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Tax Working Group Report Recommending Capital gains Tax.

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The long awaiting tax working group report has finally been released and as predicted, has recommended the introduction of a comprehensive capital gains tax.

But the working group were far from unanimous in their recommendation with a quarter of the panel refusing to support the recommendations in their current form.

Dissenters included many of the most respected authorities on tax in New Zealand including policy official Robin Oliver, tax lawyer Joanne Hodge and Business NZ leader Kirk Hope.

What wasn't predicted, and what may account for the distension in the working group, is that the proposed CGT would be one of the worlds harshest regimes of its kind with the rate set at the high marginal income tax rate, that for most will mean 33%. By contrast, in Australia, whilst CGT on individuals is set at their marginal tax rate, a 50% discount is applied if the asset has been held for more than one year.

Whilst commentators are already diving into the detail of the report's recommendations there are a few key things to understand, and they are primarily political.

Firstly, there is very little to be gained by focusing on the working groups recommendations. They are only that, recommendations, to a government that must now decide what to do with the highly charged tax grenade that they requested be lobbed into their trench.

The government will respond to the report recommendations in April 2019 and this will be when we find out what the government will have accepted and what they have rejected of the working group report.

You can be certain the government will water down and cherry pick the portions of the recommendation they can live with politically when actually forming their policy.

Already, the Prime Minister has made statements assuring small business owners and farmers that, their interests, are forefront in her mind. No mention though of the hard-working kiwis that provide the countries rental housing stock.

Until we see the governments response, the ultimate form the CGT policy may take is pure speculation.

Remember, the government has given an undertaking that CGT will not be passed into law before the next election so the people will have the opportunity to decide if this tax ultimately gets passed into law.

Secondly, there is a political elephant in the room in the form of Winston Peters and NZ First. Its impossible to consider CGT without first contemplating what position Winston will take.

NZ First has always opposed a capital gains tax but have chosen coalition government with parties that support it.

Their opposition to CGT provides Winston, should he choose it, the perfect card to play to differentiate himself from labour and the Greens in the run up to the next election.

His position on CGT may well determine whether he can get back over 5% support and again secure the balance of power at the next election, he can then put a stop to CGT by either backing National who oppose it or requiring Labour to abandon the plan as the price for another term in government.

So, what of the tax proposal itself?

It seeks to be comprehensive, both in its application to asset classes and its rate, set at the full marginal income tax rate.

The family home will be exempted, meaning that already two thirds of residential property in NZ will fall outside the tax. This exemption will promote "mansion building" as kiwis invest in increasing the capital value of their personal homes rather than their investment assets and in so doing avoid CGT.

Thankfully, shares and equities are included. For two long property has been considered the villain with tax policy targeting property as an asset class whilst ignoring share speculators. The share market is a place of rampant speculation with gains failing to be declared under existing legislation that taxes any gain on a share purchased for on sale. There has simply been no will to enforce these rules with the government and the IRD seemingly only interested in enforcing laws that tax speculation in property. The howls of protest are already loud and strong from the fund managers of the "productive sector" but it's hard to see how banking a tax-free gain by speculating on shares can be considered any more productive that providing a worker accommodation in a dwelling.

Now, the question we are asked the most, "will the gain I already have on my rental property be taxed under this CGT proposal?'. No. Only gains derived after the introduction of the tax will be caught. The tax will not be introduced with retrospective application.

This then requires all assets that may be subject to the tax to have their values assessed on valuation day, the day the tax is introduced. The logistics and cost of this exercise are themselves, staggering, not only for property investors but for business owners alike.

The governments great hope with CGT is that the promise of fiscal neutrality and improved fairness will sell middle New Zealand on the merits of the tax, and it is easy to see how voter support for a tax that promises a cut in income tax would be music to the ears of those who hold no risk from being impacted by CGT.

The problem though is that fiscal neutrality is an impossibility. Despite its bold predictions that the tax will bring in 8 billion in the first 3 years and 3 billion annually thereafter the reality is that the government has no sound basis to predict the receipts from CGT or the timing of them. This is particularly true as we see property prices begin to decline on the back of policies like the foreign buyer ban and ring fencing of tax losses from property that are designed to drive down the demand for residential property and then, drive down its price.

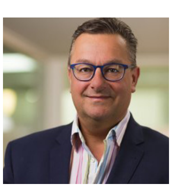
Those holding the assets will determine when CGT is paid as nothing is payable unless an asset is disposed of and then, only when a gain is derived.

Promising a tax cut then that can be costed with a high degree of certainty but hoping to fill the gap in the coffers with a tax that has an uncertain take, is folly in the extreme.

Capital gains tax is now set to become a central election issue and voters will be required to make sense of its implications.

We look forward to assisting our clients understand exactly what CGT will mean for them.

We will be back in touch on the matter in April when the government responds to the report.



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