Journal of Australian Taxation

TABLE OF CONTENTS

FOREWORD

JONATHAN BARRETT
GUEST EDITOR

Kia ora koutou

This special edition of the *Journal of Australian Taxation* arose from a conversation between Lisa Marriott, the President of the Australasian Tax Teachers Association, and the editors of this journal, John McLaren and John Passant, at the 2019 ATTA conference in Perth. After discussing New Zealand's impending Tax Working Group ('TWG') report, they concluded that the TWG's recommendations were likely to be of interest beyond New Zealand. They invited me to edit this special edition. We think the articles in this special edition will indeed be of interest to readers in Australia, New Zealand and beyond.

While the TWG's key recommendation — a comprehensive capital gains tax ('CGT') — was not taken up by the government, its final report is significant in other regards and may have a long-term influence on tax policy and debate in New Zealand and overseas. In addition to following the usual benchmarks for a good tax system, the TWG sought to incorporate *Te Ao Māori* (a Māori worldview) and Treasury's Living Standards Framework ('LSF'). It also adopted the concept of a circular economy.

The succinct articles in this special edition of the journal analyse key features of the TWG's report. The authors, who are mostly emerging tax scholars, bring original perspectives and critical insights to the issues raised.

One of the most significant features of the TWG's work was its recognition that government, as a Treaty of Waitangi partner, must incorporate *Te Ao Māori* when developing tax policy. Matthew Scobie (Kāi Tahu) and Tyron Rakeiora Love (Te Ātiawa) provide an Indigenous perspective on this imperative, but warn against tokenism. The authors conclude:

> Achievement of genuine government–*iwi* partnership requires clear and concise strategies that communicate to the public why Māori engagement in developing tax policy is not just an obligation on the Crown under the Treaty, it is a process that will bring positive outcomes for all New Zealanders.

Alison Pavlovich unpacks Treasury's LSF in relation to the TWG and emphasises, in particular, pursuit of intergenerational equity. Alison places the TWG and its adoption of *Te Ao Māori* and the LSF in the historical context of previous tax reviews. She concludes that substantive intergenerational equity indicates the need for a CGT and significant environmental taxes.

Kathleen Makale and I analyse the TWG's endorsement of the radical environmentalism of a circular economy. We draw on the work of Kate Raworth, in particular, to show how taxes could contribute meaningfully to New Zealand meeting its commitments under the Paris Agreement. However, the analysis also takes account of the country's reliance on agriculture and the power of the dairy lobby.

Suzy Morrissey provides a feminist critique of the TWG and its failure to take proper account of the experience of women and taxation. Suzy draws on TWG supporting documents that few of us will have read and situates them in a narrative of a decline in rigorous fiscal research into gender. Nevertheless, she expresses optimism that the more nuanced approach of the TWG may lead to proper consideration of gender and taxation in the future.

Andrew Maples and Sue Yong analyse the TWG's CGT recommendation and its rejection. A comprehensive CGT was supported by the Labour and Green components of the government, but was vetoed by New Zealand First, a small but pivotal populist party. A once in a generation opportunity to introduce an equitable and practicable CGT appears to have been lost. Nevertheless, we can expect a CGT to feature in future tax debate and reviews — Andrew and Sue explain why a CGT is a necessity for New Zealand.

Coterminous with the TWG's review of the overall tax system, Inland Revenue investigated the possibility of a digital services tax ('DST'). Ben Walker critically examines the DST proposal. Ben draws on German language texts, among other sources, to analyse the premises on which the DST is based. He questions whether highly digitalised businesses really do pay less tax than other multinational enterprises, and cautions against New Zealand taking unilateral action on possibly unreliable premises.

I was pleased to take up the offer to be guest editor of this special edition but, of course, a project such as this is a team effort. In particular, I would like to thank Lisa and the editors for their support, the authors, the reviewers, Barbara Graham for her careful editing, and the Wellington School of Business and Government for a funding grant. We hope you find the articles stimulating and enjoyable.

Ngā mihi nui

Jonathan

THE TREATY AND THE TAX WORKING GROUP: *TIKANGA* OR TOKENISTIC GESTURES?

MATTHEW SCOBIE (KĀI TAHU) AND TYRON RAKEIORA LOVE (TE ĀTIAWA)*

ABSTRACT

This paper engages with the Māori perspectives in the Tax Working Group *Future of Tax* report. It is argued that a Māori worldview can contribute to a more equitable and sustainable tax system, and that engaging with Māori people and worldviews beyond tokenistic and obligatory gestures has the potential to alter/disrupt prevailing systems of public policy in subtle yet commanding ways. Two frameworks informed by Māori knowledge within the report are introduced and evaluated for their ability to inform and enhance policy development. One aspect of these frameworks is explored in detail and it is argued that while this can provide a profound shift in thinking, rights must be acknowledged and addressed to avoid tokenism. We conclude that achievement of genuine government–Māori partnership in policy development requires clear strategies that communicate to the public why Māori engagement in developing tax policy is not only an obligation on the government of New Zealand under the Treaty of Waitangi, but will result in positive outcomes for all New Zealanders.

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I INTRODUCTION

In 2017, the New Zealand government mandated the Tax Working Group Te Awheawhe Tāke (‘TWG’) to investigate and make recommendations on the ‘structure, fairness and balance’ of the country’s tax system.[1] The TWG’s *Future of Tax* report, which was released on 21 February 2019, made consistent references to the importance of incorporating Indigenous Māori perspectives on wellbeing and living standards.[2] In this article, we seek to do several things. We give an overview of two interrelated Māori-informed frameworks (He Ara Waiora, and a cascading model proposed by the TWG) that were developed through engagement with Māori beyond the TWG.[3] We then explore one aspect of these intersecting models — *kaitiakitanga* — in more detail, and argue that, without a clarification of rights prior to policy development, tokenism may result. Finally, we discuss and make two substantive points: (1) a Māori worldview can contribute to a more equitable and sustainable New Zealand tax system; and (2) engaging with Māori people and worldviews — beyond tokenistic and obligatory gestures — could transform existing systems of public policy development.

II HISTORICAL AND CONTEMPORARY CONTEXTS

The New Zealand government has an obligation to engage Māori in policy development. The most enduring and effective argument for this obligation has been through rights guaranteed by the Treaty of Waitangi (‘the Treaty’). The Treaty, which was first signed at Waitangi on 6 February 1840, is an agreement between Māori and the British Crown that makes concrete promises to Māori regarding their rights.[4] The Crown breached and gradually ignored the Treaty over time, although more recently it has been incorporated into legislation based on a broad set of principles.[5] Other disputes over the Treaty regard interpretations — for example, the nuance between ‘sovereignty’ in the English version and ‘*kāwanatanga*’ in the Māori version. Orange points out that *kāwanatanga* was unlikely to convey a precise definition of sovereignty to Māori readers.[6] In addition, the English translation of Article II confirms and guarantees Māori collective or individual possession over lands and estates, forests, fisheries and other properties, whereas the Māori version guarantees *rangatiratanga* (chieftanship) over their lands, villages, and all property and *taonga* (treasures), and omits the collective/individual distinction.[7]

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

[2] 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’).

[3] Sacha McMeeking, Hamuera Kahi and Komene Kururangi, *He Ara Waiora: Recommendations for Advancement* (Report prepared for the Tax Working Group, November 2018) <https://taxworkinggroup.govt.nz/sites/default/files/2019-02/twg-bg-4066385-he-ara-waiora.pdf>.

[4] Claudia Orange, *The Treaty of Waitangi* (Bridget Williams Books, 2011).

[5] Ibid.

[6] Ibid.

[7] Ibid.

For Māori, '*rangatiratanga*' means more than possession, and better approximates to sovereignty than '*kāwanatanga*', which tends to imply authority in an abstract rather than concrete sense.[8] Orange notes that Governor Hobson (the Crown's Treaty signatory) and others stressed the benefits of the Treaty while playing down the effects of British sovereignty on *rangatiratanga* as self-determining authority.[9] Morgan Godfery explores the constitutional status of the Treaty and argues that it reaffirms Māori constitutional power through *rangatiratanga* and that it conferred a new power on the British settlers — *kāwanatanga*. When the empowering system is a Māori constitution with Māori law, the concept of '*mana*' in the pre-1840 constitutional system becomes '*rangatiratanga*' in the post-1840 system. This can now be conceptualised as a partnership in which *rangatiratanga* and *kāwanatanga* constitute separate sites of power.[10]

III Māori-Informed Frameworks

Two Māori-informed frameworks — He Ara Waiora (see Figure 1) and a cascading model (see Figure 2) — were proposed by the TWG. The He Ara Waiora framework presents a pathway towards wellbeing and is a reflection of *Te Ao Māori* (a Māori worldview), which draws on four *tikanga* (guiding principles, ethics or values).[11] These *tikanga* are seen to support the design of the Living Standards Framework being developed more broadly by the New Zealand Treasury.[12] He Ara Waiora is a draft framework, and while reports suggest that there is broad support among Māori involved in consultation around its development, more engagement and implementation is required to turn the good intent of He Ara Waiora's development into practical and measurable progress.[13] In part, this *tikanga* framework is seen as a meaningful and appropriate reflection of the commitments Māori and the Crown have made in the spirit of the Treaty. There are aspirations to extend the framework to all policy developments in New Zealand.[14] If implemented in a genuine and committed way, the framework could be world-leading in providing alternatives to reductive dominant development perspectives. Additionally, the framework could assist the New Zealand government in meeting its obligations to Māori through the Treaty and the *United Nations Declaration on the Rights of Indigenous Peoples* ('UNDRIP').[15]

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[8] Morgan Godfery, 'The Political Constitution: From Westminster to Waitangi' (2016) 68(2) *Political Science* 192.

[9] Orange (n 4).

[10] Godfery (n 8).

[11] McMeeking et al (n 3).

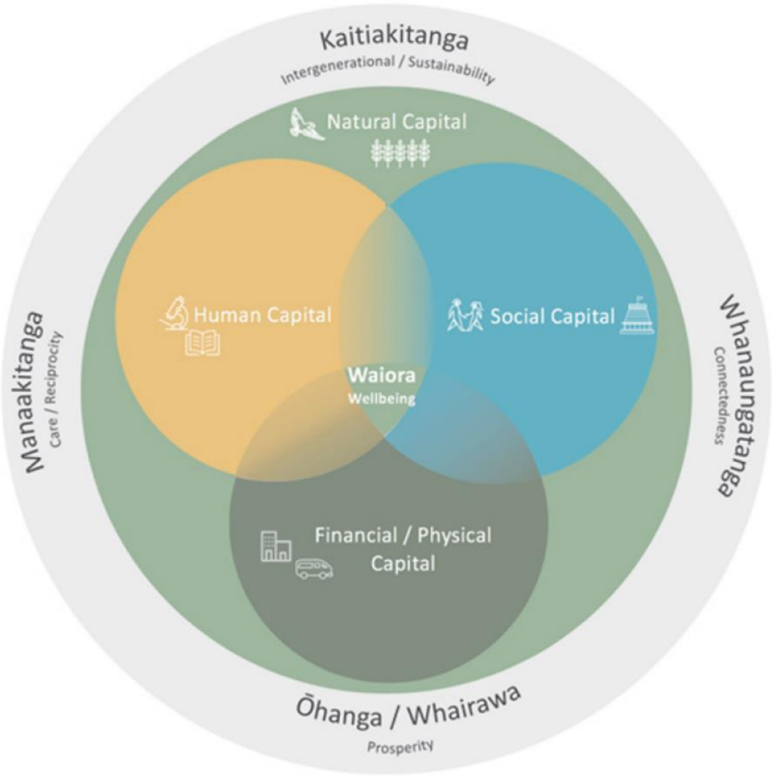
[12] 'Living Standards', *The Treasury* (Web Page, 4 December 2018) <https://treasury.govt.nz/information-and-services/nz-economy/living-standards>.

[13] McMeeking et al (n 3).

[14] Ibid.

[15] *United Nations Declaration on the Rights of Indigenous Peoples*, GA Res 61/295, UN Doc A/RES/61/295 (2 October 2007, adopted 13 September 2007).

Figure 1: He Ara Waiora — A Pathway towards Wellbeing[16]



The framework is centred on the concept of '*waiora*', a Māori expression of wellbeing.[17] This acknowledges that *wai* (water) is the source of all life. Here a moral imperative for wellbeing within the tax system could be 'all New Zealanders live a life they value, with specific recognition of Māori living the lives that Māori value and have reason to value'.[18]

The TWG report stressed that He Ara Waiora in conjunction with Treasury's Living Standards Framework can help New Zealand move towards greater systems-thinking that reflects an interconnected view of the world and resources, grounded in a uniquely Aotearoa New Zealand[19] perspective.[20] McMeeking et al point out that New Zealand values have been shaped by *tikanga* Māori, and while *tikanga* resides with Māori, the values that emerge have a resonance with contemporary New Zealand.[21] During consultation, the risks of tokenism, distorting *tikanga*, and the performance gap between aspirations and applications of values were raised. One approach proposed by Mānuka Henare to address these concerns is a model

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[16] McMeeking et al (n 3) 6.

[17] TWG (n 2).

[18] Ibid 11. See also Amartya Sen, *Development as Freedom* (Oxford University Press, 1999).

[19] Here we deliberately use 'Aotearoa New Zealand' to assert the potential for more mature government–iwi relations.

[20] TWG (n 2).

[21] McMeeking et al (n 3).

designed to give 'cascading and tangible guidance to the purpose',[22] performance measures, and outcome elements of policy design. This model was also explored in detail with communities during the consultation period.[23]

Figure 2: Cascading *Tikanga* Implementation Model[24]

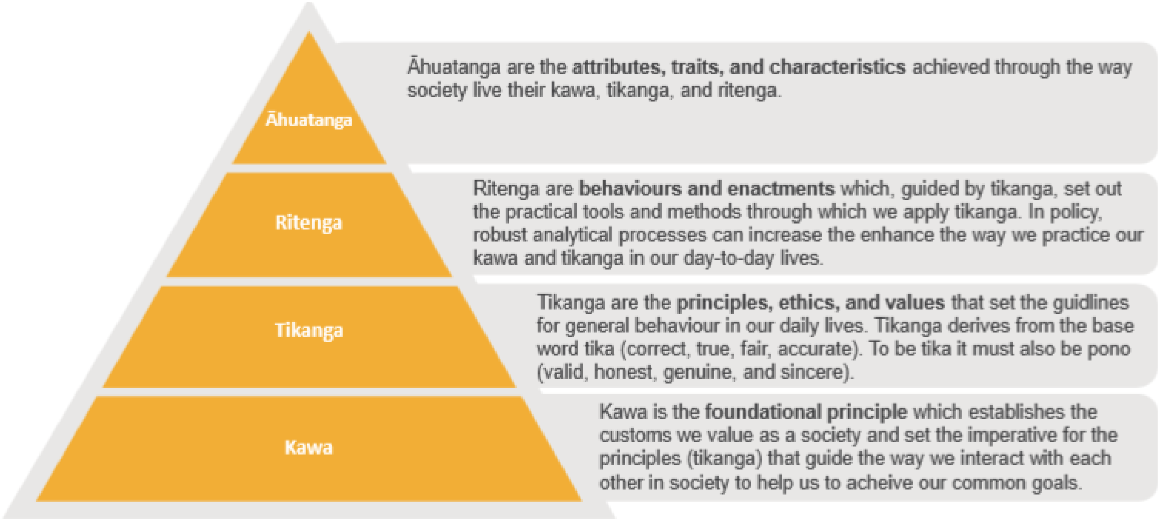

Figure 2 has been presented as a tool to overcome the identified shortcomings of He Ara Waiora. There are four elements to this model. First, *kawa* is the foundational principle and is driven by a moral imperative: 'New Zealanders live a life they value, including specifically Māori living the lives that Māori value'.[25] Second, *tikanga* are framing objectives that give effect to specific values; these objectives require discussion and consideration and should be informed by historical and contemporary practices. Third, *ritenga* are behaviour guidelines that give greater specificity to the objectives of *tikanga*. Finally, *āhuatanga* embody attributes and characteristics manifested in a suite of indicators to reflect *tikanga* and *ritenga* that are specific and measurable. He Ara Waiora represents a holistic framework based on Māori values and practices, whereas the cascading model provides a tangible way to operationalise these values into practical and measurable objectives and outcomes.

A *Kaitiakitanga*, Freshwater and Tax

Here we explore one *tikanga* — *kaitiakitanga* — in more depth, and consider its implications for policy development around freshwater and taxation. *Kaitiakitanga* can provide a profound shift in thinking about how nature, resource management and taxation intersect. However, without Treaty rights being upheld, implementing *kaitiakitanga* is near impossible. *Kaitiakitanga* is an obligation to maintain capital for current and future generations. The He Ara Waiora framework recognises that three forms of capital — human, social and

[22] Ibid 8.

[23] Ibid.

[24] Model proposed by Mānuka Henare: see TWG (n 2) 27.

[25] McMeeking et al (n 3) 9.

financial/physical — all function within natural capital. That's because land, water and all other resources nourish all living things. If natural capital is depleted, then all other capitals are irrelevant.[26]

Kaitiakitanga is an ancestral obligation to collectively sustain, guard, maintain, protect and enhance *mauri* (life being or force). An actor who carries this responsibility is called a *kaitiaki*, and the obligation of the *kaitiaki* is embodied in resource management practices. The relationship between the *kaitiaki* and the resource (for example, freshwater) is seen as reciprocal. Social, economic and political benefits are obtained through resources, but the resources must be cared for and even improved. *Kaitiaki* are genealogically linked to the resources and derive rights and responsibilities through *whakapapa* (a structured genealogical relationship between all things).

Take the health of a river as an example of a consideration under a *kaitiakitanga* approach. Poipoia Ltd suggest that a *kaitiakitanga* method driven by a Māori worldview would start by asking 'how does the river sound, smell and feel?' Quantitative assessments — like testing pH levels, clarity and turbidity[27] — may offer glimpses into a river's health, but they should also consider the deeper intersections of the *mauri* of the river. Poipoia Ltd suggest that pricing through a quota system may redistribute water access in an equitable fashion, but only after first addressing water quality and *mauri*.[28] This approach emphasises a further essential aspect of river *kaitiakitanga*; the relationships that exist between *mana whenua* (those with authority from the land) and the river.

An important question for us is, how can a particular price on a tradeable water allocation enable both an efficient allocation of water and maintain/improve the *mauri* of a body of water? Answering this type of question will not only benefit Māori rights and improve ancestral relationships with water, lakes and rivers, it will progress the environmental lifeways of the country and the economy. Therefore, under the *tikanga* of *kaitiakitanga*, water and waterways need to be maintained and improved over time in their own right — in addition to maintaining and enhancing social, human and financial/physical capitals — through recognising the intimately interrelated genealogical relations between these things.

There is a very real risk, however, that if we prioritise *kaitiakitanga* as an aspirational value, but cannot measure the wellbeing of the water as simply and directly as we can measure the financial wellbeing of, say, a farm or a water bottling company drawing from that water, then the more specific and measurable approach through assessing financial capital will be prioritised. Yet, it is our assertion that a *kaitiakitanga* approach can maintain the integrity of Māori ways of knowing and being while incorporating techno-scientific information.[29] This is

[26] Although we agree with the sentiment, particularly expressing all other capitals within natural capital, we are sceptical about expressing the intimacy and complexity of nature and nature–human relations as natural capital.

[27] Poipoia Ltd, *Māori Perspectives on Environmental Taxes and Economic Tools* (Report prepared for the Tax Working Group, July 2018) 11 <https://taxworkinggroup.govt.nz/resources/twg-bg-4007811-maori-perspectives-on-environmental-taxes-and-economic-tools>, citing Gail Tipa and Laurel Teirney, *A Cultural Health Index for Streams and Waterways: A Tool for Nationwide Use* (Report prepared for the Ministry for the Environment, April 2006) <https://www.mfe.govt.nz/sites/default/files/cultural-health-index-for-streams-and-waterways-tech-report-apr06.pdf>.

[28] Poipoia Ltd (n 27).

[29] John Reid and Matthew Rout, 'Can Sustainability Auditing Be Indigenized?' (2018) 35(2) *Agriculture and Human Values* 283, 283.

because, when approaching any phenomenon from a Māori epistemological view, the approach will naturally be to try to understand connections and relationships between human and non-human others.

To elaborate, a Māori worldview, according to Reid and Rout, 'provides a broad moral framework, which avoids discrediting subjectivity and reducing socio-ecological systems to only their instrumental value'.[30] The authors further highlight that Māori ontologies are able to accommodate emotional and embodied Indigenous (subject/subjective) knowledge, as well as explicitly codified (object/objective) knowledge into their understanding of the socio-ecological family, while maintaining ontological integrity.[31] Accordingly, we see *tikanga* (like *kaitiakitanga*) as foundational to creating a more holistic, equitable and sustainable tax framework for New Zealand. The next question is: how can these *tikanga* be operationalised?

Kaitiakitanga empowers Māori to call for more meaningful inclusion in environmental decision-making, because 'the most appropriate way of exercising contemporary *kaitiakitanga* is through partnership, for example, partnership with central and local government and environmental agencies'.[32] This perspective would suggest a clear role for adhering to *kaitiakitanga* in freshwater and taxation policy. However, Te Maire Tau argues that the *Resource Management Act 1991* (NZ) has reduced the Treaty rights of Māori from ownership of water to stewardship.[33] This implies something less than full ownership, but as Tau points out, one cannot be a *kaitiaki* without ownership. As such, *rangatiratanga* is required to exercise *kaitiakitanga*, and we agree with this assessment.

In the discussion on freshwater, the TWG report emphasised the need to acknowledge and address Māori rights and interests in water in advance of employing tax instruments to manage water quality and allocation.[34] The TWG also suggested that if Māori rights and interests are addressed, then water tax instruments (for example, auctioned tradeable permits) are potential tools for improving efficiency of water use and ensuring a significant and sustainable long-term revenue source. Water is a *taonga*, and *rangatiratanga* over *taonga* is guaranteed for Māori in Article II of the Treaty. *Mana whenua* therefore have an underlying right (and obligation under *kaitiakitanga*) to freshwater governance in their regions.

Te Maire Tau gives a Ngāi Tūāhuriri (*hapū* of Ngāi Tahu) *mana whenua* perspective, which takes this argument further.[35] He argues that, as Māori ownership of water has been historically reduced, the Crown has created a default property right through consents to extract water for commercial purposes.[36] How the Crown is able to permit the extraction of water when it does

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[30] Ibid.

[31] See also Hazel Petrie, *Chiefs of Industry: Maori Tribal Enterprise in Early Colonial New Zealand* (Auckland University Press, 2013).

[32] Hauauru Rae and Michelle Thompson-Fawcett, 'Ngā Ura — Values' (2013) *Māori and Mining* 15, 16.

[33] Te Maire Tau, *Water Rights for Ngāi Tahu* (Canterbury University Press, 2017).

[34] TWG (n 2).

[35] Tau (n 33).

[36] The Waitangi Tribunal does not make any conclusions on whether water permits could be seen as a form of property rights, but notes that 'permits allow the use and control of water and therefore are analogous to the claimants' residual proprietary rights in the respective water bodies. They have been imposed over the top of those rights in disregard for them.' See Waitangi Tribunal, *WAI 2358 — Waitangi Tribunal Report 2019: The Stage 2 Report on the National Freshwater and Geothermal Resources Claims* (2019)

not own water is an important question to be addressed in negotiations prior to policy development. The Crown and regional councils are wrongly assuming they can issue consents to a resource they do not own, and this indirect property right discards the inherent ownership of water held by Ngāi Tūāhuriri, according to Tau. This breaches Article II of the Treaty, as water was never sold to the Crown and aboriginal title has never been extinguished through other means. The Crown's management of water through the *Resource Management Act 1991* is inconsistent with the Treaty.[37] The allocation of water through consents is a continued dispossession of Māori resources and any future taxation system that did not address this would be continuing colonial dispossession.

A further complication is that balancing rights and interests also includes bodies of water that have rights and interests themselves under New Zealand legislation — for example, the granting of legal personhood to the Whanganui *awa* (river).[38] Poipoia Ltd assert Te Mana o te Wai as the *kawa*, or foundational principle — that is, the first rights of the water are to the water itself.[39] Tau refers to this position as nebulous at best and not a sound basis for negotiating. We value the sentiment of Poipoia Ltd's position, who also assert the need to clarify Māori rights in addressing ecological crises, but we understand the pragmatism of Tau's position given the settler-colonial reality. Whatever the process and outcomes, it is clear that recognising the rights of water and the rights of Māori and *mana whenua* as *kaitiaki* are requirements in advance of designing a tax instrument. These require direct negotiation between *iwi* (large kinship groupings) or hapū and the Crown since, as it stands, *iwi* are not generally and effectively involved in the governance of freshwater, and mostly participate reactively in resource consenting processes.[40]

Whether or not *rangatiratanga* and *kaitiakitanga* over water is to be exercised through clear property rights or through co-governance is the next challenge for negotiations. As per all other policy decisions, any pricing mechanism for water requires the Treaty as a foundation, where *iwi* maintain their own *mana* over particular waterways and regional autonomy is respected in any management system, including governance arrangements.

B *Evaluating the Frameworks*

Several of the weaknesses of the draft frameworks are already identified in the TWG report and supporting evidence. These generally revolve around preserving the integrity of *tikanga* values in their application to policy, and include specific concerns around tokenism, the distortion of *tikanga*, and a performance gap. By tokenism, we mean symbolic gestures that

<https://www.waitangitribunal.govt.nz/news/tribunal-releases-stage-2-report-on-freshwater-and-geothermal-resources>.

[37] Ibid 12.

[38] *Te Awa Tupua (Whanganui River Claims Settlement) Act 2017* (NZ) s 14.

[39] Te Mana o te Wai emerged through negotiations between Māori and the Crown around 2013 as an overarching idea for freshwater management. At this stage, its inclusion was understood to recognise that the health and *mauri* of the water, the environment and the people was seen by Māori as the primary outcome for managing water. The Crown's inclusion of this has since been subject to criticism as 'tokenism', in addition to being unclear, uncertain and inadequate, despite being a positive reform. See Waitangi Tribunal (n 36).

[40] Poipoia Ltd (n 27).

neither have substance nor display any sort of material change.[41] Examples of this include decorating New Zealand police cars in Māori language and motifs, while continuing to disproportionately target and incarcerate Māori people,[42] or giving a Māori name to the State agency responsible for disproportionately uplifting Māori children from their families.[43] *Tikanga* can be distorted as a result of tokenism when they are co-opted into existing practices for symbolic reasons, rather than informing practices in the first instance. Performance gaps between what is said and done manifest out of tokenism and distortion, when *tikanga* are positioned as aspirational values but displaced by conventional policy outcomes more typically measured by existing mechanisms. This displacement arises from the dissonance between *tikanga* values and the conventional design principles of a tax system.[44] Any dissonance could lead to trade-offs inconsistent with the aspirations and obligations under a *tikanga* framework.

All of these concerns were raised in engagement, the specific implication being that these frameworks would use Māori language and concepts, while maintaining conventional policy development practices, with progressive rhetoric being deployed as a means of hindering actual change. The concerns were addressed in part by developing the cascading model to provide tangible guidance to the purpose, performance measures and outcomes of policy design. Although it is yet to be fully established how this framework addresses those concerns in practice, its cascading nature outlines explicit steps for practical application, measurable performance outcomes and, thus, a better-defined basis for accountability.[45] In addition, Henare points out that *tikanga* are informed by historical and contemporary practices associated with villages, food gathering, gifting and other forms of distributing goods and community wellbeing. Any policy development needs to be cognisant of how *tikanga* are derived from particular practices across diverse contexts, if they are to avoid tokenism and distortion.

Having a clear framework for accountability and implementation, developed with authentic Māori participation, goes some way to addressing these concerns. The existence of such a framework asserts that the Māori terms within it are principles/imperatives, with specific framing objectives, tangible performance and behavioural expectations that can be measured, and indicators that can be applied to reflect performance and behaviours. Therefore, the Māori terms are moved out of the realm of esoteric and aspirational values, and become specific and measurable policy objectives and outcomes. As McMeeking et al conclude in their support for this approach, a *tikanga* approach ought to result in tangible changes in policy outcomes, the true measure of which is in whether or not it achieves greater fairness and better outcomes for all.

While these frameworks present useful ways to develop, implement and evaluate a tax system according to Māori custom, clarifying rights under the Treaty is a fundamental means through which to address these concerns. Well-defined rights will address the concerns of tokenism, distortion and performance gaps by providing more certainty and authority in policy

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[41] Anaru Eketone and Shayne Walker, 'Bicultural Practice: Beyond Mere Tokenism' in Kate van Heugten and Anita Gibbs (eds), *Social Work for Sociologists: Theory and Practice* (Palgrave Macmillan, 2015) 103, 119.

[42] Te Kuru o te Marama Dewes, 'Police Cop Flak for Māori-Designed Police Car', *Te Ao Māori News* (online, 13 September 2017) <https://teaomaori.news/police-cop-flak-maori-designed-police-car>.

[43] Oranga Tamariki, 'Babies and Children Entering Oranga Tamariki Care' (OIA Release, 28 June 2019).

[44] McMeeking et al (n 3) 7.

[45] Ibid 8.

development. Extracting Māori knowledge from communities of practice in symbolic ways, without respecting the rights of Māori guaranteed under the Treaty and the UNDRIP, is simply another form of colonial dispossession.

IV Towards More Equitable and Sustainable Taxation through Māori Engagement

A Māori worldview can contribute to a more equitable and sustainable New Zealand tax system and, as such, engaging with Māori people and worldviews beyond tokenistic and obligatory gestures has the potential to transform prevailing systems of policy development in subtle yet commanding ways. We assert that, for one, *kaitiakitanga* is fundamental to the development of any policy because of the temporal acknowledgement of interconnectedness across generations, and the obligations in the present that this creates. However, *kaitiakitanga* needs protection from tokenism and distortion as a practice derived from enduring traditions rather than an aspirational value made subservient to a more conventional and easily measurable goal, like GDP maximisation.

The TWG report was clear that, 'while there was a particular emphasis on fairness and equity for Māori, there was also recognition that incorporating values based analysis would deliver pervasive public benefit'.[46] This is in line with international developments around engaging with Indigenous and alternative perspectives to tackle the wicked problems of today.[47] Two key points emerge. First, engagement with Māori is not only about how the tax system can help Māori, but also about how Māori can help the tax system. Second, what is good for Māori is good for all of New Zealand — the economy, society and the environment. Indeed, the aspects of the worldview outlined see all of these as an intimately interrelated whole.

Kaitiakitanga is already present in a number of New Zealand resource management and governance systems (for example, the *Resource Management Act 1991* (NZ)). However, it is important to acknowledge the limitations of *kaitiakitanga* without *rangatiratanga*[48] or ownership and control being established, and that Māori practise *kaitiakitanga* within existing development needs. As the frameworks suggest, a Māori approach to wellbeing is holistic in nature. The strengths of the interrelated frameworks have been made clear throughout this article. Developing and implementing a *tikanga*-led framework in partnership with Māori will illustrate the government's commitment to principles of both the Treaty and the UNDRIP.

The strength of the He Ara Waiora framework is that it recognises the many and interrelated interests that Māori have across economic, environmental, social and cultural outcomes, in contrast to Māori interests being positioned as simply 'cultural'. The *tikanga*-based approach is a flexible but holistic analytical lens for exploring values in the policy design process. The cascading model provides transparency and consistency for the application of the *tikanga* framework, and overcomes some limitations identified through the initial Māori engagement process. These frameworks can apply an effective lens to policy development to create

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[46] McMeeking et al (n 3).

[47] See Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services, 'Nature's Dangerous Decline: "Unprecedented" Species Extinction Rates "Accelerating"' (Press Release, UN Environment Programme, 6 May 2019) <https://www.unenvironment.org/news-and-stories/press-release/natures-dangerous-decline-unprecedented-species-extinction-rates>.

[48] Tau (n 33) 10.

distinctive Māori and New Zealand values in determining and evaluating how to live our lives together. This not only provides a novel framework for determining, measuring and improving wellbeing, developed with grounded Indigenous knowledge(s), but can provide a tangible commitment to the UNDRIP and other normative obligations that settler-states have to Indigenous communities. However, Māori are not a homogenous whole with a unified 'hive mind'. Different *iwi*, *hapū* and *rūnanga* (groupings within *iwi*) around the country have different needs and aspirations. Any policy development driven by Treaty obligations must acknowledge these diverse requirements to ensure *rangatiratanga*.

Poipoia Ltd highlight the tendency for pricing mechanisms to dominate policy decisions. For example, the often implicit assumptions that come with calculative rationales can crowd out the more holistic and normative aims of *kaitiakitanga*. Safeguards against the reductive nature of pricing mechanisms will need to be explored, and made subservient to, or at least in partnership with, the rights-based approach of the *tikanga* framework. The seductive nature of pricing mechanisms to know 'the price of everything but the value of nothing'[49] needs to be put in check. Furthermore, engagement is costly. The Crown is better-resourced than Māori groups, which often consist of *whānau* volunteering their time. Sufficient resourcing is needed to support Māori in engagement around policy development if this engagement is to reach its full and equal potential. Governance structures between central or local government and *iwi* need to be as efficient as possible to maximise the use of resources. Finally, this framework is moving New Zealand forward in the maturity of its obligations under Te Tiriti (the Treaty) and the UNDRIP. This should not, however, be used as a way to inhibit further more radical and co-created constitutional reform and recognition of rights,[50] but as a step towards them.

Designing tax policy without committed engagement with Māori can have devastating consequences. Hooper and Kearins uncover the role that accounting techniques and taxation played in the dispossession of Māori land between 1840–59,[51] 1860–80[52] and 1885–1911.[53] The authors argue that taxation by pre-emption through the monopoly purchase of land by the State for substantial profit was effectively a capital gains tax on Māori and, because of a lack of formal representation, was taxation without representation. They also note examples of undervaluing Māori land, exploiting the State's monopsony position, extortionate transaction and valuation costs, and the use of local Land Boards as agents. In the 1880s, a 'dog tax' was introduced, which Māori saw as authoritarian and discriminatory.[54] It was aimed particularly at Māori because these communities tended to host large numbers of dogs. Many Māori refused

[49] Oscar Wilde, *The Picture of Dorian Gray* (Wordsworth Classics, 1992 ed) 43.

[50] Margaret Mutu and Moana Jackson, 'He Whakaaro Here Whakaumu Mō Aotearoa: The Report of Matike Mai Aotearoa — The Independent Working Group on Constitutional Transformation' (Matike Mai Aotearoa, 2016) <https://researchspace.auckland.ac.nz/handle/2292/33496>.

[51] Keith Hooper and Kate Kearins, 'Substance but Not Form: Capital Taxation and Public Finance in New Zealand, 1840–1859' (2003) 8(2) *Accounting History* 101.

[52] Keith Hooper and Kate Kearins, 'Financing New Zealand 1860–1880: Maori Land and the Wealth Tax Effect' (2004) 9(2) *Accounting History* 87.

[53] Keith Hooper and Kate Kearins, 'The Walrus, Carpenter and Oysters: Liberal Reform, Hypocrisy and Expertocracy in Maori Land Loss in New Zealand 1885–1911' (2008) 19(8) *Critical Perspectives on Accounting* 1239.

[54] Atholl Anderson, Judith Binney and Aroha Harris, *Tangata Whenua* (Bridget Williams Books, 2016).

to pay this tax and the government responded with vigorous policing, including arrests and forced labour.

More recently, Te Maire Tau notes that, since 1958, council regulations have prohibited the sub-division of the Māori reserve land that stayed in Māori hands.[55] The combination of the *Town and Country Planning Act 1953* (NZ) and the *Māori Affairs Amendment Act 1967* (NZ) resulted in a mass migration by external design of Māori from rural land that they owned, to urban areas where they predominantly had to rent. The effect of the *Town and Country Planning Act* meant Māori land could be re-zoned as rural, and therefore only one house could be built on approximately 10 acres. Māori land was too small and dispersed to be commercially viable and too externally constrained for it to be residentially viable. These Acts also reduced the capital value of the land. The land then came under the *Ratings Act 1967* (NZ), which meant that councils could sell Māori land where rates were unpaid. Because of the commercial and residential unviability described above, rates were unable to be paid and land was lost. This had the dual effect of making cheap Māori reserve land available for the predominantly settler agricultural economy, and requiring Māori to move into cities to provide labour for the predominantly settler industrial economy.

Finally, water being allocated through consents has been demonstrated as a breach of the Treaty; if further allocations were established through the tax system without acknowledging Māori rights to water, this would represent a further colonial dispossession through taxation. These are just a few specific examples of the discriminatory effect of designing taxes without a recognition of rights, and without committed engagement with Māori.

To enable separate sites of power to work together in the contemporary context requires significant constitutional reform.[56] In the meantime, partnership and co-governance agreements are presented as interim arrangements.[57] Under the existing Treaty settlement process, national and local bodies are required to give consideration, to consult with or include Māori in the formulation, implementation or delivery of public policy.[58] Bargh outlines the following principles for engagement with Māori.[59] In *Wellington International Airport Limited and others v Air New Zealand*, McKay J established that consultation is ‘meaningful only when parties are provided with sufficient information to enable them to make “intelligent and useful responses” and when it is undertaken with an open mind’.[60] The Waitangi Tribunal also outlines principles that

[55] Te Maire Tau, ‘Brief of Evidence of Rawiri Te Maire Tau for Te Rūnanga o Ngāi Tahu and Ngā Rūnanga’ (Report No 2458/2821, 5 November 2015) <http://www.chchplan.ihp.govt.nz/wp-content/uploads/2015/07/2458-TRoNT-Ng%C4%81-R%C5%ABnanga-Evidence-of-Te-Maire-Tau-5-11-2015.pdf>.

[56] Ibid.

[57] Tau, *Water Rights for Ngāi Tahu* (n 33).

[58] Katharina Ruckstuhl, Michelle Thompson-Fawcett and Hauauru Rae, ‘Māori and Mining: Indigenous Perspectives on Reconceptualising and Contextualising the Social Licence to Operate’ (2014) 32(4) *Impact Assessment and Project Appraisal* 304.

[59] Maria Bargh, ‘A Small Issue of Sovereignty’ in Maria Bargh (ed), *Resistance: An Indigenous Response to Neoliberalism* (Huia, 2007) 133, 147.

[60] [1993] 1 NZLR 671, as cited in ibid 140.

> include that the Crown has a duty to consult as a way to demonstrate good faith; consultation must also involve a diverse range of Māori groups, provide sufficient time, preferably be face to face, and there must be an active protection of Māori rights.[61]

The TWG report noted the importance of including a more diverse range of voices in policy development, including greater engagement with Māori to be guided by the government's emerging model for Māori–Crown relations.[62] These all point towards the need to take the Treaty and Māori perspectives and rights seriously in tax and other policy development, well beyond tokenism, for a more sustainable and equitable future.

V Conclusion

This article has given a brief overview of how and why engagement with Māori and a Māori worldview, in the design and implementation of an equitable tax system, is not only good for Māori but is also good for New Zealand as a whole, including the country's environment. The Treaty and the obligations established to recognise and protect *rangatiratanga* and *taonga* were introduced and contextualised into a contemporary partnership and engagement context. We then explored two of the frameworks put forward in the TWG report and supporting evidence that were developed through engagement with Māori. Next, we introduced one *tikanga* in detail, *kaitiakitanga*, which is inherent to a Māori worldview of the tax system. But for *kaitiakitanga* to be practised effectively, rights need to be clarified first.

Māori perspectives can provide the necessary systems-thinking to tax policy in order to make that policy work for current and future generations, and for the environment.[63] The Māori worldview consists of a flexible ontology, which privileges rights and broad normative aspirations that centre relationships. This flexible ontology is able to incorporate techno-scientific detail in order to assert these rights, strive towards these aspirations and enhance these relationships. Māori are more than happy to share and develop this worldview in order to imagine and create more positive futures together. Again, however, we assert the importance of establishing *rangatiratanga* — that is, clear and well-defined rights — by honouring the Treaty, as necessary for the effective exercise of *kaitiakitanga*. Values can always be extracted from Māori communities and distorted in their symbolic gestures. But, with a cascading framework that introduces specific and measurable outcomes, and with well-defined rights, these practices can lead to a more equitable and sustainable framework, at least as far as the Treaty and its obligations are concerned.

While a Māori perspective on the development and implementation of an equitable tax system can have clear benefits with nuance and time, these benefits require effective communication. An example of ineffective communication is provided by the failure of the TWG to explain the benefits of a capital gains tax. This failure allowed opponents of a capital gains tax to fill the communication vacuum with misinformation. Further implementation of a Māori worldview in national governance faces similar challenges both from recalcitrant elements that reject well-established Treaty principles,[64] and media and mainstream commentary bias against

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[61] Bargh (n 59) 140.

[62] TWG (n 2) 103.

[63] McMeeking et al (n 3).

[64] See, for example, *Honour Hobson's Pledge* (Web Page) <https://www.hobsonspledge.nz>.

engagement with alternative perspectives.[65] Achievement of genuine government–*iwi* partnership requires clear and concise strategies that communicate to the public why Māori engagement in developing tax policy is not just an obligation on the Crown under the Treaty, it is a process that will bring positive outcomes for all New Zealanders.

65 Tyron Love and Elspeth Tilley, 'Temporal Discourse and the News Media Representation of Indigenous–Non-Indigenous Relations: A Case Study from Aotearoa New Zealand' (2013) 149 *Media International Australia* 174.

STRIVING FOR INTERGENERATIONAL WELLBEING

ALISON PAVLOVICH*

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.

[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

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[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

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[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>.

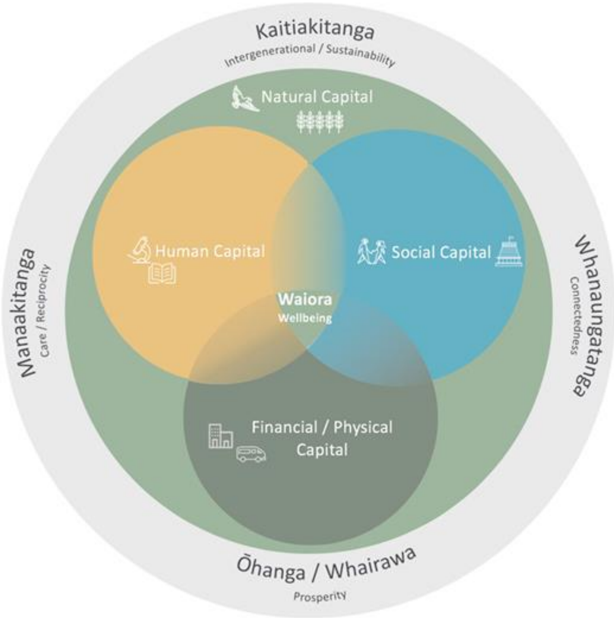
[60] John Janssen, 'The Start of a Conversation on the Value of New Zealand's Financial/Physical Capital' (Discussion Paper No 18/07, Treasury, July 2018). In the summary is stated: 'Compared to the capitals covered in the February papers — human, natural and social — financial/physical capital is relatively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

[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

[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.

THE ENVIRONMENT IS NOT AN EXTERNALITY: THE CIRCULAR ECONOMY AND THE TAX WORKING GROUP

JONATHAN BARRETT AND KATHLEEN MAKALE*

ABSTRACT

The final report of New Zealand's Tax Working Group ('TWG') is unusual for this type of inquiry. Rather than restricting its consideration to equity, efficiency and other usual tax criteria in the context of the existing economy, the TWG final report signalled aspirations for a paradigmatic shift in the way the economy is constituted and functions. As well as seeking to incorporate *Te Ao Māori* (a Māori worldview) and Treasury's Living Standards Framework, the TWG embraced the radical environmentalism of the circular economy model. As the 2030 achievement target for the United Nations Sustainable Development Goals ('SDGs') draws closer, it is increasingly pertinent for policy advisors to ensure their proposals and recommendations align with the SDG ethos. Tax policy is no exception, and the TWG's explicit consideration of sustainability, wellbeing and the circular economy may suggest an attempt to take New Zealand's commitment to the SDGs seriously. However, despite its espousal of these features, the TWG's recommendations for the greening of taxation were modest.

This article considers what the key features of a tax system for a circular economy might be, and assesses the TWG's recommendations against that model. Particular attention is paid to the New Zealand context, including an economy that is currently greatly dependent on the export of primary products, notably dairy.

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I Introduction

The final report of New Zealand's Tax Working Group ('TWG')[1] is unusual for this type of inquiry.[2] Rather than restricting its consideration to equity, efficiency and other usual tax criteria in the context of the existing economy, the TWG final report signalled aspirations for a paradigmatic shift in the way the economy is constituted and functions. As well as seeking to incorporate *Te Ao Māori* (a Māori worldview)[3] and Treasury's Living Standards Framework,[4] the TWG embraced the radical environmentalism of the circular economy model. According to the Ellen MacArthur Foundation,

> [a] circular economy aims to redefine growth, focusing on positive society-wide benefits. It entails gradually decoupling economic activity from the consumption of finite resources, and designing waste out of the system. Underpinned by a transition to renewable energy sources, the circular model builds economic, natural, and social capital. It is based on three principles:
>
> - Design out waste and pollution;
> - Keep products and materials in use;
> - Regenerate natural systems.[5]

While issues of sustainability and wellbeing, and the principles of the circular economy, are unusual features for a final report outlining potential future directions for tax policy in New Zealand, the current socio-political climate here suggests that inclusion of such features should not be surprising. Indeed, this type of broad and holistic thinking is arguably long overdue. New Zealand is a signatory to the Paris Agreement[6] and the United Nations Sustainable

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[1] Tax Working Group, New Zealand Government, *Future of Tax: Final Report* (February 2019) <https://taxworkinggroup.govt.nz/resources/future-tax-final-report> ('TWG').

[2] Compare with 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').

[3] See Ministry of Justice, New Zealand Government, *He Hīnātore ki te Ao Māori: A Glimpse into the Māori World — Māori Perspectives on Justice* (March 2001) <https://www.justice.govt.nz/assets/Documents/Publications/he-hinatora-ki-te-ao-maori.pdf>. 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.

[4] 'The [Living Standards Framework] looks across the human, social, natural and financial/physical aspects of those things that affect our wellbeing — the "four capitals". It is a tool that emphasises the diversity of outcomes meaningful for New Zealanders, and helps the Treasury to analyse, measure and compare those outcomes through a wide and evolving set of indicators.' See '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>. For a discussion of the Living Standards Framework and the TWG, see Alison Pavlovich, 'Striving for Intergenerational Wellbeing' (2019) (NZ special edition) *Journal of Australian Taxation* 15.

[5] 'Concept', *Ellen MacArthur Foundation* (Web Page, 2017) <https://www.ellenmacarthurfoundation.org/circular-economy/concept>.

[6] *Paris Agreement*, opened for signature 12 December 2015 (entered into force 4 November 2016), within *United Nations Framework Convention on Climate Change*, opened for signature 9 May 1992, 1771 UNTS 107 (entered into force 21 March 1994) <https://unfccc.int/sites/default/files/english_paris_agreement.pdf>.

Development Goals ('SDGs'),[7] both of which call for international cooperation in an effort to promote sustainable development and combat the negative effects of climate change. In its first Voluntary National Review, the government recognised the SDGs as an opportunity 'to get serious about delivering an integrated and balanced social, economic and environmental agenda'.[8] Thus, as the 2030 achievement target — reducing New Zealand's greenhouse gas ('GHG') emissions by 30 per cent below 2005 levels by 2030 — draws ever closer, it is increasingly pertinent for policy advisors to ensure their proposals and recommendations align with the SDG ethos. Tax policy is no exception, and the TWG's explicit consideration of sustainability, wellbeing and the circular economy may suggest an attempt to take New Zealand's commitment to the SDGs seriously.

This article sketches the idea of a circular economy, and considers what the key features of a tax system for such an economy might be. The TWG's recommendations are then assessed in light of that model. Attention is paid to New Zealand's particular context, including an economy that is currently greatly dependent on the export of primary products, notably dairy.

After this introduction, the article is structured as follows: first, there is a brief overview of the New Zealand context in relation to a failure to meaningfully implement green tax initiatives, despite perceived opportunities to do so. Second, the authors sketch a generalised concept of a circular economy, followed by an outline of a system of taxation in a circular economy, drawing, in particular, on the work of Kate Raworth. Third, there is a discussion of the TWG's espousal of a circular economy, and its environmental tax recommendations. Fourth, the authors present a critical discussion of the TWG's recommendations, and those recommendations are assessed against a broad model of a taxation system for a circular economy. Conclusions are then drawn.

II Promises v Politics: The Challenges for Green Taxes in New Zealand

Despite its espousal of sustainability, wellbeing and the circular economy, the TWG's basic recommendations on green taxes were modest:

> The tax system *can* play a greater role in delivering positive environmental and ecological outcomes in New Zealand. It *can* help change behaviours and fund transitions towards a more regenerative, circular economy.[9]

Recognition of the distribution of power in New Zealand's current economic paradigm, where promises made on an international stage conflict with the pressures of domestic politics, may have played some role in the TWG's reticence in this regard.[10] Despite its successful promotion

[7] See 'Sustainable Development Goals', *United Nations* (Web Page) <https://www.un.org/sustainabledevelopment>.

[8] Ministry of Foreign Affairs and Trade, New Zealand Government, *He Waka Eke Noa: Towards a Better Future, Together: New Zealand's Progress towards the SDGs — 2019* (July 2019) 6 <https://www.mfat.govt.nz/assets/Uploads/New-Zealand-Voluntary-National-Review-2019-Final.pdf>.

[9] TWG (n 1) 54 (emphasis added). A bolder recommendation might have used 'must', rather than 'can'. When he was the Minister of Finance (from 1999 to 2008), Sir Michael Cullen, the chair of the TWG, demonstrated pragmatism if not conservatism in tax policy — for example, refusing to consider a CGT and withdrawing a proposed carbon tax.

[10] Ibid.

of a 'Clean Green' image,[11] New Zealand has significant environmental issues, often arising from its intensive agriculture and dairy practices.[12] The dairy industry is a disproportionately important sector of New Zealand's export-oriented economy; it is, indeed, the country's largest goods exporter.[13] However, agriculture, in particular the raising of livestock and dairy cows, is a major contributor to GHGs. Their digestive processes cause ruminant livestock (cattle, sheep and deer) to expel, mostly through belching, methane gas. 'Methane is 25 times more effective than carbon dioxide (CO_2) in trapping heat in our atmosphere.'[14] Their release of methane 'amounts to almost 1/3 of New Zealand's greenhouse gas emissions, and it is the largest contributor'.[15]

Despite widespread recognition of these facts, successive governments have failed to tackle environmental degradation through effective regulation or meaningful taxes from, it seems, fear of upsetting the 'golden goose' of dairy.[16] A 2003 proposal for a levy on livestock to fund research into methane reduction was dropped due to farmers' protests.[17] Furthermore, despite its leading role in producing the country's GHG emissions, agriculture has so far been excluded from the New Zealand Emissions Trading Scheme ('ETS'), which currently taxes emissions from all sectors except methane and nitrous oxide from agriculture.[18] Under the Paris Agreement, New Zealand has committed to reducing its GHG emissions by 30 per cent below 2005 levels by 2030.[19] It seems clear that taxing agricultural emissions must be a vital component of the government's plan to incentivise the agriculture sector to reduce its emissions, if the commitments made under the Paris Agreement and the SDGs are to be met.

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[11] Ben Collins, 'New Zealand's Clean-and-Green Image Questioned by OECD', *Dow Jones Institutional News* (online, 20 March 2017) <https://search-proquest-com.helicon.vuw.ac.nz/docview/1878958792?accountid=14782>.

[12] OECD, *OECD Environmental Performance Reviews: New Zealand 2017* (OECD Publishing, 20 March 2017) <http://www.oecd.org/newzealand/oecd-environmental-performance-reviews-new-zealand-2017-9789264268203-en.htm>.

[13] See John Ballingall and Daniel Pambudi, *Dairy Trade's Economic Contribution to New Zealand* (NZIER, report to DCANZ, February 2017) <https://nzier.org.nz/static/media/filer_public/29/33/29336237-3350-40ce-9933-a5a59d25bd31/dairy_economic_contribution_update_final_21_february_2017.pdf>.

[14] 'What Do People Mean by "Fart Tax"?', *NIWA* (Web Page, 2016) <https://www.niwa.co.nz/atmosphere/faq/what-do-people-mean-by-fart-tax>.

[15] 'Methane Emissions', *Manaaki Whenua: Landcare Research* (Web Page, 2019) <https://www.landcareresearch.co.nz/science/greenhouse-gases/agricultural-greenhouse-gases/methane-emissions>. See also Parliamentary Commissioner for the Environment, New Zealand Government, *A Note on New Zealand's Methane Emissions from Livestock* (August 2018) <https://www.pce.parliament.nz/publications/a-note-on-new-zealand-s-methane-emissions-from-livestock>.

[16] See David Bullock, 'Emissions Trading in New Zealand: Development, Challenges and Design' (2012) 21(4) *Environmental Politics* 657, 673.

[17] David Fickling, 'Farmers Raise Stink over New Zealand "Fart Tax"', *The Guardian* (online, 5 September 2003) <https://www.theguardian.com/world/2003/sep/05/australia.davidfickling>.

[18] See 'Emissions Trading Scheme', *Ministry for Primary Industries* (Web Page, 22 November 2019) <https://www.mpi.govt.nz/protection-and-response/environment-and-natural-resources/emissions-trading-scheme>.

[19] 'About New Zealand's Emissions Reduction Targets', *Ministry for the Environment* (Web Page, 25 November 2019) <https://www.mfe.govt.nz/climate-change/climate-change-and-government/emissions-reduction-targets/about-our-emissions>.

Yet, as recently as this year with the proposed amendments to the 'Zero Carbon Bill',[20] legislation aimed at bringing the agriculture sector into the remit of the ETS has largely failed to deliver. In the long-term, the government is considering a recommendation from the final report of the Interim Climate Change Committee ('ICCC') that proposes achieving a revised emissions reduction target of 2050.[21] This proposal includes continued exclusion of the agriculture sector from the ETS in favour of a separate farm-level levy-rebate scheme. In the short-term, two possible options for the taxing of agricultural emissions have been considered by the government. The first, proposed by the ICCC, would bring the agriculture sector at the processor and farm level into the ETS as soon as practicable (by 2025 at the latest), but allow 95 per cent free allocation on their emissions.[22] Revenue collected would then be recycled back into the sector to help farmers reduce their emissions, by funding technological research and developing for greener farming and forestry practices. The second, a sector-led proposal, would bring the agriculture sector into an emissions pricing scheme by 2025, which would be managed and funded through the sector's levy organisations, namely Fonterra, Synlait, and NZ Beef and Lamb.[23] Both options sparked criticism from civil society groups and climate change experts, who argue that neither proposal goes far enough to amount to the reduction in GHG emissions from the sector that would be required if New Zealand is going to meet its international commitments. However, the government argues that such an approach is necessary in order to balance the requirements for emissions reduction to which New Zealand has committed, with the interests of the country's most important industry.[24] Indeed, the question about how and when emissions from the agriculture sector would feature in the existing ETS appears to have been answered. In October 2019, the government announced its decision to put a price on agricultural emissions from 2025, and is now set to work with iwi/Māori and the agriculture sector to develop a joint action plan, and 'enter into a formal agreement based on the Primary Sector Leader Group's proposal, He Waka Eke Noa: A Primary Sector Climate Change Commitment'.[25]

In addition to a disappointing record on meaningful regulation and taxes in the agriculture sector, New Zealand's performance has also lagged in another important emissions area: reducing fossil fuel emissions associated with transport. New Zealand benefits from a high percentage of renewable electricity generated from renewable sources, such as hydropower and wind. In 2017, a remarkable 82 per cent of New Zealand's electricity was generated from

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[20] The *Climate Change Response (Zero Carbon) Amendment Act 2019* (NZ) received royal assent on 13 November 2019. Time and space do not permit a discussion of the legislation in this article.

[21] Interim Climate Change Committee ('ICCC'), New Zealand Government, *Action on Agriculture Emissions: Evidence, Analysis and Recommendations* (30 April 2019) <https://www.iccc.mfe.govt.nz/what-we-do/agriculture/agriculture-inquiry-final-report/action-agricultural-emissions>.

[22] Ibid.

[23] See Hon Damien O'Connor and Hon James Shaw, 'Consensus Reached on Reducing Agriculture Emissions' (Press Release, New Zealand Government, 16 July 2019) <https://www.beehive.govt.nz/release/consensus-reached-reducing-agricultural-emissions>.

[24] See Zane Small, 'Jacinda Arden Defends "Laughable" 5 Percent Tax Proposed on Farming Emissions', *Newshub* (online, 16 July 2019) <https://www.newshub.co.nz/home/politics/2019/07/jacinda-ardern-defends-laughable-5-percent-tax-proposed-on-farming-emissions.html>.

[25] 'Action on Agricultural Emissions', *Ministry for the Environment* (Web Page, 13 August 2019) <https://www.mfe.govt.nz/consultation/action-agricultural-emissions>.

renewable sources.[26] In comparison, only 14 per cent of Australia's electricity comes from renewables.[27] According to the ICCC, electricity generation is responsible for just 5 per cent of the country's GHG emissions, whereas fossil fuels used in transport and process heat account for over 30 per cent.[28] Therefore, there is a major opportunity for New Zealand to reduce emissions from transport by switching from fossil fuels to electricity. This advantage and opportunity ought to put New Zealand in a leading position to switch its vehicle fleet to predominantly electric vehicles ('EVs'), and indeed, the government is currently exploring options for EV subsidies, in conjunction with a new fee on imports of high GHG-emitting vehicles. However, government nudges, relative to other jurisdictions, notably Norway[29] and Iceland,[30] have been negligible,[31] and EV uptake has been commensurately low.[32]

As evidenced by the discussion above, New Zealand has generally failed to leverage its providential advantages through green taxes and subsidies. According to the Organisation for Economic Co-operation and Development ('OECD'), in New Zealand, '[r]evenue from environmentally related taxes accounts for 1.3% of GDP and 4.2% of total tax revenue, among the lowest shares in the OECD; it has declined as a share of GDP by nearly 20% since 2000'.[33] This trend runs counter to New Zealand's promises to the international community to take seriously its commitment to reducing emissions in line with the expectations of the Paris Agreement and the SDGs. Therefore, the TWG report's consideration of issues pertaining to green taxes, including the circular economy model, is relevant and timely.

[26] Ministry of Business, Innovation and Employment, New Zealand Government, *Energy in New Zealand 18: Comprehensive Information on and Analysis of New Zealand's Energy Supply, Demand and Prices* (October 2018) <https://www.mbie.govt.nz/assets/d7c93162b8/energy-in-nz-18.pdf>.

[27] Office of the Chief Economist, Department of Industry, Innovation and Science, Australian Government, *Australian Energy Update 2016* (October 2016) 3 <https://www.energy.gov.au/sites/default/files/2016-australian-energy-statistics.pdf>.

[28] ICCC, New Zealand Government, *Accelerated Electrification: Evidence, Analysis and Recommendations* (30 April 2019) <https://www.iccc.mfe.govt.nz/assets/PDF_Library/daed426432/FINAL-ICCC-Electricity-report.pdf>.

[29] See, for example, Bjart Holtsmark and Anders Skonhoft, 'The Norwegian Support and Subsidy Policy of Electric Cars: Should It Be Adopted by Other Countries?' (2014) 42 *Environmental Science and Policy* 160.

[30] See Prime Minister's Office, Government of Iceland, *Iceland's Implementation of the 2030 Agenda for Sustainable Development: Voluntary National Review* (June 2019) 56–7 <https://sustainabledevelopment.un.org/content/documents/23408VNR_Iceland_2019_web_final.pdf>.

[31] See Lisa Marriott and Anna Mortimore, 'Emissions, Road Transport, Regulation and Tax Incentives in Australia and New Zealand' (2017) 12(1) *Journal of the Australasian Tax Teachers Association* 23.

[32] As at December 2017, EVs constituted 0.18 per cent of the light vehicle fleet. See Ministry of Transport, New Zealand Government, *Annual Fleet Statistics 2017* (2017) <https://www.transport.govt.nz/assets/Uploads/Research/Documents/Fleet-reports/1b33252a3d/The-NZ-Vehicle-Fleet-2017-Web.pdf>.

[33] OECD (n 12) 3. It should be noted, however, that other researchers arrive at significantly different conclusions. According to Adam Tipper and Jane Harkness, 'environmental taxes increased in absolute terms and as a share of total taxes (from 5.5% in 2009 to 6.2% in 2016) … environmental taxes (in relation to total taxes) were above the OECD average'. See Adam Tipper and Jane Harkness, 'Environmental Taxation and Expenditure in New Zealand' (Working Paper in Public Finance No 10/2018, Victoria University of Wellington, June 2018) 21. It seems unlikely that New Zealand's traditional lagging behind other OECD members in this area should have recently and radically changed.

III A Circular Economy and Taxation

This part of the article identifies the principal features of a circular economy, and, drawing in particular on the work of Kate Raworth, outlines a model for taxation in a circular economy.

A *What Is a Circular Economy?*

The traditional industrial economy is linear. According to Stahel:

> A linear economy flows like a river, turning natural resources into base materials and products for sale through a series of value-adding steps. At the point of sale, ownership and liability for risks and waste pass to the buyer (who is now owner and user). The owner decides whether old tyres will be reused or recycled — as sandals, ropes or bumpers — or dumped. The linear economy is driven by 'bigger-better-faster-safer' syndrome — in other words, fashion, emotion and progress. It is efficient at overcoming scarcity, but profligate at using resources in often-saturated markets. Companies make money by selling high volumes of cheap and sexy goods.[34]

In contrast, a circular economy can be likened to a lake,[35] or to loops.[36] For Göpel, the circular 'mindshift replaces the lens of fighting nature's limits by extracting more natural resources faster' with one of 'aligning production and consumption patterns with her circular reproductive cycles'.[37] In Lacy and Rutqvist's explanation:

> The circular economy is a generic term for an economy where growth is decoupled from scarce resource use. This model is regenerative by design. Material use is of two types: biological (renewable) materials, designed for reuse and ultimate return to the biosphere; and technical (nonrenewable) materials, designed to move back and forth between production and consumption with minimal loss in quality or value. Companies in a circular economy are primarily focused on value creation based on managing resources in the markets, as opposed to managing resources solely in production. Ultimately, the circular economy results in zero-waste value chains powered by regenerative (renewable) energy, and natural resources are used in connected loops rather than consumed and discarded in linear flows.[38]

'The circular economy concept has deep-rooted origins and cannot be traced back to one single date or author. Its practical applications to modern economic systems and industrial processes, however, have gained momentum since the late 1970s, led by a small number of academics,

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[34] Walter R Stahel, 'The Circular Economy', *Nature* (online, 23 March 2016) <https://www.nature.com/news/the-circular-economy-1.19594>.

[35] Ibid.

[36] Kate Raworth, *Doughnut Economics: Seven Ways to Think Like a 21st Century Economist* (Chelsea Green Publishing, 2017) 47 refers to the Māori *takarangi* as a 'symbol of dynamic balance'. According to Te Rangi Hiroa, '[t]he peak of Maori curvilinear motifs was the double spiral … The *piko rauru* has a centre of two separate ends and the spirals are formed by close sharp-edged ridges. The *takarangi* has a circular centre and the spiral ridges are spaced with short beaded sections between them, thus resembling the war canoe spiral termed *pitau*.' See Te Rangi Hiroa, *The Coming of the Māori* (Māori Purposes Fund Board, 1949) 314–15.

[37] Maja Göpel, *The Great Mindshift: How a New Economic Paradigm and Sustainability Transformations Go Hand in Hand* (Springer, 2016) 80.

[38] Peter Lacy and Jakob Rutqvist, *Waste to Wealth: The Circular Economy Advantage* (Palgrave Macmillan, 2015) 4–5.

thought-leaders and businesses.'[39] Landmark developments in the evolution of the circular economy include: Stahel and Reday's 1976 research report *The Potential for Substituting Manpower for Energy,* commissioned by the European Commission, which presented the vision of an economy in loops;[40] the European Commission's adoption of a strategy and plan of action towards a circular economy;[41] and China's adoption of a circular economy strategy in 2002.[42] The TWG's espousal of a circular economy is not, then, innovative or revolutionary — China, in particular, has already made substantial practical steps in moving away from a linear economy.[43]

B *Overview of Extant Green Taxes*

The objectives of existing environmental taxes can be sorted into the following categories:

- correcting externalities or mispricing
- reducing pollution and carbon emissions
- cross-subsiding sustainable practices
- signalling resource scarcity
- using land most efficiently.

1 *Externalities and Mispricing*

The term '[e]xternalities refers to situations when the effect of production or consumption of goods and services imposes costs or benefits on others which are not reflected in the prices charged for the goods and services being provided'.[44] To the extent possible, taxes and charges should be designed to ensure economic actors pay the full marginal social cost of their actions that affect the environment. In other words, policies should seek to internalise externalities. Bird argues, '[w]henever possible, charge for efficiency, charges should be levied on the direct recipients of benefits, whether residents, businesses or "things" (real property)'.[45] A fuel levy, for example, more accurately reflects benefit than funding roads from general revenue, but, traditional car-user fees, which 'include gasoline taxes, motor vehicle sales taxes and registration fees, parking user fees and tolls for road user entry into central areas',[46] tend to fund the building and maintenance of roads, rather than deterring cars from using those roads.

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[39] 'Schools of Thought', *Ellen MacArthur Foundation* (Web Page, 2017) <https://www.ellenmacarthurfoundation.org/circular-economy/concept/schools-of-thought>.

[40] See 'Cradle to Cradle', *Product-Life Institute* (Web Page, 2017) <http://www.product-life.org/en/cradle-to-cradle>.

[41] See 'Circular Economy: Implementation of the Circular Economy Action Plan', *European Commission: Environment* (Web Page, 8 August 2019) <http://ec.europa.eu/environment/circular-economy/index_en.htm>.

[42] See, generally, Jianguo Qi et al, 'Origin and Background of Circular Economy Development' in Jianguo Qi et al (eds), *Development of Circular Economy in China* (Springer Singapore, 2016) 1.

[43] Ibid.

[44] 'Glossary of Statistical Terms: Externalities', *OECD* (Web Page, 5 March 2003) <https://stats.oecd.org/glossary/detail.asp?ID=3215>.

[45] Richard Bird, 'Threading the Fiscal Labyrinth' (1993) 46(2) *National Tax Journal* 207, 212.

[46] Michael Replogle, 'Overcoming Barriers to Transportation Cost Internalization' in Olav Hohmeyer, Richard L Ottinger and Klaus Rennings (eds), *Social Costs and Sustainability: Valuation and Implementation in the Energy and Transport Sector* (Springer, 1997) 431, 431.

Newman and Kenworthy, therefore, argue that fuel taxes should be increased to the full external costs of transportation.[47]

Eliminating perverse incentives created by harmful subsidies,[48] such as for parking, is a corollary of charging for externalities. Blais prescribes unbundling the costs of parking from other building costs, and then repricing parking to fully incorporate externalities.[49] Measures include increasing the price of parking and restricting parking spaces. Boulder, Colorado, for example, doubled its parking fees and fines,[50] whereas Portland, Oregon placed a cap on parking in the city's CBD.[51] Los Angeles and New York have adopted variable parking fees, which increase in congested areas during peak times.[52] Adopting a different approach, Toronto operated a commercial concentration tax between 1990 and 2010.[53]

Urban sprawl encourages car use and, as a manifestation of mispricing, promotes 'an inefficient development pattern'.[54]

2 *Pollution and Carbon Emissions*

Fringe benefit tax on employer-provided cars and parking may improve congestion, mitigate pollution and encourage use of public transport.[55]

Congestion charges, which 'are fees for road use that are applied exclusively or more intensely during peak traffic periods',[56] can be expected to reduce pollution in cities.[57] Indeed, Beevers and Carslaw report that the London congestion charge reduced the city's carbon dioxide

[47] Peter Newman and Jeffrey Kenworthy, *Sustainability and Cities: Overcoming Automobile Dependence* (Island Press, 1999) 184.

[48] Olaf Merk et al, 'Financing Green Urban Infrastructure' (Working Paper No 2012/10, OECD Regional Development, OECD Publishing, 2012) 8 <http://www.oecd.org/cfe/regional-policy/WP_Financing_Green_Urban_Infrastructure.pdf>.

[49] See Donald Shoup, *The High Cost of Free Parking* (American Planning Association/Planners Press, 2005) <http://shoup.bol.ucla.edu/PrefaceHighCostFreeParking.pdf>; Todd Litman, *Parking Taxes: Evaluating Options and Impacts* (Victoria Transport Policy Institute, 29 August 2013) <http://www.vtpi.org/parking_tax.pdf>.

[50] Newman and Kenworthy (n 47) 205.

[51] Ibid 208.

[52] Merk et al (n 48) 23.

[53] AECOM Canada Ltd, *Detailed Case Studies of Selected Revenue Tools: Final Report* (Report prepared for Metrolinx, Government of Ontario, September 2012) 18–19 <http://www.metrolinx.com/en/regionalplanning/funding/Detailed_Case_Studies_of_Selected_Revenue_Tools_EN.pdf>.

[54] Pamela Blais, *Perverse Cities: Hidden Subsidies, Wonky Policy and Urban Sprawl* (UBC Press, 2010) 222–3.

[55] See Donald C Shoup and Richard W Willson, *Employer-Paid Parking: The Problem and Proposed Solutions* (University of California Transportation Center, August 1992) <http://escholarship.org/uc/item/2x6240jr>.

[56] Merk et al (n 48) 23.

[57] See, generally, OECD and International Transport Forum, *Implementing Congestion Charges: Round Table 147* (2010) 135 <https://www.itf-oecd.org/sites/default/files/docs/10rt147.pdf>.

emissions by 19.5 per cent in the period 2002–3.[58] In addition to London,[59] Singapore[60] and Stockholm[61] levy comprehensive congestion charges, whereas Boulder introduced congestion pricing for SUVs only.[62] Congestion charges are likely to be most effective at reducing traffic and emissions when differentiated according to the level of congestion, peak hours or both.[63] Linking pricing structures to vehicle type as well may strengthen incentives to switch to greener forms of transport.[64]

3 *Cross-Subsidisation*

Earmarking tax revenue from road pricing charges to pay for public transport represents 'the carrot' to accompany 'the stick'. When taxes are imposed on cars, attractive and affordable alternatives must be available, otherwise the poor will be disproportionately affected.[65] A gasoline surtax was applied in Vancouver to fund public transit in British Columbia.[66] Likewise, Boston's gasoline tax has been used to fund the Massachusetts Bay Transport Authority.[67] Toronto employed a vehicle registration surcharge, including a 'feebate' on large vehicles to fund air quality initiatives.[68] In Copenhagen, area-specific development charges contributed to the construction of a metro line.[69] Generally, funds may be levied on unsustainable forms of private transport to pay for innovative, sustainable transit projects.[70] Transportation should be taxed more effectively, first covering external costs, then using the revenues to build a 'sustainable city' based on traffic calming; quality transit, bicycling, and walking; urban villages; and growth management.[71]

[58] Sean D Beevers and David C Carslaw, 'The Impact of Congestion Charging on Vehicle Emissions in London' (2005) 39 *Atmospheric Environment* 1, 4.

[59] See Jonathan Leape, 'The London Congestion Charge' (2006) 20(4) *Journal of Economic Perspectives* 157.

[60] See Sumit Agarwal, Kang Mo Koo and Tien Foo Sing, 'Impact of Electronic Road Pricing on Real Estate Prices in Singapore' (2015) 90 *Journal of Urban Economics* 50.

[61] See Jonas Eliasson, KTH Royal Institute of Technology, 'The Stockholm Congestion Charges: An Overview' (Working Paper No 2014:7, Centre for Transport Studies, 2014) <http://www.transportportal.se/swopec/CTS2014-7.pdf>.

[62] Newman and Kenworthy (n 47) 205.

[63] Merk et al (n 48) 23.

[64] Ibid 8.

[65] Newman and Kenworthy (n 47) 143.

[66] Ibid 219.

[67] Ibid 231.

[68] Ibid 204.

[69] Merk et al (n 48) 22.

[70] Newman and Kenworthy (n 47) 184.

[71] Ibid 144.

4 *Signalling*

According to Merk et al, fees for water and waste services should be more responsive to actual resource use — fees and prices should be used to signal the scarcity of the resources being consumed, as well as covering the costs of infrastructure investment and service provision.[72]

5 *Efficient Land Use*

Site or land value taxes ('LVTs') use the unimproved value of land as a tax base and, in a pure form, have a single rate of tax. In contrast, capital value taxes use the improved land value as the base. An LVT 'is potentially a powerful anti-sprawl tool'.[73]

6 *Conclusion*

What is the difference between existing green tax measures and proposed taxes for a circular economy? While some principles and strategies are common, existing taxes seek to change behaviour and correct externalities, but leave the linear economic structure fundamentally intact. New green taxes aim to contribute to a radical restructure of the economy in terms of which it is recognised that the environment is not an externality.[74] As Raworth observes:

> Taxes, quotas and tiered pricing can clearly help to ease humanity's pressures on Earth's sources and sinks but … [i]n practice they fall short because they are rarely set to the level required … These policies fall short in theory too: from a systems-thinking perspective, quotas and taxes to limit the stock and reduce the flow of pollution are indeed leverage points for changing a system's behaviour — but they are low points of leverage. Far greater leverage comes from changing the paradigm that gives rise to the system's goals.[75]

C *A Tax System for a Circular Economy*

According to Raworth,

> [g]overnments have historically opted to tax what they could, rather than what they should, and it shows. The long-advocated switch from taxing labour to taxing non-renewable sources can be boosted by subsidies for renewable energy and resource-efficient investment. Such measures would refocus industry's attention away from raising *labour* productivity and

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[72] Merk et al (n 48) 8.

[73] H Spencer Banzhaf and Nathan Lavery, 'Can the Land Tax Help Curb Urban Sprawl? Evidence from Growth Patterns in Pennsylvania' (2010) 67 *Journal of Urban Economics* 169. See also Wallace E Oates and Robert M Schwab, 'The Impact of Urban Land Taxation: The Pittsburgh Experience' (1997) 50(1) *National Tax Journal* 1; Richard W Landholm, 'Twenty-One Land Value Taxation Questions and Answers' (1972) 31(2) *American Journal of Economics and Sociology* 153.

[74] See 'Kate Raworth: A Good Doughnut', *Nine to Noon* (Radio New Zealand, 14 March 2019) <https://www.radionz.co.nz/national/programmes/ninetonoon/audio/2018686503/kate-raworth-a-good-doughnut>.

[75] Raworth (n 36) 182. Recognition of effective leverage points is an important consideration. In her ranking of effectiveness, Donella Meadows places 'Constants, parameters, numbers (such as subsidies, taxes, standards)' in twelfth place. Donella H Meadows, *Leverage Points: Places to Intervene in a System* (The Sustainability Institute, 1999) 3. Meadows ranks 'The power to transcend paradigms' as the most effective leverage point.

> towards raising *resource* productivity, dramatically reducing the use of new materials and creating jobs at the same time.[76]

Switching 'from taxing labour to the use of non-renewable resources … would help to erode the unfair tax advantages currently given to firms investing in machines (a tax deductible expense) rather than in human beings (a payroll expense)'.[77]

While Raworth's call for 'a global carbon tax levied on all oil, coal and gas production'[78] is politically implausible, it indicates the kinds of behaviour shifts that are needed. Raworth argues for a Georgist land tax.[79] She also promotes a shift from income taxes to wealth taxes to reduce the role increasing GDP plays in ensuring sufficient tax revenue.[80]

According to Rau, 'whose company facilitates resource management between manufacturer, supplier, and end-user through consulting and other services':

> It is completely strange that people should pay taxes when adding value instead of paying the tax when destroying value … Instead of paying VAT, people should pay value destruction taxes (VDT). That would significantly change the behaviour of firms.[81]

Conversely, Groothuis envisages high rates of VAT playing an important role in deterring destructive forms of consumption, while zero-rating should be used to encourage merit activities, such as regenerating buildings.[82]

The key features of a tax system for a circular economy can be summarised as:

1. recalibration of existing environmental taxes to incorporate *real* prices for externalities

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[76] Raworth (n 36) 201–2 (fn omitted). See also Kate Raworth, 'Why It's Time for Doughnut Economics' (2017) 24(3) *IPPR Progressive Review* 216. On the possibilities of job creation in a circular economy, see Anders Wijkman and Kristian Skånberg, *The Circular Economy and Benefits for Society: Jobs and Climate Clear Winners in an Economy Based on Renewable Energy and Resource Efficiency* (Report prepared for Club of Rome, with support from the MAVA Foundation, 2015) <https://www.clubofrome.org/wp-content/uploads/2016/03/The-Circular-Economy-and-Benefits-for-Society.pdf>. Creation of jobs, at a time of expected retrenchment from robotics, is a major theme of circular economy discourse. See, for example, L Hunter Lovins et al, *A Finer Future: Creating an Economy in Service to Life* (New Society Publishers, 2018).

[77] Raworth, *Doughnut Economics* (n 36) 164. New Zealand does not levy a payroll tax. Employers are expected to pass on the costs of fringe benefit tax to employees. Employer superannuation contribution tax is unlikely to change employers' behaviour.

[78] Ibid 170.

[79] Ibid 152. The VUW review preferred a comprehensive land tax levied at a low rate in lieu of a general CGT. See VUW review (n 2) 11. The recommendation was ignored by the National-led government that convened the working group. The mandate of the 2019 TWG expressly excluded consideration of a comprehensive land tax because it was not permitted to consider 'taxation of the family home or the land under it'. See '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').

[80] Raworth, *Doughnut Economics* (n 36) 152.

[81] Cited by Lacy and Rutqvist (n 38) 109. It seems that Rau may have misunderstood what value adding for VAT means.

[82] Femke Groothuis, *New Era New Plan: Europe — A Fiscal Strategy for an Inclusive, Circular Economy* (The Ex'tax Project Foundation, 2006) <http://www.neweranewplan.com/wp-content/uploads/2016/12/New-Era-New-Plan-Europe-Extax-Report-DEF.compressed.pdf>.

2. incentivised recycling (cradle to cradle) in fundamental ways

3. shift from labour to resource-use taxes

4. greater use of merit and demerit concepts in nudging consumers towards desired behaviours

5. comprehensive taxation of land to promote optimal use.

IV Tax Working Group

The main focus of interest arising from the TWG final report was its recommendation for a general capital gains tax ('CGT') on realised gains.[83] As Hope, a dissenting member of the TWG, observed, the debate was 'one of the largest tax discussions [we'd] had for some time'.[84] But a general CGT would simply bring New Zealand in line with almost every other developed economy. Conversely, the TWG's ostensible embrace of a circular economy implies radical change to the entire economy and the tax system, but received little attention.

The TWG distinguished between tax recommendations in the short-, medium- and long-terms. The short-term (1–5 years) recommendations were:

- better use of environmental taxes to price negative externalities
- removing 'tax concessions that are harmful to natural capital'.[85]

The medium-term (5–10 years) recommendation was:

- using environmental tax revenue 'to help fund a transition to a more sustainable economy'.[86]

The long-term (10–30 years) recommendation was:

- 'scope for environmental taxes to broaden New Zealand's current tax base, sitting alongside income tax, GST and excise taxes'.[87]

Specifically, the TWG supported 'a reformed Emissions Trading Scheme (ETS) remaining the centrepiece of New Zealand's [GHG] emissions reduction efforts but [recommended] it be made more "tax-like"'.[88] Critically, agriculture would be included. With regard to water abstraction and pollution, the TWG recommended 'greater use of tax instruments', but only 'if Māori rights and interests can be addressed'.[89] The TWG also supported the Ministry for the

[83] TWG (n 1) 15–16.

[84] Kirk Hope, 'Even a "Pure" Tax Has Real Costs', *The Dominion Post* (Wellington, 12 April 2019) 21.

[85] TWG (n 1) 39.

[86] Ibid.

[87] Ibid 40.

[88] Ibid 16.

[89] Ibid.

Environment's review of the waste disposal levy,[90] and Auckland Council's investigation of a congestion charge for the city.[91]

V DISCUSSION

A tax inquiry that seeks to situate its investigation in the fullest context of the country in which the tax system must operate is to be welcomed. New Zealand is a bicultural, multi-ethnic country, and so the TWG's attempt to incorporate *Te Ao Māori* into its investigation is long overdue. As previously noted, the country has also committed itself to the Paris Agreement and the SDGs, despite its patchy record of environmental protection. And so, espousal of a circular economy is compelling. Nevertheless, the TWG's recommendations seem unlikely to make a significant contribution to achieving a circularity in the economy.

A *Terms of Reference*

The TWG was to a great extent hamstrung by its mandate. Support for comprehensive land taxes in promoting the most efficient use of land is no longer restricted to orthodox Georgists.[92] But the effectiveness of comprehensive land tax proposals is commonly limited by politically motivated compromises, such as excluding taxpayers' principal residences.[93] Indeed, the TWG was not permitted to investigate such a tax.[94] Raworth warns about the connection between pursuit of continuous economic growth and income tax — that is why she recommends shifting the tax base towards accumulated wealth.[95] But the TWG's mandate excluded wealth taxes.[96] Groothuis envisages variegated rates of VAT, including deterrent rates,[97] but GST increases were also out of bounds for the TWG.[98] It would be unfair, then, to critique the TWG for failing to investigate issues beyond its remit. Nevertheless, grounds exist for criticising the recommendations that did fall within its remit.

B *Short-, Medium- and Long-Term Perspectives*

The TWG's short- and medium-term recommendations would simply correct, to some extent, New Zealand's historical neglect of environmental taxes. Since inquiries into the tax system

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[90] See Ministry for the Environment, New Zealand Government, *Review of the Effectiveness of the Waste Disposal Levy 2017* (2017) <http://www.mfe.govt.nz/sites/default/files/media/Waste/Review-of-the-effectiveness-of-the-waste-disposal-levy-2017.pdf>. The next review will be published in 2020.

[91] See 'The Congestion Question', *Ministry of Transport* (Web Page, 6 March 2019) <https://www.transport.govt.nz/land/auckland/the-congestion-question>.

[92] See Raworth, *Doughnut Economics* (n 36) 152.

[93] See, for example, 'Land Tax', *ACT Revenue Office* (Web Page, 11 October 2017) <https://www.revenue.act.gov.au/land-tax>.

[94] TOR (n 79). Nevertheless, TWG (n 1) 16 recommended against 'introducing a land tax'.

[95] Raworth, *Doughnut Economics* (n 36) 152.

[96] TOR (n 79). Nevertheless, TWG (n 1) 16 recommended against 'introducing a wealth tax'.

[97] The authors note but do not necessarily endorse Groothuis on VAT increases. New Zealand's 'pure' GST system has great administrative and compliance merit. Conversely, variegated rating, including punitive and zero rates, has signalling value.

[98] TOR (n 79).

tend to be commissioned roughly once a decade in New Zealand, long-term recommendations seem otiose. Presumably the aim of such a recommendation is to send a signal to future tax inquiries. The same might have been expected of the VUW review's recommendation of a comprehensive land tax, which its members must have known would not be accepted by the then incumbent National government. But, as noted, in 2018, a Labour-led government, wary of alienating property owners, not only pre-emptively excluded a person's principal residence from any TWG recommendation (thereby eviscerating any CGT proposal it might make), but also excluded a land tax. It would be naïve to think that a future tax inquiry would not face similar formal and political constraints to those faced by the two most recent tax inquiries.

C *The ETS*

In certain regards, the ETS seems to be a neoliberal relic, and manifests some of the least desirable features of market solutions for social problems. Harris identifies four key problems with the ETS: it is 'highly opaque and difficult to understand'; 'there is evidence that a significant number of overseas credits used in New Zealand are fraudulent'; the 'ETS may have allowed manipulative pricing by electricity and fuel companies'; and it 'does not appear to have had a significant impact on reducing emissions'.[99] Harris proposes a British Columbia-style carbon tax to replace the ETS.[100] A carbon tax has similar signalling effects to an ETS but generates revenue for government that could be used to retrain people for new circular economic jobs, retrofit energy-efficient buildings, research different ways of farming, and so forth. Alternatively, as in British Columbia, a carbon tax could be revenue-neutral, allowing reduction in other taxes payable by the less wealthy to mitigate regression.[101] The TWG recommends making the ETS more 'tax-like': it would be preferable to go to the root of the problem and institute a comprehensive carbon tax.

VI Conclusion

Tax inquiries are in an invidious position. They typically comprise representatives of agonistic, if not antagonistic, groups in society; they are inundated with disparate and incompatible submissions; they are shackled by their Terms of Reference; and yet they are expected to make politically plausible recommendations. The TWG was no different. Nevertheless, at a level of principle, respecting *Te Ao Māori*, considering the Living Standards Framework, and signalling the need for a greener economy in line with global commitments to sustainability and combating climate change are broadly consensus issues in New Zealand. But, because vested interests become vulnerable when paradigmatic change is indicated, recommendations for practically achieving such lofty goals inevitably lead to dissensus. Comment on the TWG's ostensibly radical proposal for pursuit of a circular economy was muted by the brouhaha over CGT. Once, its implications are better understood, debate is likely to become more heated. The simple recommendation that agriculture should be included in a reformed ETS belies the power of the farming lobby in New Zealand, and is unlikely to amount to the kind of radical change

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[99] Max Harris, *The New Zealand Project* (Bridget Williams Books, 2017) 204–5.

[100] Ibid 207. In British Columbia, '[b]etween 2007 and 2015, provincial real GDP grew more than 17%, while net emissions declined by 4.7%'. See 'British Columbia's Carbon Tax', *British Columbia* (Web Page) <https://www2.gov.bc.ca/gov/content/environment/climate-change/planning-and-action/carbon-tax>.

[101] Harris (n 99) 207.

needed to see the achievement of the goals pertaining to GHG emissions reduction by 2030 as stipulated in the Paris Agreement and the SDGs.

WOMEN AND THE TAX WORKING GROUP

SUZY MORRISSEY*

ABSTRACT

The impact of the tax system on women and men is not the same. Women earn less than men, have lower levels of savings, and derive more of their income from wages than wealth. This means that progressivity is particularly important for women, and the taxation (or non-taxation) of savings and capital is particularly relevant to men.

To provide a basis for discussion of the way in which the New Zealand government's Tax Working Group ('TWG') was invited to consider the issue of gender, and how the recommendations in its final report would impact women, this article provides an introduction to the differences between men's and women's experiences of the tax system. These include the relationship of the tax system with the transfer system, and the gendered difference in treatment for non-compliance in each system.

This article examines the recommendations in the TWG's final report and explains how gender was reflected. It also critically examines the background paper, 'Taxation and Gender', that was provided to the TWG. The paper offered just one substantive point for discussion: 'Does the Group agree with the Secretariat's overall judgement that childcare costs should not be deductible?' The limitations of this focus are discussed. This article suggests that the restricted view of gender and tax in the background paper reflects a broader lack of understanding of gender issues across the New Zealand public sector. It reflects on how this situation came about and considers how it might change.

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I Introduction

The Tax Working Group ('TWG') was established by the New Zealand government in order 'to examine further improvements in the structure, fairness and balance of the tax system'.[1] In their Terms of Reference, the government outlined its objectives for the tax system, which included 'a system that treats all income and assets in a fair, balanced and efficient manner' and 'a progressive tax and transfer system for individuals and families'.[2] The government requested the TWG to report on four areas, including 'whether the tax system operates fairly in relation to taxpayers, income, assets and wealth' and 'whether there are changes to the tax system which would make it more fair, balanced and efficient'.[3] The government also provided direction on areas that should be considered, including the changing economic environment, the potential for a capital gains tax and a progressive company tax rate, and the potential role of the tax system in delivering positive environmental and ecological outcomes. A number of areas were specifically ruled to be out of scope, including inheritance tax and 'the adequacy of the personal tax system and its interaction with the transfer system'.[4] The stated reason for these omissions was that they were to be considered as part of a separate review of Working for Families ('WfF'), which falls under the scope of the Welfare Expert Advisory Group ('WEAG'), which was established in June 2018.[5] The Terms of Reference for the WEAG state that they should make 'high level recommendations for improvements to Working for Families'.[6] The transfer system is considered further in Section II, but it is sufficient to note here that despite WfF being the major tax credit for parents in paid employment, it was excluded from the TWG's reporting, as was taxation on savings and wealth passed on to the next generation.

The TWG was chaired by Sir Michael Cullen (a previous Minister of Finance) and consisted of 10 other members, from academia, advisory roles, trade unions, business, and a former senior public servant from Inland Revenue.[7] There were four women and six men. This was in marked contrast to the 2009 Victoria University of Wellington Tax Working Group, whose 12 members, as well as the Chair, were all men.[8] The TWG was supported by a Secretariat of

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

[2] Ibid.

[3] Ibid.

[4] Ibid.

[5] 'Establishing the Welfare Expert Advisory Group', *Welfare Expert Advisory Group* (Web Page, 3 May 2019) <http://www.weag.govt.nz/news/establishing-the-welfare-expert-advisory-group>.

[6] New Zealand Government, 'Terms of Reference for the Welfare Expert Advisory Group' (2018) <https://www.beehive.govt.nz/sites/default/files/2018-05/WEAG%20Terms%20of%20Reference_0.pdf>.

[7] Tax Working Group, 'Sir Michael Cullen Welcomes TWG Members' (Press Release, 20 December 2017) <https://taxworkinggroup.govt.nz/resources/sir-michael-cullen-welcomes-twg-members>.

[8] 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) 7 <https://www.victoria.ac.nz/sacl/centres-and-institutes/cagtr/pdf/tax-report-website.pdf>.

officials from Treasury and Inland Revenue — in keeping with their joint responsibility for tax policy advice — and an independent advisor.

This article is structured as follows. Section II considers the impact of the tax and transfer system on both women and men. As women earn less than men, have lower levels of savings, and derive their income more from wages than wealth, the ways men and women interact with the tax system are different. The gendered difference in treatment for non-compliance in each system is discussed. Section III considers the TWG's final report, and outlines some of the gender impacts of the recommendations. Section IV considers how a narrow focus (on the deductibility of childcare costs) might have arisen. It documents the decline in gender analysis skills in the New Zealand public sector and explores how this might be remedied. Conclusions are presented in Section V.

II Women, Tax and Transfers

Any policy is likely to impact different groups in different ways — often deliberately so, in the case of any redistributive or means-tested policy measure. However the 'apparent neutrality' of the tax system,[9] and therefore the tax policies that combine to make the tax system, is held as a long-standing and firm principle.[10] This view is inconsistent with a significant body of literature, and is discussed in this part of the article.

A *Women and Tax*

Tax law reveals much about our society, 'since what we tax and how we tax reflect a multitude of philosophical, social, and political choices'.[11] Tax policy is 'affected by a wide range of political, economic, cultural, institutional, and historical factors',[12] some of which include discrimination against women.[13] These factors may have been incorporated into the *Convention on the Elimination of All Forms of Discrimination against Women*,[14] when it states that tax policies must consider 'a more substantive concept of equity that recognises the need to transform traditional gender roles in society that are presently inequitable'.[15]

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[9] Lois Harder, 'Child Care, Taxation and Normative Commitments: Excavating the Child Care Expense Deduction Debate' (2004) 73 *Studies in Political Economy* 89, 89.

[10] Nancy C Staudt, 'Taxing Housework' (1995–6) 84 *Georgetown Law Journal* 1571, 1589.

[11] Marjorie E Kornhauser, 'Through the Looking Glass with Alice and Larry: The Nature of Scholarship' (1998) 76 *North Carolina Law Review* 1609, 1609.

[12] John L Campbell, 'The State and Fiscal Sociology' (1993) 19 *Annual Review of Sociology* 163, 164.

[13] Kathleen Barnett and Caren Grown, *Gender Impacts of Government Revenue Collection: The Case of Taxation* (Commonwealth Secretariat, 2004) 26.

[14] *Convention on the Elimination of All Forms of Discrimination against Women*, opened for signature 1 March 1980, 1249 UNTS 13 (entered into force 3 September 1981).

[15] Imraan Valodia, 'Conclusion and Policy Recommendations' in Caren Grown and Imraan Valodia (eds), *Taxation and Gender Equity: A Comparative Analysis of Direct and Indirect Taxes in Developing and Developed Countries* (Routledge, 2010) 299, 301.

Alstott suggests that tax law has 'institutional complexity'.[16] Evidence in New Zealand of this complexity includes a dedicated forum for hearing tax disputes (the Taxation Review Authority) and specialist tax qualifications, such as a Chartered Accountant or a Master of Taxation. The risk associated with such complexity is that the potential for broad debate on tax issues is significantly reduced. For Philipps, the tax system is 'dominated by expert knowledge' to an extraordinary degree, which 'inhibits critical conversation about tax laws by those defined as nonexperts'.[17] For example, experts advise the parliamentary Finance and Expenditure Select Committee when discussing tax legislation, and the Minister of Finance has a tax advisor seconded to his office from Inland Revenue. The TWG also had an independent advisor.

To open this place of 'neutral' complexity to feminist critique is not without challenge. Philipps notes how the contrast between the perceived rational basis of tax law and consideration of women's caregiving work, 'with all its bodily, emotive, and expressive associations', can result in making tax law 'particularly resistant' to feminist critical tax theory.[18] A second consideration is the number of women involved in making decisions on tax and other political matters. Women have been described as the most under-represented social group in Western politics.[19] Worldwide, there are fewer women than men in government, both as senior public servants designing policy, and as politicians making decisions on implementing policy. According to United Nations Women, as at November 2018, only 24 per cent of national parliamentarians were female, with less than 10 per cent female representation in 29 countries and none at all in four countries.[20] In Norway, the figure is 41 per cent,[21] reflecting voluntary quota systems introduced by different parties during the 1970s and 1980s.[22] This approach has been described as a 'systematic implementation of gender recognition measures', and was applied at all levels of politics.[23] In New Zealand, only one major party (Labour) has a quota system in place. Stotsky suggests that increasing the number of women in political roles may lead to increased demand for redistributive policies and public insurance.[24] Kornhauser

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[16] Anne L Alstott, 'Tax Policy and Feminism: Competing Goals and Institutional Choices' (1996) 96(8) *Columbia Law Review* 2001, 2004.

[17] Lisa C Philipps, 'Discursive Deficits: A Feminist Perspective on the Power of Technical Knowledge in Fiscal Law and Policy' in Anthony C Infanti and Bridget J Crawford (eds), *Critical Tax Theory: An Introduction* (Cambridge University Press, 2009) 46, 47.

[18] Ibid.

[19] Brodie quoted in Gillian Pascall, 'Citizenship — A Feminist Analysis' in Glenn Drover and Patrick Kerans (eds), *New Approaches to Welfare Theory* (Edward Elgar, 1993) 113, 118.

[20] 'Facts and Figures: Leadership and Political Participation', *United Nations Women* (Web Page, June 2019) <http:/www.unwomen.org/en/what-we-do/leadership-and-political-participation/facts-and-figures>.

[21] 'Proportion of Seats Held by Women in National Parliaments (%)', *The World Bank: Data* (Web Page, 2019) <https://data.worldbank.org/indicator/sg.gen.parl.zs>.

[22] 'Gender Quotas Database — Norway', *International IDEA* (12 November 2019) <https://www.idea.int/data-tools/data/gender-quotas/country-view/228/35>.

[23] Randi Kjeldstad, 'Gender Policies and Gender Equality' in M Kautto et al (eds), *Nordic Welfare States in the European Context* (Routledge, 2001) 66, 95.

[24] JG Stotsky, 'Budgeting with Women in Mind' (2007) 44(2) *Finance & Development* 13; JG Stotsky, 'Women at Work: Reductions in Gender Disparity Don't Translate to Equal Opportunity' (2013) 50(2) *Finance & Development* 8.

suggests 'a simple proposition: a change in the gender composition of the people who make tax laws would change the content of those laws'.[25]

Testing Kornhauser's hypothesis would require looking at countries that had experienced an increase in women in Parliament, and see whether there had been a change in the laws passed. One potential way to undertake such research would be to examine those countries that have quotas in place, notably Norway; New Zealand also provides an interesting case study at the moment, as it is led by its third female Prime Minister and, at 38 per cent, there are more female Members of Parliament than ever.[26]

Tax policy has a 'special interest' for women, because they generally earn less than men and so benefit from a progressive tax system. Also, their income is disproportionately likely to come from wages rather than wealth, so they are unfairly penalised when income from wages is taxed more heavily than income from wealth.[27] Women live longer than men but have less savings, and in some countries the most costly welfare benefits are payments for families raising children, on which women rely heavily.[28] In countries where the aged pension is linked to the recipient's tax contributions, women are particularly affected by the fact that household labour is not taxed, as that restricts their access to these 'critical resources'.[29] In New Zealand, women are the majority of welfare beneficiaries,[30] and have lower KiwiSaver balances than men.[31] The difference in their salary and wages to men — the gender pay gap — contributes to the 'feminisation of poverty'[32] that we see in New Zealand.[33]

B *Women and Transfers*

Tax policy issues are intrinsically related to transfers for two reasons. Transfers or welfare represent the other side of the tax and transfer system, and the tax system has been increasingly used to deliver social policy.[34] According to Stewart, the tax system is itself 'a "massive

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[25] Marjorie E Kornhauser, 'A Legislator Named Sue: Re-Imagining the Income Tax' (2001–2) 5 *Journal of Gender, Race, and Justice* 289, 294.

[26] 'Record Number of Women MPs in New Zealand Parliament', *New Zealand Parliament* (Web Page, 8 March 2018) <https://www.parliament.nz/en/get-involved/features/record-number-of-women-in-new-zealand-parliament>.

[27] Mimi Abramovitz and Sandra Morgen, *Taxes Are a Woman's Issue: Reframing the Debate* (The Feminist Press, 2006) 11–12.

[28] Miranda Stewart, 'Women and Tax' in Patricia Easteal (ed), *Women and the Law in Australia* (LexisNexis Butterworths, 2010) 441, 442.

[29] Staudt (n 10) 1597.

[30] 'Social Welfare', *Ministry for Women* (Web Page, 22 June 2016) <https://women.govt.nz/work-skills/paid-and-unpaid-work/social-welfare>.

[31] Financial Services Council, 'KiwiSaver 2050: Pathways to the Future' (Discussion Paper, September 2019) 19.

[32] Martha E Gimenez, 'The Feminization of Poverty: Myth or Reality?' (1999) 25(2–3) *Critical Sociology* 336, 351.

[33] CP Kingfisher, 'Reforming Women in the United States and Aotearoa/New Zealand: A Comparative Ethnography of Welfare Reform in Global Context' (2001) 103(3) *American Anthropologist* 714, 732.

[34] See, for example, Richard M Titmuss, 'The Role of Redistribution in Social Policy' (1965) 28(14) *Social Security Bulletin* 14, 20.

spending program": tax concessions can be considered as functionally equivalent in many respects to transfers, that is, expenditures'.[35] For Prasad, 'tax preferences are equivalent to welfare spending';[36] she observes that the two types of measures are perceived very differently — 'the politics of tax preferences are distinct from the politics of social spending in that tax preferences are introduced with less struggle than direct welfare spending'.[37]

In contrast to spending on welfare transfers, tax preferences or expenditures are not reported as a fiscal cost in the New Zealand Budget or government financial statements. However, since 2010, Treasury has produced a Tax Expenditure Statement as part of the Budget, and although this document is described as providing 'additional transparency', it only quantifies four tax expenditures and six tax credits.[38] Morrissey questions the adequacy of this approach.[39]

A final point of consideration regarding the tax system, one that contrasts strongly with the transfer system, is the treatment of those who are found to be non-compliant. As identified by Marriott, these differences begin early, as welfare fraud is investigated at a higher rate than tax evasion. However, other differences exist, as 'welfare fraudsters' are more likely to be prosecuted than 'tax evaders', and those convicted of welfare fraud receive a harsher sentence than those convicted of tax evasion, for equivalent levels of financial harm.[40] These differences in treatment do not appear to reflect public opinion, as recent research in New Zealand and Australia found respondents did not hold more punitive attitudes to welfare fraud than tax evasion.[41] This issue has been previously identified in New Zealand.[42] The gendered distribution of welfare, as noted above, results in a gendered difference in detection and punishment for welfare and tax crimes.

III TWG Recommendations

The TWG's interim report opened with a very brief summary of the key features of the tax system, which included two paragraphs on gender, to note that women have lower income and

[35] Miranda Stewart, 'Domesticating Tax Reform: The Family in Australian Tax and Transfer Law' (1999) 21(3) *Sydney Law Review* 453, 455.

[36] Monica Prasad, 'Tax "Expenditures" and Welfare States: A Critique' (2011) 23(2) *Journal of Policy History* 251, 251.

[37] Ibid 252.

[38] 'Tax', *The Treasury* (Web Page, 13 October 2016) 5 <https://treasury.govt.nz/information-and-services/interest-areas/tax>.

[39] Suzy Morrissey, 'Gender Budgeting: A Useful Approach for Aotearoa New Zealand' (Working Paper No 18/02, Treasury, New Zealand Government, April 2018) <https://treasury.govt.nz/sites/default/files/2018-04/twp18-02.pdf>.

[40] Lisa Marriott, 'The Construction of Crime: The Presumption of Blue-Collar Guilt and White-Collar Innocence' (2017) 16(2) *Social Policy and Society* 237, 237.

[41] Lisa Marriott and Dalice Sim, 'Tax Evasion and Welfare Fraud: Do Punishments Fit the Crime or the Perception of the Crime?' (2017) 29(4) *Pacific Accounting Review* 573.

[42] Susan St John, Catriona MacLennan, Hannah Anderson and Rebecca Fountain, 'The Complexities of "Relationship" in the Welfare System and the Consequences for Children' (Background Paper, Child Poverty Action Group, November 2014) 4 <https://www.cpag.org.nz/assets/141204CPAG%20Welfare%20System%20final.pdf>.

wealth compared to men.[43] It also included two comments noting that women have lower levels of savings than men. Childcare, such an important — and gendered — topic in the Secretariat's background paper,[44] was discussed, but it was not situated within a specific discussion on gender (as there was none). It was considered alongside other policy areas as part of the chapter on personal income and the future of work. The brief discussion centred on whether deductibility of childcare costs would increase the labour market participation of mothers, and how deductibility would have a greater benefit for those on a high income, compared to those on a low income.[45] TWG agreed with submitters that additional support for childcare costs is desirable, but best provided outside the tax system. Such an approach also keeps the support directed towards the child or the family, rather than the mother in particular, which avoids reinforcing a gendered concept of the care role.

The TWG's final report contained no reference to gender, nor did gender feature in the opening comments regarding distributional outcomes. This was a departure from the material in the interim report. Equity and fairness were discussed in terms of receiving the same income but facing different tax outcomes, and in terms of the difference in wealth between households. The demography of those households was not analysed. Women were mentioned as a group only once, as the most likely recipients of the recommendation to provide the KiwiSaver Member Tax Credit to the primary carer in the year of the child's birth,[46] regardless of their KiwiSaver contributions.[47]

There was very little direct discussion of gender in the TWG reports. Some of the recommendations in the final report supported improvement of women's financial situation, but others supported the accumulation of wealth, which has been noted to lie mostly with men. Relevant recommendations and their effects on women are summarised in Table 1 below.

[43] Tax Working Group, New Zealand Government, *Future of Tax: Interim Report* (September 2018) 18 <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-interim-report-sep18.pdf> ('TWG 1').

[44] Tax Working Group, New Zealand Government, 'Taxation and Gender: Background Paper for Session 12 of the Tax Working Group' (June 2018) <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3996764-taxation-and-gender.pdf>.

[45] Tax Working Group, New Zealand Government, *Future of Tax: Final Report* (February 2019) 8, 49, 51, 97 <https://taxworkinggroup.govt.nz/resources/future-tax-final-report> ('TWG 2').

[46] It may be assumed that this would also be available to those adopting, in line with the treatment of adoption in the *Parental Leave and Employment Protection Act 1987* (NZ), but particular reference would have been helpful and inclusive.

[47] TWG 2 (n 45) 30, 31–3, 93.

Table 1: Summary of Relevant Recommendations

No	Recommendation	Effect on women
6–8, 16	Increase emissions rules or charges; congestion pricing.	More analysis would be needed but, as women use public transport more than men,[48] the effects could be positive.
43	Remove employer's superannuation contribution tax for KiwiSaver members earning up to NZD48,000 pa; provide the maximum member tax credit by a KiwiSaver member on parental leave, regardless of their level of contributions; increase the member tax credit; and reduce the lower portfolio investment entity rates for KiwiSaver funds.	Positive benefit because women are lower earners, with lower savings, and have a disproportionate responsibility for childcare.
50	Increase the net benefit payments to ensure beneficiaries receive the same post-tax increase as other people on the same income.	Positive benefit because women have higher rates of main benefit receipt.[49]
68	Take measures to improve data collection on wealth.	Positive contribution to discussion on taxation of wealth, which could improve distributional impacts, as men have more wealth than women.
78, 82, 83	Review periodically the charitable sector's use of revenue to verify that intended social outcomes are being achieved; distinguish between privately controlled foundations and other charitable organisations; and amend the de-registration tax rules.	Possible indirect benefit if increased distribution of funds occurs, from which women may benefit, noting that privately controlled foundations are established by those with the most wealth.
94	Prioritise non-tax measures to help people stop smoking, rather than further raising excise rates; recognise the complex factors behind smoking, as reflected in recent Ministry of Health research into barriers affecting young	Positive effect, especially for Māori women who have the highest smoking rate (38 per cent), and pregnant women aged under 20 years (35 per cent).[51]

[48] 'Main Mode of Transport to Work on Census Day', *Environmental Health Indicators New Zealand* (Web Page, 12 July 2018) <http://www.ehinz.ac.nz/indicators/transport/main-mode-of-transport-to-work> ('EHINZ').

[49] 'Social Welfare' (n 30).

[51] 'Facts & Figures', *Smokefree* (Web Page, 5 November 2019) <https://www.smokefree.org.nz/smoking-its-effects/facts-figures>.

	Māori women's ability to quit smoking.[50]	
95	Develop a clearer articulation of government goals regarding sugar consumption and gambling activity.	Possible benefits from a better understanding of men and women's different consumption patterns of obesogenic food, and gambling.[52]
3	No wealth tax.	Supports the status quo in which men have more wealth than women.
88–90	No GST on financial services and no financial transactions tax.	Specific benefit for men as they utilise financial services, such as life insurance and retirement schemes, more than women.[53] Similar consideration applies to a financial transactions tax.
46	Increase the bottom threshold of personal tax.	Sole parents gain the least from any change to raise the bottom threshold,[54] and, at 84.2 per cent, this group is disproportionately represented by women.[55]
47, 48	Consider combining increases in the bottom threshold with an increase in the second marginal tax rate; reduce the abatement rate for WfF.	As women earn less than men, they are more likely to be impacted by changes to the lower brackets, and while higher earners are likely to still be better off overall, that may not be the case for those with earnings below the top of the second tax bracket. Reducing the abatement rate of WfF would benefit eligible mothers.

Some of the recommendations were equivocal. Recommendation 43 on KiwiSaver changes began with the caveat 'depending on its priorities', which is not otherwise included in the final report. It seems that administrative changes are viewed as something that should happen if the fiscal situation allows, but changes to directly improve women's savings — and standard of living in retirement — are something that only *may* be considered important.

While not making a recommendation, the TWG noted that many submissions called for an increase in the top personal tax rates, in order to enable policies that would make a material

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[50] 'Insights into Māori Women Smoking', *Ministry of Health* (Web Page, 18 October 2018) <https://www.health.govt.nz/our-work/preventative-health-wellness/tobacco-control/insights-maori-women-smoking>.

[52] 'The Social Report 2016 — Obesity', *Ministry of Social Development* (Web Page, 2016) <http://socialreport.msd.govt.nz/health/obesity.html>; Statistics New Zealand, New Zealand Government, *Gaming in New Zealand* (May 2001) <http://archive.stats.govt.nz/~/media/Statistics/browse-categories/health/gambling/gaming-in-nz/gaming-in-nz.pdf>.

[53] Suzy Morrissey, 'Implicit Gender Bias in GST Systems' (2017) 23 *New Zealand Journal of Taxation Law and Policy* 37, 45.

[54] TWG 2 (n 45) 19, 88.

[55] '2013 Census QuickStats about Families and Households', *Stats NZ* (Web Page, 2013) <http://archive.stats.govt.nz/Census/2013-census/profile-and-summary-reports/qstats-families-households/one-parent-children.aspx>.

reduction in income inequality through the personal tax system. However, such increases were precluded by the Terms of Reference and so were not considered. This is a lost opportunity, as it could have made an impact on all those who experience income inequality, not just women, but also Māori and Pasifika peoples.[56]

The TWG recommended further action in relation to the hidden economy. The largest part of the hidden economy is the unpaid domestic and care work undertaken by women. Although not a recent figure, in 1999 the value of unpaid work in New Zealand was calculated at NZD40 billion, equivalent to 39 per cent of gross domestic product ('GDP').[57] The issue of how unpaid work is systematically ignored and undervalued by conventional economic measures continues to be raised by Marilyn Waring.[58] Politicians have suggested that unpaid work should be recognised as essential to our society and economy, and that the first 'Wellbeing Budget' moves the country beyond GDP being the only measure of economic success.[59] However, the downgrade of the previous stand-alone Time Use Survey to a supplement to the New Zealand General Social Survey is likely to reduce the data available to researchers and policymakers to consider this important issue.[60]

A further noteworthy point: the TWG does not recommend lowering the rate of GST or removing GST from certain products, such as food and drink, instead suggesting that low- or middle-income families would be more effectively supported through welfare transfers or personal income tax changes. The change in terminology to 'families' instead of 'households' or 'earners' (used in discussion of personal income tax) is notable. As the unit of study is a difficult issue in tax, terminology is generally carefully considered, and family is not a frequently used term. Its use here, particularly in relation to shopping for food items, risks projecting a traditional image of 'family life' that may not reflect reality for many people.

IV Discussion

This part of the article discusses the insufficient consideration of gender by the TWG, why this reflects general government practice, and what might be done to rectify it.

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[56] Tax Working Group, New Zealand Government, 'Distributional Analysis: Background Paper for Session 5 of the Tax Working Group' (March 2018) 15 <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-distributional-analysis.pdf> ('TWG 3').

[57] Matt Morris, 'Unpaid Domestic Work — The Importance of Unpaid Work', *Te Ara — the Encyclopedia of New Zealand* (Web Page, 11 March 2010) <https://teara.govt.nz/en/unpaid-domestic-work/page-1>.

[58] 'Marilyn Waring: Still Counting the Value of Women's Unpaid Work', *Sunday Morning* (Radio New Zealand, 16 December 2018) <https://www.radionz.co.nz/national/programmes/sunday/audio/2018675816/marilyn-waring-still-counting-the-value-of-women-s-unpaid-work>.

[59] Julie Anne Genter, 'A Chance to Recognise Unpaid Work' (Press Release, New Zealand Government, 8 March 2019) <https://www.beehive.govt.nz/release/chance-recognise-unpaid-work>.

[60] 'Household Surveys Programme 2018–22 (Third Edition)', *Stats NZ* (Web Page, 3 September 2018) <https://www.stats.govt.nz/methods/household-surveys-programme-2018-22-third-edition>.

A *When I Say 'Gender', Do You Say 'Children'?*

In September 2018, the TWG released its interim report,[61] along with a series of background papers that the Secretariat had prepared on the various topics of discussion. Gender was discussed at Session 12 in June 2018 and, as for other topics, a dedicated background paper, 'Taxation and Gender', was prepared for that meeting. The background papers varied in size and scope, but all had a cover sheet outlining the purpose and key points for discussion, along with recommended actions.

The 'Taxation and Gender' background paper covered three topics, as well as the gender-based submissions received from the public consultation. The topics were: the gendered distribution of income and wealth; childcare costs; and tax compliance (although this was just two paragraphs). The cover sheet raised just two discussion points: 'Does the Group agree with the Secretariat's overall judgement that childcare costs should not be deductible?' and 'Is there any further information or advice that the Group would like?'[62] It was much briefer than for other topic areas, and the Secretariat's focus on childcare costs merits some consideration.

The chapter titled 'Impact of childcare costs on women's ability to participate in workforce' discusses women's labour market participation rates, childcare costs, and how the *Income Tax Act 2007* (NZ) ('the Act') operates to make them non-deductible. The impact of making childcare deductible is assessed with respect to equity, efficiency, cost, and compliance/administration considerations, which we recognise as commonly used criteria for assessing tax policy. However, tax is not gender neutral, so these criteria may benefit from feminist critique to determine if they remain appropriate for use. Against these criteria, the conclusion was drawn that childcare costs should not be deductible, and instead options for supporting middle- and lower-income families with childcare costs were suggested. These included a new tax credit, the existing WfF tax credit, and existing subsidies such as OSCAR (Out of School Care and Recreation) and 20 hours funded early childhood education (both paid to the childcare provider). Drawing on Bacchi's WPR ('What's the problem represented to be?') approach,[63] a solution of a subsidy represents the 'problem' as expensive childcare services, which some parents need financial assistance to access. It focuses on women and their interaction with the labour market and ignores any other experiences they may have. However, the tax system impacts many aspects of our lives, and is different for women and men because their experiences differ.

Economic, transport and health examples are illuminating. As women earn less, and have less savings and wealth, the tax concessions (lack of taxation) that apply to capital gains, gifts and inheritance benefit men more than women. As women have a higher use of public transport than men,[64] any tax concessions for private vehicles benefit more men, and any changes that impact public transport impact women more than men. In a time of technological change, and increasing use of environmental taxes, tax choices can have gendered impacts. Finally, women have different experiences under the two-part health service in New Zealand. Men and women are both eligible for healthcare from Ministry of Health providers, such as GPs and hospitals,

[61] TWG 1 (n 43).

[62] TWG 3 (n 56).

[63] Carol Bacchi, *Analysing Policy: What's the Problem Represented to Be?* (Pearson Education, 2009).

[64] EHINZ (n 48).

funded through general taxation. However, the Accident Compensation Corporation ('ACC') system, provides gendered services. As Duncan notes, the health conditions most likely to affect workers in female-dominated occupations are excluded from coverage under the scheme.[65] These conditions include stress-related illnesses (mental illnesses, depression and anxiety) arising from psychosocial hazards such as bullying, harassment, occupational violence, workload stress and fatiguing care demands.[66] ACC is funded through employer, employee and motor vehicle levies, and through an appropriation from general taxation (for non-earners). Any decisions on funding Ministry of Health providers or ACC levies or appropriations have gendered implications.

B *How Did We Get Here?*

We arrived here through a lack of skills, resources and commitment, all of which are related and dependent on various factors across the public sector and Parliament. There is a lack of gender analysis skills in the New Zealand public sector at present because they have not been required or requested in recent years.

For gender analysis to be included in policy analysis there has to be political will. From 2002, papers for the Cabinet Social Equity Committee required a Gender Impact Statement.[67] However, with the change of government in 2008, the committees were changed, and the requirement for a Gender Impact Statement was not carried over. The change of government in 2017 has not resulted in a return to their use.

Individual ministries could include gender analysis as part of their policy work, but there has been little evidence of this. Curtin observes that there has been little negative implication for agencies that fail to conduct gender analysis.[68] If a Ministry or analyst did want to undertake gender analysis, it is unlikely they would find any tools or guidance, either within their Ministry or at the Ministry for Women ('MfW'). Until recently, the MfW website had no resources for undertaking gender analysis. The focus of the Ministry's activities has changed over the years. While its original internal organisational design may have been 'explicitly inspired by feminist thought and practice', this is no longer the case.[69]

Other, more recent resources are available to help policy analysts understand different population groups. The Health Equity Assessment Tool, which was released in 2008,[70] has a strong focus on improving health outcomes for Māori. A Child Impact Assessment Guide was

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[65] Dawn Duncan, '50 Years On from the Woodhouse Report' (2019) 15(1) *Policy Quarterly* 54, 56.

[66] Ibid 56.

[67] Cabinet Office, New Zealand Government, 'Gender Analysis — Inclusion of Gender Implications Statement in All Submissions to the Cabinet Social Equity Committee' (Cabinet Office Circular No CO (02) 2, 6 March 2002) <https://dpmc.govt.nz/publications/co-02-2-gender-analysis-inclusion-gender-implications-statement-all-submissions-cabinet>.

[68] Jennifer Curtin, 'The Evolution of Gender Equality Policy in New Zealand' in Michael Hill (ed), *Studying Public Policy: An International Approach* (Policy Press, 2014) 116, 121.

[69] Jennifer Curtin and Katherine Teghtsoonian, 'Analyzing Institutional Persistence: The Case of the Ministry of Women's Affairs in Aotearoa/New Zealand' (2010) 6 *Politics and Gender* 545, 554.

[70] L Signal, J Martin, F Cram and B Robson, *The Health Equity Assessment Tool: A User's Guide* (Ministry of Health, New Zealand Government, June 2008) <https://www.health.govt.nz/system/files/documents/publications/health-equity-assessment-tool-guide.pdf>.

released in 2018 by the Ministry of Social Development.[71] The Department of the Prime Minister and Cabinet established the Policy Project to build 'a high performing policy system that supports and enables good government decision making'.[72] However, there is no guidance on gender analysis.

The State Services Commission ('SSC') is also responsible for improving policy analysis skills. One of the roles of the State Services Commissioner is to advise on 'the design and capability of the State services'.[73] However, the SSC neither provides resources to undertake gender analysis, nor requires such analysis to be undertaken.

In this light, it is not surprising that there is a lack of gender analysis skills in the public sector, or that the background paper on gender for the TWG was not more detailed.

C *How Can We Move Forward?*

Unless outcomes are examined from a gender perspective, it is unlikely that much will occur to improve them. Over recent years, the gender pay gap has received a large amount of attention, particularly when Statistics New Zealand releases updated earnings figures, and when private companies and state organisations release remuneration details. And the gender pay gap has fallen (although there is plenty more to be done). The transparency of making such information public provides impetus for action. Without similar focus on the gender implications of policy initiatives we are unlikely to see a change in which policies proceed.

Gender analysis skills need to be developed. This requires training and recognition of gender analysis as a core element of policy analysis — not a 'nice to have' but a 'must have'.

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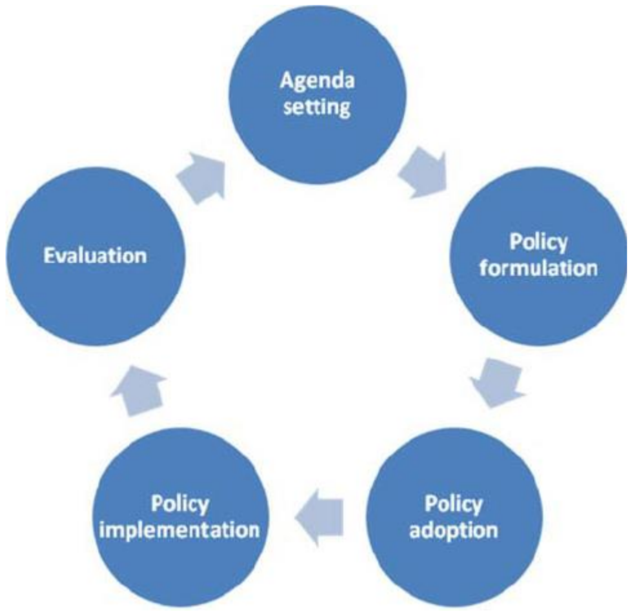
[71] Ministry of Social Development, New Zealand Government, *Improving the Wellbeing of Children and Young People in New Zealand: Child Impact Assessment Guide* (July 2018) <https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/resources/child-impact-assessment-guide-jul18.pdf>.

[72] 'The Policy Project', *Department of the Prime Minister and Cabinet* (Web Page, 28 June 2019) <https://dpmc.govt.nz/our-programmes/policy-project>.

[73] 'State Services Commissioner — Role and Functions', *State Services Commission* (Web Page, 13 August 2015) <http://www.ssc.govt.nz/sscer>.

Figure 1: The Policy Cycle[74]

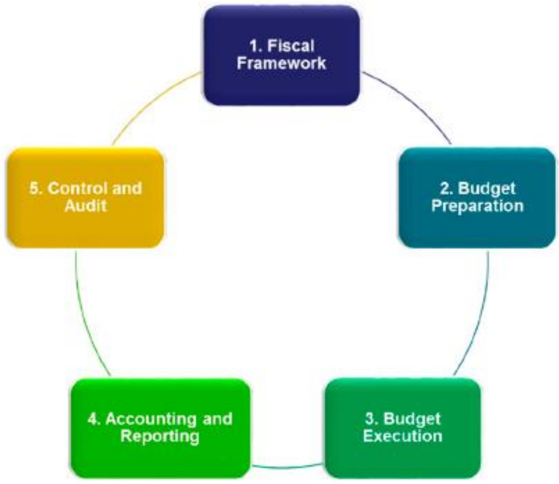


The policy cycle, as illustrated above, provides opportunities for gender to be considered at every stage. In agenda setting, the voices of women could be sought, not merely for ‘engagement’ on something already decided but to raise the issues of relevance to them. Whose view is sought is an important first consideration, as there is a risk that policymakers will only engage with those best known to them. This is likely to lead to a Wellington-centred view, and may benefit from the inclusion of, for example, advocacy and NGO groups. Another consideration is that when the view sought is considered a ‘minority view’, or is delivered by a person who is a minority within a particular group, there is a risk of that view being sidelined. Therefore, it would be important to consider how these views are sought and actioned, to ensure they are given the necessary weight.

Policy formulation can be a collaborative process — with women, not for women. It could include gender analysis of the issue at hand and of the potential policy responses. Adoption and implementation can similarly occur through and with women. This may be especially important from an intersectionality perspective, to ensure policy is implemented in a culturally appropriate manner. Evaluation should include input from those actually impacted by the policies, not just assessment against simple, generic criteria that may not address any underlying systemic issues.

[74] Based on figure in Christoph Knill and Jale Tosun, ‘Policy Making’ in Daniele Caramani (ed), *Comparative Politics* (Oxford University Press, 2008) 495.

Figure 2: The Budget Process[75]



The budget process, as illustrated above, provides another avenue for considering gender issues, in the form of gender budgeting or gender-responsive budgeting. It analyses government expenditure and fiscal policy to promote gender equality, and consists of many tasks. Gender budgeting is becoming common around the world, supported by the OECD, the United Nations, the International Labour Organization and the International Monetary Fund. It can involve *ex ante*, concurrent, and *ex post* activities to provide gender analysis, perspective, incidence analysis and audit. A common output is a Gender Statement, either as part of the official Budget documents if undertaken by the government, as in Canada, or independently created and issued, as in Australia and the UK.[76]

The 2019 national Budget was New Zealand's first 'Wellbeing Budget', the priorities for which were informed by Treasury's Living Standards Framework.[77] The Living Standards Framework was developed to help Treasury advise governments on 'the likely effects of their policy choices on New Zealanders' living standards over time'.[78] Gender analysis is essential to understanding the effects of policies on women, and the Wellbeing Budget presented an opportunity to include a Gender Statement in the Budget documents — unfortunately this opportunity was not taken up.

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[75] Sourced from International Monetary Fund, 'Gender Budgeting in G7 Countries' (Policy Paper, 19 April 2017) 9.

[76] Morrissey (n 39) 1, 4, 16.

[77] 'The Wellbeing Budget 2019', *The Treasury* (Web Page, 30 May 2019) <https://treasury.govt.nz/publications/wellbeing-budget/wellbeing-budget-2019-html>.

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

V Conclusion

Gender focus was absent from the TWG report. At one level, this is not surprising, as the interaction between the tax and transfer system had been specified as out of scope. However, this places women as low-income earners, who can benefit more from changes to transfers. Another view would see women as potential beneficiaries of a more equitable tax system that taxes earnings from both income and capital, or a tax system that addresses environmental concerns. The TWG made recommendations on both these topics: a capital gains tax will not be progressed; and environmental concerns have been consigned to 'consider for inclusion on work programme'.[79] Of the broader set of 99 recommendations, few are likely to have a positive effect on women, and many retain the taxation status quo. Those with higher incomes and wealth continue to benefit from a taxation system without inheritance tax, wealth tax, land tax, gift duty or (last but not least) a capital gains tax.

The background paper on gender lacked depth, and again this is not surprising given the decline in gender analysis skills in the public sector over the last decade. Gender analysis is not required to be undertaken and there is currently no gender reporting in Budget documentation. Gender appears to be absent from policymaking, and from tax policy in particular. This article has shown that tax is not gender neutral and asks whether the traditional criteria used to analyse tax policy remain appropriate in this light. The inadequacy of the conversation about gender in the work of the TWG indicates that gender analysis skills and a critical review of the traditional criteria for tax policy would improve policy generally and tax policy in particular. Perhaps the new focus on wellbeing will assist in that regard.

[79] New Zealand Government, 'Government's Response to the Recommendations of the TWG' (17 April 2019) <https://www.beehive.govt.nz/sites/default/files/2019-04/TWG%20Government%20response%20table.pdf>.

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.

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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

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[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

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[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

[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.

[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>.

ANALYSING NEW ZEALAND'S DIGITAL SERVICES TAX PROPOSAL

BEN WALKER*

ABSTRACT

The allocation of taxing rights for cross-border digital profits is a critical issue for the 21st century. The New Zealand government has responded with a discussion document proposing a digital services tax as an interim measure. Given the lack of global consensus on solutions for the issue, a digital services tax is a serious possibility. This article examines the government's proposal.

The proposal's rationale is based on active contribution, which is conceptually weak and contains several interpretative issues. The proposal fails to distinguish between traditional businesses and highly digitalised businesses ('HDBs') and, as a result, business activities of traditional businesses are, theoretically, in scope. However, high *de minimis* thresholds ensure that only large HDBs are liable.

Fundamentally, there is a lack of evidence that HDBs are paying tax at a lower effective rate than other businesses. Given this, it is strange that an international effort has been made to tackle HDBs. Furthermore, this unilateral approach could dangerously reduce multilateral cooperation in tax matters.

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I Introduction

On average, New Zealanders spend nearly two hours per day on social media.[1] Non-resident social media companies derive income from selling our attention to advertisers. They operate multi-sided platforms that connect users and advertisers. New Zealand, along with nearly all other jurisdictions, currently treats the income earned by social media companies and non-resident digital platforms as non-taxable in New Zealand. However, there is global unease as prominent businesses, such as Facebook and Google, derive large revenue from market jurisdictions. New Zealand is participating in talks at the Organisation for Economic Co-operation and Development ('OECD'), where jurisdictions are attempting to ascertain a multilateral approach to tackle the 'digital economy'.[2] However, New Zealand's government, along with those of other jurisdictions,[3] has proposed a digital services tax ('DST') as an interim or final solution if there is no multilateral consensus. Inland Revenue ('IR') has produced a discussion document, *Options for Taxing the Digital Economy: A Government Discussion Document,* outlining the government's proposal.[4]

The DST represents a new unilateral approach to international tax issues. It applies a flat 3 per cent tax rate to large businesses on gross turnover of certain in-scope activities. This article analyses the government's proposal. Section II examines the DST. There are several interpretative issues in the government's proposal, and, furthermore, there are several negative consequences. Section III tests whether highly digitalised businesses ('HDBs') are paying their fair share of tax. Furthermore, it explores the rationale of active contribution as a justification for taxing rights, and questions the path of unilateralism. Section IV concludes with closing remarks.

II DST Proposal: Interpretation and Analysis

A *Interpretation*

The DST proposal outlines a systematic process to determine liability:

6. Determine if the group's business includes any of the activities defined to be in scope.
7. Assess whether the group exceeds two *de minimis* thresholds.
8. Determine the group's annual gross revenue attributable to its in-scope business activities.

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[1] Hootsuite and we are social, 'Digital in 2018: In Oceania — Part 2: East' (SlideShare, 29 January 2018) <https://www.slideshare.net/wearesocial/digital-in-2018-in-oceania-part-2-east>.

[2] OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy: Public Consultation Document* (OECD Publishing, 6 March 2019).

[3] Austria, Belgium, the Czech Republic, Italy, Poland, Slovenia, Spain and the UK.

[4] Inland Revenue, New Zealand Government, *Options for Taxing the Digital Economy: A Government Discussion Document* (June 2019) <https://taxpolicy.ird.govt.nz/sites/default/files/2019-dd-digital-economy.pdf>.

9. Determine the group's proportion of that revenue attributable to New Zealand.

10. Calculate the group's DST payable on that attributable revenue at 3 per cent.

11. Return and pay the DST to IR by the due date.

B *Calculation of DST*

1 *Step 1: Are the Group's Activities within Scope?*

As a general principle, the DST would 'apply to the services provided by business activities whose value is dependent on the size and active contribution of their user base'.[5] Therefore, the two requirements are that:

- the service must consist of a business activity
- the business activity's value depends on the size and active contribution of the user base.

This principle assesses the relationship between the business and users. The Macmillan Dictionary defines 'user base' as 'the number of people who use a particular product or service, especially one available on the Internet'.[6] Hence, the DST is restricted to internet users — it cannot apply to a farmer's market, for example.

The first requirement is straightforward: business activities. The *Income Tax Act 2007* (NZ) defines 'business' as including an 'undertaking carried on for profit'.[7] Many online services are not carried on for a profit, hence these services are excluded.

The second requirement is more complex. The reference to size suggests that the DST only applies to business activities that have network effects — that is, where a service gains additional value the more people use it. Network effects are evident across many industries (insurance, telecommunications, etc). The active contribution of users is the key underlying pillar of the DST. Users in New Zealand must actively contribute to the value of the HDB through personalised content, such as posting, uploading photos, commenting, creating groups

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[5] Ibid 3.20. Several exceptions apply, at 3.21:

- The sales of ordinary goods or services (other than advertising or data) over the internet. It would not apply to goods sold online (for example, by Amazon itself).
- The provision of online content, such as music, games, TV shows and newspapers. This means it would not apply to Netflix for example. The DST would apply to a platform which facilitated the sale of goods, services or content between buyers and sellers, such as Apple music. In this case, the DST would apply to the platform owner, but not to the people who made or supplied the good, services or content over the platform.
- Services delivered directly through the internet, such as accounting services delivered via the cloud.
- Information and communications technology (ICT) providers, such as telecommunication companies and internet service providers.
- Standard financial services, such as credit cards and EFTPOS providers.
- Television and radio broadcasting.

[6] *Macmillan Dictionary* (online at 13 November 2019) 'user base' <https://www.macmillandictionary.com/dictionary/british/user-base>.

[7] *Income Tax Act 2007* (NZ) s YA 1; *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101 (CA); *Case 2/2012* [2012] NZTRA 02/(2012) 25 NZTC 1-014.

and tracking devices. It is contentious whether tracking users would constitute active contribution. Many applications (for example, Google Maps) track the location or browser history of users. The users are contributing data, but not to such an extent as on Facebook. Furthermore, it is also arguable whether users subjected to targeted online advertising (with some clicking on the advertisements), without providing personalised content, constitutes active contribution. The general principle is unlikely to be included in any legislative proposal; however, it gives a clue about the purpose of the DST proposal.

The below list provides a more concise test:[8]

> Specifically, the DST would apply to supplies made through:
>
> – intermediation platforms, which facilitate the sale of goods or services between people (like Uber and eBay);
>
> – social media platforms like Facebook;
>
> – content sharing sites like YouTube and Instagram; and
>
> – search engines and the sale of user data.

The above test applies to 'supplies made through' various platforms. It is debatable whether 'supplies' refers to the supply of services by the platform owner to the user (for example, Facebook offering a free platform to users), or the supply of services by the platform owner to the advertiser (for example, Facebook offering advertising space to a café). The general principle would support reference to the supplies provided to the user. Step 4 refers to the proportion of New Zealand users when attributing an amount to New Zealand. The example in IR's discussion document refers to the activity of fictional multinational group SocMed, but does not explain the nature of the activity.[9] None of the exclusions at s 3.21 provide any indication. Further clarification from IR is necessary.

The first category, an 'intermediation platform', is an intermediary that brings different types of users together (for example, Uber and eBay). Other prominent intermediaries include Airbnb, Booking.com, Expedia, Groupon, TripAdvisor and Trade Me. The second category, a 'social media platform', 'is a web-based technology that enables the development, deployment and management of social media solutions and services'.[10] Facebook, YouTube, Instagram, Pinterest, Tumblr and Reddit are examples of social media platforms. The third category, 'content sharing sites', is very broad. All websites share content. The listed companies, such as YouTube and Instagram, suggest that the category only applies to sites where users can upload their own content.

The fourth category includes two parts: 'search engines' and the 'sale of user data'. Google dominates the search engine market in New Zealand with a 96.32 per cent share.[11] Bing is the only other company with more than 1 per cent (2.18 per cent). Hence, it is highly likely that

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[8] Inland Revenue (n 4) 3.20.

[9] Ibid 19.

[10] 'Social Platform', *Technopedia* (Web Page, 2019) <https://www.techopedia.com/definition/23759/social-platform>.

[11] 'Search Engine Market Share New Zealand July 2019', *statcounter: GlobalStats* (Web Page, 2019) <http://gs.statcounter.com/search-engine-market-share/all/new-zealand>.

only Google would be in scope. The 'sale of user data' is a unique sub-category: it does not involve a multi-sided platform but the pure selling of user data. There are hundreds of companies that access data by various methods (public records, browser cookies and trackers, club lists, loyalty programmes, etc), which sell this data to other companies. The sub-category, however, only applies to the 'sale of user data'. This suggests only data collected digitally is applicable. As mentioned earlier, it is debatable whether the general principle of active contribution covers collection of user data by businesses (that is, passive contribution). The 'sale of user data' sub-category indirectly includes passive contribution only where a company later sells data. It is most likely an anti-avoidance provision to prevent HDBs from collecting data and selling it to different entities.

There are several important exclusions to the DST.[12] The first exclusion is the 'sale of ordinary goods or services (other than advertising or data) over the internet'. The DST is targeting the platform owners rather than the user or the advertiser (for example, Amazon itself). This is a buyer–seller relationship, rather than a multi-sided platform.

The second exclusion is the 'provision of online content, such as music, games, TV shows and newspapers'. Netflix is explicitly excluded, as there is only a transaction between users and Netflix. Netflix offers a subscription service (without advertising) directly to the user. On the other hand, Apple music provides online music, but it is explicitly included as it facilitates the sale of music owned by another party to users. It acts as a platform to bring interested parties together.

Several newspapers and online media websites provide online content. In addition, many traditional television and radio broadcasters provide online content. Nearly all major newspapers, online media websites, traditional television and radio broadcasters use online advertising on their websites. These activities are arguably in scope, as their advertisements facilitate the sale of goods or services between users and advertisers. Furthermore, the sale of advertising is explicitly removed in the second exclusion. Newspapers, television and radio broadcasting are excluded; however, this refers only to non-digital activities, rather than the entities themselves. The active contribution rationale is difficult to ascertain in these cases. These businesses' primary activity is to provide information to users, rather than connect advertisers to users. The advertisements are similar to traditional non-digital advertising — as these businesses have limited information about users, they have limited ability to target advertisements to particular users. Therefore, it is difficult to justify including the sale of advertising within the scope of the DST.

These examples illustrate how traditional businesses are digitalising their products to enhance value. The automobile industry is a subtle illustration. Olbert and Spengel showed how BMW gathers revenue from its Connected Drive application.[13] The application offers BMW customers digital services on demand, which has a unique value. BMW allows third-party commercial users to connect with BMW customers accessing the application. The revenue directly from customers would likely fall outside of the DST. However, the revenue from allowing commercial users access to customers would likely fall within the DST. BMW would need to identify the relevant revenue stream that would apply to the DST.

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[12] For all exclusions, see Inland Revenue (n 4) 3.21.

[13] Marcel Olbert and Christoph Spengel, 'Taxation in the Digital Economy — Recent Policy Developments and the Question of Value Creation' (2019) 2(3) *International Tax Studies* 1, 8.

Furthermore, the revenue mix will likely change over time as business models develop more digital revenues. Online grocery platforms are another example. Customers can now shop online for their groceries or even order packaged meals. Platform owners often take a fee for providing the platform for advertisers to sell to users. Hence, they are facilitating the sale of goods between persons. These activities are likely to fall within the scope of the DST. It is again difficult to justify the rationale of active contribution. The DST proposal fails to distinguish between businesses using digital technology to support their activities and businesses with digital platforms as their core activities.

The saving grace for the DST is its high *de minimis* thresholds. The global revenue for in-scope activities by traditional businesses is unlikely to exceed the thresholds. Hence, traditional businesses will not pay the DST. However, distinguishing between in-scope activities constitutes a compliance burden for many businesses.

2 *Step 2: Are Both* de minimis *Thresholds Exceeded?*

Two *de minimis* thresholds are applicable.[14] First, the group's global revenue must exceed EUR750 million. Second, the amount of the group's global revenue that is attributable to New Zealand users must exceed NZD3.5 million. Step 4 explains how to attribute revenue to New Zealand users. Both thresholds ensure that the DST only applies to large businesses. The EUR750 million threshold, taken from the country-by-country reporting requirement of the OECD, is a positive step in reducing the compliance burden for small- and medium-sized businesses.

3 *Step 3: Determine the In-Scope Global Revenue*

The DST 'would apply to any revenue from in-scope business activities',[15] as defined in Step 1. The group would be required to exclude out-of-scope business activities.[16] Given the increased role of digital platforms for traditional businesses, this will become difficult. The discussion document indicates that registration with IR is required where a DST liability is applicable.[17] Therefore, it appears that businesses have no obligation to notify IR of in-scope activities where they fall below the threshold.

4 *Step 4: Determine the Amount Attributable to New Zealand*

Unlike the calculation method for global in-scope activities, the amount attributable to New Zealand is the proportion of global users in New Zealand.[18] As mentioned in Step 2, the group's global revenue that is attributable to New Zealand users must exceed NZD3.5 million. The discussion document identifies the possibility of using the actual contribution of users in a country, but cites difficulties for certain companies.[19]

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[14] Inland Revenue (n 4) 3.24.

[15] Ibid 3.29.

[16] Ibid 3.30.

[17] Ibid 3.48.

[18] Ibid 3.33.

[19] Ibid 3.37.

The discussion document defines a user as 'anyone who used the platform or service; however the exact definition would vary depending on the type of platform and revenue'.[20] This ignores that digital platforms offer myriad different interaction options, and users themselves often differ significantly in their use of digital platforms. One user may spend more than three hours a day on digital platforms, while another user may spend one hour a month. Revenue derived from different jurisdictions is also likely to vary significantly depending on the wealth of the nations. The average American consumer creates greater value for a digital platform than the average New Zealand consumer. However, the global users test treats them equally. The discussion document acknowledges this issue.[21]

A second issue is locating a user. The majority of citizens will live in one country for a significant period of the year; however, a significant number of New Zealanders will travel outside New Zealand for holidays. Under the discussion document, a user is in New Zealand if they are located there. New Zealand has experience in dealing with this issue from a goods and services tax ('GST') perspective.[22] For example, the person's billing address or the mobile country code is often used.

Overall, there is no easy solution for identifying a user. However, experience with the GST system should at least guide IR.

5 *Step 5: Calculate the DST Payable*

The group must apply a 3 per cent tax to the amount attributable to New Zealand. The government chose not to include a safe harbour test, which would reduce the burden on HDBs with losses or low profit margins.[23] Since some HDBs are currently incurring losses (for example, Uber), it is unfair to burden them with further costs when the target of the DST is large, profitable HDBs.

6 *Step 6: Return and Pay the DST*

The group must nominate a member to return and pay DST. All group members are jointly and severally liable.[24] There is a concern that New Zealand will be unable to enforce the DST, as there are few enforcement mechanisms available if groups ignore it. However, the author is confident that IR could enforce the DST, if it utilised available mechanisms like an online supplier registration model (similar to GST on remote sales).[25] Recent experiences with registration for GST purposes suggests that businesses will comply.

Various questions arise. For example, if IR has identified a firm that could potentially fall within the DST, how could IR gather information and what are the rights of the firm? If a firm is cooperative with the tax administration, what are the boundaries to the tax audit? HDBs have highly valuable algorithms, developed over years, and would be reluctant to share any

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[20] Ibid 3.40.

[21] Ibid 3.36.

[22] *Goods and Services Act 1985* (NZ) s 8B(2).

[23] Inland Revenue (n 4) 3.46.

[24] Ibid 3.53.

[25] Ibid 3.48.

commercially sensitive information. Guidance from IR could reduce compliance burdens and uncertainty.

Overall, each step creates several compliance and administrative costs. The DST is predicted to only raise between NZD30 million and NZD80 million.[26] Companies will require guidance from IR. Given the small amount of tax, it is difficult to justify the administrative and compliance hurdles.

C *Unique Issues*

The discussion document discusses several issues with the DST. This section briefly explores three key issues.

1 *Conflict with Double Tax Agreements*

There is concern that the DST is an income tax under New Zealand's double tax agreements ('DTAs'). According to the government, '[t]he current problem with taxing the digital economy only relates to income tax'.[27] An income tax, however, would violate New Zealand DTAs where the HDBs have no permanent establishment ('PE') in New Zealand. Under nearly all PE articles, without a physical presence of the firm, the market country has no taxing rights to income.[28] Hence, the DST is designed to fall outside the DTAs.

The European Commission ('Commission') stated that their proposed DST is an indirect tax,[29] although their target is large technology giants.[30] The Commission has taken the opposite view in another matter involving a social solidarity tax, introduced by France, based on the total annual turnover of the taxpayer.[31] The Commission has taken the position that the tax is a direct tax.[32] Hence, the Commission's own position on the DST is questionable.

Recourse to the OECD Model Commentaries provides some guidance.[33] Article 2(2) includes taxes on 'elements of income'. Article 2(4) expressly covers 'identical' taxes that replace or supplement existing taxes: 'The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes'.

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26 Ibid 3.69.

27 Inland Revenue and Treasury, *Options for Taxing the Digital Economy* (Tax Policy Report Nos T2018/3710 and IR2018/801, 13 December 2018) 2.

28 India is an exception.

29 European Commission, 'Digital Taxation: Commission Proposes New Measures to Ensure That All Companies Pay Fair Tax in the EU' (Press Release IP/18/2041, 21 March 2018) Proposal 2.

30 Fred van Horzen and Andy van Esdonk, 'Proposed 3% Digital Services Tax' (2018) 25(4) *International Transfer Pricing Journal* 267, 270.

31 Cour de cassation [French Court of Cassation], C-39/17, ECLI:EU:C:2018:49, 14 June 2018.

32 van Horzen and van Esdonk (n 30) 270.

33 Michael Lang and Florian Brugger, 'The Role of the OECD Commentary in Tax Treaty Interpretation' (2008) 23 *Australian Tax Forum* 95; Klaus Vogel, 'The Influence of the OECD Commentaries on Treaty Interpretation' (2000) 54(12) *Bulletin for International Fiscal Documentation* 612.

The contentious issue is whether the DST is 'identical or substantially similar' to an income tax. On the one hand, the DST applies only to large HDBs deriving more than NZD3.5 million revenue from New Zealand, which suggests an income tax. On the other hand, the DST applies to the supply of in-scope activities and ignores the net accretion of economic power. This suggests that the DST is closer to an indirect tax. The DST appears as a hybrid between an income tax and an indirect tax. On the balance of probabilities, it is more likely that the DST would not violate the DTAs. Recent experience with the UK's diverted profit tax indicates that businesses will not challenge the DST from a DTA perspective.

2 *Burden of Tax*

The discussion document acknowledges that New Zealand residents will incur a tax burden.[34] It is important to distinguish between who pays a tax and who bears the burden of the tax. The actual burden of a DST depends ultimately on the elasticity of demand and supply. Given the dominant position of prominent technology businesses, the incidence of tax could likely fall on the consumer,[35] hence the tax burden would fall to New Zealand residents. New Zealand residents will face higher prices for the services consumed. Businesses that are not monopolistic would suffer a greater incidence of tax than the consumer, hence a DST would burden businesses in competitive markets.

3 *Distortion of Competition*

The arbitrary nature of the DST would favour out-of-scope activities and possibly distort consumer decisions.[36] Schön notes that taxes are usually only created on goods if there is a market failure — for example, tobacco — but HDBs are not seen as a market failure.[37] All major political organisations proclaim the benefits of digitalisation.[38] However, our narrow concept of its value could be undermined in the future, once we understand the impact of digitalisation on society.

Categorising certain types of income or taxpayers for tax purposes under domestic and international tax law is standard practice — for example, artists, entertainers and athletes. However, a different treatment is only appropriate where the 'the underlying concepts of taxing rights do not contradict those applied for the more generic cases'.[39] Hence, different treatment should align with allocation of taxing rights and principle-orientated solutions. Targeting certain HDBs that derive revenues from extracting certain value to the exclusion of others lacks a serious principled approach.

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[34] Inland Revenue (n 4) 3.81.

[35] Wolfgang Schön, 'Ten Questions about Why and How to Tax the Digitalized Economy' (2018) 72(4/5) *Bulletin for International Taxation* 278, 284.

[36] Ibid; van Horzen and van Esdonk (n 30) 271.

[37] Schön (n 35) 285.

[38] G20 Research Group, 'Communiqué' (G20 Finance Ministers and Central Bank Governors Meeting, 17–18 March 2017) para 6.

[39] Schön (n 35) 281.

III THE CONCEPTUAL ARGUMENT FOR A DST

The rationale for a DST based on active contribution is premised on three key arguments. First, non-resident HDBs do not pay their fair share of tax. Second, active contribution is unique to HDBs. Third, a unilateral approach is the only alternative where a multilateral approach fails. A closer analysis shines doubt on these arguments.

A *Paying a Fair Share of Tax*

The fear that HDBs are paying less tax than businesses in other industries is a key driver of the DST. The discussion document states: 'There has been significant international concern over the under-taxation of the digital economy, and digital multinationals in particular.'[40]

This accurately encapsulates the concerns of governments and other organisations. However, are HDBs under-taxed?

There is no clear answer. Ascertaining the average tax rates for HDBs is extremely difficult. The discussion document quotes a Commission report, which claims that the average tax rates for a digital company and a traditional business are 9.5 per cent and 23.2 per cent, respectively,[41] based on another report by the Centre for European Economic Research ('ZEW').[42] However, it is unclear how the Commission derived these numbers, as the ZEW report does not state these percentages. The ZEW report adopts the Devereux and Griffith model for calculating effective tax rates,[43] which considers a hypothetical incremental investment with several theoretical assumptions, including statutory tax rates.[44] Hence, it is inappropriate to use their model as an indicator of assessing average tax rates between businesses and across industries.[45]

Bauer claims that HDBs are paying effective corporate tax rates ('ECTRs') similar to traditional businesses.[46] Bauer's report compared the ECTRs between less-digital corporations, non-digital corporations (Euro Stoxx 50 index) and digital corporations, using actual financial statements. Taking data from a five-year period, the digital corporations had a higher ECTR

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40 Inland Revenue (n 4) 1.

41 Ibid 2.12; European Commission, 'Impact Assessment' (Staff Working Document No SWD(2018) 81 final/2, 21 March 2018) 18.

42 Christoph Spengel et al, *Effective Tax Levels: Using the Devereux/Griffith Methodology — Final Report 2016* (Centre for European Economic Research, October 2016) <https://ec.europa.eu/taxation_customs/sites/taxation/files/final_report_2016_taxud.pdf>.

43 MP Devereux and R Griffith, 'The Taxation of Discrete Investment Choices' (Working Paper No 98/16, Institute for Fiscal Studies, 1999).

44 Christoph Spengel et al, 'The Impact of Tax Planning on Forward-Looking Effective Tax Rates' (Taxation Paper No 64, Centre for European Economic Research, 31 August 2016) 10 <https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_paper_64.pdf>.

45 Institute for Economic Research, *Die Besteuerung Der Digitalwirtschaft* (*Taxing the Digital Economy*) (August 2018) 4 <https://www.ifo.de/DocDL/Studie-Digitalsteuer-2018.pdf>.

46 Matthias Bauer, 'Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions' (Occasional Paper No 03/2018, European Centre for International Political Economy, 2018) <https://ecipe.org/wp-content/uploads/2018/02/ECI_18_OccasionalPaper_Taxing_3_2018_LY08.pdf>.

(29.1 per cent) compared to traditional corporations (27.1 per cent).[47] Furthermore, profitability levels and tax expenses of digital corporations varied in a similar manner to non-digital corporations.[48] A report from the Institute for Economic Research found that digital corporations had an average tax rate of 20.9 per cent compared to 26.7 per cent for non-digital corporations.[49] Both reports used the income tax expense calculated under accounting standards. However, this is misleading as actual taxes paid will be different to the accounting income tax expense. This mainly arises through different treatment of depreciation. Furthermore, businesses may take 'uncertain tax positions', where favourable tax positions are less than certain.

Without any disclosure by the Commission, it is impossible to verify their claims for under-taxation of HDBs. Media illuminates high-profile examples of tech giants paying low rates of taxation based on total revenue. However, media reports cannot justify new tax rules.[50] Spengel et al illustrated that the main drivers for lower effective tax rates of digital businesses (based on a theoretical model) are: immediate expensing of investment costs for digital business; more generous depreciation rates for fixed assets; and special provisions that favour digital business models.[51] Countries compete for digital businesses to stimulate their economies.[52] However, a theoretical model is not clear evidence.

Overall, there is a lack of substantial evidence to suggest that HDBs are paying less tax than other businesses. This insight seriously questions the efforts to target HDBs. Ultimately, a lack of evidence did not stop the OECD from pursuing the Base Erosion and Profit Shifting ('BEPS') project, and thus, it is unlikely to stop countries targeting HDBs.

B *Active Contribution*

There is a major conceptual flaw with active contribution. A key rationale for the DST is that active contribution by users creates network effects — that is, a service gains additional value the more people who use it. However, as mentioned earlier, the network effects created by HDBs are evident in many industries. For example, consider an old technology, such as fax machines.[53] The more users participating by sending messages via fax machines, the more valuable fax machines become. Telecommunication networks operate in the same manner. Based on the same logic, the users are creating value that justifies taxation of that value where the users are located. Another example is clinical trials.[54] New medicines often require a rigorous clinical trial that involved users providing personal information in exchange for

[47] Ibid 10.

[48] Ibid 7.

[49] Institute for Economic Research (n 45) 6.

[50] Olbert and Spengel (n 13) 4.

[51] Marcel Olbert and Christoph Spengel, 'Measuring and Interpreting Countries' Tax Attractiveness for Investments in Digital Business Models' (2019) 47(2) *Intertax* 148.

[52] Italy, Austria and Ireland all have provisions to reduce the tax burden of digital businesses.

[53] OECD, 'Public Comments Received on the Possible Solutions to the Tax Challenges of Digitalisation' (13 February–6 March 2019) 5 <https://www.oecd.org/tax/beps/public-comments-received-on-the-possible-solutions-to-the-tax-challenges-of-digitalisation.htm>.

[54] Ibid.

compensation. The resulting data leads eventually to new medicines whereby the pharmaceutical company derives profits. Even a basic loyalty scheme for a local supermarket involves participants receiving targeted advertisements. Other examples include newspapers, broadcast television, video game consoles, financial exchanges, and farmer's markets.[55] Therefore, it is arbitrary to focus only on value created by users on digital platforms. Several value factors within a market jurisdiction could justify taxation — for example, infrastructure, rule of law, reliable payment systems, welfare payments, and so on. Focusing on active contribution by users of particular digital platforms appears confusing and incoherent. The OECD has acknowledged the difficulty of attempting to isolate the digital economy.[56] Efforts to demarcate the digital economy from the rest of the economy are likely to face these issues.

C *Unilateral Approach*

The DST is advocated as the only alternative to a multilateral approach. The DST represents a unilateral approach that could set a dangerous precedent to the multilateral approach to international tax issues. The integrity of DTAs will erode if jurisdictions take actions that are essentially targeting income, but designing them in such a manner as to avoid DTAs. The key principle of *pacta sunt servanda* — that is, parties to a treaty must adhere to a treaty in good faith — would be seriously undermined.[57] Perhaps a movement against the ideology of globalisation and free markets is the driving force behind the proposals.[58]

The DST could ignite a cascade of unilateral approaches by governments to common and complex tax issues that could damage the international tax system. The positive aspects of our international tax system cannot be ignored: global institutes that provide a platform for common ground (such as the OECD and United Nations); the rule-based system of DTAs; and exchange of information and cooperative relationships between tax administrations. It is far easier to damage a system than improve it. The New Zealand government should carefully consider this important truth.

IV Conclusion

There are no easy solutions for jurisdictions attempting to confront the new economic digital reality. The article has identified several interpretative issues regarding the DST proposal. The DST scope is very broad. The proposal fails to distinguish between HDBs and traditional businesses that are digitalising. The reference to 'supplies' should be clarified. The third

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55 Ibid 6.

56 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 — 2015 Final Report* (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, October 2015) 118 <https://dx.doi.org/10.1787/9789264241046-en>. '[B]ecause the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy. Attempting to isolate the digital economy as a separate sector would inevitably require arbitrary lines to be drawn': at 54.

57 *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 340 (entered into force 27 January 1980) art 31(1).

58 See BIAC comment in OECD, *Tax Challenges of Digitalisation: Comments Received on the Request for Input — Part I* (25 October 2017) 32 <https://www.oecd.org/tax/beps/tax-challenges-digitalisation-part-1-comments-on-request-for-input-2017.pdf>.

category, 'content sharing sites', would include many traditional businesses and, therefore, IR should consider removing this category. This would remove from scope businesses that are using digital platforms to support their business, rather than as a business model itself. Furthermore, the explicit inclusion of advertising should also be removed. Advertising will often take place where users are not actively contributing data, for example, users on newspaper websites. Ultimately, the general principle of active contribution does not adhere to the concise test provided in the proposal. However, the high *de minimis* thresholds ensure only large HDBs will be liable to pay the DST.

There is anecdotal evidence of BEPS behaviour from prominent HDBs, however, there is no clear evidence that HDBs are under-taxed. The tax incentives offered by jurisdictions to HDBs suggests lower effective tax rates, but it also provides a possible explanation. The rationale of active contribution is conceptually weak, as network effects are evident across industries. Lastly, a unilateral approach is a dangerous course for a small country such as New Zealand to pursue.