110] Ibid.

[111] Ibid.

[112] Girol Karacaoglu, Treasury, 'How Does the Treasury's Long-Term Fiscal Model Work, and What Is Our Initial Analysis Showing?' (Speech, 'Affording Our Future' Conference, Victoria University of Wellington, 10–11 December 2012) 6 <https://treasury.govt.nz/publications/speech/how-does-treasury's-long-term-fiscal-model-work-and-what-our-initial-analysis-showing>.

Balance excluding DFC ('primary balance')	-2.5	2.6	1.0	-0.8	-1.7	-3.2	-0.8%

Assuming that the forecasts are correct, the government is likely to have growing budget deficits from 2030. Due to the ageing population, 'healthcare and retirement income policy are the two significant drivers of the [forecast] fiscal gap'.[113] The sustainability of the government's fiscal position influences economic conditions and performance in several ways, including the cost of capital and its ability to issue debt. A potentially unsustainable fiscal position would see the government (and private sector) face borrowing constraints such as a higher country risk premium added to the cost of their borrowing.[114] In addition, from an intergenerational perspective, government debt can be seen as an obligation passed from one generation of taxpayers to the next. Higher levels of debt mean either higher levels of tax or reduced government expenditure for future generations.[115] Both alternatives are inequitable between generations and are ultimately not sustainable.

The ageing population (and downstream fiscal impacts) along with factors such as the present narrow tax base (and 'potential threats to these factors due to macro trends')[116] therefore means it is inevitable for taxes to increase and the tax base to broaden.

B *Capital Gains Tax — A Source of Revenue?*

Broadening the tax base to include CGT is one option to increase tax revenue. According to the projections by the TWG, taxing capital gains on the realisation of real property and equities could provide a growing revenue base for the future (as indicated in Table 2).

[113] Ibid.

[114] Buckle and Cruickshank (n 105) 12–13.

[115] Ibid 15.

[116] Interim Report (n 2) 41. These threats include 'the rise of the contractor, robotic and AI technologies, globalisation and the digital economy'.

Table 2: Projected Revenue from Taxing Capital Gains on Realisation, 2021–30[117]

Tax revenue (NZ$m)	Yr 1 2021	Yr 2 2022	Yr 3 2023	Yr 4 2024	Yr 5 2025	Yr 6 2026	Yr 7 2027	Yr 8 2028	Yr 9 2029	Yr 10 2030
All residential land, excluding family home	50	170	330	530	770	1,020	1,300	1,600	1,910	2,240
Commercial, industrial and other land	50	120	230	360	520	690	900	1,120	1,360	1,620
Rural land	30	70	140	220	310	400	510	610	730	840
Domestic shares	160	500	1,030	1,060	1,090	1,120	1,160	1,190	1,230	1,260
Total	290	860	1,730	2,170	2,690	3,230	3,870	4,521	5,220	5,960

There are two key issues in terms of fiscal sustainability and CGT. The first is that forecasting the potential ongoing tax revenue to be generated by a future CGT is difficult, due in part to the unknown impact of the design of the tax. For example, it is likely that the exclusion of family homes and collectables would see investment increase in those asset classes to the detriment of other investments, reducing the effectiveness of a CGT. The CGT may also encourage lock-in to postpone triggering any CGT liability (and meaning potentially sub-optimal investment decisions are made).[118]

Evans and Krever observe that 'the [ongoing] yield from CGT is usually a relatively small proportion of the income tax and the total tax yield (never more than around five per cent), and typically never more than one per cent of GDP';[119] rather, the essential role of a CGT is to act as a 'backstop' to the income tax system — to protect the tax base.[120] However, while comparatively small in percentage terms, in absolute terms even a 5 per cent (or less) collection rate would be a significant boost to the government's tax collection — and could be targeted at reducing poverty and income inequality and/or contributing to funding superannuation payments.

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[117] Ibid.

[118] In Canada, the Fraser Institute observe that CGT revenue represents a mere 1.1 per cent of the federal government's overall revenue, but hurts the economy by discouraging investment and entrepreneurship: Fraser Institute, 'Reducing Capital Gains Taxes Would Encourage Investment and Grow Canada's Economy', *State News Service* (online, 6 November 2014). They also comment that to exclude capital from taxable income increases the attractiveness of risky investments, which otherwise might not be undertaken because of inadequate post-tax return.

[119] Evans and Krever (n 25) 494.

[120] Ibid. The TWG similarly noted that extending the taxation of capital income could 'generate between 1% and 4% of total yearly tax revenue in the first ten years': TWG Volume I (n 16) 64.

In addition, Evans and Krever caution that the yield from a CGT is 'volatile and unpredictable'.[121] Asset prices fluctuate, with the state of the local and global economy impacting on the tax generated (and forecasts such as in Table 2), especially if an allowance is made for capital losses. The TWG similarly observed:

> Greater revenue volatility will also require disciplined fiscal management, so that future governments do not lock themselves into permanent spending commitments on the basis of temporary peaks in capital gains revenue.[122]

A CGT alone may not be a reliable and constant stream of revenue to fund regular, ongoing expenditure such as superannuation, and therefore should be one of a suite of new taxation measures aimed at ensuring future fiscal sustainability in New Zealand.

VI Concluding Observations

This paper is set against the background of the TWG consideration of the future of the New Zealand tax system and subsequent rejection by the government of the TWG's recommendation to extend the taxation of capital gains in New Zealand. The paper considered whether the government's failure to pursue the possible implementation of a CGT was a lost opportunity to address three socio-economic challenges: housing affordability, income/wealth inequality and fiscal sustainability.

The available evidence indicates that a CGT would have only a limited (and possibly inflationary) impact on house prices (and affordability). Countries with CGTs, such as Australia and Canada, also battle rising house prices (and bubbles) and the consequential negative impact on affordability.[123] As far as the domestic housing market is concerned, while it 'is likely that the tax system has created a bias in decision-making towards investment in housing',[124] the consensus is that non-tax factors, including supply issues and immigration, have been the primary drivers of house prices. As noted, the tax advantages of rental housing have also been significantly reduced in the last decade, with no discernible impact on house prices. For progress to be made on housing affordability, the non-tax drivers need to be addressed. In that context, the 'value' of a CGT would then lie more in the signal that it sends to the electorate (of a government willing to tackle all causes of rising house prices).

Income/wealth inequality in New Zealand, which is due in part to falling homeownership rates, continues to grow, as do the consequential negative impacts on society. The above discussion concluded that the limited link between the tax system and house prices means a CGT would do little to address this cause of income/wealth inequality. Further, the tax changes made to rental housing investment, including ring-fencing of losses and the abolition of depreciation on buildings, along with non-tax changes, have diminished the appeal of rental housing as an investment (and should reduce the inequality between residential property investors and other

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[121] Evans and Krever (n 25) 494. The TWG also noted that 'the experience in Australia suggests that there can be significant peaks and troughs in capital gains revenue': TWG Volume I (n 16) 65.

[122] TWG Volume I (n 16) 65.

[123] Patrick Flannery, 'Do We Really Need a Capital Gains Tax?', *New Zealand Herald* (online, 18 August 2014) <https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11310433>. See also 'The Economist House Price Index', *The Economist* (Web Page) <https://infographics.economist.com/2017/HPI/index.html>.

[124] Inland Revenue and Treasury, 'Tax and Housing' (n 43) 22.

investors/savers). The extension of the bright-line rule to five years, along with the already comprehensive income tax provisions applying to land sales, effectively means there is already a de facto CGT operating in this area.

Treasury (and others) have projected that New Zealand's 'prevailing fiscal programmes are unsustainable over the longer term',[125] due in part to the ageing population and the consequential effects on the government's tax revenue and expenditure. The government will, therefore, need to increase tax revenue from existing sources and/or devise new sources of tax revenue (thus widening the current tax base). While, in percentage terms, the revenue generated by a CGT is small compared with other forms of taxation, its introduction would have added another source of revenue for the New Zealand government (and protected the income base). However, the fact that revenue yields from a CGT are volatile and unpredictable also needs to be acknowledged in the development of broader future tax policy in New Zealand.

New Zealand is in a unique position as a potential late adopter of a CGT to look at, and learn from, the practices of other jurisdictions. However, in designing any tax, it is important that it has a clear policy rationale supported by evidence (including international experience). As noted, the government asked the TWG to 'consider a package or packages of measures which reduces inequality, so that New Zealand better reflects the OECD average while increasing both fairness across the tax system and housing affordability'.[126] While a CGT would generate additional tax revenue, its introduction would have arguably done little to improve housing affordability and the related inequality issues. In addition, some issues cannot simply be solved by taxation; housing affordability is one such issue.

[125] Buckle and Cruickshank (n 105) 4. See also Treasury, *New Zealand's Long-Term Fiscal Position* (n 107); Treasury, *Challenges and Choices* (n 107).

[126] Tom Pullar-Strecker, 'Ministers Issue Fresh Request to Tax Working Group to "Consider Inequality"', *Stuff* (online, 20 September 2018) <https://www.stuff.co.nz/business/107131315/capital-gains-tax-would-have-pros-and-cons-says-tax-working-group>.