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Regular commentary from our experts on topical tax issues

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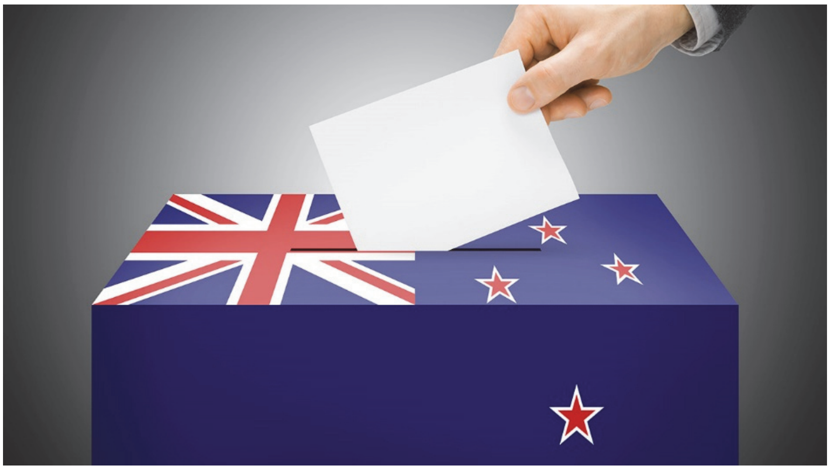

The Opportunities Party asset tax policy released

Snapshot

The Opportunities Party ("TOP") founded by Gareth Morgan has released one of its key **tax policies**. It aims to close two "loopholes":

- Accumulating wealth, including owner occupied housing, that produces little or no taxable income.
- Business assets that make a taxable return below "risk-free" NZ Government bonds.

TOP's solution is to tax a deemed minimum rate of return on all productive assets, including all housing and land, if the ordinary tax rules would tax a lower amount. The tax collected will be redistributed through tax cuts weighted to lower income earners. TOP estimates 80% will either be unaffected or pay less tax.

Taxing a deemed rate of return is not a new policy. The 2001 Tax Review considered a similar approach for assets, including housing. For mainly political reasons this received little traction at the time. Is it time for a re-think?

TOP also promises a policy for taxing foreign businesses before year's end.

Economists see housing as an investment, and what doesn't go out – i.e. rent saved – is income. Including these "imputed rents" in the tax net will improve economic efficiency

For (almost) everyone else, their house is their home and something must come in for it to be income. Otherwise, there is nothing to properly tax

These perspectives are worth debating to see if NZ's tax system needs improvement

It remains to be seen whether the economist's view will gain public support

Contact us

John Cantin
Partner
T: +64 4 816 4518
E: jfcantin@kpmg.co.nz

Darshana Elwela
National Tax Director
T: +64 9 367 5940
E: delwela@kpmg.co.nz

What's the problem according to TOP?

Lack of fairness in the tax system

TOP says the key issue is that wage earners are discriminated against in favour of owners of assets and businesses with low or no taxable income.

Its policy statement notes the differing tax treatments of different assets and investments. This is despite:

> *"All productive assets – and that includes the house that provides you with your accommodation each year – produc[ing] income each and every year, not cash necessarily but income nevertheless."*

Understanding the underlined words is critical to understanding the rationale for TOP's policy. A person who owns and occupies their own house does not pay rent. This saving, the "imputed rent" (which TOP refers to as "free" accommodation), is income in the economist's definition. It is not, however, in the ordinary definition of income.

Not taxing it creates an advantage for owner occupation. After-tax, other things constant, this is a better option than buying a rental property or putting money in the bank (as rent and interest are both taxable).

For businesses, TOP says that if a business does not generate a taxable return higher than NZ Government bonds it is not a viable commercial enterprise. Taxing based on a minimum return will encourage better use of capital.

What is TOP proposing?

Taxing a minimum deemed rate of return on all "productive" assets

TOP's proposal is to deem a minimum rate of return for housing, land and business assets, on which tax is payable. Put simply:

> *the net value of the asset* **x** *minimum deemed rate* (not confirmed in TOP's policy statement but, say, 5%) **=** *minimum taxable income from that asset*

If the actual taxable income is greater, that will remain the taxable amount. By definition, if the asset has no taxable income under current rules, the new rules will apply. This will apply particularly to owner occupied homes.

As transitional measures, TOP proposes:

- Stepping up to the deemed rate over a few years, to give asset owners time to adjust.
- Allowing homeowners aged 65+ to pay tax on change of ownership of their home, to avoid cash-flow issues.
- Allowing businesses facing a temporary/cyclical downturn to defer the tax up to 3 years (with interest payable on the deferral).

TOP states that its overall tax package will be tax neutral. Every additional dollar of tax collected will be given back via income tax cuts. The statement says this re-distribution will favour lower income earners.

The effect on house prices

TOP suggests that its policy will "make housing more affordable over time". It will lead to more sensible investment decisions.

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Is this mainstream tax policy?

Taxing owner occupied housing is not commonplace around the world. Most countries exempt the family home from any capital gains tax that applies. However, there are a few countries in Europe which attempt to tax imputed rents from housing (the Netherlands being one).

For business assets, the Allowance for Corporate Equity (or "ACE") system is a variant of taxing a deemed return. It taxes businesses on returns above a risk free rate (i.e. gives an effective tax deduction for the cost of equity). This is intended to equalise between the tax treatment of equity and debt funded investment. Norway and Belgium have variants of this.

In New Zealand, the **2001 Tax Review** explored the idea of a Risk Free Return Method ("RFRM") for taxing owner occupied housing. It did not proceed. The current Fair Dividend Rate method for taxing offshore investments has its genesis in this RFRM concept.

More recently, the **2010 Tax Working Group** considered that a low-rate land tax could be used to achieve other tax reductions in New Zealand. (A land tax has similar characteristics to taxing a deemed rate of return.) The Government did not implement that recommendation.

Our view

TOP's release of this policy confirms that tax will be an election issue. This is particularly when combined with the thorny issue of how to make housing affordable.

The policy is very much based on an economist's view of what should be taxed. Your house is an investment. "What doesn't go out" (rent saved) and "what comes in" (rent earned) are both income and should be taxed identically.

For (almost) everyone else, their house is their home. And it is only what comes in that is income. These are understandable and, for many, personal deeply-held convictions. The 2001 Tax Review's RFRM suggestion did not attract public or political support. The family home was a sacred cow.

The difficulty in bridging these perspectives is that most will not see anything that should properly be taxed. However, it is a debate worth having. One that needs to be based on facts, rather than misinformation and emotion.

Whether the debate will garner the public support necessary to progress TOP's policy remains to be seen.

From a tax policy perspective, we expect 2017 will be another interesting and challenging year.

For further information

John Cantin
Partner, Tax
Wellington
Phone: +64 4 816 4518
Email: jfcantin@kpmg.co.nz

Darshana Elwela
National Tax Director
Auckland
Phone: +64 9 367 5940
Email: delwela@kpmg.co.nz

kpmg.com/nz
twitter.com/KPMGNZ