

**TAXING AND PLEASING:
THE RHETORIC AND REALITY OF VERTICAL EQUITY IN THE
DEVELOPMENT OF THE NEW ZEALAND INCOME TAX ON EMPLOYEES,
1891 TO 1984**

A thesis submitted in partial fulfilment of the
requirements for the Degree of Doctor of Philosophy
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NOTE
NEW ZEALAND CURRENCY

New Zealand adopted decimal currency from 1 July 1967. Previously, New Zealand's currency was as follows:

One pound (£1) equaled 20 shillings (20s.)

One shilling equaled 12 pence (12d.)

On adoption of decimal currency, section 5(4) of the Decimal Currency Act 1964 provided that:

One pound (£1) equaled two dollars (\$)

One shilling (1s.) equaled 10 cents (c)

One penny (1d.) equaled $\frac{5}{6}$ cent.

To convert amounts denominated in pounds to dollars, multiply by two.

ABSTRACT

Taxation equity may be classified into *horizontal* equity, where people who are in the same economic position should be taxed the same, and *vertical* equity, where those who differ economically should be treated differently. In the New Zealand income tax, the vertical equity norm has primarily been achieved by progressive tax rates, and by family-friendly adjustments. Given that the income tax intentionally discriminates between taxpayers on the basis of taxpayer-specific characteristics such as income level and domestic situation, the question arises as to how the New Zealand income tax in its successive manifestations has been justified as fair; that is, what vertical equity in the New Zealand income tax looked like and how it was justified.

This thesis considers the practice of the New Zealand income tax since its introduction in 1891 until 1984. By illuminating an employee's lived experience of the income tax, it illustrates what taxation fairness actually looked like in practice, and contrasts this with the rhetoric of those responsible for the tax. It concludes that the reality of external events, rather than the rhetoric of taxation fairness, appears to have been the main driver of taxation practice. By focusing attention on the experience of the taxpayer, rather than merely on aggregated taxation data, legislative provisions or political discussion, the thesis permits the political rhetoric or fairness to be assessed against the fiscal impact on personal taxpayers.

The thesis commences by reviewing certain influences on New Zealand income tax thought: from religion, antiquity, and more particularly from certain key British philosophers. It finds that despite their importance, these do not provide a clear direction for taxation policy. The thesis then shifts from philosophical discussions of what constitutes a fair tax to look at what the income tax actually looked like in the case of a wage or salary earner. It adopts an inductive approach by calculating the effect of the income tax legislation on employees at three income levels and in three domestic situations. The resulting nine cases demonstrate how taxpayers were distinguished for the purposes of vertical equity.

Returning to the sources, this thesis then reviews contemporary Parliamentary Debates and Reports for evidence of how Parliament justified the practice of vertical equity in the income tax. Despite frequent appeals to fairness or equity, no clear basis was found. Rather, significant changes to the income tax, and thus to the practice of vertical equity, largely reflected pragmatic responses to political or economic events. Yet once such crises had passed, the income tax, and

vertical equity in that tax, did not revert to the pre-crisis shape, but rather conformed to a new paradigm.

DEDICATION

This thesis is dedicated to my wonderful wife, Andy. Without her encouragement and support this thesis would never have been started, let alone completed. Even if this tome merely gathers dust on a shelf at the University of Canterbury library, she, at least, will be a little wiser about the history of New Zealand and of its income tax. Thank you, Duzzy – a woman of valour, whose price is above rubies.

ACKNOWLEDGEMENTS

Reviewing the genesis and progress of a significant project such as this only serves to confirm the advice of the ancient sage that wisdom is found in an abundance of counsellors. Such counsellors provide insight when the lights seem to have dimmed, encouragement when the engine has died, and strength when the body is failing.

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Finally, thanks be to God for his daily blessings, not the least of which are the privilege of living in a beautiful, peaceful, and largely non-corrupt country like New Zealand, and the joy of having spent more than half my life with his gift of a wife in Andy.

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Chapter 1

Introduction

Here this extraordinary man, then Chancellor of the Exchequer, found himself in great straits. To please universally was the object of his life; but to tax and to please, no more than to love and to be wise, is not given to men. However, he attempted it.

Edmund Burke¹

1.1 Background

Edmund Burke was probably right: to tax and to please rarely, if ever, meet. Yet through the ages, Chancellors of the Exchequer, Colonial Treasurers, and Finance Ministers have tried to do both. And the populations upon whom they levied their taxes have usually decried their efforts.

Aside from judicial punishment and war, taxation is one of the few occasions where a person may lawfully be deprived of his or her property without personal consent, recourse, or recompense. By an act of the ruler or state, private property is almost magically reconstituted as public property; the needs and desires of the ruler or community extinguish certain prior property rights and freedoms of the individual. A political power, backed by an exclusive claim on “legal violence,”² ensures that this transfer actually takes place. Since it involves coercion, taxation is unlikely to be *pleasant*, except perhaps for those who are exempt. However, taxation might be more or less *pleasing*, depending upon how it is implemented.

Writing in 1776, Adam Smith suggested four maxims for the practice of taxation, “whose evident justice and utility ... have recommended them more or less to the attention of all nations.”³ These included convenience to the taxpayer, non-arbitrariness, and economy. However, his first maxim had to do with the distribution of the tax burden among taxpayers:

¹ Edmund Burke, “Speech of Edmund Burke, Esq., on American Taxation,” in *Select Works of Edmund Burke. A New Imprint of the Payne Edition*, ed. E. J. Payne (Indianapolis, IN: Liberty Fund, 1999), 1:149.

² Gianfranco Poggi, *The State: Its Nature, Development and Prospects* (Cambridge: Polity Press, 1990), 5.

³ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan (London: Methuen, 1950), 5.2.2.

*The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.*⁴

This suggests that the distribution of the tax burden among residents is central to good tax policy. A maldistribution among taxpayers is unlikely to be *pleasing*. Yet, as the ambiguity of Smith's first maxim suggests,⁵ that the tax burden *should* be distributed fairly does not tell us *how* this might be done.

Taxation highlights and quantifies questions of distributive justice, an issue that has "no simple answer."⁶ As a social phenomenon, taxation evinces the role and limits of government, the relationship between the individual and the community, and the relationship between the individuals within the community. Assuming that taxation per se is legitimate, how should that tax be distributed between individuals?

Despite the significant questions to which taxes give rise, taxation, let alone fairness in taxation, is a missing actor in much writing on history. Perhaps this is a reflection of Benjamin Franklin's agnosticism that, "In this world, nothing can be said to be certain, except death and taxes." Or perhaps taxes are so much a part of the scheme of things that they hardly warrant a mention. In the case of New Zealand, general histories touch lightly on taxation. Easton comments that "New Zealand general histories tend to ignore the economy and its implications for the evolution of New Zealand;"⁷ if the economy tends to be ignored, so too is tax. Recent popular general histories mention taxation briefly, if at all. The popular works of Sinclair,⁸ Olssen & Stenson,⁹ Belich,¹⁰ King,¹¹ Mein Smith,¹² and Brooking¹³ barely refer to taxation: taxation was there,

⁴ Ibid.

⁵ Arthur D. Lynn Jr., "Adam Smith's Fiscal Ideas: An Eclectic Revisited," *National Tax Journal* 29 (1976): 372.

⁶ Richard A. Musgrave, "Equity and the Case for Progressive Taxation," in *Tax Justice: The On-Going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002), 9.

⁷ Brian Easton, "A New Economic History of New Zealand," (paper presented at the Asia-Pacific Economic and Business History Conference Sydney, Australia, 12-14 February, 2007), <http://www.eastonbh.ac.nz/?p=823>, (accessed 19 November 2009), 2.

⁸ Keith Sinclair, *A History of New Zealand* (Auckland: Penguin, 1991).

⁹ Erik Olssen and Marcia Stenson, *A Century of Change: New Zealand 1800-1900* (Auckland: Longman Paul, 1989).

¹⁰ James Belich, *Paradise Reforged: A History of the New Zealanders* (Auckland: Penguin, 2001).

¹¹ Michael King, *The Penguin History of New Zealand* (Auckland: Penguin, 2003).

occasionally it was politically significant, but otherwise it remained as essential – and as invisible – as air. Indeed the latest edition of the *Oxford History of New Zealand* continues this trend, focusing on topical social history almost to the exclusion of economic or even political concerns, and taxation barely rates a mention.¹⁴

Economic histories of New Zealand are rarer. Those that have been written, for example by Condliffe,¹⁵ Lloyd Prichard,¹⁶ Hawke,¹⁷ and Gould,¹⁸ tend to focus on the macro-economy, with little specific attention directed to discussions of taxation. The New Zealand economy changed substantially over the twentieth century, and the increasing role of the state must rank as one of the most significant changes. This increase was largely financed by substantial increases in taxation, and particularly of the income tax, yet taxation is hardly discussed. In a chapter specifically devoted to the economy, Dunstall notes that “the distribution of income has long been influenced by state activity,”¹⁹ and goes on to mention macro-economic activity and social welfare provisioning, but hardly mentions a significant element of both state activity and distribution, namely taxation. In the introduction to his work on the origins of the Australasian income tax, Harris notes that:

This study was in some ways born out of frustration. After many years of research into taxation I had not found a publication on the origins of the Australian income tax. The best book I found, an excellent book, was Mills (1925).²⁰

New Zealand taxation history is scarcely better served.

¹² Philippa Mein Smith, *A Concise History of New Zealand* (Cambridge: Cambridge University Press, 2005).

¹³ Tom Brooking, *The History of New Zealand* (Westport, CT: Greenwood Press, 2004).

¹⁴ Giselle Byrnes, *The New Oxford History of New Zealand* (South Melbourne: Oxford University Press, 2009).

¹⁵ John B. Condliffe, *New Zealand in the Making: A Study of Economic and Social Development* (London: George Allen and Unwin, 1959).

¹⁶ Muriel F. Lloyd Prichard, *An Economic History of New Zealand to 1939* (Auckland: Collins, 1970).

¹⁷ Gary R. Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985).

¹⁸ John D. Gould, *The Rake's Progress? The New Zealand Economy since 1945* (Auckland: Hodder and Stoughton, 1982).

¹⁹ Graeme Dunstall, “The Social Pattern,” in *The Oxford History of New Zealand*, ed. Geoffrey Rice (Oxford: Oxford University Press, 1992), 472.

²⁰ Peter A. Harris, *Metamorphosis of the Australasian Income Tax 1866-1922* (Sydney: The Australian Tax Research Foundation, 2002), 7.

Goldsmith's recently published political history of tax in New Zealand since 1840 provides a welcome exception to this void.²¹ His work provides a useful general overview of all types of tax, and highlights the growth of taxation in New Zealand. In contrast to this thesis, Goldsmith focuses on taxation aggregates and legislative change, rather than on the actual effect of the tax on individual taxpayers. There is a trade-off between description and analysis; Goldsmith's breadth of vision and intended popular audience necessarily limit the scope for in-depth analysis. Despite Goldsmith's work, Marriott and Fowler's comment that, "Historical research on taxation in New Zealand is limited,"²² remains valid.

If there is a dearth of historical taxation research in general, considerations of equity or fairness in taxation over time are even rarer. Murphy and Nagel, in their work subtitled "Taxes and Justice," suggest that rhetorical appeals to fairness tend to supplant serious discussions of justice:

*Whatever the reason, there seems to us to be a gap or at least an under-populated area in philosophical discussion of the ethical dimensions of public policy ... This is especially important at a time when serious public discussion of economic justice has been largely displaced by specious rhetoric about tax fairness.*²³

Such philosophical discussion of the ethical dimensions of taxation would be furthered by some understanding of the historical practice and justifications for taxation policy. A cursory review of taxation history suggests that conceptions of fairness in taxation are not static; instead Ventry suggests that there has been a shift in focus from equity concerns to efficiency concerns in taxation policy discussions and practice:

Even into the 1950s, the case for steeply progressive taxation could be defended on ethical and moral grounds ... Over the last two generations, however, the tax pendulum

²¹ Paul Goldsmith, *We Won, You Lost, Eat That! A Political History of Tax in New Zealand since 1840* (Birkenhead: David Ling Publishing, 2008).

²² Lisa Marriott and Carolyn Fowler, "From Social Policy to Economic Policy: Taxation Incentives for Retirement Income Savings in New Zealand (1910-2005)," *Accounting History* 12 (2007): 88.

²³ Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford: Oxford University Press, 2002), 4.

*has swung from equity to efficiency concerns. Modern day tax discussions avoid unsettling questions of relative burdens and benefits.*²⁴

Taxation equity suggests interpersonal evaluations, and these might be considered in a number of dimensions, including inter-generational,²⁵ gender,²⁶ inter-racial,²⁷ or even international.²⁸ At a more general level, taxation equity is usually discussed in terms of the taxation of equals (horizontal equity), and of unequals (vertical equity). Thus Holmes comments, “Equity falls into two categories: vertical equity and horizontal equity.”²⁹ Similarly, Cooper et al. note that:

Equity, or fairness, has two dimensions:

- *Horizontal equity, which means that people in similar economic circumstances should be treated similarly; and*
- *Vertical equity, which means that people in different situations should be treated differently, with those who are better off bearing a greater share of the tax burden.*³⁰

Significantly, the focus of both horizontal and vertical equity is the *economic* well-being of the taxpayer. Other considerations such as race, gender, and inter-generational equity may be subsumed under the umbrella of horizontal equity; that is, all things being equal, no distinction should be made between persons for tax purposes except on economic grounds. Any distinction based on race, gender, or the like provides an exception to the horizontal equity norm that equals

²⁴ Dennis J. Ventry Jr., “Equity versus Efficiency and the U.S. Tax System in Historical Perspective,” in *Tax Justice: The On-going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: The Urban Institute Press, 2002), 26.

²⁵ On the inter-generational implications of New Zealand social policy in general, refer David Thomson, *Selfish Generations? How Welfare States Grow Old* (Knapwell, Cambridge: White Horse Press, 1996), 124.

²⁶ Claudia D Scott, *Women and Taxation*, (Wellington: Institute of Policy Studies, 1993).

²⁷ The respective treatment of Maori and Pakeha for tax purposes is worthy of its own study.

²⁸ The implications of globalisation for taxation practice are discussed in Adrian J. Sawyer, *Developing a World Tax Organisation: The Way Forward* (Birmingham: Fiscal Publications, 2009).

²⁹ Holmes’ thesis is devoted to examining the meaning of income as a surrogate for the underlying features of a person’s well-being. However, unlike this thesis, he specifically focused on horizontal rather than vertical equity, and his approach was conceptual rather than historical: Kevin Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* (Amsterdam: International Bureau of Fiscal Documentation, 2001), ix.

³⁰ Cooper, Graeme S., Richard E. Krever, and Richard J. Vann. *Income Taxation: Commentary and Principles*. Sydney: Law Book Company, 1989, p. 24. The same two-fold distinction is made in Ross, Stan, and Philip Burgess, *Income Tax: A Critical Analysis* (Sydney: LBC Information Services, 1996). The question of whether horizontal has any independent significance apart from vertical equity is subject to debate: refer Paul R. McDaniel and James R. Repetti, “Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange,” *Florida Tax Review* 1 (1993): 607-622.

should be treated equally. Conversely, distinctions based on taxpayers' levels of income, (which provides a surrogate for their economic well-being), and also their domestic situation, (which affects their level of economic commitments), are typically in view when considering the vertical equity of the income tax.

This focus on the taxpayers' economic position, and the recent shift to efficiency as perhaps the primary concern of social policy, is itself an ethical choice. It reflects the idea that ethics and efficiency do not mix. Thus, one economics textbook notes that, "Many proposed changes in the tax laws increase efficiency while reducing equity or increase equity while reducing efficiency."³¹ Indeed, by the 1970s, so-called Optimal Tax Theory effectively ignored, or perhaps eclipsed, equity concerns.

Optimal Tax Theory attempts to do as it says; ascertain the optimal tax structure to maximise revenue whilst minimising inefficiency. Optimal Tax Theory addresses such questions as how progressive the tax system should be, and addresses the issue raised by the Laffer Curve: that increases in tax rates may result in a decrease in tax revenues as individuals substitute leisure for taxable income-producing activity. Mirrlees comments:

*The questions therefore arise what principles should govern an optimum income tax; what such a tax schedule should look like; and what degree of inequality would remain once it was established.*³²

Using econometric modeling, Mirrlees concludes that, "An approximately linear income-tax schedule, with all the administrative advantages it would bring, is desirable."³³ It is noteworthy that Mirrlees makes no mention of equity as a relevant concern in devising this optimal tax structure. As the focus shifted to the impact of taxation on abstract economic efficiency, it would seem that sight was lost of the human dimension of taxation: the effect on the individual taxpayer.

³¹ N. Gregory Mankiw, *Principles of Economics* (Fort Worth, TX: Harcourt College Publishers, 2001), 262. See also: Arthur M. Okun, *Equality and Efficiency: The Big Tradeoff* (Washington, DC: Brookings Institution, 1975).

³² J. A. Mirrlees, "An Exploration in the Theory of Optimum Income Taxation," *The Review of Economic Studies* 38 (1971): 175.

³³ *Ibid.*, 208.

This shift in thinking may be symptomatic of a more general shift in social mores. Discussing what she regards as the erosion of the social liberal political tradition in Australian and New Zealand society, Sawyer comments:

*I was particularly struck by a statement by a leading [Australian] Liberal politician that governments should be judged in accordance with 'how lightly they touch our purse' [efficiency]. This was very different from the social-liberal view I was familiar with: that governments should be judged on the extent to which they provide equal opportunity [equity].*³⁴

For many New Zealanders, as for Australians, fairness or justice is wrapped up in the notion of a “fair go”³⁵ – a mix of equal treatment and equal opportunity, coupled with sympathy for the “underdog”. A “fair go” may require the differentiated treatment of those who differ, which is a manifestation of vertical equity. In tax terms, vertical equity is commonly understood to mean that “the tax burden should differ between people in different positions such that a proportionately heavier burden falls on those who are better able to bear it.”³⁶

Since the late nineteenth century, this vertical equity ideal has perhaps been most clearly expressed in the progressive income taxation of personal incomes. The resulting income tax impost provides a measurable illustration of how New Zealand implemented its concept of “fair go” in the economic realm. Yet the frequent changes to the income tax since its introduction suggest that the ideal of vertical equity, like taxation itself, is dynamic and not static; the 1892 version of “fair go” might well have been considered grossly unfair in 1984.

This thesis considers how vertical equity has been expressed in New Zealand’s personal income tax on employees from its introduction in 1891 until 1984, and how Parliament justified changes to it during those years. In a democracy, decisions as to how to apportion social costs among its

³⁴ Marian Sawyer, *The Ethical State: Social Liberalism in Australia* (Melbourne: Melbourne University Press, 2003), 1.

³⁵ Elizabeth and Harry Orsman, *The New Zealand Dictionary* (Takapuna: New House Publishers, 1995), s.v. fair; G. A. Wilkes, *A Dictionary of Australian Colloquialisms*, (Oxford: Oxford University Press, 1996), s.v. fair go. The phrase was recently used by New Zealand’s Prime Minister, John Key, in his keynote speech: “The Kiwi Way: A Fair Go for All” (30 January 2007), <http://www.national.org.nz/Article.aspx?ArticleID=9215> (accessed 20 November 2009).

³⁶ Holmes, *The Concept of Income*, vii.

members by way of taxation illustrate society's views on economic justice. If New Zealanders could indeed believe and perceive that the personal income tax manifested vertical equity, then perhaps it would be possible for the government both to tax and to please.

1.2 Research Question

Any tax affects vertical equity, that is, the relative treatment of persons who differ by some measure. Equity, like its synonyms justice and fairness, points toward a state of affairs between persons and groups that is considered to be desirable, but tells us little as to what that state of affairs might look like. The question, "What is justice (or fairness or equity)?" may be answered in numerous ways. Even in a specific context, no single answer is available: what is tax justice for one person may seem gross inequity to another.

Attempts have been made to define justice; however, a strictly deductive approach ignores not only the subjectivity of the person formulating the definition, but also the dynamic social context outside of which the concept of justice or fairness makes little sense. Similarly, an inductive approach that describes how a particular society practises justice, and induces from this what a society understands by the concept, can hardly lead to any basis upon which to evaluate divergent approaches. What *is* is not necessarily what *ought* to be. In practice it is neither feasible nor meaningful to isolate deduction from induction: theory (deduction) or data (induction) in isolation is sterile. Instead, as data are interpreted, and the interpretations are again assessed against new data, knowledge grows. This interaction of observation and cogitation is particularly necessary where a reality (such as taxation) meets an ideal (such as vertical equity).

This is not to say that there is no distinction between the ideal and the real: society may aim at "a more perfect union"³⁷ and yet remain divided. So too, there may be agreement that tax policy should be equitable, even while there is no consensus as to what this might mean. However, in the absence of dissimulation, there should be some convergence between the ideal and real, with each informing the other. The practice of taxation should reflect, at least to some extent, the ideals of those with the power to tax. In a democracy, their policies will also take into account the will of the electorate.

³⁷ Preamble to the United States Constitution (1787).

This research describes what vertical equity looked like to New Zealand taxpayers, but it also considers how this was justified by the legislators. In particular, it considers what the idea of equity may have meant in the context of the frequently changing phenomenon of personal income taxation as it affected employees. The focus of this research may be summarised in the following question:

How has vertical equity (that is, the taxation of unequals) developed in the context of the New Zealand income tax on wage and salary earners from 1891 to 1984?

1.3 Methodology and Method

1.3.1 Methodology

Margaret Lamb comments that:

As an object for research, taxation can be seen to represent an ‘interdisciplinary problem’. As such, this may be a problem of knowledge and practice that would best be understood and pursued in the round.³⁸

Lamb’s “in-the-round” metaphor refers to theatre staging. A typical theatre has a stage on which the action takes place, with the audience seated outside the stage, looking at, but not involved in, the action. In contrast, theatre in-the-round may have no stage as such. Instead, an open space is left in the middle of the auditorium, resulting in an intimacy of performance since the action can be seen from all sides.³⁹ An interdisciplinary approach to taxation research similarly considers taxation from a variety of angles and perspectives.

In succeeding chapters, Lamb goes on to discuss taxation research as fitting in a range of research traditions: as legal, economic, accounting, political science, or social policy research. Yet there is no chapter on taxation research as historical research. Despite the significance of taxation in human history, history appears to be a missing actor on the stage of taxation research just as taxation appears to be a missing actor in much historical writing.

³⁸ Margaret Lamb, “Interdisciplinary Taxation Research – An Introduction,” in *Taxation: An Interdisciplinary Approach to Research*, ed. Margaret Lamb et al. (Oxford: Oxford University Press, 2005), 7.

³⁹ Oscar G. Brockett, *The Essential Theatre* (Orlando, FL: Holt, Rinehart and Winston, 1988), 278-80.

This thesis reflects Lamb's contention that taxation represents an interdisciplinary problem. Since taxation is enacted as law, legislation must be consulted and interpreted. Effective taxation presupposes the power of the state to effect compliance on the part of the citizenry, involving political science. The effect of the legislation raises sociological concerns; and concerns about fairness and distributive justice prompt philosophical issues. Yet given its focus on the past, this thesis is rooted in history.

Historical research always involves the selection and interpretation of data, but also the subjectivity of the historian. Whilst recognising that "an objective knowledge of the past can only be obtained through the subjective experience of the scholar,"⁴⁰ this thesis concurs with Evans:

*The past does speak through the sources, and is recoverable through them. There is a qualitative difference between documents written in the past, by living people, for their own purposes, and interpretations advanced about the past by historians living at a later date.*⁴¹

Stanford proposes a schema to show the interaction between history-as-events ("history₁"), and history-as-story ("history₂"). Stanford's model is illustrated in Figure 1.1, and reflects the approach adopted in this research. Although past events cannot be observed (1), there is historical evidence of these events, such as volumes of legislation, or award wage rates (2). These form the basis of an (unseen) construction in the historian's mind (3), which may become evident in a historical communication, such as this thesis (4). The response of the public mind to this communication is again unseen and may result in unintended outcomes (5). This response may become evident in actions taken by the public (such as sustaining the doctoral defense) (6). This approach recognises both the interplay but also the distinction between evidence and interpretation. The latter is based on the former, but extends beyond it. Stanford's schema is open-ended: the historical actions at step 6 may in turn become part of historical events, thus restarting the cycle. Santayana perhaps put this rather elegantly: "those who cannot learn from history are doomed to repeat it."⁴²

⁴⁰ Michael Stanford, *The Nature of Historical Knowledge* (Oxford: Blackwell, 1986), 27.

⁴¹ Richard J. Evans, *In Defence of History* (London: Granta Books, 1997), 126.

⁴² George Santayana, *The Life of Reason* (London: Constable, 1905), 1:105.

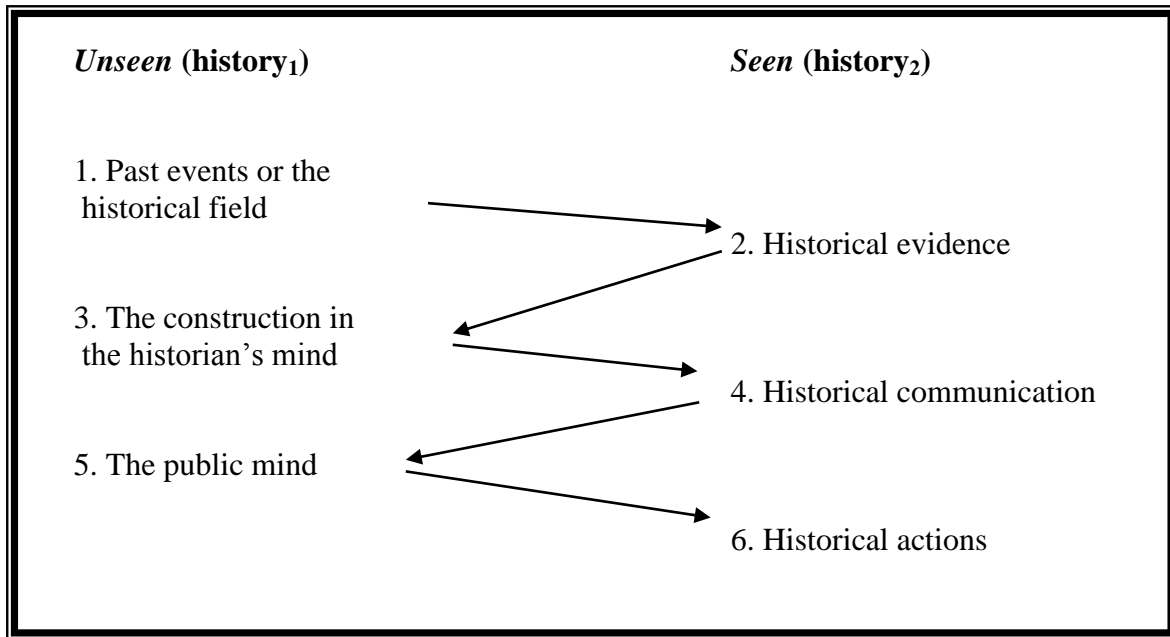


Figure 1.1 Structure of historical activity⁴³

Having summarised the context in which the New Zealand income tax arose, this research adopts an inductive approach in discussing the understanding and practice of vertical equity in the New Zealand income tax as it affected employees. In keeping with Stanford's model, neither the rhetoric nor the practice of vertical equity are pre-specified deductively; that is, the focus of the research is not on what vertical equity *should* look like. Rather, both the actual practice of vertical equity as it relates to personal income tax on employment income, and the arguments advanced in defence of this practice are derived inductively from the sources.⁴⁴ The data is thus allowed to speak, and once it has spoken, inferences are drawn.

1.3.2 Method

Vertical equity in the income tax involves the unequal treatment of persons who differ. This difference is defined in revenue acts passed by Parliament, and then applied to taxpayers as they calculate their annual income tax liability. The actual effect of the income tax legislation may be expressed as the average tax rate applying to a taxpayer, calculated as the total tax liability divided by their gross (that is, pre-tax) income. The practice of vertical equity appears when the effective average tax rate differs between persons who differ in some material respect or respects.

⁴³ Stanford, *Historical Knowledge*, 6.

⁴⁴ Inductive reasoning provides a useful approach to data which also permits conclusions to be drawn; see Rachel A. Tooma, *Legislating against Tax Avoidance*, Amsterdam: IBFD, 2008, p. 1.

New Zealand's income tax legislation has distinguished taxpayers in two main ways. First, a person's tax liability increased as their pre-tax income levels increased. Since its inception in 1891, the income tax rates scale has been progressive. Secondly, a person's income tax was affected by their domestic situation, as over time exemptions and allowances reduced the effective tax payable by married taxpayers, and reduced it still further for married taxpayers with children. Thus both income level and domestic situation were grounds for distinguishing between taxpayers. To permit interpersonal comparison to be made, a low, a medium, and a high income level, and three domestic situations – single, married, and married with no children, are considered. This provides nine cases to illustrate the practice of vertical equity in the New Zealand income tax on employees.⁴⁵

Having determined a range of cases, the thesis then inductively discusses the development of vertical equity in the New Zealand income tax. First, it calculates the shape of vertical equity in the New Zealand income tax as it affected employees, by summarising the relevant income tax legislation and then calculating and graphing the average tax rate for the nine defined cases. This data provides prima facie evidence of what vertical equity looked like for New Zealand employees by enabling comparisons to be made of the average tax rates faced by employees who differed in terms of income level or domestic situation or both.

The *New Zealand Parliamentary Debates* are then reviewed for evidence of how vertical equity was understood by those who enacted it, namely the Members of Parliament.⁴⁶ Again this data is approached inductively; rather than adopt a deductive approach, where the Parliamentarians' rhetoric is compared to a pre-specified standard, no assumptions are made as to what fairness should look like; rather, the sources are allowed to speak. At a broader level, Parliament periodically established a Commission or Task Force to investigate into and advise on taxation in New Zealand. These provide a higher level consideration into the practice of taxation, independent of Parliament. Since these were held at roughly twenty year intervals,⁴⁷ they provide further evidence into changes in New Zealand taxation ideals. The evidence provided by the

⁴⁵ Refer chapter 5, section 5.3 (pp. 136-46).

⁴⁶ Brief summaries of the Parliamentary careers of Members of Parliament referred to in this thesis may be found in Appendix 1.

⁴⁷ Such Commissions were held in 1922/24, 1951, 1967, and 1982.

calculation of average tax rates and the review of the Parliamentary discussions is then synthesised.

Despite initial appearances that there were no patterns in the practice of the New Zealand income tax, some structure did become evident which helps make sense of the data, and provides insights into what vertical equity might mean in the case of income tax on employees from the introduction of the income tax in 1891 until the election of the Fourth Labour Government in 1984. This pattern changed after 1984; that latter date marks the start of a significant shift in New Zealand taxation policy, a shift Sinclair describes as described as involving the biggest taxation reforms since the income tax was first introduced.⁴⁸ In particular, “these changes [of the 1980s] improved the efficiency and equity of the tax system relative to the comparatively narrow-based, high-rate system that preceded it,”⁴⁹ and significantly altered the provision of family-focussed welfare. It thus provides an appropriate terminal point for this study.⁵⁰

Based on this archival research into New Zealand taxation practice and debate, some conclusions may be drawn concerning vertical equity in the context of the New Zealand personal income tax as it was levied on employees. Given the increasing significance of the income tax during the twentieth century, what is considered to be fair in income tax should reflect what is considered fair in society in general. This study of New Zealand taxation thus also contributes to an understanding of New Zealand’s social history, of what a “fair go” might actually look like.

1.4 Structure of the Thesis

The remainder of this thesis is divided into four parts. Part A (Chapters 2 and 3) sets the general context prior to the introduction of the New Zealand income tax, while Part B (Chapters 4 and 5) focuses on the practice of the income tax in New Zealand. Part C (Chapters 6 to 13) describes the New Zealand experience of the income tax, and considers how the income tax was justified. Part D (Chapters 14 and 15) then structures the foregoing discussion and summarises.

Part A sets the context of New Zealand’s income tax. Chapter 2 commences by suggesting that the concepts of justice, fairness, and equity may be regarded as synonymous. Justice or fairness

⁴⁸ Keith Sinclair, *A History of New Zealand* (Auckland: Penguin, 1991), 323.

⁴⁹ Tax Working Group, *A Tax System for New Zealand’s Future: Report of the Victoria University of Wellington Tax Working Group*, (Wellington: Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010), notes that, “These changes [of the 1980s] improved the efficiency and equity of the tax system relative to the comparatively narrow-based, high-rate system that preceded it (p. 16).”

⁵⁰ Refer section 5.2 (pp. 134-6).

may be considered in terms of rules or duty, or in terms of outcomes. In any event, justice is something that arises in a social context: justice is always between *persons* or *groups of persons*.

Next, the concept of taxation is considered. Far from being uncontentious, taxation raises issues as to the legitimacy of government per se, and more particularly the right of government to take private property from its holders and apply it to the rulers' own, or to community, purposes. With these issues in mind, the idea of equity, and particularly vertical equity in taxation, is discussed, and several bases for this concept are noted.

Chapter 3 shifts the focus from general concepts to the human context within which these concepts were realised. Taxation was not discovered in nature, and nor did it arise in a vacuum. Rather, it is a distinctly human activity, and its practice reflects social and political realities and thinking. The chapter commences by considering key socio-political preconditions for the modern income tax, in terms of the state as taxpayer, the tax itself, and the taxpayer. The thinking of several key writers then illumines the social and the intellectual background to the New Zealand income tax.

Part B shifts from this background to the tax itself. Chapter 4 considers the New Zealand income tax legislation, and asks how vertical equity was practised in New Zealand's personal income tax on employment income from its introduction until 1984. First, the legislative history is outlined. Next, whilst recognising the general continuity of the income tax over that period, the main ways in which individuals have been distinguished for the purpose of the income tax are listed, namely, in terms of level of income (high or low), type of income (for example, earned or unearned), or some personal characteristic (such as family circumstances, or age). By these means, vertical distinction between taxpayers was effected, and some form of vertical equity was achieved (whether intentionally or otherwise).

Having described the legislative measures that made distinctions between taxpayers, Chapter 5 focuses on taxpayers themselves, and asks what vertical equity looked like to them. Since the legislation differentiated between taxpayers primarily in two dimensions, namely incomes and family situation, a low, medium and high income level are defined, as are three distinct domestic situations. The resulting income tax payable in each case is then calculated, and the period under review is divided into episodes for further discussion, and the scope of this research is justified.

Part C shifts from the “what” to the “why”. Chapter 6 deals with the introduction of the income tax in 1891. How was it possible to introduce such a radical change in New Zealand’s revenue structure and what arguments were presented in favour of and against it? Given that the New Zealand Parliament was democratically elected throughout the whole period from 1891 the views expressed by Parliamentarians should to some extent reflect the opinions found within the electorate. At the same time Parliamentarians must balance personal preference and even conviction with notions of “common good” and fiscal need.

Chapters 7 through 13 consider the subsequent history of the income tax following its introduction. Taking each episode from the income tax’s introduction in 1891 through to 1984 in turn, they outline the general, and then the taxation, context of each episode, before briefly summarising the significant changes in the income tax legislation during that episode. These chapters then illustrate what the income tax actually looked like to differently situated individuals, before considering what light the Parliamentary discussions and Commissions of Enquiry shed on the justification for vertical equity.

Part D summarises the data. Chapter 14 returns to the question of the thesis: *How has vertical equity (that is, the taxation of unequals) developed in the context of the New Zealand income tax on a wage or salary earner from 1891 to 1984?* It concludes that, although the practice of differentiation between taxpayers was in measure justified on ethical grounds, the extent to which equity, rather than fiscal constraints, political context, or macro-economic goals drove policy may be questioned. In particular, it highlights the role played by crises in legitimating significant changes to the practice of the income tax, and thus of vertical equity. Chapter 15 concludes the thesis, sets out its limits in more detail, and provides recommendations for further study.

Taxation may indeed never be pleasant. However, to the extent that the practice of taxation is considered to be fair or equitable, it may be more or less pleasing, that is, more or less acceptable to the taxpayers and considered to comply with the norms of justice as understood within a society. This study of the development of vertical equity in New Zealand’s personal income tax on employment income provides a contribution to this ongoing discussion.

PART A
SETTING THE SCENE

Chapter 2

Concepts of Justice and Taxation

It's our job to be fair.

New Zealand Inland Revenue Department, 1990s¹

2.1 Introduction

Children often lament, “It’s not fair!” and adults appeal for a “fair go!” Usually their concern reflects dissatisfaction with their lot in life compared to that of others. Almost always it suggests more than that the person is unhappy; rather, it is a cry of moral indignation, a shorthand way of saying that things are just not the way they should be. Fairness is a preferred state – one more or less attained here on earth.

But what does fairness mean? There are many terms in common speech that express this idea. Roget’s *Thesaurus* suggests as synonyms for “fair”: “disinterested, dispassionate, equitable, fair-minded, impartial, indifferent, just, nonpartisan, objective, square, unbiased, unprejudiced. Idiom: fair and square.”² The *Oxford English Dictionary* provides a similar definition of the adverb “fair”: “Equitably, honestly, impartially, justly; according to rule. Also ... fair and square.”³ Three of these terms appear often and virtually synonymously in taxation discussions: “justice,” “equity,” and “fairness”. So, in the sentence, “When pursuing tax *justice*, *fairness* is achieved when the requirements of vertical *equity* are attained,” the three italicised words are virtually interchangeable, and will be treated as such in this thesis.⁴

Taxation provides a practical demonstration of fairness. In particular, taxation epitomises concerns of distributive justice, that is, “normative principles designed to guide the allocation of

¹Ian McKay et al., *Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance* (Wellington: New Zealand Government, 1998), 16.27.

² *Roget's II: The New Thesaurus* (Boston, MA: Houghton Mifflin, 1995), s.v. “Fair.”

³ *Oxford English Dictionary*, s.v. “Fair adv. 4.”

⁴ Compare Raphael who notes that, “Although I have frequently written of justice ‘or’ fairness as if the two terms had the same meaning, they are not quite synonymous. In the law the concept of justice is distinguished from equity, which is pretty well synonymous with fairness”: David D. Raphael, *Concepts of Justice* (Oxford: Oxford University Press, 2001), 237.

the benefits and burdens of economic activity.”⁵ But taxation is more than just a concept: it also *really* hits the taxpayer in the pocket. The amount of pain felt is largely relative to the taxpayer’s assessment of the fairness of the tax, and not (merely) its quantum.

Yet some consider the idea that fairness might have any relevance to taxation with suspicion, if not outright disdain.⁶ The moral category of fairness, equity, or justice seems to have little to do with taxation, which often is perceived as a legally sanctioned but otherwise arbitrary and amoral, or even immoral, taking, imposed at the caprice of the sovereign power. Indeed, how could any non-consensual taking of private property possibly be considered fair or just? And if taxation itself is morally questionable, discussions as to how best to go about taxing may seem to be little better than discussions between murderers as to the best way to practise their nefarious art. Surely the notion of tax justice is an oxymoron?

If taxation were arbitrary, comments about fairness would be little more than platitudes or slogans, understood in different ways by different groups. This is aptly demonstrated by the rise and demise of the New Zealand Inland Revenue Department’s one time motto, “It’s our job to be fair”. Instead of sending a positive message:

*Taxpayers’ misconception of the meaning of ‘it’s our job to be fair’ is an example of a common error that comes about from mixing the relative certainty of legal norms with the subjective flexibility that is characteristic of people’s attitudes to morality.*⁷

The United States’ Supreme Court Justice Oliver Wendell Holmes Jr. famously commented that “taxes are what we pay for civilized society”.⁸ If this is so, taxation would seem to be inevitable. However, inevitability need not mean arbitrariness or unfairness. Taxation may be more or less fair, and there may be more or less just ways to assess it. In New Zealand’s relatively short history the form of taxation has changed numerous times; yet the absence of revolt, and general

⁵ Julian Lamont and Christi Favor, “Distributive Justice,” in *The Stanford Encyclopedia of Philosophy* ed. Edward N. Zalta (Stanford, CA: Stanford University, 2008), <http://plato.stanford.edu/archives/fall2008/entries/justice-distributive/> (accessed 17 October 2008).

⁶ Robert W. McGee, “Is Tax Evasion Unethical?” *Kansas Law Review* 42 (1994): 411.

⁷ McKay, *Report to the Treasurer*, 16.27.

⁸ *Compania de Tabacos v. Collector*, 275 U.S. 87 (1927), 100.

tax compliance, suggest that most New Zealanders at least acquiesce in the assessed taxation, even if they might think it could be fairer.

This chapter focuses on the two terms “justice” and “taxation”. It starts by considering what “justice”, or the related terms “fairness” or “equity” might mean in a general sense, and then what might be meant by the term “taxation”. These two ideas are then combined to consider what might be meant by taxation fairness. In particular, the question of vertical equity, that is, how unequals should be treated, is discussed, and how this might be justified.

2.2 The Meaning of “Justice”

2.2.1 Definitions of justice

Even if justice, fairness, and equity were indeed synonymous, the question remains as to what they denote. Questions of justice arise wherever society exists. Yet justice, like truth, is easier to claim than to define or justify. It seems to be elusive or even absent in the “real” world. Unlike physical objects such as gold or trees, justice cannot be discussed independently of the subjective humans who claim it. Throughout history, justice has been subject to theological, philosophical, and legal reflection and debate, but experience suggests that it is more often aspirational than realised.

The *Oxford English Dictionary* defines “justice” in a non-judicial sense as:

The quality of being (morally) just or righteous; the principle of just dealing; the exhibition of this quality or principle in action; just conduct; integrity, rectitude. (One of the four cardinal virtues).⁹

This definition demonstrates the difficulty of defining justice, and is somewhat less than helpful. The definition is largely tautological – *justice* is being *just*, dealing *justly*, *just* conduct – leaving us little the wiser. Where the defining terms are not tautologous, they themselves require definition: what do “morally,” “righteous,” “integrity,” or “rectitude” mean? Whilst all these terms involve value judgments, the inclusion of the term “righteous” suggests links between justice and religion – the Greek word used for justice by Plato and Aristotle may equally be

⁹ *Oxford English Dictionary*, s.v. “Justice.”

translated righteousness.¹⁰ What the definition does point to is that justice, at root, is a priori, and therefore, in measure, subjective. In the absence of a social consensus, discussions of justice, like pornography, easily become a matter of “I know it when I see it,” and not much beyond.¹¹

Admittedly, not all view justice subjectively. Marxist thought, for example, locates justice within society, and characterises it as a means whereby class-based economic interests are furthered. For Marx, “morality [and thus justice] was an historically fairly specific ideological institution, functioning to mystify and discipline people in accordance with the oppressive needs of class society.”¹² By characterising certain behaviours or (re-) distributions as just, the exploitation of weaker classes is legitimated. Instead of seeing justice as a positive aspirational ideal that is occasionally and partially attained, Marxist thought recasts it as a conventional legitimation of an unfair status quo and of existing power relations. Economically, justice is seen as a means whereby an inherently unfair distribution of resources is legitimated and maintained. Taxation becomes normalised, part of the conception of the world which is uncritically absorbed,¹³ and reproduced through culture, social convention, political practices, and law.

Such critical positions have generally been a minority view in Western society, and certainly in New Zealand. Indeed, even the staunchest Marxist prefers a particular social structure: the issue concerns what that would look like. However, attenuated socialist views have significantly affected social and political thinking and practice in New Zealand, particularly during the years of the rise of the Labour Party.¹⁴

Throughout history, humankind has sought and preached justice, but struggled to find it, let alone define it. Yet despite this, justice is appealed to as desirable and beneficial. This is perhaps most obvious in documents of fundamental law. Hence section 8 of New Zealand’s Bill of Rights Act 1990 provides that, “No one shall be deprived of life except on such grounds as are established

¹⁰ Henry G. Liddell and Robert Scott, *A Greek-English Lexicon* (Oxford: Clarendon Press, 1996), s.v. “*Dikaiosunē*.”

¹¹ Paul Gewirtz, “On ‘I Know It When I See It,’” *Yale Law Journal* 105 (1996): 1023, which discusses US Supreme Court Justice Stewart’s use of this phrase in concurring that the subject film was not obscene in *Jacobellis v. Ohio* 378 U.S. 184 (1964).

¹² Richard J. Norman, *The Moral Philosophers: An Introduction to Ethics* (Oxford: Clarendon Press, 1983), 187.

¹³ Antonio Gramsci, *Selections from the Prison Notebooks*, ed. and trans. Quintin Hoare and Geoffrey Nowell (London: Lawrence and Wishart, 1971), 332-4.

¹⁴ Barry Gufstafson, *Labour's Path to Political Independence: The Origins and Establishment of the New Zealand Labour Party 1900-19* (Auckland: Auckland University Press, 1980).

by law and are consistent with the principles of fundamental justice.” Similarly, the United States’ Constitution commences, “We the People of the United States, in Order to form a more perfect Union, establish Justice ...”. If a goal of public policy is to promote a just society, there must be some degree of consensus as to what, in fact, is just.

2.2.2 Approaches to justice

A just or fair situation may be described in two ways: in terms of outcomes, or in terms of actions. Murphy and Nagel comment that in discussions of political legitimacy:

A fundamental division runs through these debates, between two types of normative theory – those that focus on outcomes, conventionally called “consequentialist,” and those that focus on actions, conventionally called “deontological” (from the Greek word meaning “ought”).¹⁵

The first approach focuses on the results of an action. Such a *consequentialist* approach evaluates the fairness of an action or policy in terms of its consequences: if good results, the action is justifiable. The right action is the action that results in good. The justice of an action cannot be evaluated independently of its consequences. The end may justify the means.

In contrast, a deontological approach evaluates an action on the basis of a pre-specified standard. On this basis the good action is the action that is right.¹⁶ The end cannot justify the means. The justice or fairness of an action may be evaluated *ex ante*, and an action may be deemed to be just or fair, notwithstanding outcomes that might seem undesirable.

There is considerable overlap between the two approaches. Consequentialism asserts some a priori standard – that the end justifies the means; yet there must be some (deontological) basis for determining what in fact would constitute a desirable outcome. Murphy and Nagel comment that:

¹⁵ Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford: Oxford University Press, 2002), 42.

¹⁶ Colin Farelly, *Contemporary Political Theory: A Reader* (London: Sage Publications, 2004), 4.

... consequentialist theories usually accept the existence of rights, but they deny that rights are morally fundamental. Rather, they hold that rights must be justified by the overall benefits of a system that recognizes them.¹⁷

Conversely, deontological arguments are generally strengthened by the idea that compliance with a standard or duty conduces to the good. Yet the distinction between deontological and consequentialist bases will affect the nature of the argument, though not always the policy prescriptions that ensue. Writing in the context of tax compliance, Kaplan and Henderson note that individuals' ethical judgments are "influenced by both deontological and teleological ethical orientations."¹⁸ Similarly, Murphy and Nagel comment that since discussion of taxation ethics involves "disagreement at the level of theory, it does not inevitably result in disagreements at the level of policy."¹⁹ Yet concerning the practical issue of taxes, they suggest that, "the evaluation of taxes will be much affected by whether one adopts a deontological or a consequentialist conception."²⁰

On deontological grounds, income tax policy might be considered fair if it were consistent with a certain rule or standard.²¹ This basis may be provided by a religious teaching, such as "Render to Caesar what is Caesar's,"²² or a philosophical commitment, such as Kant's categorical imperatives. These provide norms to be followed independently of outcomes. However, practice may differ considerably depending on which verse or maxim is prioritised and interpreted. Which maxim – whether religious or philosophical – to choose as a basis for action, and what that implies for policy, remain open questions. So, for example, though Kant's third formulation of the categorical imperative specifies that "every rational being must so act as if he were

¹⁷ Murphy and Nagel, *Myth of Ownership*, 43.

¹⁸ B. Charlene Henderson and Stephen E. Kaplan, "An Examination of the Role of Ethics in Tax Compliance Decisions," *Journal of the American Taxation Association* 27 (2005): 43.

¹⁹ Murphy and Nagel, *Myth of Ownership*, 43.

²⁰ *Ibid.*, 44.

²¹ A recent example of this in the New Zealand context which mirrors the views of Robert Nozick is found in Alex Penk, *Is It Just Tax? The Shaping of Our Society: Tax Discussion Series Paper 2* (Auckland: Maxim Institute, 2008).

²² Mark 12:17.

through his maxim always a legislating member in the universal kingdom of ends,”²³ a general norm such as this tells us little as to the detail of specific taxation policy.²⁴

A consequentialist approach appears to avoid these problems, since it focuses on outcomes. The best tax policy would then be the one with the best or fairest outcomes. Yet this still begs the question as to what is meant by best or fairest. Fair for whom? Who decides what the desirable outcome should be: the person levying the tax, or the person paying the tax? And how can competing claims be measured?

The distinction between deontological and consequentialist ethical positions may provide a taxonomy, but still requires a choice between the bases for policy. Should a deontologist base his ethics on divine fiat, government dictate, or some notion of natural law? Conversely, which outcomes should a consequentialist consider to be desirable? Besides, ethical decisions are rarely, if ever, uni-dimensional, and this is particularly so at the social level.

For all its lack of specificity, justice in a society describes a situation where people are treated fairly or equitably. To put it more generally, justice prevails when things are the way they should be. Though there is considerable disagreement as to how things should be, or even how this might be determined, it does provide a sufficient focus for this thesis, which seeks to uncover what vertical equity *did* look like in the New Zealand personal income tax on employees and how this was justified, rather than what it *should* look like.

2.3 The Meaning of “Taxation”

What, then, is taxation? Taxation appears in a variety of forms, ranging from the provision of (forced) labour, through to the payment of money to a ruler. It may be levied on persons, goods, wealth, or even on specific personal characteristics such as age or race. Subjectively, taxation may be considered as either a legitimate appropriation of private property, or an illegitimate deprivation thereof, by the Sovereign.

²³ Immanuel Kant, *Grounding for the Metaphysics of Morals*, trans. J. W. Ellington (London: Hackett, 1993), 43.

²⁴ McGee highlights this in arguing from Kant in favour of tax evasion on the basis that it results in nothing bad: McGee, *Tax Evasion*, 425.

That taxation is far from a natural or neutral phenomenon is evident in the conflicting definitions given it. Grapperhaus, somewhat aphoristically, defines it as, “An individual sacrifice for a collective goal.”²⁵ This highlights the social character of taxation, but makes no mention of compulsion, leaving the impression that taxation is akin to a voluntary donation to a charity. Taken to extremes, equity issues would not arise, as the “giving” by the taxpayer in return for agreed-upon social goals would be almost akin to a gift or the fair bargain of a contract voluntarily entered into.

McGee provides a contrasting perspective, namely that taxation is theft. In syllogistic form his reasoning runs:

Major premise: Theft is the taking of property without the owner’s consent.

Minor premise: Taxation is the taking of property without the owner’s consent.

Conclusion: Taxation is theft.²⁶

Like Grapperhaus, McGee presupposes the social nature of taxation, but questions its legitimacy. For most citizens, taxation is an imposition, a taking without consent,²⁷ a necessary evil that is paid grudgingly where it cannot be avoided.²⁸ Yet both Grapperhaus’s and McGee’s definitions of taxation minimise the ethical issue: for the former taxation is above question; for the latter it is beyond redemption.

The *Oxford English Dictionary* provides a more prosaic definition of taxation:

*Tax (1a): A compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc., now at fixed rates, mostly proportional to the amount on which the contribution is levied.*²⁹

²⁵ Ferdinand H. M. Grapperhaus, *Tax Tales from the Second Millennium* (Amsterdam: International Bureau of Fiscal Documentation, 1998), 1.

²⁶ McGee, *Tax Evasion*, 434.

²⁷ McGee reflects a neo-Lockean insistence on consent – “deliberate, voluntary alienation of rights” as a prerequisite for any coercion: A. John Simmons, *On the Edge of Anarchy: Locke, Consent, and the Limits of Society* (Princeton, NJ: Princeton University Press, 1993), 69.

²⁸ See Martin T. Crowe, *The Moral Obligation of Paying Just Taxes* (Washington, DC: Catholic University of America Press, 1944), for this dilemma even in Catholic circles: namely whether tax evasion itself is sinful, or merely the failure to pay the penalty (though not the evaded tax) when caught. Concerning Roman Catholic views on taxation in general refer Charles E. Curren, “Just Taxation in the Roman Catholic Tradition,” *Journal of Religious Ethics* 13 (1985): 113.

²⁹ *Oxford English Dictionary*, s.v. “Tax.”

A key word in this definition is “compulsory”. Taxation cannot be levied without a taxpayer having the power to exact the tax. If the taxpayer is considered illegitimate, the fairness of the tax must be questioned. Yet taxation continues to be paid to corrupt or despotic rulers, which raises the question as to how such compliance is obtained. The threat of force always lies tacitly behind compliance; in its absence a society would be a voluntary association rather than a polity. Weber comments:

But what is a ‘political’ association from the sociological point of view? What is a ‘state’? ... Ultimately, one can define the modern state sociologically only in terms of the specific means peculiar to it, as to every political association, namely, the use of physical force.³⁰

However, the threat may be more clearly evident as in the case of a press gang, or it may be almost invisible where there is general conformity to the requirements of (tax) law – at least until there is actual non-compliance.

These elements of compulsion and non-reciprocity distinguish taxation from contract. Contract assumes a fair and voluntary exchange and mutual benefit. In contrast, taxation does not; resources are taken from an individual with no requirement for, or expectation of, consent by the taxpayer or reciprocity by the government. Excluding the limited case of user pays or fees for service, there need be no direct link between government revenue and government expenditure.

Taxation is a social event, and, in measure, reifies the relationship between the individual and society. It shifts the issue of the relationship between the individual and the group from the conceptual level to that of the (fiscal) real world. As such, it is a potent manifestation of the issue of the one and the many; how can the demands of the group be balanced with the rights of the individual? Or to put it in terms of taxation, what is the boundary between private and public property, and on what basis is the unrewarded taking of private property for public purposes justified?

³⁰ Max Weber, “Politics as a Vocation,” in *From Max Weber: Essays in Sociology*, trans. and ed. H. H. Gerth and C. Wright Mills (New York: Oxford University Press, 1946), 77.

Taxation may be levied in a variety of ways. In the past, tax was often levied in kind; today almost all taxes are levied in monetary terms.³¹ Further, there are several bases upon which it may be levied, such as persons, property, income, commodities, or transactions. Each basis gives rise to its own equity questions, as does the actual overall mix of taxes; although a particular tax might be considered fair in isolation, the overall system of taxes might not be. At a systemic level, the mix of taxes and their interrelationship must be considered in assessing the fairness of the tax system.³² Although one particular tax (for example, an income tax) might be considered to be fair in isolation, the combined effect of all the taxes in the system (such as an income and a payroll tax) may result in unfairness.³³ To be fair, a tax must itself be fair, but so too must the tax system as a whole.³⁴

Since taxation itself is a complex and contested phenomenon, fairness in taxation is necessarily a fraught issue. Issues of fairness impact on tax at a large number of points and in various ways. However, the fairness of a *particular* tax may also be evaluated in isolation, quite apart from the effect it has on the overall fairness of the tax system. This thesis focuses on a single income tax type, the personal income tax, and specifically on the fairness of the apportionment of the income tax burden between taxpayers who were in employment.

³¹ The Swiss requirement for all citizens for military service and to have and maintain arms is a residual form of taxation in kind: refer Lawrence P. MacDonald, George S. Patton, and Lewis W. Walt, *The Swiss Report* (Alexandria, VA: Western Goals Foundation, 1983), http://www.constitution.org/mil/swiss_rpt.pdf (accessed 29 September 2008).

³² The balancing of direct and indirect taxes as a means to ensure inter-class fairness in Victorian Britain is discussed in Martin Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge: Cambridge University Press, 2001). The issue arose again in New Zealand following its shift back towards indirect taxation after the introduction of a comprehensive Value Added Tax known as Goods and Services Tax (GST) in 1988: refer Robert Stephens, "The Economic and Equity Effects of GST in New Zealand," in *GST in Retrospect and Prospect*, ed. Richard Krever and David White (Wellington, Brookers, 2007), 65.

³³ Although the income tax rates scale may be nominally progressive, the effect of other income-based taxes which are limited to the first portion of income may reduce or reverse progressivity, as McMahan suggests is the case with the Payroll Tax in the USA: Martin J. McMahan Jr., "The Matthew Effect and Federal Taxation," *Boston College Law Review* 45 (2003-4): 993.

³⁴ Popular evaluations of the fairness of nation's taxations systems are occasionally published, for example Michelle Quah, "S'pore, HK Tax Systems Seen as Most Fair," *The Business Times*, 2 July 2008, <http://www.asiaone.com/Business/News/My%2BMoney/Story/A1Story20080701-73982.html>, (accessed 4 December 2008). This evaluation was made by members of a professional body of accountants, and ranked six nations in terms of the fairness, simplicity, and transparency of their taxation systems. It is not clear, though, what was meant by "fairness" other than a subjective evaluation.

2.4 Tax Fairness

Taxation affects the distribution of resources within a society. Distributive justice focuses more specifically on how resources ought to be allocated. How can the concepts of taxation and justice be linked?

2.4.1 Distributive justice

Principles of distributive justice are normative principles that guide the allocation of the benefits and burdens of economic activity.³⁵ In simple terms, distributive justice addresses the question of who should get or pay what in a society. The implications for taxation are obvious: (distributive) justice in taxation addresses the question of who should pay the tax in a society, or in other words how to apportion tax between the members of a society.

Any specific allocation of resources is made in a particular context. No society truly starts from scratch; even Robinson Crusoe commenced his life on the island with an endowment of cultural capital and goods retrieved from the shipwreck, and his very right to use the island could be called into question by any other current or future resident. Hence a prior question pertains to the fairness of the original distribution. If it is considered to be fair, any subsequent alteration must be justified. If it is considered to be unfair, an alteration might be considered to be just, being an attempt to remedy this state of affairs (for example, via redistributive taxation).

2.4.2 Taxation equity

Writing in the context of the ancient Athenian society, Aristotle argued that benefits should be assigned in proportion to some characteristic of the recipients, and posited personal merit as the basis of division. Aristotle then drew two inferences: Equals should be treated equally, and unequals unequally.³⁶ These principles neatly encapsulate the concepts of horizontal equity and vertical equity.

In writing on taxation, Musgrave reflects this Aristotelian heritage when he gives the following criteria for equity in taxation:

(1) that the index of equality should be defined in terms of accretion;

³⁵ Lamont and Favor, *Distributive Justice*.

³⁶ Aristotle, *Nicomachean Ethics*, trans. William D. Ross (Oxford: Oxford University Press, 1980), Book 5.

- (2) *that people in equal positions should be treated equally without discrimination – horizontal equity; and*
- (3) *that people in unequal positions should be subject to moderately progressive taxation – vertical equity.*³⁷

Although Musgrave's first criterion has a long history in the form of tithes or tribute, only relatively recently has accretion, rather than wealth or expenditure, become the mainstay of taxation. Accretion as a basis suggests a shift from indirect to direct taxation. Writing in 1911, Seligman suggested that history has shown a shift from the individual, to property, to expenditure and product, and finally to income, which "responds more accurately to modern demands," as the test of faculty for taxation.³⁸ Two decades later, Simons argued for "the income tax as the proper source of those necessary revenues which cannot be provided by the few good impersonal taxes,"³⁹ and for income as the best surrogate for the persons who are the proper subject of taxation, noting that:

*The income tax is not a tax upon income but a tax upon persons according to their respective incomes; and, subject to the requirement of adherence to simple, general rules, the objective of policy must be fairness among persons, not fairness among kinds of receipts (whatever that might be construed to mean).*⁴⁰

Yet the question as to whether accretion, wealth, or expenditure is the better basis for taxation is far from settled, as the introduction of a broad-based Goods and Services Tax (GST) in New Zealand in 1986, accompanied by significant income tax rates cuts, demonstrates. Although the balance between income tax and indirect taxes raises significant equity issues,⁴¹ that discussion is beyond the scope of this thesis, which is focused specifically on the income tax, that is, accretion.

³⁷ Richard A. Musgrave, "Growth with Equity," *The American Economic Review* 53 (1963): 327.

³⁸ Edwin R. A. Seligman, *The Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad* (New York: Macmillan, 1911), 15.

³⁹ Simons, *Personal Income Taxation*, 205.

⁴⁰ *Ibid.*, 128.

⁴¹ The potentially negative effect of GST on equity has been raised by James Belich, *Paradise Reforged: A History of the New Zealanders* (Auckland: Penguin, 2001), 409: "Even defenders acknowledged that this was a 'regressive' move, in that it benefited the rich more than the poor." Robert Stephens similarly suggests that, "Upper income groups were the major beneficiaries from the cuts in the personal income tax, and they had the smallest incidence from GST," Robert Stephens, "The Economic and Equity Effects of GST in New Zealand," in *GST in Retrospect and Prospect*, ed. Richard Krever and David White (Wellington: Brookers, 2007). For a contrasting view, compare L. N. Ross, *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington: Government Printer,

2.4.2.1 Horizontal equity

Musgrave's second criterion is relatively easy to state: equals should be treated equally. However, this is not as easy to apply, since it requires clarification as to what is meant by "equals". Holmes devotes a thesis to examining how income might function as a surrogate for an individual's well-being for the purpose of achieving horizontal equity in taxation, and highlights the difficulties in converting this into practical policy.⁴² The key question for horizontal equity is what is meant by "equal". In terms of the income tax, this becomes a matter of how to define the tax base. What does "income" include and exclude and how should its components be valued? Simons perhaps provided the seminal statement on this, arguing that:

*... personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.*⁴³

Yet this comprehensive definition of income, commonly referred to as the Haig-Simons definition, still requires elaboration as to what is included and excluded (such as psychic income, leisure, deemed income), and how it should be valued.

In practice, horizontal equity is elusive. Usually only monetary income is included in the tax base, and interpersonal comparisons are based on whatever is legally defined to be taxable income. Leaving problems of implementation to one side, however, the idea of treating equals equally is generally uncontested. Equal treatment seems to resonate with an innate sense of justice, as Musgrave suggests:

*The principle of horizontal equity – that people in equal positions should be treated equally – is hardly debatable. A democratic society should not permit arbitrary discrimination ... the principle of equal treatment is the basic rule.*⁴⁴

1967), para. 824f; Tax Working Group, *Changing the Rate of GST: Fiscal, Efficiency, and Equity Considerations* (Wellington: Victoria University, 2009), <http://www.victoria.ac.nz/sacl/CAGTR/taxworkinggroup/session-two/TWG%20GST%20paper%20for%20website.pdf> (accessed 11 September 2009), 6-14.

⁴² Kevin Holmes, *The Concept of Income: A Multi-disciplinary Analysis* (Amsterdam: International Bureau of Fiscal Documentation, 2001), v.

⁴³ Simons, *Personal Income Taxation*, 50.

2.4.2.2 Vertical equity

Musgrave's third criterion for equity in taxation, vertical equity, builds upon the base of horizontal equity.⁴⁵ Once different levels of income have been identified, unequal treatment is applied, with differing taxation burdens at different income levels usually resulting in an increasing impost as the income level increases. Holmes comments:

*Vertical equity proposes that the tax burden should differ between people in different positions such that a proportionately heavier burden falls on those who are better able to bear it. The vertical equity criterion has manifested itself in most income tax systems by way of progressive marginal tax rates and in indirect value added tax systems by way of the imposition of higher tax rates on luxury goods and services and lower rates on necessities.*⁴⁶

Like the principle of horizontal equity, this principle of vertical equity is simple to state but fiendish to apply or justify. Musgrave's comment is apt: although horizontal equity may be relatively easy to define:

*... matters are less clear-cut when it comes to the principle of vertical equity, that is, how taxation among unequals should differ. For vertical equity to be achieved, horizontal equity must also prevail ... Vertical equity, after all, is part of the larger problem of distributive justice, an issue that has no simple answer.*⁴⁷

As far as the income tax is concerned, the vertical equity debate initially centred on the propriety of proportional as opposed to progressive rates. Although the original British income tax was degressive rather than proportional,⁴⁸ the idea of proportionality was regarded as the norm in Victorian Britain. Daunton argues that the principle of proportionality "was not seriously

⁴⁴ Richard A. Musgrave, "Equity and the Case for Progressive Taxation," in *Tax Justice: The On-going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002), 9.

⁴⁵ *Ibid.*

⁴⁶ Holmes, *The Concept of Income*, viii.

⁴⁷ Musgrave, *Equity and the Case for Progressive Taxation*, 9.

⁴⁸ F. Shehab, *Progressive Taxation: A Study in the Development of the Progressive Principle in the British Income Tax* (Oxford: Oxford University Press, 1953), 9.

challenged during the mid-Victorian debates over the ability of different forms of income to bear taxation.”⁴⁹

This had changed by the early twentieth century. Writing in 1921, Baron Josiah Stamp commented:

*Progressive taxation of income is now wellnigh universal, and it is difficult to realise that only two decades ago it was still looked upon askance by all but advanced thinkers in this country, and in France it is still viewed with much suspicion. The nineteenth century economists in the main accepted proportion with an element of degression and an exemption limit, and they regarded any departure from a plain proportional rate as a dangerous and socialistic step leading to confiscation.*⁵⁰

Although progressive rates may now be the norm, the rationale for them is far from clear. Writing in the 1930s, Simons could only end his appeal for a progressive income tax on rather vague ground of equality:

*The case for drastic progression in taxation must be rested on the case against inequality – on the ethical or aesthetic judgment that the prevailing distribution of wealth and inequality reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely.*⁵¹

Similarly, after 104 pages discussing what they termed “the uneasy case for progressive taxation,” Blum and Kalven concluded with little more than a whimper:

But in the end it is the implications about economic inequality which impart significance and permanence to the issue and institution of progression. The case for progression, after a long critical look, turns out to be stubborn but uneasy. The most distinctive and technical arguments advanced in its behalf are the weakest. ... Ultimately a serious

⁴⁹ Daunton, *Trusting Leviathan*, 27.

⁵⁰ Josiah Stamp, *The Fundamental Principles of Taxation in the Light of Modern Developments* (London: Macmillan, 1921), 38.

⁵¹ Simons, *Personal Income Taxation*, 18f.

*interest in progression stems from the fact that a progressive tax is perhaps the cardinal instance of the democratic community struggling with its hardest problem.*⁵²

Although vertical equity means more than just progressive tax rates, progression is perhaps the most obvious, and contested, manifestation of vertical equity. Collapsing horizontal and vertical equity, Staudt argues that “the only relevant question for tax theorists relates to vertical equity – or on what basis and to what extent is differential treatment between individuals justified?”⁵³ She suggests that the debate over vertical equity, centred on the legitimacy of progressive tax rates, is “key for tax policymaking, and has been at the center of controversy for over a century.”⁵⁴ New Zealand tax history confirms that vertical equity has been a matter of controversy for the policy makers in Parliament for over a century, though the debate extends beyond the single issue of tax rates. Perhaps part of the difficulty in justifying progressive taxation is that the unequal treatment required for vertical equity may offend an inherent sense of justice in a way that the equal treatment required for horizontal equity does not.

2.5 Justifications for Vertical Equity in Taxation

As Musgrave indicated, vertical equity is generally considered a prerequisite if taxation is to be fair. Aristotle assumed that those who were unequal should be treated unequally. More recently, this has usually been translated into some form of progression in taxation: those on higher incomes should pay tax at higher rates than those on lower incomes. Yet it is one thing to say *that* those with higher incomes should pay more; it is another to justify *why* and *how*. Several theories have been adduced to justify the unequal treatment of unequals.

2.5.1 Benefits theory

The benefits theory of taxation essentially treats the relationship between the taxpayer and the taxer in contractual terms. Taxation is the price paid by the taxpayer for benefits or services provided by the taxer. Hence, taxes should be low or zero for those who receive no benefits from the state, and high for those deriving the most.

⁵² Walter J. Blum and Harry Kalven Jr., “The Uneasy Case for Progressive Taxation,” *University of Chicago Law Review* 19 (1952): 520. Blum considered the case to be even less easy following the prosperity of the fifties and sixties: Walter J. Blum, “Revisiting the Uneasy Case for Progressive Taxation,” *Taxes: The Tax Magazine* (January 1982): 16-21.

⁵³ Nancy C. Staudt, “The Hidden Costs of the Progressivity Debate,” *Vanderbilt Law Journal* 50 (1997): 932.

⁵⁴ *Ibid.*, 957.

Benefits theory may make sense in the hypothetical case of a minimal or “night watchman” state, limited to the functions of protecting all its citizens against violence, theft and fraud, and to the enforcement of contracts.⁵⁵ It might still make sense if, as Adam Smith allowed, the range of state functions was increased to include defence, justice, public works and public institutions (including education and religion), and the dignity of the Sovereign,⁵⁶ though the contractual analogy becomes increasingly tenuous.

According to benefits theory, the government’s role effectively is to protect life and property. Anything other than a proportional valuation of life might be questioned, either on the religious grounds that all humans are created in the image of God, or in such philosophical grounds as the “self-evident truth that all men are created equal” as in the United States’ Declaration of Independence. The value of the protection of property might, however, bear some direct relation to the value of the property that is protected, and increase as the value of the property increased.

Where the taxpayer extends its activities beyond mere protection and becomes involved in economic development, benefits theory may still make sense. Infrastructural development generally provides greatest benefit to those with property. However, benefits theory would seem to be counter-intuitive in the context of a welfare state, if it is assumed that recipients of welfare benefit the most from state activity. Unless social welfare is in some way analogised to and structured like an insurance contract, benefits theory would suggest that those in receipt of social welfare should pay for that benefit, thereby defeating the purpose of the redistribution.

However, if benefits are assessed in social rather than individual terms, benefits theory might yet perhaps be applied in a welfare state; the true beneficiaries of taxation expenditures are perhaps not so much the recipients of social welfare, but rather the owners of property, who are better secured in their possession by the (bought) acquiescence of those on lower incomes.⁵⁷ Alternatively, the benefit might be redefined as “the creation, maintenance and protection of a society within whose markets individuals can pursue and accumulate income and wealth.”⁵⁸

⁵⁵ Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974). Nozick suggests that even such a limited state “appears to be redistributive,” refer p. 26.

⁵⁶ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan, (London: Methuen, 1950), V.

⁵⁷ Robert Stanley, *Dimensions of Law in the Service of Order: Origins of the Federal Income Tax, 1861-1913* (New York: Oxford University Press, 1993).

⁵⁸ Graeme S. Cooper, “The Benefit Theory of Taxation,” *Australian Tax Forum* 11 (1994): 493.

Since it reflects contract law, benefits theory has the advantage of appearing to be equitable in that the (tax) payment is made in exchange for a benefit received. A failure to pay tax is a failure to keep one's side of the bargain. However, it still lacks the purity of contract in at least two respects: taxpayers do not assess the value of the benefit for themselves, and they are not free to opt out. Rather, taxation is assessed exogenously and compliance is coerced. Whereas contract results from a voluntary meeting of the minds as to benefit and value, benefits theory at best only mimics the *quid pro quo* of contract.⁵⁹ Despite this, benefits theory has had a long and enduring influence on taxation policy.

2.5.2 Ability to pay theory

Holmes pointed to the ability to pay basis when he said that, "Vertical equity proposes that the tax burden should differ between people ... such that a proportionately heavier burden falls on those who are better able to bear it."⁶⁰ Ability to pay usually denotes more than mere capacity: those who have more are not only able to, but *should* pay more. Although a proportional tax may be justified on an ability to pay basis, it is more often used to justify a progressive tax. So, if A has an income x times greater than B, he or she has an ability to pay that is *more* than x times greater than B. Ordinarily this may be the case; however, the question must be raised whether a possibility can create an obligation. It also says little about how *much* more the person having the higher income should pay.

A key difference between benefits theory and ability to pay theories of taxation is that the former ties tax revenue to expenditure: a personal taxpayer's tax is akin to the cost of the services he or she receives. Ability to pay requires no such link since taxation is separated from expenditure. Fairness is assessed not in relation to value received but in relation to how much another person pays.

2.5.3 Sacrifice theory

A derivative of ability to pay theory is sacrifice theory. Progression in taxation might be justified on the basis that taxpayers ought to be assessed so as to equalise the sacrifice of each. This view

⁵⁹ John S. Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (London: Longmans, Green and Co, 1909), 5.2.2 (p. 804).

⁶⁰ Holmes, *The Concept of Income*, viii.

was popularised by J. S. Mill who wrote, “Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice.”⁶¹

Over time, equality of sacrifice came to be understood in marginal, rather than absolute terms, with the assumption of a declining marginal income utility schedule, applicable to all taxpayers alike. This provides a significant justification for progressive taxation: if the benefit of an extra dollar to a millionaire is less than to a pauper, equal marginal sacrifice required a greater impost on the former than on the latter – after all, the millionaire would “feel” the tax on the final dollar much less keenly than would the pauper. However, even assuming the validity of the above assumption, the measurement of utilities *per se*, let alone *relative* utilities, is fraught.⁶²

2.5.4 State’s prerogative

Ability to pay, benefits, and sacrifice bases of taxation each locate the fairness of the tax apportionment in or between the taxpayers themselves. An alternative locus might be found in the taxpayer. Albeit hesitantly, Sir Josiah Stamp allowed that ulterior objects in taxation might be permissible. Thus:

*... starting with the right of the State to improve [the distribution of wealth] by way of taxation, one can, without recourse to ability to pay, or to the principles of equal marginal sacrifice, or to economic surplus, reach progressive taxation.*⁶³

If progressive taxation can be justified for the purposes of redistribution, why can it not also for other purposes? Only prudence would seem to limit the prerogatives of the state to tax. Behind this idea is a particular, almost Hobbesian,⁶⁴ conception of the state as absolute Sovereign, and a shift away from a focus on the individual. The group, rather than the individual, is put in the foreground. In the absence of private property, distributive justice could be understood simply to

⁶¹ Mill, *Principles*, 5.2.2 (p. 804).

⁶² See Arnold J. Cohen Stuart, “On Progressive Taxation,” in *Classics in the Theory of Public Finance*, ed. Richard A. Musgrave and Alan T. Peacock (New York: Macmillan, 1967). Also, Simons’ example of the relative evaluations of non-monetary income by a *Flügeladjutant* and the Sovereign he serves is instructive: Simons, *Personal Income Taxation*, 53.

⁶³ Stamp, *Fundamental Principles*, 171f.

⁶⁴ Harold M. Groves, *Tax Philosophers: Two Hundred Years of Thought in Great Britain and the United States* (Madison: University of Wisconsin Press, 1974): “The choice [faced by a group of people] was between despotism and anarchy and the people preferred the former. The covenant thus established not only gave the king a monopoly of violence; it gave him [the despot] all but unlimited power over individuals” (p. 5).

mean whatever distribution the state (whether representative or independent of the community) decided.

2.5.5 The nature of property

Justifications for the vertical equity norm based on benefits, ability to pay, and sacrifice assume that taxpayers have a prior claim over their pre-tax income. If, instead, private property is considered to be conventional, the result of numerous political decisions, then pre-tax income lacks independent moral significance; it does not provide a base-line against which to measure the tax impost. The question of vertical equity then does not revolve around the taking of private property for public use, but rather the post-tax distribution of resources, since “property rights are the rights people have in the resources they are entitled to control after taxes, not before.”⁶⁵ This view accords moral significance not to pre-tax income, but rather to a (fair) post-tax distribution. At the extreme, private property is divested of all moral significance, as in communist or certain types of anarchist thought. In that case it is not taxation that is theft, but rather private property.⁶⁶

2.5.6 Summary

Behind each of these justifications for vertical equity lies an assumption that the state *may* tax: in no case is private property held to be inviolable. Taxation per se is considered legitimate; the question is how to apportion the tax. Benefit theories tend towards a contractual view of taxation; private property may not be taken without reciprocation. Ability to pay/sacrifice theories accord greater liberty to the state to appropriate private property. Statist theories assert the right of the state to apply force in taxing, whereas communitarian or communist theories question the very institution of private property.

Justifications for the practice of vertical equity thus mirror justifications for taxation itself, and in turn reflect differing positions as to the ethical claims of property, and whether priority should be accorded to the distributive claims of the individual or the group. Attitudes to taxation can thus be considered on a continuum, with private property at one end, and communal property at the other. At either extreme there would be no tax. Between the poles, various mediating positions are possible, allowing for varying degrees of taxation and methods of assessing taxation. Those,

⁶⁵ Murphy and Nagel, *Myth of Ownership*, 175.

⁶⁶ Pierre-Joseph Proudhon, *What is Property?* ed. and trans. Donald R. Kelley and Bonnie G. Smith (Cambridge: Cambridge University Press, 1994), 13.

like McGee,⁶⁷ who would disallow any tax except with consent (by means of contract), might allow for limited progression if the benefits increase progressively with income. Others, who question the notion of private property, might allow for a greater degree of progression on the grounds that it is post-tax rather than the pre-tax income that has moral significance.

2.6 Conclusion

Generations of taxpayers have lamented that taxation is not fair. Yet it is not immediately clear what fairness might mean in the abstract, let alone in the context of taxation. Taxation involves the non-contractual appropriation of resources from individuals by the powers that be. For taxation to be fair requires, at a minimum, that the power to tax be accepted as legitimate, and that the practice of taxation be accepted as such. Behind these issues lie questions of the relationship between the individual and the group, and their respective claims on society's resources. This involves the problem of distributive justice, a problem with no simple answer.

Difficult questions arise in addressing how unequals should be taxed. If equals are taxed the same, that is, if horizontal equity obtains, fairness issues do not arise between the individuals similarly taxed, even if the tax itself is considered inequitable. But the taxation of unequals, that is vertical equity, raises questions of interpersonal fairness beyond the question of the fairness of the taxation itself. Various bases have been suggested to justify the non-proportional treatment of taxpayers. Each is an attempt to justify the practice of vertical equity, which is itself a subset of distributive justice.

Since the concepts of both justice and of taxation are contested, it is not surprising that there is no one approach to the practice of taxation. Certainly, individual perceptions of fairness will differ from person to person, depending on the objective factor of perceived benefits received for tax dollars given, but also, and significantly, perceptions as to "the equity of the taxpayer's burden in reference to that of other individuals."⁶⁸ However, the fact that a society can impose taxation, and that it is more or less accepted, suggests that there is some consensus as to how to tax fairly.

Taxation has been practised from time immemorial, and philosophers have long discussed how to go about the task of taxing. As a relative latecomer on the world stage New Zealand reflected and

⁶⁷ McGee, *Tax Evasion*.

⁶⁸ Betty R. Jackson and Valerie C. Milliron, "Tax Compliance Research: Findings, Problems, and Prospects," *Journal of Accounting Literature* 5 (1986): 137.

borrowed institutions and ideas from older societies.⁶⁹ The next chapter discusses this context within which the New Zealand's first (1891) income tax was enacted.

⁶⁹ Belich develops this theme of New Zealand as a latecomer on the world stage: James Belich, *Replenishing the Earth: The Settler Revolution and the Rise of the Angloworld, 1783-1939* (Oxford: Oxford University Press, 2009).

Chapter 3

Historical Context of the New Zealand Income Tax

To the citizen of the modern state, taxation, however disagreeable it may be, seems natural. It is difficult to realize that it is essentially a recent growth and that it marks a comparatively late stage in the development of public revenue; it is more difficult to realize that each age has its own system of public revenue, and that the taxes of to-day are different from those of former times; it is still more difficult to perceive that our ideals of justice in taxation change with the alteration in social conditions.

E. R. Seligman¹

3.1 Introduction

The previous chapter discussed vertical equity, which is the idea that fairness requires the unequal treatment of those who are unequal. Applied to taxation, vertical equity suggests that those who have more of the tax base (such as income in the case of the income tax), should pay more in taxation. Yet this concept is difficult to translate into practice.

United States Supreme Court Chief Justice Earl Warren once argued that “it is the spirit and not the form of law that keeps justice alive.”² However, taxpayers might well question such judicial idealism when their taxation liability is assessed not according to the spirit, but rather in terms of the letter, of the tax law. Further, that law is far from static; since taxation arises in a social context, changes in social structures and in a society’s thinking affect the way that taxation will be enacted and justified. These changes affect the practice of vertical equity.

New Zealand’s Land and Income Assessment Act of 1891 did not arise in a vacuum. As a relative newcomer on the world stage New Zealand built upon the institutions and thinking of previous generations and societies. Before turning attention to the New Zealand income tax, then, it is informative to consider the context within which it was enacted. Whereas Chapter 2 considered justice and taxation in the abstract, this chapter discusses the historical context by

¹ Edwin R. A. Seligman, *Essays in Taxation* (New York: Macmillan, 1895), 1.

² Earl Warren, “The Law and the Future,” *Fortune*, November 1955, 224.

looking at social and philosophical thinking on taxation and taxation fairness up to the time that the New Zealand income tax was introduced.

The chapter commences with a review of the socio-political context before a fair income tax could be implemented. By 1890 New Zealand had developed sufficiently to permit a permanent and modern income tax to be implemented. Next the philosophical background which informed discussions before the introduction of the income tax is discussed. Although New Zealand of 1891 provided a suitable context for the income tax, there was a range of philosophical ideas that made a progressive income tax possible, though not inevitable.

3.2 General Context

Although Benjamin Franklin may have quipped that taxation was one of only two certainties in life,³ the practice of taxation is far from certain – a basic definition of taxation as “a compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc ...”⁴ admits of an almost endless variety of forms of taxation. It certainly gives no indication as to the legitimacy or acceptability of any *particular* form of taxation.

Edwin Seligman, an influential American economist writing at the turn of the nineteenth century, wrote several seminal works on taxation. Coats suggests that Seligman’s “concepts of ‘faculty’ or ability to pay, and benefit, were the first systematic modern efforts to develop theoretical criteria of taxation.”⁵

Seligman considered the development of taxation as an inexorable evolutionary and materialistic process: since “the watchword of modern science is that of evolution through natural selection”⁶ and “the material has always preceded the ethical,”⁷ ethics was merely “a historical category”.⁸

³ The other being death. The complete quotation is: “Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes”: Eugene C. Gerhart, *Quote It Completely! World Reference Guide to More than 5,500 Memorable Quotations from Law and Literature* (Buffalo, NY: William S. Hein, 1998), 263.

⁴ *Oxford English Dictionary* s.v. “Tax.”

⁵ A. W. Coats, “Seligman, Edwin Robert Anderson,” in *The New Palgrave: A Dictionary of Economics*, ed. John Eatwell, Murray Milgate, and Peter K. Newman (London: Macmillan, 1987). Coats describes Seligman as an economist “of unusual erudition, energy and wide-ranging interests.” Ibid.

⁶ Edwin R. A. Seligman, *The Economic Interpretation of History* (New York: Columbia University Press, 1924), 23.

⁷ Seligman, *Economic Interpretation*, 127.

⁸ Seligman, *Essays in Taxation*, 1.

The title of his work, *The Economic Interpretation of History*, suggests the role of Marx in Seligman's thinking.⁹ Though considered "the leading academic apologist for capitalism in America,"¹⁰ he followed Marx by positing a progression in taxation that mirrored changes in the social structure: from a simple poll tax, through a tax on gross produce, and then on to personal property taxes.¹¹ Ultimately this process led to an income tax, that is, a tax corresponding as nearly as possible to the revenues of the citizens. This, Seligman argued, was "the last step in the evolution" of taxation.¹²

Seligman notwithstanding, change and development (factual matters) do not necessarily indicate progress (an evaluative matter), and taxation had certainly not reached its "last step" in his time. Nor is there any set linear sequence through which a society passes in its development of taxation. The record of history suggests that Seligman's schema is too tidy: although a number of nations introduced what might be recognised as a "modern" income tax during the nineteenth century,¹³ there had been forms of taxation on income from antiquity. The ancient Greek *eisphora* provides one example: a tax resulting from a "census based not on capital but on annual income assessed in terms of agricultural produce – cereal, oil, and wine – with which other forms of income were integrated."¹⁴ Although this form of income tax differed from its modern descendant in being class-based, occasional, and fixed in amount rather than rate, it challenges Seligman's evolutionary assumption. More recently, there has been a shift *away* from revenue to expenditure as a tax base with the post-World War Two rise of Value Added Taxes, and Britain even attempted to resurrect the Poll Tax.¹⁵ No one form of taxation has even been universally accepted, not least the income tax. Dickson comments:

⁹ Seligman, *Economic Interpretation*, 69ff.

¹⁰ Clyde W. Barrow, "From Marx to Madison: The Seligman Connection in Charles Beard's Constitutional Theory," *Polity* 24 (1992): 379, 381.

¹¹ *Ibid.*

¹² Seligman, *Essays in Taxation*, 18.

¹³ Edwin R. A. Seligman, *The Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad* (New York: Macmillan, 1911).

¹⁴ Nicholas G. L. Hammond, *A History of Greece to 322 B.C.* (Oxford: Oxford University Press, 1986), 160. See also, Rudi Thomsen, *Eisphora: A Study of Direct Taxation in Ancient Athens* (Copenhagen: Gyldendalske Boghandel, 1964).

¹⁵ Roger Bowles and Phillip Jones, "Non-payment of Poll Tax: An Exploratory Analysis of Tax Resistance," *International Review of Law and Economics* 13 (1993): 445. See also Barbara H. Fried, "Why Proportionate Taxation?" in *Tax Justice: The Ongoing Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002), 183.

*Of the fiscal instruments that owe their origins to the 20th century – the progressive income tax in the first half and the VAT and persistent fiscal deficit from the second half – only the value added tax still finds favour and acceptance. The other two persist but most governments would prefer that they did not.*¹⁶

Ethically, there is a danger that the most recent manifestation of taxation will be considered to be the fairest, at least to date; or that developments in taxation are viewed as mirroring the progress of democracy, considered as an unalloyed good. Seligman might argue that:

*... we discern the slow and laborious growth of standards of justice in taxation, and the attempt of the community as a whole to realize this justice ... until finally in modern times revenue or income has come to be regarded as the most equitable and the most practicable measure of individual and social faculty.*¹⁷

However, this approach to ethics confuses the status quo (what is), with the moral (what ought to be), and tends to interpret history from the perspective of the present. Seligman's approach might be termed "Whiggish". Historian Herbert Butterfield commented that: "It is part and parcel of the Whig interpretation of history that it studies the past with reference to the present," whereas the historian's:

*... chief function is to act as a mediator between other generations and our own. It is not for him to stress and magnify the similarity between one age and another, and he is riding after a whole flock of misapprehensions if he goes to hunt for the present in the past. Rather it is his work to destroy those very analogies which we imagined to exist ... The Whig historian stands on the summit of the 20th century, and organises his scheme of history from the point of view of his own day.*¹⁸

The *existence*, let alone the pedigree, of any particular taxation system, does not prove the *equity* of that system, but rather begs the question as to what equity in taxation might mean.

¹⁶ Ian Dickson, "The New Zealand GST Policy Choice: An Historical and Policy Perspective," in *GST in Retrospect and Prospect*, ed. Richard Krever and David White (Wellington: Brookers, 2007), 63.

¹⁷ Seligman, *Essays in Taxation*, 21. A recent linking of tax fairness and democracy is found in James R. Repetti, "Democracy and Opportunity: A New Paradigm in Tax Equity," *Vanderbilt Law Review* 61 (2008): 1129.

¹⁸ Herbert Butterfield, *The Whig Interpretation of History* (London: G. Bell and Sons, 1931), 11ff.

Certainly, a changing sociopolitical context will affect the type and the fairness of the tax. Taxation may be characterised as the unrecompensed taking of resources (taxation) by those with the power to do so (the state) from those subject to their power (the taxpayers), and history is replete with examples of revolts against the state, many of which were motivated by taxation.¹⁹ Yet, the majority of taxpayers submit to a ubiquitous and intrusive form of direct taxation without any significant exercise of coercion on the part of the state.²⁰ This compliance suggests an acquiescence in the tax even if not an underlying acceptance of the fairness of the tax.

Before an income tax in its modern form could be implemented, let alone considered in any sense fair, certain developments had to take place in respect of the state, taxation, and the taxpayer. These are discussed in turn.

3.2.1 The state

The *Oxford English Dictionary* defines the state as:

*the body politic as organized for supreme civil rule and government; the political organization which is the basis of civil government (either generally and abstractly, or in a particular country); hence, the supreme civil power and government vested in a country or nation.*²¹

Poggi, reflecting Weber, discussed the nature, development, and prospects of the state, and suggested that the key characteristic of a state is its monopolisation of political, as opposed to economic or ideological, power. He then posited that the key characteristic of political power:

¹⁹ Charles Adams, *Fight, Flight, Fraud: The Story of Taxation* (Buffalo, NY: Euro-Dutch Publishers, 1982); Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilisation* (Lanham, MD: Madison Books, 1999).

²⁰ Margaret McKerchar, "Why Do Taxpayers Comply? Past Lessons and Future Directions in Developing a Model of Compliance Behaviour," *Australian Tax Forum* 16 (2001): 99; Maryann R. Richardson, and Adrian J. Sawyer, "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects," *Australian Tax Forum* 16 (2001): 140; Betty R. Jackson and Valerie C. Milliron, "Tax Compliance Research: Findings, Problems, and Prospects," *Journal of Accounting Literature* 5 (1986): 125.

²¹ *Oxford English Dictionary*, s.v. "State."

*What we would consider as unique to political power, as conceptually intrinsic to it, is control over the means of violence, rather than the direct and frequent recourse to their employment.*²²

In this regard, Max Weber noted that:

*Today the relation between the state and violence is an especially intimate one. In the past, the most varied institutions – beginning with the sib – have known the use of physical force as quite normal. Today, however, we have to say that a state is a human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory.*²³

A state may certainly attempt to monopolise all three sources of power: political, economic, and ideological, and all three are involved in a state's taxation policy. However, the monopolisation of political power (and the threat of force) makes possible attempts to control economic or ideological power; that is, the right to private property and freedom of thought can only effectively be suppressed by (the threat of) violence, which Poggi considers to be the sine qua non of political power.

This control over violence is largely invisible to most citizens in a modern democratic state in which the Rule of Law is upheld. Dicey noted that the Rule of Law embodied three concepts:

*... the absolute predominance of regular law, so that the government has no arbitrary authority over the citizen; the equal subjection of all (including officials) to the ordinary law administered by the ordinary courts; and the fact that the citizen's personal freedoms are formulated and protected by the ordinary law rather than by abstract constitutional declarations.*²⁴

²² Gianfranco Poggi, *The State: Its Nature, Development and Prospects* (Cambridge: Polity Press, 1990), 5.

²³ Max Weber, "Politics as a Vocation," in *From Max Weber: Essays in Sociology*, trans. and ed. H. H. Gerth and C. Wright Mills (New York: Oxford University Press, 1946), 78.

²⁴ Jonathan Law and Elizabeth A. Martin, *A Dictionary of Law: Oxford Reference Online* (Oxford: Oxford University Press, 2009), s.v. "rule of law" <http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t49.e3493> (accessed 20 August 2009).

Although the meaning of Rule of Law is contested, the basic idea is that “law can and should contribute in salutary, some would say indispensable, ways to channeling, constraining, and informing – rather than merely serving – the exercise of power, particularly public power.”²⁵ Essentially the law, rather than the ruler, is sovereign. Since the Rule of Law legitimates and limits the power of the state, it also provides a baseline for fairness in the state’s power to tax. Absent the Rule of Law, government, and thus taxation, would *prima facie* be considered both illegitimate and unjust.

The Rule of Law suggests that all should be treated equally, including in the area of taxation. For much of history, taxation was imposed on the unenfranchised and unrepresented masses by those in power. Thus the Greeks and Romans exempted their citizens from tax; that was what subject peoples were for.²⁶ This aversion to taxing citizens is evident in the Bible,²⁷ and beyond; Grapperhaus notes that even “Machiavelli advised kings not to hit their own subjects with taxes, but to impose them on conquered peoples.”²⁸ Where plunder and booty did not suffice,²⁹ revenue was obtained as much as possible from all sectors of society by means of excises and custom duties, rather than direct taxes on property and income. Alternatively, it was not uncommon for the wealthy to make voluntary payments to the revenue as required.³⁰ But *direct* taxation was

²⁵ M. Krygier, “Rule of Law,” in *International Encyclopedia of the Social and Behavioral Sciences*, ed. N. J. Smelser, and P. B. Baltes (Amsterdam: Elsevier, 2004), 13403.

²⁶ James Coffield, *A Popular History of Taxation: From Ancient to Modern Times* (London: Longman, 1970), 3; Rudi Thomsen, *Eisphora: A Study of Direct Taxation in Ancient Athens* (Copenhagen: Gyldendalske Boghandel, 1964), 11.

²⁷ An example is found in Matthew 17:24-27 (*New International Version*): “After Jesus and his disciples arrived in Capernaum, the collectors of the two-drachma tax came to Peter and asked, ‘Doesn’t your teacher pay the temple tax?’

‘Yes, he does,’ he replied. When Peter came into the house, Jesus was the first to speak. ‘What do you think, Simon?’ he asked. ‘From whom do the kings of the earth collect duty and taxes—from their own sons or from others?’

‘From others,’ Peter answered.

‘Then the sons are exempt,’ Jesus said to him.”

²⁸ Ferdinand H. M. Grapperhaus, *Tax Tales from the Second Millennium* (Amsterdam: International Bureau of Fiscal Documentation, 1998), 47.

²⁹ The Treaty of Versailles following World War One is a notable modern example of plunder being a consequence of war and a potential substitute for taxation.

³⁰ Refer Roy Douglas, *Taxation in Britain since 1660* (London: Macmillan, 1999), 35; Arthur Hope-Jones, *Income Tax in the Napoleonic Wars* (Cambridge: Cambridge University Press, 1939), 14; Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World* (New York: Simon and Schuster, 1986), 108. Voluntary taxation lived on into the twentieth century during war time: The New Zealand Society of Accountants made voluntary contributions to the war effort during both World Wars One and Two: refer Presidents’ addresses in New Zealand Society of Accountants Yearbooks for 1914, 1915, 1941 and 1942; Member of Parliament

generally limited to the wealthy, was occasional, and was considered a cost of representation. Over the course of the twentieth century the income tax has been democratised, affecting more or less all income earners, regardless of income level.³¹

If the law, rather than a monarch or oligarchy, is sovereign, then taxation is no longer considered a payment to an individual. Rather, tax is paid to an impersonal state or one of its agencies. Rulers are agents of the state, but are not themselves the state. Instead of a taxing ruler being able to claim “*L’état, c’est moi!*”³² and on that basis tax and spend at his or her own discretion, the modern impersonal state might claim, “*L’état, c’est vous!*”³³ and effectively charge a dissenting taxpayer with a degree of schizophrenia. This might simply mean that the dissident was not playing by the rules of democracy, or may reflect an exalted Rousseauian view of the state as the manifestation of the General Will,³⁴ a Hegelian view of the state as “a unique synthesis of the individual freedom *and* community,”³⁵ or even the “dangerous doctrine that the state can be an end in itself.”³⁶

If the Rule of Law affects the relationship between the individual and the state, so too does the extension of the franchise to all taxpayers. If not quite a quid pro quo, modern conceptions of taxation imply some right to participate in the affairs of government, at least through the ballot box: witness the cry of “no taxation without representation!” Yet a corollary of this cry is its reverse: “no representation without taxation.” This may be taken negatively or positively. Negatively, it reflects a concern that if those without means gain voting power, the “mob” will abuse this privilege for self-enrichment and expropriation of the wealthy. Positively, a modern twist is that taxation is a democratic right: all people ought to pay tax to ensure their dignity, their

Anstey referred to £159,137 of voluntary contributions to the War Fund: *New Zealand Parliamentary Debates (NZPD)* vol. 173 (1 September 1915), 278.

³¹ Coffield suggests that Parliament can fail and has indeed done so in protecting individuals against extortionary taxation: refer Coffield, *A Popular History of Taxation*, chapter 13; “The Failure of Parliament.”

³² That is, “The state, that’s me!” Attributed, possibly apocryphally, to Louis XIV of France.

³³ That is, “The state, that’s you!”

³⁴ Jean Jacques Rousseau, *The Social Contract* (Harmondsworth: Penguin, 1968).

³⁵ Ian Hampsher-Monk, *A History of Modern Political Thought: Major Political Thinkers from Hobbes to Marx* (Oxford: Blackwell, 1992), 462.

³⁶ Harold M. Groves, *Tax Philosophers: Two Hundred Years of Thought in Great Britain and the United States* (Madison: University of Wisconsin Press, 1974), 7.

connectedness to the polity.³⁷ However imperfectly, and in the absence of corruption, the government in a democracy in measure represents the will of the people who voted it in to act on their behalf. So long as the requirements of procedural fairness are met, the consequent actions of the government may, in some sense, be regarded as reflecting the will of the people, who should bear responsibility for the costs of government. Such a view was evident in New Zealand Minister of Finance Michael Cullen's reply to Opposition questioning: "We won, you lost, eat that!"³⁸ That electoral success seemed to justify subsequent policy is seen when a government "goes to the polls" in an attempt to vindicate either its hold on power, as with Prime Minister Muldoon's ill-fated snap election of 1984,³⁹ or to legitimate a policy, as the First Labour Government did in announcing of its Social Welfare initiatives prior to the 1938 election, to be confirmed following the 1938 General Election.⁴⁰ The power of the electorate to vote out an unpopular government provides a constraint on a government's ability to enact unpopular taxation.

The Rule of Law and the ballot box place limits on a state's freedom to spend and tax. Yet these limits are far from clear: in nineteenth century New Zealand they included the night watchman functions of defence and law and order, but also infrastructural development and education. In the twentieth century, social welfare, economic stabilisation, and then economic development functions were added.

A further prerequisite for the introduction of a universal income tax is the unification of a nation in a single state.⁴¹ There can be only one sovereign in a nation, one source of law, and hence one body that levies taxation. The sovereign body may delegate authority to tax to another group, such as a municipal council, and under a federal constitution, certain powers may be reserved to the states. However, the lines of demarcation must be clear, the ultimate power being in the hands of that body that "bears the sword". Taxation will be ineffective where a territory is not

³⁷ Repetti, for example, argues that "equal opportunity for self-realisation and equal participation in the democratic process should motivate the design of a tax system" Repetti, *Democracy and Opportunity*: 1178.

³⁸ Paul Goldsmith, *We Won, You Lost, Eat That! A Political History of Tax in New Zealand since 1840* (Birkenhead: David Ling Publishing, 2008). *NZPD* vol. 586 (9 August 2000), 4570.

³⁹ Barry Gustafson, *His Way: A Biography of Robert Muldoon* (Auckland: Auckland University Press, 2000).

⁴⁰ Barry Gustafson, *From the Cradle to the Grave: A Biography of Michael Joseph Savage* (Auckland: Reed Methuen, 1986).

⁴¹ The role of the *Zollverein* (customs union) in the process of German unification in the nineteenth century; the prohibition of interstate tariffs in the United States Constitution; and the moves to taxation harmonisation in the EU are examples where taxation policy furthered nationalist or trans-nationalist unity.

united under one government.⁴² Civil strife usually diminishes the ability of a ruler to levy, let alone collect, taxes. But underdevelopment of the organs of government may also thwart the Sovereign's ability to enforce his or her will. This may be seen in new states, where particular groupings may not have institutions that are prerequisite to taxing, such as individual Maori or farmers in the early days of New Zealand income taxation, or where the infrastructure does not permit the effective levying of taxes. In a new country like New Zealand the absence of communications infrastructure may inhibit the introduction of a tax.⁴³

The state which introduced the income tax in New Zealand was subject to the Rule of Law, and was put in power by a democratic franchise comprising all males – women would receive the vote two years later. Further, though the colony was less than 50 years old, the nation was unified, and had a well-regulated administration. Political reality permitted the introduction of an income tax, and the land and income tax itself furthered the development of a national consciousness.

3.2.2 Taxation

For a tax to be fair, it must be enacted by a responsible government, recorded in writing, and promulgated; a taxpayer's property may not be arbitrarily appropriated for state use apart from a positive law enacted by a responsible government and published; and the proceeds should be applied for the purposes of the "commonwealth" and not (corruptly) for private pecuniary gain. This much may be gleaned from key constitutional events of British history: the Magna Carta, the English Revolution, and the Bill of Rights of 1689, each of which arose in a conflict that was at least partly a tax dispute.

Yet a tax may be considered unfair even if levied in a democratic state subject to the Rule of Law. Aside from the danger of a majority unfairly oppressing a minority, there may be a lack of consensus in society as to what fairness might look like. There may be no agreement whether the

⁴² The example of the United States is a case in point. The inability of the Confederation to levy taxation adequate for its needs was a major factor leading to the eventual adoption of the United States' Constitution in 1789: refer Alexander Hamilton, "Federalist Paper No. 30: Concerning the General Power of Taxation," in *The Federalist: A Commentary on the Constitution of the United States, Being a Collection of Essays Written in Support of the Constitution Agreed upon September 17, 1787, by the Federal Convention, Reprinted from the Original Text of Alexander Hamilton, John Jay, and James Madison*, ed. Henry Cabot Lodge (London: T. Fisher Unwin, 1886), chapters 30-36.

⁴³ In his 1892 Financial Statement (now known as the Budget Speech), Colonial Treasurer Ballance noted the difficulty of identifying and communicating with all potential taxpayers for the purpose of assessing income tax: refer *NZPD*, vol. 75 (30 June 1892), 127.

tax might be assessed between groups or classes as it tended to be in the past, or on an individual (or possibly household) basis as it tends to be now.

There may also be no consensus as to what should be included as income. An income tax necessarily requires definition of income, valuation of that income, and calculation. Whereas most other taxes are based on a reality, the income tax is based on a concept – income – which requires definition. Prebble comments on the conceptual rather than “real” nature of income or profit, and argues that in income tax, “the true, economic, business profit . . . is removed from its legal simulacrum by an ectopia.”⁴⁴ Several practical issues arise: whose incomes are to be taxed, what is to be included in or excluded from income,⁴⁵ and how are such inclusions to be valued? There is also the conceptual question as to whether income, however defined, provides a meaningful, let alone equitable, substitute for the individual.⁴⁶

More generally, not only must income be defined, an income tax requires a monetary economy, a system of record-keeping that permits the calculation of income, and some means whereby the tax can be remitted to the authorities. In short, the modern income tax requires an efficient and effective infrastructure, accounting practices, and financial systems.

Just as a state must be considered equitable before its tax legislation can be considered to be such, so too must the tax itself be fair. Such fairness presupposes the equitable operation of the machinery of state in levying taxation. The regular and on-going amendments to the form of the New Zealand income tax indicate that this is far from uncontested even today.

3.2.3 The taxpayer

A minimum state and a level of tax sophistication were necessary before an income tax could be implemented in New Zealand. But there also had to be “buy-in” from the taxpayers. Why do most taxpayers accept an obligation to pay tax? Perhaps the answer is simply that they concur with United States Supreme Court Justice Oliver Wendell Holmes that, “Taxes are the price we

⁴⁴ John Prebble, “Income Taxation: A Structure Built on Sand: Parsons Lecture Delivered 14 June 2001,” *Sydney Law Review* 24 (2002): 310.

⁴⁵ This question, which lies at the heart of the practice of horizontal equity, is addressed in Kevin Holmes, *The Concept of Income: A Multi-disciplinary Analysis* (Amsterdam: International Bureau of Fiscal Documentation, 2001).

⁴⁶ Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), 128.

pay for civilised society.”⁴⁷ If so, taxpayers must believe that on balance they are getting a more or less fair deal from their taxes, and that the tax system is, by and large, fair.

Even if this is overstating the case, the developments mentioned above, notably the adoption of the Rule of Law and the extension of the franchise, should make the payment of tax in a constitutional democracy less onerous and seemingly more fair than payment of an arbitrary tax to an absolute monarch or oligarchy. This is particularly so where the taxpayer is a participant in the political process and can see (personal or social) benefit from the income tax.

3.2.4 Summary

Given its relative youth, New Zealand’s experience with the income tax provides a useful case study of the development of the income tax, and of what vertical equity meant in that context. At the time New Zealand introduced the income tax, it had been a Crown Colony of Great Britain for just over 50 years. Its settler population had increased from 2,000 in 1840 to 625,000 by 1891,⁴⁸ and its infrastructure had improved markedly.

New Zealand’s revenue system also developed rapidly, adopting and adapting many of the practices of the United Kingdom. In particular, the Rule of Law was accepted, as were the key constitutional documents or conventions which demarcate the rights of the citizen vis à vis the state. Bureaucratic structures also did not need to be developed from scratch, but could in measure be adopted and adapted from United Kingdom precedents. In short, to an immigrant to New Zealand from the United Kingdom the relationship between the state and the individual would have looked rather familiar. In a general sense, “New Zealand inherited the British taxation system which had derived, in turn, many of its taxation traditions from ancient Rome.”⁴⁹

This is not to say that the British and New Zealand systems were identical, or that they developed identically.⁵⁰ However, the basic preconditions for a fair taxation system were already in place at

⁴⁷ *Compania de Tabacos v. Collector*, 275 U.S. 87 (1927).

⁴⁸ Philippa Mein Smith, *A Concise History of New Zealand* (Cambridge: Cambridge University Press, 2005), 78.

⁴⁹ Keith C. Hooper, *Taxation as a Social Phenomenon: An Historical Analysis: Discussion Paper No. 93* (Palmerston North: Massey University Department of Accounting, 1989), 16.

⁵⁰ Malcolm McKinnon, *Treasury: The New Zealand Treasury 1840-2000* (Auckland: Auckland University Press, 2003), notes, “In an inversion of the assumption that aspects of New Zealand life started off by resembling British patterns and then steadily diverged, the story of the colonial Treasury is almost the reverse – in its early history it did not resemble the British Treasury, but it came to do so more at the end of the colonial era” (p. 28), that is, by the time the income tax was introduced in New Zealand.

the time that New Zealand as a British colony came to a degree of maturity. The general economic and political context did not preclude the possibility of fair taxation being enacted in New Zealand. Besides, as a settler society New Zealand could build upon the centuries of human civilisation.

3.3 Philosophical Thought

By 1890 conditions in New Zealand were such that a “modern” income tax could be introduced. Yet the *New Zealand Parliamentary Debates* (NZPD) indicate a range of views as to what vertical equity meant and how it should be practised.

The classical training of many members of New Zealand’s early Parliaments suggests that they would not have been ignorant of philosophical discussions that bore on taxation policy. Many early New Zealand politicians received their university education in England.⁵¹ Henry Sidgwick delivered lectures to “students of history and the moral sciences” at the University of Cambridge, and confined his attention “mainly to the political institutions of the ancient Greeks and Romans, and of Western Europe and its colonies in post-Roman times,” since this was where the “*higher* political development had originated and was still mainly confined.”⁵²

Any review of theories of taxation must be selective and somewhat superficial, since “theories of taxation date back to the Roman Empire.”⁵³ Yet some indication of the ideas that informed Parliamentarians’ views helps to situate the debates concerning how to distinguish between taxpayers. The several sources that follow highlight the background for such discussions, and also the development of thought in this area.

3.3.1 Religion

In Western societies, the Judeo-Christian scriptures have provided the basis for teaching in the church, and an authority for social and political thinking and action. This influence predates the

⁵¹ Martin notes that in 1870 the political élite had almost all been born outside of New Zealand, and that “Members were generally well educated. Thirty percent had a university education and a large number belonged to learned societies.” This changed when Seddon became Premier in 1893: John E. Martin, *The House: New Zealand’s House of Representatives 1854-2004* (Palmerston North: Dunmore Press, 2004), 69, 111. Eldred-Grigg discusses the education of the sons of the élite in Stevan Eldred-Grigg, *A Southern Gentry: New Zealanders Who Inherited the Earth* (Wellington: Reed, 1980), 157-9.

⁵² Henry Sidgwick, *The Development of European Polity* (London: Macmillan, 1903), 8f.

⁵³ John F. Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985), 392

rise of the West.⁵⁴ Justice (a legal term) and righteousness (a moral term) are closely linked, as reflected in the use of the same Greek word for both ideas.⁵⁵ Righteous behaviour is expected of those who claim to be pleasing to God, whether as individuals or as a society. In the Judeo-Christian tradition, a good ruler follows in the footsteps of King David, who “reigned over all Israel; and he administered justice and righteousness for all his people.”⁵⁶ However, the broad range of practice within various faith communities leaves open the question as to what justice or righteousness should look like.

Central to the Judeo-Christian tradition is Scripture; the written revelation of God’s will to humankind.⁵⁷ Certain key themes that relate to distributive justice can be found in Scripture. On the face of it, private property, a corollary of the eighth commandment, “You shall not steal,”⁵⁸ is permitted. At the same time, since God claims ownership of all his creation, human possession is more akin to the right of a tenant than an owner. Thus the Law of Moses provided for the remission of debts and the return of land to its original owners every fiftieth year in the Year of Jubilee.⁵⁹ According to Divine command, land could not be permanently alienated: “The land must not be sold permanently, because the land is mine and you are but aliens and my tenants.”⁶⁰ Possession or occupation was further circumscribed by various provisions and exhortations to consider the poor and needy.⁶¹ Hence the rights of private ownership are not absolute.

The Scriptures speak of rulers as vice-regents, or even gods,⁶² ruling under the authority of God. Rulers, having a delegated authority to tax, reclaim by taxation a portion of God’s estate for their own and for communal purposes. However, there is no clear direction as to how to practise taxation in general, let alone vertical equity. The tithe, a religious levy of 10 percent on

⁵⁴ Manuel L. Jose, and Charles K. Moore, “The Development of Taxation in the Bible: Improvements in Counting, Measurement, and Computation in the Ancient Middle East,” *The Accounting Historians’ Journal* 25 (1998): 63.

⁵⁵ Namely *dikaionē*.

⁵⁶ I Chronicles 18:14.

⁵⁷ So, for example, Article VII of the Anglican 39 Articles of 1571, *Of the Old Testament*, reads in part: “no Christian man whatsoever is free from the obedience of the Commandments which are called Moral.”

⁵⁸ Exodus 20:15.

⁵⁹ Leviticus 25:10.

⁶⁰ Leviticus 25:23.

⁶¹ Concern for the poor pervades the Old and the New Testaments. As an Old Testament example, refer to Leviticus 25:35: “Now in case a countryman of yours becomes poor and his means with regard to you falter, then you are to sustain him, like a stranger or a sojourner, that he may live with you.” Like the Old Testament, the New Testament has numerous exhortations to remember the poor (for example Galatians 2:10).

⁶² Psalm 82:1-2.

agricultural produce, suggests a proportional rate; however, other religious duties, such as the poll tax or the obligation to give to charity, respectively suggest a flat tax and a progressive tax.⁶³

The Bible is not intended to be a taxation manual. Chodorow could not locate a clearly enunciated basis for taxation policy in the Old Testament.⁶⁴ An alternative to such a textual approach is to locate general principles for taxation in religious teaching.⁶⁵ Yet despite a considerable range of views as to how to apply Scripture to questions of taxation,⁶⁶ the Bible has been a major source for ethical thinking in Western thinking on matters of justice, including taxation, and this was also true in New Zealand. Thus, after noting several key sources referred to by New Zealand Labour Party politicians in the 1930s, (including Bellamy, Hobson, Blatchford, Henry George, J. S. Mill, and Bernard Shaw), Chapman comments that, “Their most frequent source was certainly the Bible.”⁶⁷ Indeed, a Labour Member referred to its economic policy as

⁶³ Adam S. Chodorow, “Biblical Tax Systems and the Case for Progressive Taxation,” *Journal of Law and Religion* 23 (2007): 101-143.

⁶⁴ Ibid. Writing on taxation in the Protestant tradition, Shriver and Knox comment, “... it is remarkable that the most important *economic* dimensions of relations between Christians and the state – the dimension of taxation – received only episodic attention in the writings of the early Protestant Reformers and has received, if anything, less attention in the writings of their intellectual descendents. Taxation policy has not been a subject of great import in Protestant circles,” refer: Donald W. J. Shriver and E. Richard Knox, “Taxation in the History of Protestant Ethics,” *Journal of Religious Ethics* 13 (1985): 135.

⁶⁵ For example, Carolyn C. Jones, “Hard Shells of Community: Tax Equity Debates within the National Council of Churches after World War One,” in *Tax Justice: The On-going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002); Susan P. Hamill, “An Evaluation of Federal Tax Policy Based on Judeo-Christian Ethics,” *Virginia Tax Review* 25 (2006): 671; Rebecca P. Judge, “Economic Perspectives on Ethical Taxation,” *Journal of Lutheran Ethics* 6 (2006), <http://www.elca.org/What-We-Believe/Social-Issues/Journal-of-Lutheran-Ethics/Issues/April-2006/Economic-Perspectives-on-Ethical-Taxation.aspx> (accessed 17 November 2009). Similarly, the leaders of several New Zealand churches spoke on taxation matters with a clear consequentialist focus in their public statement of 1993: New Zealand Church Leaders, *Making Choices: Social Justice for Our Times* (Wellington: The Churches’ Agency on Social Issues, 1993).

⁶⁶ The range of such views is evident when the writings of Christian socialists are contrasted with their right-wing opponents. Thus the nineteenth century Christian socialist Stewart Headlam, could argue for nationalisation, brought about in part by a steeply progressive income tax: see Stewart D. Headlam, “*Fabian Tract 42: Christian Socialism*” (London: Fabian Society, 1899). Conversely, a contemporary economist could write, “The Bible does, of course, allow for some government taxation, but not much . . . As an absolute, outside limit, any tax of ten percent or more is specifically regarded by Scripture as *tyranny* – an attempt by rulers to be like God, extracting a ‘tithe.’” See David Chilton, *Productive Christians in an Age of Guilt Manipulation* (Tyler, TX: Institute for Biblical Economics, 1982), 70-1. Jones reviews a similar debate in the United States: Carolyn C. Jones, “Hard Shells of Community: Tax Equity Debates within the National Council of Churches after World War One,” in *Tax Justice: The On-going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002).

⁶⁷ Robert Chapman, “From Labour to National,” in *The Oxford History of New Zealand*, ed. Geoffrey W. Rice (Auckland: Oxford University Press, 1992), 354. In a different context, former Labour Prime Minister Mike Moore similarly appealed to the Christian background of several New Zealand Labour Party leaders in decrying the Electoral Finance Act introduced by the Fifth Labour Government: Michael Moore, “Repeal Electoral Act ... That’s Progress,” *New Zealand Herald*, 31 January 2008. http://www.nzherald.co.nz/opinion/news/article.cfm?c_id=466&objectid=10489687 (accessed 25 January 2010).

“applied Christianity.”⁶⁸ Similarly, speaking in an Australian context, Sawyer comments that, “when we turn to look ... at those who introduced this gospel in Australia, it is striking how many of them had family or personal backgrounds in Christian evangelism [sic]”⁶⁹ (p. 18), and of the effect of non-conformist Christian belief on early social policy.⁷⁰ Elsewhere other religions have similarly influenced the practice of taxation.⁷¹

That the Christian Scriptures do not provide a tax code is evident from the variety of interpretations given of them. However, their basic moral teaching of love for God and neighbour,⁷² and the treatment of others as you would be treated,⁷³ all in a world ruled by a God who himself personifies justice, has provided a basis for much Western ethical thought.

3.3.2 Antiquity: Aristotle

The classical authors of ancient Greece and Rome have also significantly influenced Western thought, and until quite recently formed the basis of the education of a “Western gentleman”. Of these, Aristotle may have been the most influential. Reintroduced to Europe via Islam, Aristotle wielded a significant influence on Jewish thought via Maimonides, and on Christian thought via St Thomas Aquinas.

Aristotle provided a relatively succinct yet specific taxonomy of justice in Book 5 of his *Nicomachean Ethics*. Legal historian Kelly summarises his basic idea as follows: “Aristotle’s meaning emerges from some general propositions, for example, that equals are to be treated equally, unequals unequally; that justice is proportion, injustice is disproportion.”⁷⁴ Aristotle here summarises the horizontal and vertical equity norms in a nutshell.

⁶⁸ Ibid., 361.

⁶⁹ Marian Sawyer, *The Ethical State: Social Liberalism in Australia* (Melbourne: Melbourne University Press, 1993), 18.

⁷⁰ Ibid., 33.

⁷¹ Azim A. Nanji, “Ethics and Taxation: The Perspective of the Islamic Tradition,” *Journal of Religious Ethics* 13 (1985): 161; A. Ben Shemesh, *Taxation in Islam: Yahya Ben Adam's Kitab Al-Kharaj: Edited, Translated and Provided with an Introduction and Notes* (Leiden: E. J. Brill, 1967).

⁷² Matthew 22:32-40.

⁷³ Matthew 7:12: “So in everything, do to others what you would have them do to you, for this sums up the Law and the Prophets,” commonly known as the Golden Rule.

⁷⁴ John M. Kelly, *A Short History of Western Legal Theory* (Oxford: Oxford University Press, 1992), 26.

Aristotle distinguished between two types of justice: distributive justice and rectificatory justice. The latter refers to two classes of transaction between people: some are voluntary, covering the area of contract law today, while others are involuntary, akin to torts or crimes.⁷⁵ The standard of justice here is arithmetical progression: where there is injustice, “the judge tries to equalise things by means of the penalty, taking away the gain from the assailant.”⁷⁶ This is not dissimilar to the *lex talionis* – the law of an eye for an eye.⁷⁷

Aristotle suggested a different principle in the area of distributive justice, since rectification is not in view, but rather:

... the distributions of honour or money or the other things that fall to be divided among those who have a share in the constitution (for in these it is possible for one man to have a share either equal or unequal to that of another).⁷⁸

In this case, justice requires what Aristotle termed a geometrical progression. Distributions should be made in proportion to the merits of the respective individuals. In other words, if the shares are proportioned to the persons, their relative condition will be the same after a distribution as it was before, and justice, which for Aristotle is virtually synonymous with equality, will have been done.⁷⁹ Thus Aristotle might be cited as an authority for proportion, rather than progression in taxation.

Although this may appear to provide a basis for taxation policy, some important qualifications should be made before placing too much reliance on this passage from Aristotle. First, Aristotle was dealing with “distributions of honour or money or the other things that fall to be divided.”⁸⁰ Dividing benefits such as the spoils of battle, or political offices and honours, or land, is a

⁷⁵ Ibid., 28.

⁷⁶ Aristotle, *Nicomachean Ethics*, trans. William D. Ross (Oxford: Oxford University Press, 1980), 115.

⁷⁷ The *lex talionis* principle is stated in various places in the Old Testament; for example Leviticus 24:17-21: “If anyone takes the life of a human being, he must be put to death. Anyone who takes the life of someone’s animal must make restitution—life for life. If anyone injures his neighbor, whatever he has done must be done to him: fracture for fracture, eye for eye, tooth for tooth. As he has injured the other, so he is to be injured. Whoever kills an animal must make restitution, but whoever kills a man must be put to death.”

⁷⁸ Ibid., 111.

⁷⁹ Francis H. Eterovich, *Aristotle’s Nicomachean Ethics: Commentary and Analysis* (Washington, DC: University Press of America, 1980), 95.

⁸⁰ Aristotle, *Nicomachean Ethics*, 111.

different matter from dividing a cost such as taxation. The former involves increasing a person's estate, whereas the latter deprives a person of something that was previously theirs. Indeed it is questionable whether Aristotle in his day would have analogised the two; after all, while honours were divided among citizens, taxation was preferably imposed on subjects. Further, the distribution of which Aristotle speaks was among a minority within the polis, namely, "those who have a share in the constitution," whereas tax is usually levied on a broader group.

Second, Aristotle's criterion of distribution is very much merit-based: "The criterion for the State's distribution of goods and services is found in the merits and demerits of the citizens."⁸¹ The idea that people deserve certain goods *regardless* of their character traits or anything they have done is distinctly modern.⁸² For Aristotle, a fair distribution is not egalitarian, but proportioned on certain characteristics of the individual. The question then becomes, "Which merits or demerits?" It is doubtful that Aristotle had income in mind.

Third, in distinguishing between individuals according to their respective merits, Aristotle clearly has proportion, and not progression, in view. His geometric progression does not, on the face of it, provide a justification for the progression which is a mainstay of income tax practice today.

These caveats might suggest that Aristotle's conception of justice differs substantially from contemporary Western practice, which favours both direct taxation and progressivity. However, the idea that justice involves a balancing is entrenched in Western thought – scales, after all, are a recognisable symbol of justice. Further, the idea that distributions should be proportioned on merit was normative until relatively recently. Fleischacker argues that:

*... people do not generally realize that the meaning of "distributive justice" has changed, or that for most of human history practically no one held, even as an ideal, the view that everyone should have their basic needs satisfied.*⁸³

This change occurred quite recently; social welfare legislation until the 1940s included language that indicated that support was contingent on some measure of worthiness. Thomson notes that

⁸¹ Eterovich, *Aristotle's Nicomachean Ethics*, 94.

⁸² Samuel Fleischacker, *A Short History of Distributive Justice* (Cambridge, MA: Harvard University Press, 2004), 13.

⁸³ *Ibid.*, 2.

New Zealand's first foray into public social welfare, the Old Age Pensions Act 1898, was very circumscribed, minimalist, and based on worthiness, not need; and that welfare provisions remained so until at least 1938. It was not until the years around 1970 that the legal requirement that children maintain their aged parents was scrapped, or that pensions were granted without reference to moral deserts.⁸⁴

Despite the passage of time and changes in context, both the Bible and Aristotle significantly continued to inform social policy and philosophical thought in ensuing centuries. More recent writers build upon a foundation that had previously been laid.

3.3.3 The British inheritance

The British income tax imposed during the Napoleonic wars in 1798 is generally regarded as the first modern income tax, supplementing what Hill called the “two new modern taxes, the excise and the land tax” of 1643.⁸⁵ By this time, the supremacy of Parliament over the Crown had been clearly established for about a century. However, significant constitutional developments predated the enactment of that tax.

The Magna Carta of 1215 provides a starting point for British, and thus New Zealand,⁸⁶ constitutional history. Sir Edward Coke confirmed its function as basic law when he commented that, “Magna Charta is such a fellow, that he will have no sovereign.”⁸⁷ It has been called “the keystone of English liberty, to which all that has since been added is little more than confirmation or commentary.”⁸⁸

⁸⁴ David Thomson, *A World without Welfare: New Zealand's Colonial Experiment* (Auckland, New Zealand: Auckland University Press, 1998), chapter 5.

⁸⁵ Christopher Hill, *Reformation to Industrial Revolution: A Social and Economic History of Britain 1530-1780* (London: Weidenfeld and Nicholson, 1967), 144.

⁸⁶ The New Zealand Parliament explicitly adopted British Acts of Parliament as applied in 1840 in the English Laws Act 1858. The full title of this act was, “An Act to Declare the Laws of England so far as applicable to the Circumstances of the Colony, to have Been in Force Therein on and after the 14th day of January, 1840,” which included such clauses of Magna Carta still in effect on that date.

⁸⁷ But note Jeffrey D. Goldsworthy, *The Sovereignty of Parliament: History and Philosophy*. (Oxford: Oxford University Press, 1999), 114: “It should be stated that his [Coke's] supposed statement, ‘Magna Carta is such a fellow that he will have no sovereign’, is now regarded as a misquotation.”

⁸⁸ Cited in Thomas P. Taswell-Langmead, *English Constitutional History from the Teutonic Conquest to the Present Time* (9th ed.) (London: Sweet and Maxwell, 1929), 90.

A leading textbook of the nineteenth century referred to the Magna Carta as one of three great political documents “in the nature of fundamental compacts between the Crown and the nations.”⁸⁹ Lord Chatham referred to Magna Carta, the Petition of Right, and the Bill of Rights as “the Bible of the English Constitution.”⁹⁰ Though it was a pact between the King and the nobility and not the general populace, its enduring influence suggests that this document was “not a mere piece of class legislation.”⁹¹

An early type of taxation was a significant factor in the dispute that gave rise to the Magna Carta. King John’s fruitless wars required funding, and the Barons were less than compliant with his demands.⁹² As far as direct taxation was concerned, articles 12 and 14 of the Magna Carta limited the independence of the sovereign in taxing his subjects:

12. No ‘scutage’⁹³ or ‘aid’⁹⁴ may be levied in our kingdom without its general consent, unless it is for the ransom of our person, to make our eldest son a knight, and (once) to marry our eldest daughter. For these purposes only a reasonable ‘aid’ may be levied.

14. To obtain the general consent of the realm for the assessment of an ‘aid’ – except in the three cases specified above – or a ‘scutage’, we will cause the archbishops, bishops, abbots, earls, and greater barons to be summoned individually by letter. To those who hold lands directly of us we will cause a general summons to be issued, through the sheriffs and other officials, to come together on a fixed day (of which at least forty days notice shall be given) and at a fixed place. In all letters of summons, the cause of the summons will be stated. When a summons has been issued, the business appointed for the day shall go forward in accordance with the resolution of those present, even if not all those who were summoned have appeared.⁹⁵

⁸⁹ Ibid.

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² A. E. Dick Howard, *Magna Carta: Text and Commentary* (Charlottesville, VA: University Press of Virginia, 1964).

⁹³ *Oxford English Dictionary*, s.v. “Scutagium: (Latin) – Scutage: A tax levied on knight’s fees; chiefly in restricted sense, such a tax paid in lieu of military service.”

⁹⁴ Ibid., s.v. “Auxilium (Latin) – Aid: 5. *Feudal System*. A pecuniary contribution by a feudal vassal to his lord; limited by *Magna Carta* to three special occasions.”

⁹⁵ Magna Carta, British Library. http://www.bl.uk/treasures/magnacarta/shockwave/magna_carta_broadband.htm (accessed 19 September 2008).

It may be too strong to suggest that these articles give the principle of “no taxation without representation.”⁹⁶ However there is a nudge in that direction. The primary issue was the balance of power (or fairness) between the Sovereign (the taxer) and the subject (the taxpayer). Issues of fairness between classes in society, let alone between individuals themselves, do not feature large.

After Magna Carta, taxation continued to be a source of discontent between the Sovereign and the Commons. During the reign of Edward III, the Commons asserted that all taxation without the consent of Parliament was illegal.⁹⁷ At best, this meant that the Sovereign must obtain the consent of the gentry before levying a tax. Any such direct tax would only be directly levied on the wealthy, who would in turn extract it from their own subjects. However, it did provide a limitation on the power of the Sovereign, as rule without resources is an impossibility.

Relationships between the Sovereign and the populace waxed and waned. The seventeenth century Stuarts would happily have ruled without Parliament, but had to resort to it when an attempt to tax without the consent of Parliament was upheld in the courts but rejected by Parliament in *Hampden’s Case*, which concerned an early form of direct taxation, namely ship money.⁹⁸ Coffield argues that it was the unadorned assertion of the divine right of kings by Sir Robert Berkeley, one of the judges on the King’s Bench, and his “naked and unvarnished claim to the arbitrary use of the taxing power, without the consent of Parliament,”⁹⁹ that motivated Parliament to resistance. Taxation was certainly one of the causes of the ensuing English Civil War of the 1640s, for once the Sovereign who demands taxation is considered illegitimate, taxation is tantamount to theft and property must be defended.

Yet it was not until 1688 and the accession of William and Mary at the “Glorious Revolution” that the concept of Parliamentary sovereignty, previously expressed at least embryonically in 1215, was clearly asserted. The Bill of Rights, assented to then by the Sovereign, commences:

⁹⁶ Howard, *Magna Carta*, 11.

⁹⁷ Taswell-Langmead, *English Constitutional History*, 237.

⁹⁸ Coffield, *Popular History of Taxation*, 67ff.

⁹⁹ *Ibid.*, 71ff.

*Whereas the late King James the Second, by the assistance of divers evil counsellors, judges and ministers employed by him, did endeavour to subvert and extirpate the Protestant religion and the laws and liberties of this kingdom ... By levying money for and to the use of the Crown by pretence of prerogative for other time and in other manner than the same was granted by Parliament ... And thereupon the said Lords Spiritual and Temporal and Commons, pursuant to their respective letters and elections, being now assembled in a full and free representative of this nation, taking into their most serious consideration the best means for attaining the ends aforesaid, do in the first place (as their ancestors in like case have usually done) for the vindicating and asserting their ancient rights and liberties declare ... That levying money for or to the use of the Crown by pretence of prerogative, without grant of Parliament, for longer time, or in other manner than the same is or shall be granted, is illegal ...*¹⁰⁰

This language is reminiscent of the Magna Carta: no taxation without representation, at least as far as direct taxation is concerned. However, the power of the Sovereign was now effectively controlled; Parliament was sovereign.

Against this background of Parliamentary sovereignty, the New Zealand Parliament implemented its income tax. But unlike the British income tax of 1798, it was also enacted in the context of universal male suffrage. All men were represented (and women would be from 1893). Hence the two pre-conditions of the Rule of Law and of representation were essentially in effect. However, although these principles provide parameters for the exercise of the taxing power, they say little as to how the tax burden might be fairly apportioned among taxpayers.

Although Parliament effectively had control over taxation from the late seventeenth century, taxation, not to mention the nature of the state, remained an open question. In ensuing years certain key writers more or less addressed the question as to how to tax the population, occasionally addressing the issue of vertical equity directly. Of the many authors who could be referenced, five – Thomas Hobbes, John Locke, Adam Smith, John S. Mill, and the Fabian Tractarians – have been selected as representing development in thinking. They also continued to

¹⁰⁰ *English Bill of Rights 1689: An Act Declaring the Rights and Liberties of the Subject and Settling the Succession of the Crown*, Avalon Project at Yale Law School, http://avalon.law.yale.edu/17th_century/england.asp (accessed 2 April 2009).

be influential well into the twentieth century, as is evident in the New Zealand Parliamentary debates on taxation.

3.3.4 Thomas Hobbes

It has been suggested that Hobbes's *Leviathan* has defined the character of modern politics more than any other work.¹⁰¹ Born in 1579, Thomas Hobbes lived during the English Civil War, and died having seen the restoration of the Stuart dynasty, but prior to the Glorious Revolution of 1688. This was a period of conflict between Stuart claims of monarchical absolutism and the assertion of the authority of Parliament. Several of Hobbes's works address politics.¹⁰² In these works, Hobbes addressed economic subjects rather briefly and almost incidentally,¹⁰³ and therefore addressed taxation as a necessary concomitant of the state, and not in isolation.

3.3.4.1 Role of the state

Hobbes' preoccupation was the elimination of fear by ensuring the safety of each citizen.¹⁰⁴ For Hobbes, fear was the ultimate basis of political obligation.¹⁰⁵ This fear arose from the fact that the notional pre-governmental "state of nature" constituted a state of "Warre, where every man is Enemy to every man ... And the life of man, solitary, poore, nasty, brutish, and short."¹⁰⁶ If this is so, the rational person for Hobbes is not a utility maximiser, but rather a disaster avoider,¹⁰⁷ prepared to cede personal sovereignty to ensure his or her own security. For Hobbes, a state of nature is hell, and society is a necessary safeguard to ensure life and safety.

The role of the Sovereign is thus to provide security. To do so, the Sovereign must have unlimited, though tempered, powers. As Ryan puts it:

¹⁰¹ Thomas Hobbes, *Leviathan*, ed. Richard Tuck (Cambridge: Cambridge University Press, 1996), ix.

¹⁰² Thomas Hobbes, "De Corpore Politico," in *Human Nature and De Corpore Politico*, ed. J. C. A. Gaskin (Oxford: Oxford University Press, 1994); Thomas Hobbes, *On the Citizen* (Cambridge: Cambridge University Press, 1998); Thomas Hobbes, *Leviathan* (Cambridge: Cambridge University Press, 1996).

¹⁰³ Aaron Levy, "Economic Views of Thomas Hobbes," *Journal of the History of Ideas* 15 (1954): 1959.

¹⁰⁴ Alan Ryan, "Hobbes's Political Philosophy," in *The Cambridge Companion to Hobbes*, ed. Tom Sorell (Cambridge: Cambridge University Press, 1996), 222.

¹⁰⁵ Lee C. McDonald, *Western Political Theory* (New York: Harcourt Brace Jovanovich, 1968), 311.

¹⁰⁶ Hobbes, *Leviathan*, 89.

¹⁰⁷ Ryan, *Hobbes's Political Philosophy*, 224.

*The High Court of Parliament on Hobbes's account of the matter could change the law only to the extent that the sovereign empowered it to do so ... Yet, a coincidence of utilitarian and deontological considerations leads Hobbes to the conclusion that a sovereign should govern in a constitutional fashion.*¹⁰⁸

3.3.4.2 Property rights

Hobbes regarded taxation as very much within the Sovereign's powers and as a necessary concomitant of civil society. Outside of society there can be no private property, not only because of the incessant "warre of all against all," but also because what constitutes theft (and property) is determined by the Sovereign. As Hobbes put it:

*The Distribution of the Materials of this Nourishment, is the constitution of Mine, Thine and His; that is to say, in one word, propriety; and belongeth in all kinds of Commonwealth to the Sovereign power.*¹⁰⁹

Just as it is the Sovereign who both determines and protects wealth, so the Sovereign may appropriate wealth for appropriate purposes such as the protection of life and property, and the maintenance of the dignity of the Sovereign. A recent echo of this view is provided by Murphy and Nagel, who suggest that:

*If there is a dominant theme that runs through our discussion, it is this: Private property is a legal convention, defined in part by the tax system; therefore, the tax system cannot be evaluated by looking at its impact on private property, conceived as something that has independent existence and validity. Taxes must be evaluated as part of the overall system of property rights that they help to create. Justice or injustice in taxation can only mean justice or injustice in the system of property rights and entitlements that result from a particular tax regime.*¹¹⁰

3.3.4.3 Apportionment of taxation

Lest the civil accord be disturbed due to discontent, taxation should be fair. Hobbes comments:

¹⁰⁸ Ibid., 211, 233.

¹⁰⁹ Hobbes, *Leviathan*, 171.

¹¹⁰ Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford: Oxford University Press, 2002), 8.

*The second factor, we have shown, which disposes men to sedition is the discontent that arises from poverty; even if their poverty results from their own extravagance or idleness, nevertheless they blame it on those who govern the commonwealth, claiming they are oppressed and exhausted by taxes. Yet it may sometimes happen that their complaint is justified, namely when the burdens of the commonwealth are imposed on the citizens unequally.*¹¹¹

In this case, there is a danger of the Commonwealth dissolving. To prevent this:

*It is in the interest of the public peace to remove a justified complaint, and consequently it is a duty of sovereigns to ensure that public burdens are equally borne.*¹¹²

What does this mean? Hobbes points back to “the natural law,”¹¹³ that is, “in awarding rights to others, you have to be fair [aequalis] to both sides”.¹¹⁴ In practical terms, Hobbes argues that taxation should discriminate between persons based on their consumption, not their wealth:

*For although all men equally enjoy peace, the benefits are not equal for all. For some acquire more property and some less. And again, some consume more property and some less.*¹¹⁵

Yet to tax persons on their wealth would be to discriminate against the thrifty in favour of those who waste their wealth in extravagant living, “and hence, where they pay taxes in proportion to their wealth, they equally enjoy the benefit of peace, but do not bear the burdens of the commonwealth equally.”¹¹⁶

Hobbes’ Sovereign is benevolent. Although the primary function of taxation (as of the Sovereign) is to enable civil society, tax revenue may be used to aid those in need:

¹¹¹ Hobbes, *On the Citizen*, 13.10, (p. 147).

¹¹² Ibid.

¹¹³ Ibid.

¹¹⁴ Ryan, *Hobbes’s Political Philosophy*, 50.

¹¹⁵ Hobbes, *On the Citizen*, 13.11, p. 148.

¹¹⁶ Ibid.

*And whereas many men, by accident unavoidable, become unable to maintain themselves by their labour; they ought not to be left to the Charity of private persons; but to be provided for (as far-forth as the necessities of Nature require), by the Lawes of the Common-wealth. For it is Uncharitableness in any man, to neglect the impotent; so it is in the sovereign of a Common-wealth, to expose them to the hazard of such uncertain Charity.*¹¹⁷

Any “such as have strong bodies”¹¹⁸ should not, however, be supported.

Several implications follow. First, taxation is *prima facie* fair, on the deontological ground that the Sovereign *is* sovereign, as well as on the teleological ground that it is necessary to enable Sovereigns to secure their subjects in their possessions and to maintain peace (or, rather, to avoid the natural state of war).

Secondly, the Sovereign as the head of civil society has a right to levy taxation, for, after all, private property is merely conventional, that is, established by law. Private property, for Hobbes, has no absolute deontological status.

Thirdly, consumption, rather than accretion, provides the fairest measure of taxable obligation: “the equality of imposition, consisteth rather in the equality of that which is consumed, rather than of the riches of the persons that consume the same.”¹¹⁹ This view remained common until late in the nineteenth century, and has made something of a comeback with the introduction of GST in New Zealand in 1986 and Australia in 2000.

Fourthly, all citizens should pay taxes. Hobbes speaks of “the debt that every man oweth to the commonwealth for his defense.”¹²⁰ This being so, “it is logical that those who equally enjoy the peace should pay equal shares, by contributing either money or services to the

¹¹⁷ Hobbes, *Leviathan*, 239.

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid.*, 238.

¹²⁰ *Ibid.*

commonwealth.”¹²¹ Finally, taxation revenue is primarily to be used for the protection of the citizens – from one another, and from those outside the state.

Jackson provides a useful summary of Hobbes’ taxation theory, suggesting that Hobbes’ argument on taxation proceeds in logical steps:

1. *The levying of taxes is justified as the price of security;*
2. *Therefore all citizens should pay taxes;*
3. *And, taxes should be equally imposed;*
4. *And, equality of impositions means equating taxes to benefits;*
5. *And, benefit is to be assessed by consumption; therefore a tax on commodities is the right tax (as a tax paid ‘equally’ by all);*
6. *A tax on commodities is further justified because it benefits those who save, and penalises those who squander, their wealth, and*
7. *Finally, a tax on commodities is desirable because it is least likely to cause ‘trouble’.*¹²²

However, this summary may be a little too neat, as it ignores the fact that economics in general, let alone taxation per se, was only of incidental interest to Hobbes. Levy suggests that this was because Hobbes was mainly interested in philosophy and political theory, and that he treats economic subjects rather briefly and almost incidentally, and that insofar as they affected his primary concern, namely politics.¹²³ Yet such views on taxation as Hobbes offers contrast with the despotic tones in which he is often portrayed, as Baumgold notes:

*In popular imagination, Hobbism has come to be identified with arbitrary despotism, even with twentieth-century absolutism ... But careful readers notice that Hobbes commends fair and lawful government, directed to the common interest.*¹²⁴

In short, although Hobbes proposes an absolute Sovereign, he does not argue for arbitrariness in taxation. Instead, as regards vertical equity, all should pay tax, but in proportion to the benefit

¹²¹ Hobbes, *On the Citizen*, 13.10 (p. 147).

¹²² Dudley Jackson, “Thomas Hobbes’ Theory of Taxation,” *Journal of Political Studies*, 21 (1973): 175.

¹²³ Levy, *Economic Views of Thomas Hobbes*, 589.

¹²⁴ Deborah Baumgold, *Hobbes’s Political Theory* (Cambridge: Cambridge University Press, 1988), 101.

received. This benefit, namely security or freedom from fear, is best measured in terms of each person's consumption. One suspects that due to administrative constraints it would have been impossible to implement his proposal in his own day. Perhaps present-day value added taxes come closest to complying with Hobbes' view of the ideal tax.

Hobbes' views on taxation appear rather modern, despite the undemocratic context within which he placed them. Yet he also points back to Aristotle, defining distributive justice in Aristotelian terms:

Distributive justice is concerned with men's dignity and deserts, so that if awards are made κατά την αξίαν, [that is, according to value]¹²⁵ – more to the more worthy, less to the less worthy, and it is done proportionately – distributive justice occurs.¹²⁶

For Hobbes proportion rather than progression should characterise fair taxation. In effect, tax is seen as a fair exchange – the debt owed to ensure security of life and property. This appears to conform more to the benefits theory of taxation than to an ability to pay basis.

3.3.5 John Locke

John Locke (1632-1704) was a younger contemporary of Hobbes, who lived through the Restoration of the Stuart monarchy (1660-1689), and saw the Glorious Revolution of 1688. That he sided with Parliament against the monarchy is evident not only from his writings, but also from his time of self-imposed exile in 1683 after he was suspected of sedition.¹²⁷

Although Locke, like Hobbes, argued for a form of social contract as the basis for a state, his version differs from Hobbes's. For Hobbes, the key function of the state was security in a context of war of all against all. In contrast, Locke assumed a peaceful original condition. Rather than the state arising to preserve life in a state of war, Locke argued that the state arose by consent, primarily to secure an individual against foreign aggression.¹²⁸ Certainly the state provided

¹²⁵ Literally: according to value. This appears to be a direct reference to Aristotle's *Nicomachean Ethics*, 5.3 – refer Henry Jackson, *The Fifth Book of the Nicomachean Ethics of Aristotle* (New York: Arno Press, 1973), 19.

¹²⁶ Hobbes, *On the Citizen*, 3.6 (p. 46).

¹²⁷ Peter Laslett, Introduction to *Two Treatises of Government*, Edited with an Introduction by Peter Laslett, by John Locke (Cambridge: Cambridge University Press, 1988), 45-66.

¹²⁸ John Locke, "Second Treatise on Government," in *Two Treatises of Government*, Edited with an Introduction by Peter Laslett, (Cambridge, Cambridge University Press, 1988), 2.107 (p. 339).

security; however, the motive for the establishment of political society was, for Locke, the concept of property.¹²⁹ The role of the state was pre-eminently to protect citizens in their possessions.

3.3.5.1 Property rights

According to Locke, in a state of nature all goods were originally, under natural law, held in common. However, since “every Man has a *Property* in his own *Person* ... the *Labour* of his body and the *Work* of his Hands, we may properly say are his.”¹³⁰ This ownership is, however, limited by two conditions: first, people should only acquire that which they or their family could use: “As much as any one can make use of to any advantage of life before it spoils; so much he may by his labour fix a Property in.”¹³¹ Secondly, in taking property for personal use, a person must leave enough and as good in common for others:

*For this Labour being the unquestionable Property of the Labourer, no Man but he can have a right to what that is once joyned to, at least where there is enough and as good left in common for others.*¹³²

In contrast to Hobbes, property did not arise from above, from the Sovereign, but rather from below, from the individual. As Locke puts it:

*But Government into whatsoever hands it is put, being as I have before shew'd, intrusted with this condition, and for this end, that Men might have and secure their Properties, the Prince or Senate, however it may have power to make Laws for the regulating of Property between the Subjects one amongst another, yet can never have a Power to take to themselves the whole or any part of the Subjects Property, without their own consent. For this would be in effect to leave them no Property at all.*¹³³

¹²⁹ Laslett, *Introduction*, 101f.

¹³⁰ *Ibid.*, 2.27 (pp. 287f). The italics and capitalisations are Locke's.

¹³¹ *Ibid.*, 2.31 (p. 290).

¹³² *Ibid.*, 2.27 (p. 288).

¹³³ *Ibid.*, 2.139 (p. 361).

This suggests representative, rather than monarchical, rule. If each person has absolute rights in his or her property, then persons may only be deprived of that property if they consent. From this, Locke derives the Rule of Law, and democratic government:

These are the Bounds which the trust that is put in them by the Society and the Law of God and Nature, have set to the Legislative Power of every Commonwealth, in all forms of Government.

First, They are to govern by promulgated establish'd Laws, not to be varied in particular Cases, but to have one Rule for Rich and Poor, for the Favourite at Court, and the Country man at Plough.

Secondly, These Laws also ought to be designed for no other end ultimately but the good of the People.

*Thirdly, they must not raise taxes on the Property of the People, without the consent of the People, given by themselves, or their Deputies.*¹³⁴

Otherwise it cannot be said that a person is at all secure in his or her property. To be workable such consent might be given by deputies lawfully chosen by those whose property is protected. Should the legislature act beyond its powers, “there remains *in the people a Supream Power* to remove or *alter the Legislative*, when they find the *Legislative* act contrary to the trust reposed in them.”¹³⁵ Alternatively, persons might physically remove themselves from the Commonwealth.

3.3.5.2 Apportionment of taxation

If the role of the government is to protect persons in their property, but taxation may only be levied by consent, how then should the tax burden be apportioned? A person’s share of the costs of government should be proportionate to the share of the protection he or she receives. Anything beyond this deprives a person of the very security in property that government is intended to secure. As Locke puts it:

‘Tis true, Governments cannot be supported without great Charge, and ‘tis fit every one who enjoys his share of the Protection, should pay out of his Estate his proportion for the maintenance of it. But still it must be with his own consent, i.e. the consent of the

¹³⁴ Ibid., 2.142 (p. 363).

¹³⁵ Ibid., 2.149 (p. 367).

*majority, giving it either by themselves, or their representatives chosen by them: for if any one shall claim a Power to lay and levy Taxes on the people, by his own authority, and without such consent of the people, he thereby invades the Fundamental Law of Property, and subverts the end of Government. For what property have I in that which another may by right take, when he pleases to himself?*¹³⁶

Although Locke does not discuss exactly what is to be taxed, the uses to which taxation is put would be limited to those approved by those who have property. Anything beyond this smacks of confiscation and is thus an implicit breach of the social contract.

There is, however, room for considerations of charity. First, the strictness of Locke's benefits theory should be tempered by a consideration of his proviso: "where there is enough and as good left in common for others."¹³⁷ Williams comments that Locke wrote in the context of abundance:

*Locke's theory of acquisition then depends upon an assumption of nature's bounty. In a world of scarcity, the strict application of the proviso requires modification to a weaker form ... But with scarcity it would seem, from the modified proviso, that one could, even by permissible means, i.e., labor, acquire a property right that was not permissible because others precluded from use of the property were worse off. The transition from abundance to scarcity changes the concept of worse position.*¹³⁸

This concern became very real in the context of the Great Depression of the 1930s, as Frisch indicates:

Accordingly, that fundamental change in orientation accomplished by the New Deal depended on the solution of a theoretical question: What is the purpose of liberal

¹³⁶ Ibid., 2.140 (p. 362).

¹³⁷ Ibid., 2.27 (p. 288).

¹³⁸ Paul F. Williams, "The Legitimate Concern with Fairness," *Accounting, Organizations and Society* 12 (1987): 181. On the implications of the Lockean proviso per se, also in the context of taxation, see John D. Feldman, "Ethics and Taxes: An Ethical Analysis of Anglo-American Theory" (PhD diss., University of Virginia, 1986).

*democratic government? Is it to provide merely for the conditions of happiness, or must it supply something of happiness itself, understood as well-being or welfare?*¹³⁹

Secondly, Locke's conception of property rights was further curtailed in the event of apparent need:

*But we know God hath not left one Man so to the Mercy of another, that he may starve him if he please: God the Lord and Father of all, has given no one of his Children such a property, in his peculiar Portion of the things of this World, but that he has given his needy brother a Right to the Surplusage of his Goods; so that it cannot justly be denied him, when his pressing Wants call for it.*¹⁴⁰

Simmons, a philosophical anarchist in the Lockean mould comments:

*Certainly the well-known classical [original acquisition] justifications all either insisted on serious limits on rights of acquisition – so that genuinely onerous obligations could not be unilaterally imposed – or defended parallel, overriding rights for others to take from an appropriator's surplus the justly acquired goods which are needed by those others for their survival (see e.g., Locke, I, 42).*¹⁴¹

However, both the Lockean proviso, and the charitable obligation, appear to be placed on the property holder, not on the state:

*As Justice gives every Man a Title to the product of his honest Industry, and the fair Acquisitions of his Ancestors descended to him; so Charity gives every Man a Title to so much out of another's Plenty, as will keep him from extream want, where he has no means to subsist otherwise ...*¹⁴²

¹³⁹ Morton J. Frisch, "An Appraisal of Roosevelt's Legacy: How the Moderate Welfare State Transcended the Tension between Progressivism and Socialism," in *The New Deal and its Legacy: Critique and Reappraisal*, ed. Robert Eden (New York: Greenwood Press, 1989), 196.

¹⁴⁰ John Locke, "First Treatise of Government," in *Two Treatises of Government, Edited with an Introduction by Peter Laslett* (Cambridge: Cambridge University Press, 1988), 1.42, (p. 170).

¹⁴¹ A. John Simmons, *Justification and Legitimacy* (Cambridge: Cambridge University Press, 2001), 221.

¹⁴² Locke, *First Treatise*, 1:42 (p. 170).

This contention is borne out by Locke's prescription of harsh treatment (by the authorities) for unlicensed beggars: three year's naval impressment or hard labour for adult males, flogging and the workhouse for children, ears cut off for forging a begging licence.¹⁴³ Charity is not a matter subject to legal taxation; rather it provides a moral limitation on the actions of an individual.

Both Hobbes and Locke suggest a benefits view of taxation; the tax burden should be apportioned based on the benefits received from the state. However, their rationales differ: for Hobbes, taxation is the price paid for security; for Locke, consent is the only reason why a person's property might be appropriated for common use. For Hobbes, property is conventional and is wrapped up in the person of the Sovereign who secures a person's interest in such property. For Locke, property originates not with the Sovereign, but with the labour of the individual. Further, although Hobbes places few limitations on the taxation by the Sovereign, for Locke explicit consent by the owner or his delegates is required: government powers, including the power to tax, "*has its Original only from Compact and Agreement, and the mutual Consent of those who make up the Community.*"¹⁴⁴

3.3.6 Adam Smith

Hobbes and Locke each presented a vision of how society arose, and from that deduced policy recommendations. In his magnum opus, *The Wealth of Nations*,¹⁴⁵ Adam Smith followed a different path. In the first four books he sought to explain:

*... in what has consisted the revenue of the great body of the people or what has been the nature of those funds, which, in different ages and nations, have supplied their annual consumption.*¹⁴⁶

His approach is descriptive and historical. Book 5 provides what is essentially a self-contained treatise¹⁴⁷ in which Smith focuses specifically on "the expenses of the sovereign, or

¹⁴³ Hampsher-Monk, *History of Modern Political Thought*, 94.

¹⁴⁴ Locke, *Second Treatise*, 2.171 (p. 382).

¹⁴⁵ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan, (London: Methuen, 1950).

¹⁴⁶ *Ibid.*, Introduction and Plan of the Work.

¹⁴⁷ Arthur D. Lynn, Jr., "Adam Smith's Fiscal Ideas: An Eclectic Revisited," *National Tax Journal* 29 (1976): 370.

commonwealth.”¹⁴⁸ This last book is divided into three chapters, dealing respectively with the expenses of the Sovereign or Commonwealth, the sources of the general or public revenue of the society, and public debts.

Smith’s economic philosophy reflected his moral philosophy, and centred on the notion of self-interest as resulting in economic progress. Smith proposed that “enlightened self-interest in the long-run is quite likely to correspond with the public interest.”¹⁴⁹ If this is so, governmental functions and public expenditure should be “limited so as not to inhibit individual self-interest and market allocation through time.”¹⁵⁰ To quote Smith:

*All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital in competition with those of any other man or order of men.*¹⁵¹

Smith’s “invisible hand”¹⁵² can achieve what a Sovereign will inevitably fail to do. The Sovereign, then, should get out of the way, not meddling in an area in which he or she is not competent:

*The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient.*¹⁵³

What then is the role of the Sovereign? Smith listed, “three duties of great importance,” namely:

... the duty of protecting societies from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society

¹⁴⁸ Smith, *Wealth of Nations*, 5.1.

¹⁴⁹ Groves, *Tax Philosophers*, 17 (emphasis in original).

¹⁵⁰ Lynn, *Adam Smith’s Fiscal Ideas*, 370.

¹⁵¹ Smith, *Wealth of Nations*, 4.9.

¹⁵² *Ibid.*, 4.2,

¹⁵³ *Ibid.*, 4.9.

*from the injustice of oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or smaller number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.*¹⁵⁴

The first two duties of government are familiar from Hobbes and Locke. The third is arguably more Hobbesian than Lockean, since it includes public works to facilitate commerce in general, particularly infrastructure of roads, bridges, navigable canals, harbours and the like,¹⁵⁵ as well as expenditure for the education of youth,¹⁵⁶ and for religious institutions,¹⁵⁷ and also a “certain expence necessary for enabling the sovereign to perform his several duties.”¹⁵⁸ Yet unlike Hobbes and Locke, in elucidating the proper functions of government, Smith did not go back to an original position. Rather, his focus was on what was necessary to increase the wealth of an existing society.

Having discussed the role of government and thus the uses of taxation, Smith goes on to consider how the required tax revenue might be raised. Before discussing taxation on the three possible sources of rent, profit, and wages, he premises “four maxims with regard to taxes in general,” of which he suggests “the evident justice and utility of the foregoing maxims have recommended them more or less to the attention of all nations.”¹⁵⁹ The latter three deal with administrative concerns: certainty, convenience, and economy in taxation. The first addresses the apportionment of the tax impost among subjects:

The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expence of government to the individuals of a great nation is like the expence of management to the

¹⁵⁴ Ibid.

¹⁵⁵ Ibid., 5.1.3.1.

¹⁵⁶ Ibid., 5.1.3.2.

¹⁵⁷ Ibid., 5.1.3.3.

¹⁵⁸ Ibid., 5.1.3.4.

¹⁵⁹ Ibid., 5.2.2.

*joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation. Every tax, it must be observed once for all, which falls finally upon one only of the three sorts of revenue above mentioned [namely rent, profit, and wages], is necessarily unequal in so far as it does not affect the other two. In the following examination of different taxes I shall seldom take much further notice of this sort of inequality, but shall, in most cases, confine my observations to that inequality which is occasioned by a particular tax falling unequally even upon that particular sort of private revenue which is affected by it.*¹⁶⁰

Although Smith's focus is on tax base, his initial sentence became a motto for fairness in taxation. Yet despite his concern for efficiency as a means to enhance the wealth of nations, in this maxim Smith also demonstrates a concern for equity in taxing. Groves suggests that, "It is the first of these maxims that entitles Smith to a place in the school of thought that features equity in its tax judgment and looks chiefly to net income as the index of tax capacity."¹⁶¹ However, it is far from clear just what Smith meant. That taxpayer's contributions are to be "in proportion to their respective abilities," suggests both proportionality in taxation, but also assessment on an ability to pay basis, independently of the benefits they receive from the state. However, that they are to contribute in proportion to the revenue which they respectively enjoy under the protection of the state reflects benefits theory. What then did Smith have in mind? Lynn comments that:

*Of course the canon is ambiguous and can be used to support either ability-to-pay or benefits received criteria for tax design. I like to think he tilted toward the former rather than the latter although the point is debatable.*¹⁶²

Seligman disagrees:

Adam Smith has been claimed as a defender of both the benefit and the faculty theory, both of the proportional and of the progressive doctrine. It is true that he is not always

¹⁶⁰ Ibid., 5.2.2.

¹⁶¹ Groves, *Tax Philosophers*, 19.

¹⁶² Lynn, *Adam Smith's Fiscal Ideas*, p. 374.

*consistent and that isolate passages may be taken to prove either view. A careful consideration of the general trend of his ideas, however, must convince us that Adam Smith held in the main to the benefit theory of taxation.*¹⁶³

Clearly Smith's first canon is ambiguous, and perhaps intentionally so. Musgrave and Peacock sidestep the issue:

*Smith ingeniously cuts across the ability-to-pay and the benefit theories of taxation. In fact the two are made to coincide, as income measures the one no less than the other.*¹⁶⁴

However, it points more, perhaps, towards an ability to pay than a benefits basis, and as such is consistent with the expenses of government previously enumerated by Smith, which cannot be apportioned in any scientific or contractual manner. Expenditure that could be apportioned on a benefits basis should be, according to Smith:

*The greater part of such public works may easily be so managed, as to afford a particular revenue sufficient for defraying their own expence, without bringing any burden upon the general revenue of the society.*¹⁶⁵

Even if Smith is understood as favouring proportional taxation, he recognises that there may be no inequity in a progressive tax. In discussing tax on house rents he notes that the proportion of income spent on accommodation increases with wealth. Hence a tax on house rent is likely to constitute a higher proportion of a wealthy person's income than a poor person's:

*A tax upon house-rents, therefore, would in general fall heaviest upon the rich; and in this sort of inequality there would not, perhaps, be any thing very unreasonable. It is not very unreasonable that the rich should contribute to the public expence, not only in proportion to their revenue, but something more than in that proportion.*¹⁶⁶

¹⁶³ Edwin R. A. Seligman, *Progressive Taxation in Theory and Practice* (Princeton, NJ: American Economic Association, 1909), 164.

¹⁶⁴ Raymond A. Musgrave and Alan T. Peacock, *Classics in the Theory of Public Finance* (London: Macmillan, 1967), p. ix.

¹⁶⁵ Smith, *Wealth of Nations*, 5.2.2.1.

¹⁶⁶ *Ibid.*, 4.8.

As far as type of tax is concerned, Smith favours a tax on land values, but not on wages, as the incidence of such a tax would either be shifted onto another or cause a reduction in the employment of capital and output, thereby retarding economic development.¹⁶⁷ He also considered an income tax impracticable as it would be difficult to determine, involving “an inquisition into every man’s private circumstances ... [which] would be a source of such continual and endless vexation as no person could support”¹⁶⁸ – a theme that pervaded nineteenth century income tax discussions both in the United Kingdom and in New Zealand.¹⁶⁹ It also would promote a flight of capital – a problem to which a tax on land is not so susceptible.¹⁷⁰

Smith’s focus was on increasing the total wealth of the nation, which would benefit all classes, rather than on redistribution. However, in moving the focus from how to justify government and taxation ab initio, he marks a shift from the social contractarians Hobbes and Locke who preceded him. Tangential, though important to this matter, was the question of how best to tax. His eclecticism, though perhaps frustrating, has proved to be resilient. Future generations would constantly appeal to Smith for a variety of approaches to taxation: whether on the basis of ability to pay or benefits, and whether proportionately or progressively.

3.3.7 John S. Mill

By the time John Stuart Mill (1806-1873) wrote on taxation, England had had a half century’s experience with the income tax, which was introduced in the context of the Napoleonic wars. Mill’s clearest statement on taxation is found in his *Principles of Political Economy*, first published in 1848, which served as text in most English universities for over half a century,¹⁷¹

¹⁶⁷ Lynn, *Adam Smith’s Fiscal Ideas*, 374.

¹⁶⁸ Smith, *Wealth of Nations*, 5.2.

¹⁶⁹ Member of the House of Representatives Mitchelson’s comments on the 1891 Financial Statement debate are typical: “Now we have had a lot of evidence brought before the House in speeches which have been delivered with reference to the income-tax being inquisitorial in its nature, and we have also had quotations read from speeches delivered in England by some of the most intellectual and liberal men of past and also of the present day, showing most clearly and conclusively that the income-tax is a tax upon honesty and a premium upon dishonesty ...” *NZPD*, vol. 71 (1 July 1891), 444.

¹⁷⁰ Smith, *Wealth of Nations*, 5.2. This point has recently been made in discussions on possible tax reform for New Zealand: “Land is an asset that is in fixed supply, (i.e. perfectly ‘inelastic’) and therefore cannot respond to economic incentives or disincentives such as taxation. Accordingly, the burden of land taxes would be borne by land owners at the time the tax is announced and cannot be passed on”: Tax Working Group, *A Tax System for New Zealand’s Future: Report of the Victoria University of Wellington Tax Working Group* (Wellington: Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010), 50.

¹⁷¹ Groves, *Tax Philosophers*, 26.

and was one of the most widely read and employed books on economics in the nineteenth century.¹⁷² Heilbroner comments that it “dominated political economy for a generation, earning at first the admiration, then gradually the impatience of subsequent writers who grew up in its shadow.”¹⁷³

Mill commences his chapter entitled *Of the General Principles of Taxation* by restating the four maxims of Adam Smith, calling them “qualities desirable, economically speaking, in a system of taxation ... generally concurred in by subsequent writers.”¹⁷⁴ Mill then homes in on the first of Smith’s maxims, equality of taxation:

... a thing imperfectly understood, and on which many false notions have become to a certain degree accredited, through the absence of any definite principles of judgment in the popular mind.¹⁷⁵

Unlike Hobbes or Locke, Mill does not concentrate on the legitimacy of government – this is assumed. Nor does he focus on wealth maximisation as Smith did. Instead, separating the production of wealth from the distribution of wealth, he spoke of the former partaking of physical truths. Thus, concerning the distribution of wealth he wrote, “This is a matter of human institutions solely. The things [namely, the fruits of production] once there, mankind, individually or collectively, can so do with them as they like.”¹⁷⁶

Although Mill did not press the implications, this statement indicates a shift from a deontological view of property focused on the individual (such as Locke’s), to a teleological view of property focused on the community as a whole. Mill recognised his break with Adam Smith, stating that “the *Wealth of Nations* is in many parts obsolete, and in all, imperfect,”¹⁷⁷ since:

¹⁷² Robert B. Ekelund Jr. and Robert F. Hébert, *A History of Economic Theory and Method* (Long Grove, IL: Waveland Press, 1997), 173.

¹⁷³ Robert Heilbroner, *Teachings from the Worldly Philosophy* (New York: Norton, 1996), 129.

¹⁷⁴ John S. Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (London: Longmans, Green and Co, 1909), V:ii:1 (p. 802).

¹⁷⁵ *Ibid.*, 5.2.2 (p. 803).

¹⁷⁶ *Ibid.*, 2.1.1 (p. 200).

¹⁷⁷ *Ibid.*, p. xxviii (Preface to the first edition of 1848).

*Political economy, properly so called, has grown up almost from infancy since the time of Adam Smith; and the philosophy of society, from which practically that thinker never separated his more peculiar theme, though still in a very early stage of its progress, has advanced many steps beyond the point at which he left it.*¹⁷⁸

In discussing taxation, Mill adopted economic rather than moral reasoning and a social rather than an individual focus. His age was one of “Benthamism and Chartism: with an emphasis on scientific method, statistics, sound administration, and a belief in the centralising powers of the state.”¹⁷⁹ For several reasons Mill rejected benefits theory, which he termed the quid pro quo principle.¹⁸⁰ First:

*... it is not admissible that the protection of persons and that of property are the sole purposes of government. The ends of government are as comprehensive as those of the social union.*¹⁸¹

Secondly, it was impossible to “set definite values on things essentially indefinite.” To do so leads to absurdity in the case of those requiring the most social assistance; those requiring the most support should then “pay the greatest share of the price,” which is “the reverse of the true idea of distributive justice, which consists not in imitating, but in redressing the inequalities and wrongs of nature.”¹⁸² Mill’s approach suggests a significant departure from Locke or Hobbes.

This notion of distributive justice also contrasts with Aristotle’s standard of proportionality. For Aristotle justice involved proportional treatment; for Mill it seems to suggest disproportion of treatment. More generally, it reflects a shift from some basic standard of what is right as the basis for policy making, to a more pragmatic focus on outcomes of the social policy: from deontology to consequentialism, consistent with Mill’s utilitarianism.¹⁸³ For Mill, the role of government could extend beyond that of a mere night watchman state:

¹⁷⁸ Ibid.

¹⁷⁹ Edmund Bohan, *Edward Stafford: New Zealand’s First Statesman* (Christchurch: Hazard Press, 1994), 13.

¹⁸⁰ Mill, *Principles*, 5.2.2 (p. 804).

¹⁸¹ Ibid.

¹⁸² Ibid., 5.2.2 (p. 805).

¹⁸³ John S. Mill, *Utilitarianism* (Oxford: Oxford University Press, 1998).

*The admitted functions of government embrace a much wider field than can easily be included within the ring-fence of any restrictive definition, and that it is hardly possible to find any ground of justification common to them all, except the comprehensive one of general expediency; nor to limit the interference of government by any universal rule, save the simple and vague one, that it should never be admitted but when the case of expediency is strong.*¹⁸⁴

Yet Mill was concerned about equity in taxation, heading up a section of his work, *Grounds of the Principle of Equality of Taxation*. His lucid prose is best quoted in full:

*For what reason ought equality to be the rule in matters of taxation? For the reason, that it ought to be so in all affairs of government. As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made to bear as nearly as possible with the same pressure upon all, which, it must be observed, is the mode by which least sacrifice is occasioned on the whole. If any one bears less than his fair share of the burthen, some other person must suffer more than his share, and the alleviation to the one is not, cæteris paribus, so great a good to him, as the increased pressure upon the other is an evil. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person towards the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his. This standard, like other standards of perfection, cannot be completely realized; but the first object in every practical discussion should be to know what perfection is.*¹⁸⁵

The standard of perfection for equality in taxation, then, is for a government to make whatever sacrifices it requires to bear as nearly as possible with the same pressure on all, thereby ensuring the least sacrifice on the whole. The motivation for this was classic utilitarianism applied to taxation, that is, the maximization of pleasure or the minimisation of pain, which “are the only things desirable as ends.”¹⁸⁶ The pain of taxation is a concomitant of the government’s efforts in

¹⁸⁴ Ibid., 5.1.1 (p. 793).

¹⁸⁵ Ibid., 5.2.2 (p. 804).

¹⁸⁶ Mill, *Utilitarianism*, 55.

maximising utility. How then could the pain of government be minimised but by ensuring an equality of sacrifice?

It would be a relatively simple step from this to a graduated income tax: as income increases, taxation could also increase more steeply without altering the relative sacrifice made. However, this would be to anticipate the writings of the Marginalist economists of the late nineteenth century.¹⁸⁷ Although Mill conceded that an income tax would be, in point of justice, the least exceptional of all taxes,¹⁸⁸ practical considerations prevented him from recommending it. Given the low state of public morality and difficulties in determining the incomes from professions and businesses, an income tax resulted in taxation falling heaviest on the most conscientious. Mill argued that, “the [income] tax, therefore, on whatever principles of equality it is imposed, is in practice unequal in one of the worst ways, falling heaviest on the most conscientious.”¹⁸⁹

Further, and perhaps surprisingly, Mill did not favour progression as a means to ensure equality of sacrifice. In part he was concerned at the effect on efficiency, stating, “To tax the larger incomes at a higher percentage than the smaller is to lay a tax on industry and economy.”¹⁹⁰ Further, he argued that such a tax lacked certainty:

*But this doctrine [that to take £100 from an income of £1,000 is a heavier impost than £100 taken from an income of £10,000] seems to me to be too disputable altogether, and even if true, not true to a sufficient extent to be made the foundation of any rule of taxation.*¹⁹¹

Instead, as recommended by Jeremy Bentham,¹⁹² Mill favoured a degressive tax: to leave a certain minimum of income sufficient to provide the necessities of life untaxed, and then to apply a fixed proportion of the balance.¹⁹³ In short, Mill argued for utilitarianism at the global, but not

¹⁸⁷ A useful discussion of the introduction of marginal theory in taxation is found in Groves, *Tax Philosophers*, 48-53.

¹⁸⁸ Mill, *Principles*, 5.3.5 (p. 829): “An income-tax, fairly assessed on these principles, would be, in point of justice, the least exceptionable of all taxes.”

¹⁸⁹ *Ibid.*, 5.3.5 (p. 830).

¹⁹⁰ *Ibid.*, 5.2.3 (p. 808).

¹⁹¹ *Ibid.*

¹⁹² Takao Dome, “Bentham and J. S. Mill on Tax Reform,” *Utilitas* 11 (1999): 325.

¹⁹³ Mill, *Principles*, 5.2.3 (p. 806).

at the individual level.¹⁹⁴ He also argued for differentiation between permanent and temporary incomes, and between certain and precarious incomes.¹⁹⁵

In summary, it would be possible to argue for a number of perspectives by picking and choosing from Mill's writings, not least because he is an example of a writer with radical ideas, yet with a generally conservative programme. In some respects he mirrors the British income tax at the time; a tax that had radical possibilities that were realised in the twentieth century, but which was essentially a degressive single rate tax throughout the nineteenth.¹⁹⁶

3.3.8 Fabian socialism

Mill was no myopic fan of the status quo.¹⁹⁷ He readily conceded that the state of society was unjust, and that if the choice were between communism and the extant society, "all the difficulties great or small of communism, would be as dust in the balance."¹⁹⁸ Yet he had not given up on private property and individual competition; rather:

*The object to be principally aimed at, is not the subversion of the system of individual property, but the improvement of it, and the full participation of every member of the community in its benefits.*¹⁹⁹

There has always been a more radical, or even utopian, vision for society, emanating from both religious and secular sources, most of which were predicated on a new property system. From the late nineteenth century, such views became more realisable due to several factors, including significant improvements in administration and infrastructure, secularisation, innovations in economic thought, extensions of the franchise, and reactions to the effects of the Industrial

¹⁹⁴ Ibid., 5.2.4 (p. 810ff); Dome, *Bentham and Mill*, 331.

¹⁹⁵ Dome, *Bentham and Mill*, 331.

¹⁹⁶ F. Shehab, *Progressive Taxation: A Study in the Development of the Progressive Principle in the British Income Tax* (Oxford: Oxford University Press, 1953).

¹⁹⁷ Mill's work *On Liberty* (1859) and his essay *The Subjection of Women* (1861) were both considered progressive when published.

¹⁹⁸ Mill, *Principles*, 2.1.3 (p. 208).

¹⁹⁹ Ibid., 2.1.4 (p. 217).

Revolution on the standard of living of the poor.²⁰⁰ A considerable and influential literature promoted this new vision for a just and equal society.

Of the numerous utopian novels published in the late nineteenth century, two were frequently referenced in discussions. William Morris's *News from Nowhere*²⁰¹ provided Morris with a vehicle to promote both his communism and his vision for an arts and crafts aestheticism. Edward Bellamy's *Looking Backward from 2000 to 1887*²⁰² similarly provided a communistic vision of society, of what a critic describes as "a world where there is no scarcity and no sin."²⁰³ Fairburn suggests that the measures of the New Zealand Liberals who introduced New Zealand's first income tax in the late nineteenth century were, in fact, utopian.²⁰⁴

Among the more radical political programmes proposed was the Marxist. As a means to the abolition of private property, Marx, in the *Communist Manifesto*, advocated a "heavily progressive or graduated income tax."²⁰⁵ Once private property had been abolished, there would be no need for taxation; there can, after all, be no taxation where there is no private property to tax.²⁰⁶

Marx's influence on modern Western thought is undeniable. However, it has been attenuated versions of Marxism that have been implemented. Rather than abolishing private property, in the twentieth century the state has taken a greater role in the economy, leading ultimately to an intentional mixed economy where the government initially intervenes to alter the distribution of wealth and continues to play an active role. The New Zealand experience is perhaps typical; government involvement in infrastructure development was significant from early on, and particularly from the Vogel Government of the 1870s. However, full scale redistribution by way

²⁰⁰ The latter was perhaps most famously discussed in the work of Charles Booth: refer Albert Fried and Richard M. Elman, *Charles Booth's London: A Portrait of the Poor at the Turn of the Century, Drawn from His 'Life and Labour of the People in London'* (New York: Pantheon Books, 1968).

²⁰¹ William Morris, *News from Nowhere* (London: Reeves and Turner, 1891).

²⁰² Edward Bellamy, *Looking Backward from 2000 to 1887* (Boston, MA: Houghton Mifflin, 1888).

²⁰³ Fleischacker, *Distributive Justice*, 40.

²⁰⁴ Miles Fairburn, *The Ideal Society and its Enemies* (Auckland: Auckland University Press, 1989). The title of Fairburn's work mirrors the title of Karl Popper, *The Open Society and Its Enemies* (London: Routledge and Kegan Paul, 1962), which warned of the dangers of control of society by well-meaning experts.

²⁰⁵ Karl Marx and Friedrich Engels, *The Communist Manifesto, with an Introduction by A. J. P. Taylor* (Harmondsworth: Penguin, 1967), 104.

²⁰⁶ Karl Marx, *Critique of the Gotha Programme* (New York: International Publishers, 1938), 19-20.

of “cradle to grave” social security was not enacted until 1938. This was around the same time that President F. D. Roosevelt implemented the New Deal in the United States of America which involved both public works and social welfare measures. On the latter, President Roosevelt commented in January 1935:

*I see no reason why every child, from the day he is born shouldn't be a member of the social security system. Cradle to grave - from the cradle he ought to be in a social insurance system.*²⁰⁷

The Fabian Society was perhaps the most influential organisation in promoting redistribution in Great Britain and New Zealand. Founded in 1883, Fabians believed that socialism could be attained through gradual, rather than revolutionary, political change.²⁰⁸ It helped found the Labour Representation Committee in 1900, which became the British Labour Party in 1906.²⁰⁹ The Fabian Society continues to be affiliated to the Labour Party both in the UK and in New Zealand. Fabianism was linked to New Zealand from the start, with the New Zealand Liberal Party MP William Pember Reeves and his wife being closely involved with the Society, even naming their son “Fabian”.²¹⁰

In its early years the Fabian Society represented a wide range of radical and socialist views. Within this diversity two main streams of thought can be found within the forebears of the Fabian Society:

*The first was the English Liberal tradition, transmitted through the later writings of John Stuart Mill ... The other mainstream was the Socialist one, especially its most powerful current, Marxism.*²¹¹

²⁰⁷ William E. Leuchtenberg, *The FDR Years: On Roosevelt and His Legacy* (New York: Columbia University Press, 1996), 19.

²⁰⁸ Fabian Society, *Fabian Tract 70: Report on Fabian Policy and Resolutions Presented by the Fabian Society to the International Socialist Workers and Trade Union Congress, London, 1896* (London: Fabian Society, 1896).

²⁰⁹ *World Encyclopedia: Oxford Reference Online*. (Oxford: Oxford University Press, 2008), s.v. “Fabian Society,” <http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t142.e3991> (accessed 17 November 2008).

²¹⁰ Keith Sinclair, “Reeves, William Pember 1857 – 1932,” in *Dictionary of New Zealand Biography* (Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 4 September, 2009).

²¹¹ A. M. McBriar, *Fabian Socialism and English Politics 1884-1918* (Cambridge: Cambridge University Press, 1962), 7.

The primary source of Fabian thought and tax policy is the numerous Fabian Tracts the Society published since its first in 1884 entitled *Why are the Many Poor*.²¹² There the importance of graduation or progression to the Fabian programme is already spelled out:

*The transfer of rent and interest from private pockets to public purposes will be mainly brought about by means of progressive taxation in the form of graduated death duties, a graduated differentiated income tax, and the rating of land values.*²¹³

Although Fabians regarded J. S. Mill as one of their progenitors, considering him to be “one of the moulders of modern Socialism and the future State,”²¹⁴ this programme clearly goes well beyond what Mill advocated. In particular, the inclusion of a progressive income tax in the desirable tax mix and the advocacy of progression differ from Mill’s policy prescriptions.

Fabian tract 152, entitled *Our Taxes as They Are and as They Ought to Be*, was published in 1911, and presents a mature view of the general tax policy proposed by the Fabians. The author pays his dues to Adam Smith, before rejecting him:

*Adam Smith made so great an advance in defining the principles of taxation in his famous “Canons” or “Maxims” that it is broadly true to say that before the appearance of “The Wealth of Nations” the principles of taxation had never been clearly set forth; and further, that from the issue of that book until the close of the nineteenth century they were never effectively restated. His maxims are not obsolete yet, but they are obsolescent.*²¹⁵

What then should take their place? This is quite clear; there are only two principles of taxation, namely equity and economy. But what does equity mean? Simply, “taxes should satisfy the sense of fairness of the majority of the community at the time.”²¹⁶ To the criticism that this is

²¹² Phillips, *Why Are the Many Poor?* (London: Fabian Society, 1884).

²¹³ Ibid.,

²¹⁴ J. S. Mill was the subject of the fourth tract in the Fabian Society’s bibliographical series: Julius West, *Fabian Tract 168: John Stuart Mill* (London: Fabian Society, 1913), 22.

²¹⁵ R. Jones, *Fabian Tract 152: Our Taxes as They Are and as They Ought to Be* (London: Fabian Society, 1911), 4f.

²¹⁶ Ibid., 6.

unscientific, Jones replies rather circuitously that “there is no measure of what is equitable that any statesman can use except what men consider as equitable.”²¹⁷

However, this apparent agnosticism is betrayed by the balance of the Tract, in which a particular scheme of taxation is presented as equitable quite independently of any canvassing of the views of society. In the succeeding sections, progressive taxation is promoted not on the basis of public sentiment, but rather as satisfying a principle of abstract “right” or “natural justice.”²¹⁸ Jones thus holds in tension his preferred approach to taxation, that is, redistribution, with the “equity” of relying on the electorate for change.

Jones rejects taxation according to benefit received; on that basis, “since women and children benefit most from the protection of the state, they should, on this theory, pay most of the taxes!”²¹⁹ He then suggests that the ability to pay and sacrifice theories are equally unsatisfactory, on ex post grounds; although a high rate of tax will hit a rich person hard, it will hit the poor person harder, possibly leaving the latter with insufficient resources upon which to live. Rather his ideal would be to replace the “obsolete economic ideal”²²⁰ of taxation in proportion to income, with “the economically perfect ideal” of taxing only the wealthy, since it would involve the minimum sacrifice.²²¹ Although he recognises that this is unlikely to be realised, he suggests that the compromise of a subsistence exemption level with a progressive income tax is a move towards what he considers the “economic ideal.”²²² Interestingly, the income tax that was introduced in New Zealand in 1891 took this form.

By means of a steeply progressive tax the socialist ideals of the Fabians might be attained. Taxation would be a means to bring about the new society. By rejecting both benefits and ability to pay theories, and adopting a modified sacrifice theory, progressive taxation could be used to

²¹⁷ Ibid.

²¹⁸ Ibid., 8.

²¹⁹ Ibid., 5.

²²⁰ Ibid., 8.

²²¹ Witte, *Federal Income Tax*, 36, comments that this is the appropriate outcome under a utilitarian view where sacrifice is the focus: “The prescription that follows from a rigorous application of minimal sacrifice is that required taxes should be extracted exclusively from the individuals in society with the highest incomes, that group continually expanding as the top incomes become equal.” Yet he goes on to note that, “Exclusive taxation of the rich, at probably close to confiscatory rates, violated even minimal considerations of fairness, based on merit of dessert.”

²²² Jones, *Fabian Tract 152*, 9.

this end. Socialist thinking justified differentiation of incomes and suggested that unearned incomes were a proper target for higher rates of tax. As George Bernard Shaw wrote in Fabian Tract 13:

*The Socialists are trying to have the land and machinery gradually “socialized,” or made the property of the whole people, in order to do away with idle owners, and to win the whole product for those whose labour produces it.*²²³

3.4 Conclusion

Seligman declared that “our ideals of justice in taxation change with the alteration in social conditions.”²²⁴ Taxation per se may be as old as human civilisation; but the form that taxation takes reflects the interaction between social conditions and philosophical thought. The enactments of the governing body affect the individual citizens who must pay their taxes, and must, in measure, meet with some degree of public approval. The contours of publicly acceptable taxation will reflect social realities, and social thought.

A review of the religious and philosophical discussions concerning taxation indicate an abiding concern for fairness in taxation but also change in the role and nature of taxation. New Zealand taxation was built upon its British heritage. The debates introducing the income tax in 1891 made reference to British practice and British thought, and the many and conflicting strands of British influence continued to inform these debates. The requirement that unequals be differentiated was increasingly heard, and then, in 1891, realised with the enactment of the Colony’s first income tax.

²²³ George B. Shaw, *Fabian Tract 13: What Socialism Is* (London: Fabian Society, 1890), 3.

²²⁴ Seligman, *Essays in Taxation*, 1.

PART B

THE PRACTICE OF THE INCOME TAX IN NEW ZEALAND

Chapter 4

Vertical Equity in the New Zealand Income Tax Legislation: 1891–1984

Such a thing as an absolutely fair tax has never been conceived in the mind of man.

Premier John Ballance¹

4.1 Introduction

The New Zealand income tax was introduced into a society that was characterised by the Rule of Law, and which had recently extended the franchise. New Zealand political practice reflected and adapted the ideas of European and particularly English thinkers. Although these did not provide a blueprint for taxation, there was a move towards the acceptance of both the income tax and progression, and from the narrow mandate implied by a benefits theory of taxation to the more generous sacrifice/ability to pay theories, coupled with increased pressure on the government to address social issues.

Government policy is effected by legislation. Taxation legislation has a very direct effect on the welfare of taxpayers and on the relative welfare of differing individuals within a society. When taxation is discussed in generalised and numerical terms, sight may be lost of the individual: tax rates may be noted, changes in the structure of the income tax recorded, and the progressive income tax discussed in terms of its (upper) extreme which affects relatively few taxpayers, with little attention given to the impact on the individual.² For taxation to be fair, it must be so not only at a general level, but also be considered to be fair at the level of the individual taxpayer. Unequal burdens call into question the fairness and sustainability of a particular tax.³

In measure the practice of taxation is related to external events, such as government policies or crises such as war; yet it can be difficult to establish such links. This was evident at the introduction of the progressive land and income tax of 1891; although the desire to break up the

¹ *New Zealand Parliamentary Debates (NZPD)*, vol. 73 (4 August 1891), 99.

² See, for example, Paul Goldsmith, *We Won, You Lost, Eat That! A Political History of Tax in New Zealand since 1840* (Birkenhead: David Ling Publishing, 2008); and Alex Penk, *Is It Just Tax? The Shaping of Our Society: Tax Discussion Series Paper 2* (Auckland: Maxim Institute, 2008).

³ G. J. Schmitt, "Relative Tax Burdens of Wage and Salary Earners and the Self-employed," in *Essays on Taxation*, ed. L. McKay and J. Prebble (Wellington: Victoria University Press, 1982), in speaking of wage and salary earners notes that, "There must be concern about the ability of any society to sustain (though "restore" might be a better word) co-operation and goodwill when one section of the community visibly carries the bulk of the burden of taxation" (p. 37).

large estates may have motivated the introduction of the progressive land tax,⁴ this was certainly not the only object. Reeves, a member of the Liberal Cabinet, noted that the land taxes:

*... were admittedly imposed with a double object, – to make the larger landowners pay their fair share of taxation, and to bring about gradually the subdivision, or, in cant phrase, the “bursting-up” of the great freehold estates.*⁵

In contrast, Belich suggests that it may have been a symbolic measure, primarily designed to raise revenue:

*From 1891, the Liberals introduced a graduated land tax and a series of Land for Settlement Acts, designed to buy great estates and subdivide them into viable farms available to the landless on easy terms. The graduated land tax was always a token measure. In practice it was aimed more at raising revenue than at breaking up large farms; and it did not do even this very well – 1,500 wealthy taxpayers paid an average of about £40 each in 1892/3, which was hardly penal.*⁶

As in 1891, a variety of objectives can be identified throughout the history of the income tax: revenue raising and redistribution being but two. Yet although taxation may have pragmatic justifications specific motivations may be evident at certain times and in certain contexts.

The practice of taxation does not only reflect pragmatic considerations; theory can play a role. The Liberals introduced new ideas in 1891. So, too, nearly a century later the New Right economic policy of the Fourth Labour Government of the 1980s provided the occasion for a wholesale reform of the income tax system. This change to the income tax “horrified traditional Labor [sic] supporters because it was regressive rather than progressive.”⁷ Ideas meet reality and are reflected in taxation policy.

⁴ Tom Brooking, *The History of New Zealand* (Westport, CT: Greenwood Press, 2004), xxi; Erik Olssen and Marcia Stenson, *A Century of Change: New Zealand 1800-1900* (Auckland: Longman Paul, 1989), 393f.; Len Richardson, “Parties and Political Change,” in *The Oxford History of New Zealand*, ed. Geoffrey Rice (Oxford: Oxford University Press, 1992), 204.

⁵ William Pember Reeves, *State Experiments in Australia and New Zealand* (South Melbourne: Macmillan, 1969), 1:252.

⁶ James Belich, *Paradise Reforged: A History of the New Zealanders* (Auckland: Penguin, 2001), 44.

⁷ *Ibid.*, 154.

The rationale for taxation change provides an interesting study. However, a focus on the putative events that accompanied or precipitated changes to the income tax rates structure, or on the ideas behind such changes, can too easily obscure the human and social effects of the compulsory “individual sacrifice”⁸ to the collectivity. Taxation affects real, living and breathing people. Ultimately taxation is always paid by human beings within a society rather than by the society itself. Personal income taxation has a direct effect on individual or household welfare, an effect that is often disguised by generalised trends or global statements. For most (compliant) salary and wage earners, it is probably *the* most frequent interaction between themselves and the state. As a direct consequence of taxation, taxpayers suffer a reduction in the residual income they have left to spend on the necessities and luxuries of life, and their financial situation may alter compared with others, leading to claims of unfairness.

This thesis considers the income tax at the individual level: what vertical equity looked like to the individual taxpayer, and how the practice of the income tax was justified. Before considering *why* vertical equity took the form it did in the NZ income tax, it is necessary to determine *what* actually occurred. This chapter reviews the legislation and practice of the income tax to identify the building blocks of vertical equity; the means by which progression was actually implemented.

4.2 The Law of Personal Income Taxation

The Land and Income Assessment Act 1891 introduced a simple income tax with three effective steps: the first £300 of income was exempt, the following £300 was taxed at sixpence in the pound (2½ percent), and the balance at one shilling per pound (5 percent). Since then, the income tax has become far from simple, and has undergone numerous amendments. Each change has affected the tax liabilities, and hence disposable incomes, of taxpayers. In other words, the practice of taxation equity, particularly vertical equity, has been changed, as the relative taxation liabilities of different taxpayers has been altered. From simple and small origins, the income tax became the complex mainstay of the New Zealand revenue system.

⁸ Ferdinand H. M. Grapperhaus, *Tax Tales from the Second Millennium* (Amsterdam: International Bureau of Fiscal Documentation, 1998), 1.

The focus of this thesis is not to determine the optimal taxation structure. Even the relatively simple question of which type of rates structure to implement is fraught, as Musgrave notes:

Choosing among the patterns of differentiation – whether tax rates should be regressive, proportional, or progressive – is controversial. This should not be surprising. Vertical equity, after all, is part of the larger problem of distributive justice, an issue that has no simple answer.⁹

Rather, this thesis primarily seeks to discover deductively how approaches to vertical equity were justified by considering what the personal income tax levied on a wage or salary earner looked like, and how Parliament justified it.

Although the progressive tax rates structure is perhaps the most obvious means whereby taxpayers at differing levels of income are differentiated, the rates structure itself is only one of the matters that affect the level of tax payable by an individual. Legislation provides the authority for taxation and its overall structure. Specific legislative provisions realise differentiation between taxpayers, as they are converted into an actual tax impost.

4.2.1 Legislation

Income taxation is a tax based upon incomes rather than upon some other basis such as property or consumption. Personal individual income taxation is that type of income tax that is levied upon the incomes attributable to individuals, as opposed to other legal persons such as trusts or companies.

In taxing the income of individuals, the original charging section of the Land and Income Assessment Act 1891 provided that:

Subject to the provisions of the Act, taxation shall be levied at stated rates in the pound sterling, in accordance with an annual Act to be passed for that purpose, upon—

(1.) All land situate in New Zealand, and on every mortgage of and in the manner provided in Schedules “A” and “B” to this Act;

⁹ Musgrave, *Equity and the Case for Progressive Taxation*, 9.

(2.) All income derived or received in New Zealand from business, employment, or emolument, in the manner provided in the several Schedules "C," "D," "E," and "F," to this Act.¹⁰

Subsection 1 enacted the land tax, which had two parts: the ordinary tax on land and mortgages, and the graduated tax on land, as elaborated in Schedules A and B of the Land and Income Assessment Act 1891 respectively. The ordinary tax on land was assessed at a rate of one penny per pound of the value of land and mortgages of land of which any person or company was the owner or the mortgagee. Improvements to a maximum value of £3,000, and any mortgages due or owing upon the land, could be deducted from the total value of the land. Further, where the resulting net value of the land did not exceed £1,500, an exemption of £500 could be deducted; this deduction was reduced by one pound for every two pounds that the assessed value of the property increased, leaving no exemption on assessed values of more than £2,500.

The graduated tax on land was assessed in Schedule B, and applied to land valued over £5,000 after allowing for all improvements, but with no deduction for mortgages. The rates of graduated tax on land commenced at one-eighth of a penny in the pound sterling on land valued between £5,000 and £10,000, increasing by one-eighth of a penny in the pound to reach a maximum rate of one penny and six-eighths of a penny in the pound where the value of the land exceeded £210,000. This is detailed in Table 4.1. A twenty percent increase was levied on persons who were subject to the tax and who had been absent from the colony for three or more years.¹¹ In measure this graduated land tax was intended to force the subdivision ("bursting up") of the large estates, by making the retention of surplus lands economically unviable, or at least costly.

¹⁰ Land and Income Assessment Act 1891, s. 15.

¹¹ Land and Income Assessment Act 1891, Schedule B.

Table 4.1 Initial rates of the graduated tax on land¹²

Value of land (£)	Rate of the graduated land tax	Rate (%)
5,000-9,999	$\frac{1}{8}$ d.	0.05
10,000-19,999	$\frac{2}{8}$ d.	0.10
20,000-29,999	$\frac{3}{8}$ d.	0.16
30,000-39,999	$\frac{4}{8}$ d.	0.21
40,000-49,999	$\frac{5}{8}$ d.	0.26
50,000-69,999	$\frac{6}{8}$ d.	0.31
70,000-89,999	$\frac{7}{8}$ d.	0.36
90,000-109,999	1d.	0.42
110,000-129,999	$1\frac{1}{8}$ d.	0.47
130,000-149,999	$1\frac{2}{8}$ d.	0.52
150,000-169,999	$1\frac{3}{8}$ d.	0.57
170,000-189,999	$1\frac{4}{8}$ d.	0.63
190,000-209,999	$1\frac{5}{8}$ d.	0.68
>210,000	$1\frac{6}{8}$ d.	0.73

Although the land tax was initially of much greater fiscal significance, income tax revenue exceeded that of the land tax for the first time in 1916. Thereafter the income tax take always exceeded the land tax.¹³ Given the focus on employees' income tax, since the land tax only applied to land-owners, it is beyond the scope of this study.

Subsection 2 of the Land and Income Assessment Act 1891 introduced the income tax. The apparently absoluteness of the adjective "all" in taxing "all income" is qualified in the schedules to the Act. Schedule C dealt with the income of companies, while Schedule D addressed income from business, and subjected business profits to taxation: "Every person shall be liable to tax in

¹² Land and Income Assessment Act 1891, Schedule B.

¹³ Income tax 1916: £1,392,199 (1915: £540,318), cf. land tax 1916: £1,048,356 (1915: £799,641). Whilst the land tax remained relatively static in succeeding years, the income tax take tripled in 1917 to £4,262,126, and continued to increase thereafter: refer New Zealand Government, *New Zealand Official Yearbook 1915*, p. 565, and *1917*, p. 640.

respect of income derived from business on the full amount of the balance of the profits or gains of such business.”

Schedule F provided miscellaneous rules for the assessment of income. In particular, unlike in the United Kingdom, a gross rather than net income basis of calculation is evident in its first paragraph, which reads, “All losses and outgoings actually incurred by any person or company in production of the income shall be deducted from the gross amount of his income.” Harris comments:

*At a fundamental level, the United Kingdom income tax is based on gains and profits. The Australian [indeed Australasian] income tax is based on assessable income less allowable deductions. Assessable income is largely a gross concept developed by case law and typically incorporates certain types of receipts. The Australian income tax specifically identifies amounts that may be deducted and expressly denies the deduction of other amounts.*¹⁴

This thesis is limited to the taxation of employment income for reasons discussed in chapter 5. Employment income was taxed under Schedule E, which defines income derived from employment or emolument quite broadly:

Income from Employment or Emolument

Every person shall be liable to tax in respect of income derived from employment or emolument and not derived from business as aforesaid [that is, as defined in schedule D].

“Income derived from employment or emolument” means the gains or profits derived or received in New Zealand in each year ending on the thirty-first day of March, and whether such person is residing in New Zealand or elsewhere, from the exercise of any profession, employment, or vocation of any kind not otherwise liable to taxation under this Act, or from any salary, wages, allowances, pension, stipend, or charge or annuity of any kind not charged on land.

¹⁴ Peter A. Harris, *Metamorphosis of the Australasian Income Tax 1866-1922* (Sydney: The Australian Tax Research Foundation, 2002), 10.

This approach of listing types of income that constitute income from employment continues to this day. Section CA 1 of the current Income Tax Act 2007 provides two general rules encompassing all types of income:

AMOUNTS THAT ARE INCOME

Amounts specifically identified

(1) An amount is income of a person if it is their income under a provision in this Part.

Ordinary meaning

(2) An amount is also income of a person if it is their income under ordinary concepts.

Employment income is then specifically defined in section CE 1 of the Income Tax Act 2007:

AMOUNTS DERIVED IN CONNECTION WITH EMPLOYMENT

The following amounts derived by a person in connection with their employment or service are income of the person:

- a. salary or wages or an allowance, bonus, extra pay, or gratuity*
- b. expenditure on account of an employee that is expenditure on account of the person*
- c. the market value of board that the person receives in connection with their employment or service*
- d. a benefit received under a share purchase agreement*
- e. directors' fees*
- f. compensation for loss of employment or service*
- g. any other benefit in money.*

This bears a familial resemblance to Schedule E of the Land and Income Assessment Act 1891. The basic structure of the current income tax can be traced back to its origins in 1891, even if the detail has changed substantially.

4.2.2 Differentiation between taxpayers

The charging clause of the Act says little about the structure of the actual tax. Although an income tax is a tax based on income, specific amounts of income may be subjected to different amounts of tax depending on the circumstances of the taxpayer. As such, income provides a surrogate for the individual, as Simons argued when he suggested that the income tax was a tax on persons according to their incomes, rather than a tax on incomes as such.¹⁵

Individuals may be distinguished for taxation purposes in a variety of ways, such as in terms of level of income (high or low), type of income (such as earned or unearned), or some personal characteristic (for example family circumstances or age). The New Zealand income tax has been modified over the years in numerous ways which affect the impact of the income tax on differing individuals. Such means create a vertical distinction between taxpayers, whether intentionally or otherwise.

After 1891, subsequent Income Tax Acts included a variety of provisions to effect differentiation between individuals, notably:

1. Changes in the balance between direct and indirect taxes;
2. Changes in the tax rates structure;
3. Changes in the rates of progression;
4. Applying a discount or surcharge to the rates structure;
5. Enacting supplementary taxes on income;
6. Changes in base of the income tax;
7. Changes related to the source of the income; and
8. Tax expenditures.

These are discussed below, before their overall effect on a range of taxpayers is calculated in Chapter 5.

4.2.2.1 Changes in the balance between direct and indirect taxes

Prior to the introduction of the income tax in 1891, the main source of government revenue was indirect taxation, that is, taxation where the person paying the tax is not intended to be the person

¹⁵ Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), 128.

bearing its cost, since the tax is passed on to another person who ultimately bears the liability for it. Hooper notes:

From 1840 to 1890 most of New Zealand's tax revenue came from customs duties (averaging around 62% of total taxation), one of the most acceptable and traditional forms of taxation. Other sources of taxation were also traditional: stamp duties (23%), a property tax (about 11%), and an excise tax on beer (4%). Much of the New Zealand Government's revenue was derived from a holding monopoly on land sales.¹⁶

The first form of direct taxation in New Zealand was a tax on land or property. A land tax was enacted in 1878,¹⁷ and a property tax in 1879.¹⁸ This property tax became increasingly unpopular, as it did not distinguish between improved and unimproved property, which, it was argued, penalised property development and encouraged speculation. Indeed, unlike the subsequent land tax, the 1879 property tax was levied on both real and personal property exceeding £500 in value.¹⁹ The Liberals, who replaced this Property Tax with the Land and Income Tax of 1891:

... consistently favoured a land and income tax instead of a property tax, believing the latter disadvantaged small tradesmen and smaller farmers, whereas a land tax applied particularly to large landowners and would encourage subdivision.²⁰

Direct taxation of the incomes of individuals had at least been mooted prior to the Land and Income Assessment Act 1891: in the 1840s,²¹ the 1860s,²² and under Premier Grey in 1879.²³ However, the attempt in the 1840s was short-lived, and later attempts did not result in legislation.

¹⁶ Keith C. Hooper, "Tracing the Origins of Taxation," in *Tax Policy and Principles: A New Zealand Perspective*, ed. Keith C. Hooper et al. (Wellington: Brookers, 1998), 18.

¹⁷ Land-Tax Act 1878.

¹⁸ Property Assessment Act 1879; Property-Tax Act 1879.

¹⁹ Property Assessment Act 1879, s. 12.

²⁰ Jim McAloon, "Class in Colonial New Zealand: Towards a Historiographical Rehabilitation," *New Zealand Journal of History* 38 (2004): 15.

²¹ Goldsmith, *We Won, You Lost, Eat That*, 23.

²² Malcolm McKinnon, *Treasury: The New Zealand Treasury 1840-2000* (Auckland: Auckland University Press, 2003), 49; Edward Bohan, *Edward Stafford: New Zealand's First Statesman* (Christchurch: Hazard Press, 1994), 194, 259.

²³ Harris, *Metamorphosis*, 50ff.

Against this background, New Zealand's personal income tax was introduced by the Liberal Government in 1891, with effect from the year ending 31 March 1893. Between then and 1984, the principal Act underwent several consolidations or replacements and has grown in length and complexity (refer Table 4.1).

Table 4.2 Principal Income Taxation Acts to 1984

Act	Number of sections (as originally enacted)
Land and Income Assessment Act 1891	48 sections plus schedules A to F
Land and Income Assessment Act 1900	104 sections
Land and Income Assessment Act 1908 ²⁴	121 sections, two schedules
Land and Income Tax Act 1916	169 sections
Land and Income Tax Act 1923	177 sections
Land and Income Tax Amendment Act 1954	246 sections, two schedules
Income Tax Act 1976	Originally 436 sections, nine schedules

Initially the income tax produced only a small proportion of the government's taxation revenue. However, the proportion of taxation taken in income tax (both company and individual), increased significantly at the time of the two world wars (refer Figure 4.1). Although reliance on income tax fell following World War One, it never reverted to pre-war levels. Subsequent to World War Two the reliance on income taxation only fell temporarily and to a limited extent before increasing beyond wartime levels. By the 1970s, various reports expressed concern about New Zealand's substantial reliance on direct taxation.²⁵ Such concerns in measure motivated the tax reforms of the 1980s, perhaps chief of which was the introduction of the Goods and Services Tax with effect from 1 October 1986, which was accompanied by significant income tax rate reduction and base broadening.

²⁴ This was a consolidating Act, as the preamble to this Act stated: "An Act to consolidate certain Enactments of the General Assembly relating to the Assessment of Land and Income for Purposes of Taxation."

²⁵ Taxation Review Committee, *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington: Government Printer, 1967), 75-87; Peter M. McCaw, *Report of the Task Force on Tax Reform* (Wellington: Government Printer, 1982), chapter 2; Pamela Jeffries et al., *Taxing Issues* (Wellington: New Zealand Planning Council, 1981), 32-41; Schmitt, *Relative Tax*, 33.

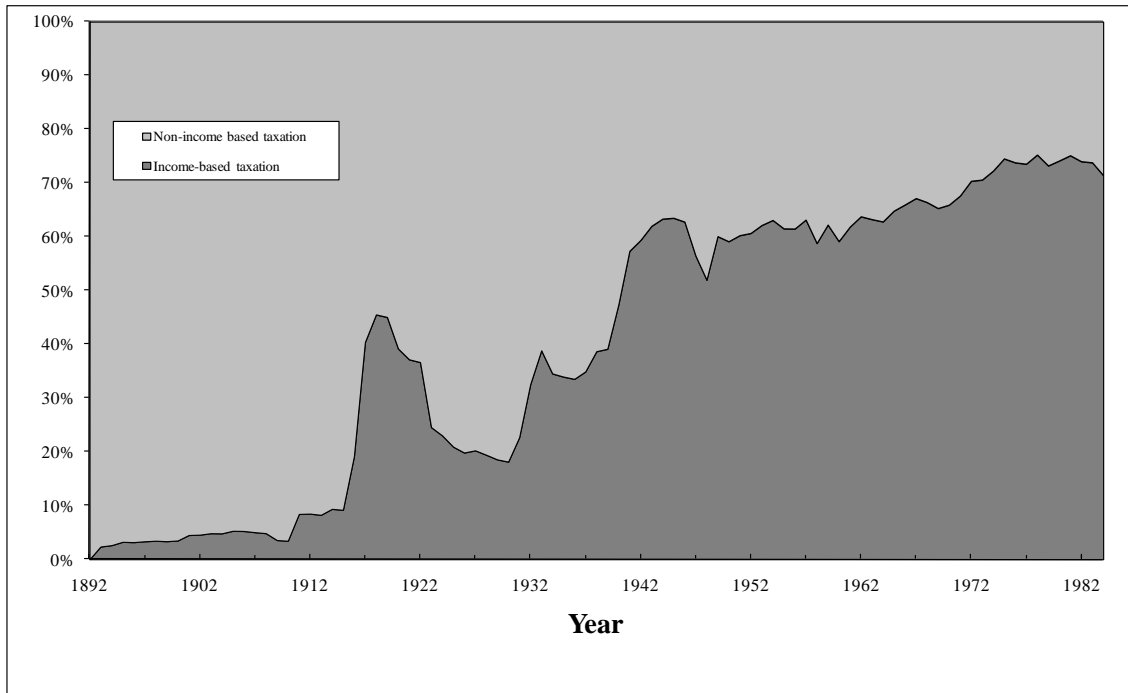


Figure 4.1 Income vs. non-income sourced taxation (1891-1984)

Source: *New Zealand Official Yearbooks*

Different types of tax affect different people in different ways. Indirect taxes are understood to impact more heavily on lower income earners, while, in the absence of evasion, direct taxes are said to affect higher income earners, particularly if an exemption is given for a living wage and a progressive rates scale applies.²⁶ Until the early twentieth century, discussions of the incidence of taxation often focused on the balance between classes, it being understood that direct taxes on the wealthy balanced the proportionately higher cost of indirect taxes on those with lower incomes.

Given the long history of indirect taxation, and more particularly the strong aversion there has been to direct taxation since antiquity, the rapid shift during the twentieth century to direct taxation as the primary source of government revenue is noteworthy.

4.2.2.2 Changes in the tax rates structure

Vertical equity is sometimes used as a synonym for progressive taxation. Staudt suggests that, “the debate over vertical equity has ... centered on the legitimacy of progressive marginal tax rates”.²⁷ Although progression may be the most obvious manifestation of vertical equity, it is not

²⁶ William Vickrey, “Progressive and Regressive Taxation,” in *The New Palgrave: A Dictionary of Economics* (vol. 3), ed. John Eatwell, Murray Milgate and Peter Newman (London: Macmillan, 1987), 1021-1023.

²⁷ Nancy C. Staudt, “The Hidden Costs of the Progressivity Debate,” *Vanderbilt Law Journal* 50 (1997): 957.

uncontested. After a detailed review, Blum and Kalven concluded that the case for progression in the income tax was stubborn but uneasy, and reflected a concern to address the vexing problem of inequality.²⁸ Yet popular acceptance of progression as the preferred approach to income taxation is relatively recent.

Strictly, progressive income tax rates are a subset of vertical equity, being but one of a number of possible approaches to it. As Palgrave put it in 1896, “Graduated taxation . . . technically includes progression, degression, and regression”.²⁹ Various possible tax rates structures are possible to bring about the taxation of unequals unequally, that is, vertical equity.

Until around the turn of the century, proportional taxation was the norm in the United Kingdom. Daunton argues that, “Equity was defined by ‘proportionality’, a principle which was not seriously challenged during the mid-Victorian debates over the ability of different forms of income to bear taxation”³⁰ – although strictly speaking that tax was degressive rather than proportional. Further, as was the case with New Zealand’s 1891 income tax, it only applied to taxpayers on high incomes.

Despite this British background, the New Zealand income tax has been progressive since its introduction; increasing marginal rates of tax have been applied to increasing levels of income. Concerning the New Zealand income tax, Harris comments, “The approach was progression rather than differentiation. This was the first progressive income tax in the Australian and New Zealand Colonies”.³¹ Unlike the British precedent, no distinction was made in the treatment of different types of income – between earned versus unearned – as J. S. Mill had advocated.³² Nor, as was the case in Great Britain, was a schedular approach adopted where various types of income - land; commercial use of land; public securities; trading, professional, and overseas earnings; and employment - was returned and assessed on independent schedules. In New Zealand by way of contrast, the assessable income from various sources was added together and the total then taxed at progressive rates.

²⁸ Walter J. Blum and Harry Kalven Jr., “The Uneasy Case for Progressive Taxation,” *University of Chicago Law Review* 19 (1952): 520.

²⁹ Palgrave (1896), cited in *Oxford English Dictionary*, s.v. “Degression.”

³⁰ Martin Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge: Cambridge University Press, 2001), 27.

³¹ Harris, *Metamorphosis*, 114.

³² Takao Dome, “Bentham and J. S. Mill on Tax Reform,” *Utilitas* 11 (1999): 331.

Of the possible types of scales of progression, two have been used in New Zealand: a step system, and a graduated system. Under a step system, the average rate of tax will be lower than the marginal rate except for income at the lowest step, as each successive step of taxation will only apply to the income within the step. Ignoring a low income exemption, New Zealand's income tax has had as few as two steps (in 1892) and as many as 39 (from 1941 to 1954).

In contrast, a graduated system provides a formula (or formulae) to calculate the rate of tax anew at each level of income. In the absence of exemptions, the marginal rate of tax will equal the average rate of tax on each pound of income. In its simplest form the rate of income tax would be calculated as follows:

On all income not included within the last two preceding clauses the rate of income-tax for every £1 of the income on which tax is payable shall ... be as follows:-

(a) ...

(b) In the case of all other taxpayers, 2s., increased by 1/100d. for every £1 of such income, but so as not to exceed in any case the rate of 8s. 7d. in the £1.³³

In other years there might be intermediate steps where the rate of progression varied, resulting in a less smooth rates curve. Thus, from 1892 to 1910, New Zealand adopted a step system of progression. There were two steps on the tax scale, with the first £300 of income being exempt from tax. The number of steps was increased from 1911 to 1913 with nine steps in place and the initial £300 exemption still applying.

From 1914 to 1940 a graduated system applied. Unlike a step system, under a graduated income tax the top rate of tax is applied to the whole income, and not merely to the income in that top bracket. This graduated rates scale was modified almost annually. Since a graduated scale progressively increases the tax rate on every unit of income earned, rather than just on the marginal unit, small increases in income may involve significant increases in taxation.

From 1941 the so-called "Basic Rates" were introduced. This involved a return to the step system of taxation, initially with 39 steps. The initial rate was two shillings sixpence in the pound on the

³³ Land and Income Tax (Annual) Act 1939, schedule part II.

first £300 of income, with each successive £100 of income being taxed at a rate three pence higher, until a top marginal rate of 12 shillings per pound (60 percent) was reached on income over £3,800.³⁴ The scale was replaced in 1955, with 37 steps culminating in a rate of 12 shillings per pound after £3,600,³⁵ and again in 1961, with 33 steps and the same top rate.³⁶ The step system has remained in place since then, with the number of steps reducing to two in the late 1980s and 1990s, and back to three in 2001 (ignoring any low income rebates).

The relative fairness of either system of progression is worthy of discussion, and was in fact discussed at the time.³⁷ The main effect is at the margin; an increase of income by one pound that pushes a taxpayer into a higher tax bracket hardly affects the total tax liability in a stepped system, as the higher rate would only apply to the last dollar earned. Under a graduated system, however, an increase in income by one pound may significantly increase the total tax impost.

4.2.2.3 Changes in the rates of progression

The type of progressive system adopted will affect the tax paid. However, of equal importance are the actual tax rates themselves. These are summarised in Table 4.2.

³⁴ Land and Income Tax Amendment Act 1940, schedule, part B.

³⁵ Land and Income Tax Amendment Act 1954, schedule.

³⁶ Land and Income Tax Amendment (No. 2) Act 1959, schedule.

³⁷ 'Editor', "Unjust Taxation on Incomes," *Accountants' Journal* 22 (1944): 25-6, where the author highlighted the inequitable effects of having a stepped personal rates scale, but a graduated company rates scale.

Table 4.3 Highest nominal marginal tax rates (excluding surtaxes) (1893-1984)

Effective Y/E 31/3	Scale type	Number of steps/graduations	Top nominal rate (per £)	Top nominal rate (%)	At income level
1893-1910	Step	2	1s.	5.00%	£1,000
1911-13	Step	9	1s. 2d.	5.83%	£2,000
1914-16	Graduated	4	1s. 4d.	6.67%	£2,400
1917	Graduated	4	2s.	10.00%	£1,003
1918-20	Graduated	3	3s.	15.00%	£1,200
1921-25	Graduated	4	7s. 4d.	36.67%	£10,000
1926-27	Graduated	4	4s. 6d.	22.50%	£8,700
1928-36	Graduated	6	4s. 6d.	22.50%	£8,700
1937-39	Graduated	3	8s. 2d.	40.83%	£8,950
1940	Graduated	2	8s. 7d.	42.92%	£7,900
1941-54	Step	39	12s.	60.00%	£3,800
1955-60	Step	37	12s.	60.00%	£3,600
1961-70	Step	33	12s.	60.00%	£3,600/\$7,200
1970-74 ³⁸	Step	15-19		46.25 – 67%	\$12,000
1975-82 ³⁹	Step	5 - 22		57.2 – 60%	\$22,000
1983	Step	9		63%	\$38,000
1984	Step	5		66%	\$38,000

The initial rates structure remained unchanged for almost two decades, from 1892 to 1910. Thereafter the basic structure was changed frequently. Besides this, various adjustments were made to the rates structure, which further altered the rates of progression.

Adjustments were made in a variety of ways:

- a) Adoption of a new rates scale: This was most evident in changing from a step to a graduated and then back to a step system of tax, as noted above.
- b) Amending the rates within the structure: In a step system, the rates structure might be revised, either by altering the tax brackets, or changing the rates applying to the brackets,

³⁸ The rates scale and number of rates bands were altered annually during this period.

³⁹ Ibid.

or both. In a graduated system, the limits might be amended, or the effective rates altered by changing the calculation (for example, from one shilling plus $\frac{1}{100}$ d. per pound to one shilling plus $\frac{1}{200}$ d. per pound). Table 4.2 illustrates the changes that were made to the basic structure itself.

- c) Applying a surcharge or discount to the basic structure (refer below).

4.2.2.4 Applying a discount or surcharge to the rates structure

Rather than making a wholesale change to the rates structure a super tax or discount could be applied. This provided a simple means for an administration to adjust the total expected revenue without having to amend the rates structure itself. Instead, income tax is initially calculated at the statutorily prescribed rates, and the resultant tax is itself then adjusted. This was first done in the tax year commencing 1 April 1915 during World War One.⁴⁰ The introduction of the “Basic Rates” in 1940 was intended to facilitate this process; the rates themselves remained constant, but the actual tax impost was the sum of the tax calculated at these basic rates, plus an additional surcharge or discount (if any). The effect is illustrated in Table 4.3.

⁴⁰ Finance Act 1915, s. 4.

Table 4.4 Taxation discounts/surcharges (1891-1974)

Effective Y/E 31/3	Scale type	Number of steps	Top nominal rate	Top nominal rate (%)	At income level	Discount (Surcharge)	Top nominal rate (after adjust.)
1916	Graduated	4	1s. 4d.	6.67%	£2,400	^a 33⅓%	8.89%
1917	Graduated	4	2s.	10.00%	£1,000	^a 33⅓%	13.33%
1918-19	Graduated	3	3s.	15.00%	£1,200	^a 150%	37.50%
1920	Graduated	3	3s.	15.00%	£1,200	^a 100%	30.00%
1921-22	Graduated	4	7s. 4d.	36.67%	£10,000	20%	44.00%
1923-24	Graduated	4	7s. 4d.	36.67%	£10,000	(20%)	29.34%
1925	Graduated	4	7s. 4d.	36.67%	£10,000	(33%)	44.67%
1931	Graduated	6	4s. 6d.	22.50%	£8,700	10%	24.75%
1932-36	Graduated	6	4s. 6d.	22.50%	£8,700	30%	29.25%
1940	Graduated	2	8s. 7d.	42.92%	£7,900	15%	49.36%
1941-42	Step	39	12s.	60.00%	£3,800	15%	69.00%
1943-45	Step	39	12s.	60.00%	£3,800	33⅓%	^b 77.50%
1946-50	Step	39	12s.	60.00%	£3,800	15%	69.00%
1951	Step	39	12s.	60.00%	£3,800	10%	66.00%
1952	Step	39	12s.	60.00%	£3,800	5%	63.00%
1953	Step	39	12s.	60.00%	£3,800	2½%	61.50%
1972	Step	16	50 cents	50.00%	\$12,000	3⅓%	51.67%
1973	Step	16	50 cents	50.00%	\$12,000	7½%	53.75%
1974	Step	16	50 cents	50.00%	\$12,000	10%	55.00%

Notes:

- a. 1916-1917: War tax of 33⅓ percent; 1918-1919: War tax of 100 percent, surcharge of 50 percent; 1920: no War tax of 50 percent or surcharge of 50 percent.
- b. Note that s. 2(4) of the Land and Income Tax Amendment Act 1940, limited the top rate to 15s. 6d. in the pound (77.5 percent). On top of this came the Social Security Tax.

These surcharges or discounts could significantly increase or decrease the amount of tax payable. For instance, in 1918 and 1919 the calculated tax was first effectively doubled, and then an additional 50 percent was added. However, this still would only amount to a maximum 37½ percent tax rate, compared to the 36⅔ percent basic rate of 1921, which, with a 20 percent surcharge, came to a 44 percent top rate. The risk that the top tax rate would become “excessive”,

whatever that might mean, was mitigated in 1940 by a tax rates cap of 15s. 6d. per pound (77½ percent).⁴¹ Adding the Social Security Charge and National Security Levy of up to 2s. 6d. in the 1942 to 1945 tax years yielded a potential maximum rate of 90 percent.

Such surcharges ordinarily altered the pre-existing tax rates without altering the progressivity of the scale itself. Surcharges could thus increase the total tax take without directly affecting the relativities between taxpayers. As such, they were well suited to providing the extra funds needed to wage a war. A discount was last applied to the whole rates scale in 1954. Subsequently, a rebate might be given of a certain percentage of the tax but subject to a maximum rebate amount. Such targeted rebates are discussed below.

From 1967 onwards the rates scale itself was manipulated almost annually. Between 1967 and 1979, the rates scale had between 19 and 22 steps, with a maximum rate of between 46¼ percent (1973) and 67½ percent (1969). From 1980 the number of steps reduced substantially to between five and nine with the top rate of between 60 and 66 percent continuing to apply to incomes above around \$60,000.

The rates structure itself, and the surcharges or discounts applied to this structure, were enacted in legislation, and thus were visible to the taxpaying public. Less visible was the effect of inflation in increasing the effective rate of taxation on taxpayers. If the rates structure is restated in real dollars, the rates of progression have increased even more markedly and consistently over time. This is illustrated in Figure 4.2, where the prevailing tax rates scale (exclusive of any surcharge or discount) is applied to a range of income, with the income restated in 1894 terms to permit a comparison of the real rate of tax applying to the resultant level of income.

Figure 4.2 illustrates three trends. First, bracket creep caused by inflation is clearly evident. Secondly, over time ever-lower (real) levels of income were subjected to income tax, and that at higher rates of tax. Thirdly, the effect of World War Two in radically shifting the rates structure and in fact democratising the income tax is obvious.

⁴¹ Land and Income Tax Amendment Act 1940, s. 2(4).

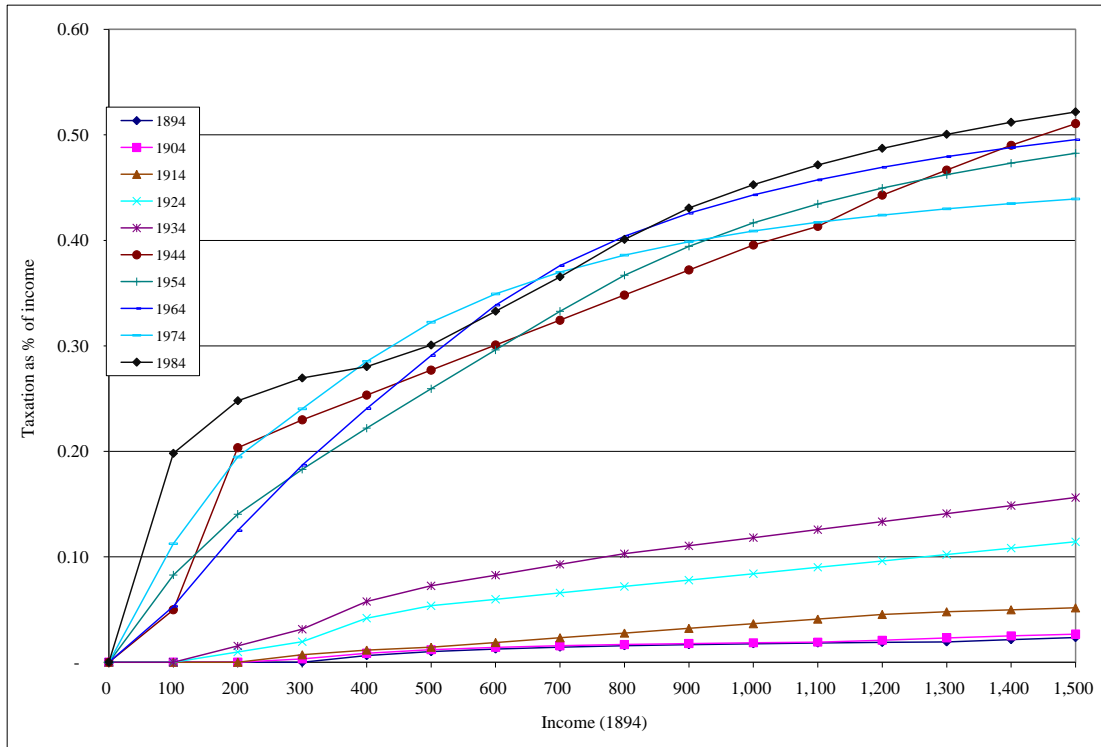


Figure 4.2 Tax on £100 stated in 1894 pounds (adjusted by nominal wages index)⁴²

4.2.2.5 Enacting supplementary taxes on income

Aside from adjusting the actual rates scale, additional income type taxes could be enacted alongside the income tax proper. These are listed in Table 4.4 and had two main causes: war, and social security. They were either levied as a separate tax, generally at a flat rate (such as the National Security Tax or the Social Security Tax), or were calculated alongside the income tax but designated for a specific purpose as in the case of the War Tax surcharge of World War One noted above. Whereas the War Tax of World War One was calculated as part of the income tax, the levies listed in Table 4.5 were calculated and paid independently of the income tax.⁴³

⁴² Sources: for the years 1914 to 1967: *New Zealand Official Yearbook 1967*, 931: Nominal Weekly Wage Index Numbers (Adult males); for the years 1895 to 1913: David Greasley and Les Oxley, "Globalization and Real Wages in New Zealand 1873-1914," *Explorations in Economic History* 41 (2004), 45. Note the assumption made herein that index for 1913 per Greasley and Oxley (Index = 131) is same as for 1914 per NZOYB (Index = 253).

⁴³ The rates of War Tax for the years 1916-1919 are noted at the foot of Table 4.4 above.

Table 4.5 Additional taxes (1931-1969)

Effective Y/E 31/3	General Unemployment Levy	Emergency Unemployment Levy	Social Security Levy	National Security Tax	Emergency Tax
1931	30s. p.a.				
1932	20s. p.a.	3d./£			4d./£ on incomes over £400
1933-34	20s. p.a.	10d./£			4d./£ on incomes over £400
1935	20s. p.a.	12d./£			4d./£ on incomes over £400
1936-39	20s. p.a.	8d./£			4d./£ on incomes over £400
1940			12d./£		
1941-42			12d./£	12d./£	
1943-46			12d./£	18d./£	
1947-51			18d./£	6d./£	
1952			18d./£		
1953			18d./£		
1954			18d./£		
1955-67			18d./£		
1967-69			7½c/\$		

* Merger of Social Security Tax and Income Tax in Land and Income Tax Amendment (No. 3) Act 1968, effective 1/4/1969. Hence the Social Security Levy was no longer assessed separately from the 1970 tax year, but incorporated in the personal tax rates scale.

These additional taxes reflect a time when the Government maintained and reported on separate funds, such as the Social Security Fund; not all public finance was reported in the Consolidated Fund. Rather the appearance (illusory or otherwise) of hypothecation, that is the designation of particular taxes for particular purposes, was employed to enhance accountability and, in a manner akin to benefits theory, compliance.

There was no exemption level for the Social Security Levies or the National Security Tax, whereas there had been for the Emergency Tax. This widening of the tax net may reflect changes in attitudes as to who should be paying the tax, and how much is fair. It also may reflect a residual belief that taxation should be levied on a benefits received basis: since the lowest

incomes receive benefits from social security, those earning such incomes should also pay toward them.⁴⁴

4.2.2.6 Changes in the base of the income tax

Since its first enactment, the income tax has allowed for exemptions, and certain groups in society have been exempted from the tax. In particular, the 1891 Act exempted farmers from income tax (but not from land tax).⁴⁵ They were included in the income tax net in 1915,⁴⁶ but again excluded in 1923,⁴⁷ only to be caught again in 1929.⁴⁸

The treatment of married women and married couples has also varied over the years. Section 39 of the 1891 Act provided that:

Any married woman seised, possessed, or entitled to any land, mortgage, or income to or for her sole or separate use, shall be chargeable with and liable to pay tax in like manner as if she were sole and unmarried.

However, the taxation of the income of a married woman was less clear, and changed over time.⁴⁹ Although the inter-gender practice of taxation is worthy of study, it is beyond the scope of this study.⁵⁰

4.2.2.7 Changes related to the source of the income

No distinction was initially made in the taxation of income of individuals based on the source of that income. The total taxable income was calculated and tax levied thereon. Unlike Britain's

⁴⁴ The same principle appears in New Zealand's Accident Compensation earner levies, where no de minimis income level applies, but a maximum does, presumably on the basis that an individual can only receive so much benefit from the Accident Compensation Corporation as calculated on an actuarial basis. The potentially inequitable effects of capping the level of assessable income is illustrated with reference to the United States payroll tax (which is only assessed on incomes up to a certain level) by Martin J. McMahon Jr., "The Matthew Effect and Federal Taxation," *Boston College Law Review* 45 (2003-4): 993.

⁴⁵ Land and Income Assessment Act 1891, s. 16.

⁴⁶ Finance Act 1915, s. 11.

⁴⁷ Land and Income Tax Act 1923, s. 79.

⁴⁸ Land and Income Tax Amendment Act 1929, s. 11.

⁴⁹ One writer referred to the aggregation of the incomes of husband and wife as "a thoroughly immoral piece of legislation" because it put a penalty on matrimony, and exacted double taxation: R. D. Brown, "The Incidence of Income Taxes," *Accountants' Journal* 31 (1952): 10.

⁵⁰ Women's experiences of taxation are discussed in Claudia Scott (ed.), *Women and Taxation* (Wellington: Institute of Policy Studies, Victoria University, 1993).

schedular system, “the approach was progression rather than differentiation,”⁵¹ that is, the applicable rate of tax depended on the level of total income rather than the type of income.

From 1922 to 1951 a distinction *was* made between earned as opposed to unearned income.⁵² The former mainly comprised income derived by reason of exertion,⁵³ whereas the latter mainly comprised rent, interest, dividends, and annuities.⁵⁴ A 10 percent discount of the tax calculated on earned income (to a maximum of £2,000) applied from 1920 to 1930, while a 33½ percent surcharge was applied to unearned income from 1931,⁵⁵ until the distinction was removed effective from the 1951 tax year.⁵⁶

Until 1931, all companies paid income tax on their incomes, with no subsequent taxation of that income in the hands of the shareholders.⁵⁷ From then, dividends were included as non-assessable income in order to calculate the applicable rate of tax and any special exemption. The system was again altered in 1939 with the introduction of the proprietary company rules which effectively deemed the shareholder’s portion of the company’s income, whether divided or not, to be the income of the shareholder for the year.⁵⁸ The taxation of dividends in the hands of the recipients was introduced in the Land and Income Tax (Amendment) Act No. 2 1958.

The distinction of income by source also affected the calculation of the tax. A key change was enacted in 1942,⁵⁹ following the (re-)introduction of the stepped system of basic rates, in an effort to preserve the progressivity of the rates structure. This method came to be known as the

⁵¹ Harris, *Metamorphosis*, 114.

⁵² Land and Income Tax Amendment Act 1922, schedule. The distinction is discussed by ‘Adjuster’, “Income Tax Notes,” *Accountants’ Journal* 1 (1922): 150.

⁵³ Staples provides a fuller definition: “*Earned income* includes all salaries, wages, allowances or pensions, and any other income derived from any source by a taxpayer (not being a company, or a Local or Public Authority) by reason of his physical exertions. Personal exertion may be other than physical or manual, e.g. it may consist of advisory work, or the acceptance of responsibility.” Charles A. Staples, *A Guide to New Zealand Income Tax Practice* (Wellington, Financial Publications, 1948), p 171.

⁵⁴ *Ibid.*

⁵⁵ Land and Income Tax (Annual) Act 1931, schedule.

⁵⁶ Land and Income Tax Amendment Act 1950, s. 4.

⁵⁷ Land and Income Tax Amendment Act 1931, s. 6.

⁵⁸ Land and Income Tax Amendment Act 1939, s. 23.

⁵⁹ Finance Act 1942, s. 5.

A+B+C method, and was an extension of the system that had been in effect since 1931.⁶⁰ Staples provides the following outline:

Briefly, the effect of the new method is to apply the “step” rates in the following order to taxable and non-taxable income:

1. *Non-assessable income.*⁶¹
2. *Earned taxable income.*
3. *Unearned taxable income.*

The position may, for the purposes of illustration, be represented as follows:

A taxpayer’s non-assessable and taxable income are: Non-assessable income: £100. Earned taxable income: £200. Unearned taxable income: £300.

<i>Taxable Income</i>	<i>Rate</i>	
£		
1-100	2s. 6d.	} <i>Attributed to non-assessable</i>
101-200	2s. 9d.	} <i>Attributed to earned taxable income</i>
201-300	3s.	} <i>Attributed to earned taxable income</i>
301-400	3s. 3d.	
401-500	3s. 6d.	
501-600	3s. 9d.	

*Thus, the initial step rates are attributed first to non-assessable income on which no tax is payable and then to earned taxable income and finally to unearned taxable income.*⁶²

⁶⁰ Land and Income Tax Amendment Act 1931, s. 6.

⁶¹ Per Staples, *Guide 1948*, 173:

“This is the term used to describe income which is not liable for income tax in the hands of the recipient, but is used for the purpose of increasing the rate of tax payable on his assessable income.

The following are the various classes of non-assessable income;-

- (a) Interest from free-of-tax New Zealand Government loans ...
- (b) Interest from free-of-tax company debentures.
- (c) All dividends and other profits derived from shares or rights of membership in companies.
- (d) Income derived from some other country within the British dominions and exempted from income tax under the provisions of Section 89 of the Income Tax Act 1923.
- (e) Interest on company debentures issued at a floating rate or in substitution for shares.”

Distinguishing income by source has equity implications.⁶³ Where a distinction is made between income on revenue account (such as wages and salaries) and income on capital account (for example rents or dividends), different sectors of society may benefit vis à vis other sectors. Since capital income is generally received by wealthier sectors of society, a higher rate of tax on such income would usually be progressive. However it may be punitively regressive when the taxpayer is a widow with no other income besides that derived from her investment portfolio.

4.2.2.8 Tax expenditures

A person's tax liability may be affected by what may be termed tax expenditures. Surrey and McDaniel posited that:

*... an income tax is composed of two distinct elements. The first element consists of the structural provisions necessary to implement a normal income tax, such as the definition of net income, the specification of accounting rules ... The second element consists of the special preferences found in every income tax. These provisions, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favour a particular industry, activity, or class of persons.*⁶⁴

The concept of tax expenditures is controversial,⁶⁵ and the distinction between the two elements is, at best, vague. Surrey and McDaniel comment that:

*Tax expenditure analysis, as applied to a particular tax, requires an understanding of the normative structure of that tax in order to determine whether a provision is part of the structural or the tax expenditure component.*⁶⁶

⁶² Ibid., 20f.

⁶³ Wills describes the A+B+C system and comments that "the government has chosen the particular arrangement of things that gives the maximum tax," E. P. Wills, "Indirect Taxes on Income," *Accountants' Journal* 28 (1949): 29. Note that the original A+B+C system of taxation became the A+B system following the removal of the distinction between unearned and earned income by the National Government in section 4 of the Land and Income Tax Amendment Act 1950. Referring to the A+B system, Brown, writing on the incidence of income taxes comments: "Nothing encourages avoidance or evasion so much as an unjust tax," R. D. Brown, "The Incidence of Income Taxes," *Accountants' Journal* 31 (1952): 11.

⁶⁴ Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures* (Cambridge, MA: Harvard University Press, 1985), 3.

⁶⁵ John F. Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985), 270.

⁶⁶ Surrey and McDaniel, *Tax Expenditures*, 3f.

However, this distinction is far from clear cut. In their survey of tax expenditures, the OECD notes that:

Although the notion of a tax expenditure is now familiar, with its origin in the 1960s, definitions of what constitutes a tax expenditure in practice can be controversial. As a consequence, countries' practices in presenting tax expenditure accounts vary substantially.⁶⁷

Although exemptions and rebates might be regarded as structural provisions, they do have the effect of differentiating between persons who otherwise have the same income level. For present purposes in the context of the personal income tax, the term tax expenditures will be taken to include legitimate concessions granted as a matter of government policy,⁶⁸ which result in different amounts of tax being paid by persons with the same base income. Under this expansive definition, tax expenditures may comprise exemptions from taxation, rebates of taxation, or cash transfers.

The shift from exemptions to rebates, and latterly to direct redistributions, is of particular relevance to the matter of vertical equity. Until the 1970s, exemptions were the primary means of altering the incidence of the income tax between persons. Exemptions exempt a certain amount of income from taxation. Consequently, the benefit of the exemption will vary depending on the taxpayer's marginal tax rate; the higher the rate, the greater the benefit of the exemption. In contrast, rebates provide an equal rate of benefit irrespective of the level of income, by reducing the tax payable rather than the taxable income. The Labour Party favoured rebates over allowances, a matter already alluded to by the Labour Member of Parliament McCombs in 1920, who thought exemptions should have taken the form of a remission of a definite amount of tax – a rebate – rather than an exemption:

Take a man with £500 income with four children. He got an exemption of £50 each – £200 exemption to be added to his £300 [General Exemption]. Of course, he was free from income-tax, and rightly so; but the sum which he saved in income-tax amounted to

⁶⁷ OECD, *Tax Expenditures: Recent Experiences* (Paris: OECD, 1996), 9.

⁶⁸ Garth Harris et al., *Income Tax in New Zealand* (Wellington: Brookers, 2004), 868.

*£12 10s. a year. But take a man with an income of £10,000 a year with four children. He got a reduction of £200, the same as the previous one; and the income on which he paid tax was not £10,000, but £9,800. But what came into operation there was this: that the £200 of his income would be subject to a tax of 8s. 9d. in the pound. But that was not the sum total of what he saved; he saved under our taxation, which was created on the two-hundredth part of a penny – he saved on the balance of his income 1d. all round, and he had dropped into the £9,800 grade ...*⁶⁹

The remaining exemptions were not replaced with rebates until the 1970s. Unlike an exemption, the Family Benefit which became universal from 1 April 1946 provided a cash grant to families, irrespective of income level. More recently, other than for charitable donations or housekeeper costs, rebates have been replaced by targeted assistance to families in the form of Family Support and the Working for Families package. The following subsections discuss exemptions, rebates, and transfers in turn.

4.2.2.8.1 Exemptions

(a) General Exemption

The first New Zealand income tax exempted the first £300 of income.⁷⁰ This exemption was subsequently modified several times, before finally being repealed in 1980. Initially the exemption applied to all taxpayers. However, from 1918 it was rebated,⁷¹ such that it only applied to incomes below £900 (£800 from 1932).⁷² It was again unabated from 1937.⁷³

The original General Exemption left a low to medium wage untaxed. Certainly such incomes were reached via the customs and excise duties. In keeping with English thinking, such as J. S. Mill's,⁷⁴ a subsistence wage ought not to be taxed. The revenue cost of this exemption was, however, substantial, and over time the exemption was clawed back, before disappearing

⁶⁹ *NZPD*, vol. 188 (12 October 1920), 501. Member of Parliament Freer contrasted Labour's approach of granting a rebate with the alternative of an exemption, and suggested that this ensured the low income earner got the full benefit: *NZPD*, vol. 282 (16 September 1948), 2319.

⁷⁰ Land and Income Assessment Act 1891, schedule E.

⁷¹ Land and Income Tax Act 1916, s. 81.

⁷² Land and Income Tax Amendment Act 1931, s. 3.

⁷³ Land and Income Tax Amendment Act 1936, s. 6.

⁷⁴ John S. Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (London: Longmans, Green and Co., 1909), 5.2.3, (p. 806).

altogether. This contrasts with the earlier view and practice, as in for example New Zealand's Land and Income Assessment Act 1891, that direct taxation should be extracted from the wealthy, and not the poor.

The relative value of the General Exemption declined over time. Taking a hairdresser's award wage rate as a surrogate for a low blue collar wage,⁷⁵ the exemption amounted to almost two and a half times a hairdresser's award rate at the turn of the century, but was only around 40 percent thereof in the early 1950s, before increasing again during the 1960s. (Refer Table 4.5).

Table 4.6 Value of General Exemption (1902-1981)

Year	General Exemption (£)	Hairdresser's Award rate (£) ⁷⁶	% of Award rate
1902	£300	£125	240%
1912	£300	£125	240%
1922	£300	£213	141%
1932	£300	£260	115%
1942	£200	£294	68%
1952	£200	£512	39%
1962	£468	£711	66%
1967	\$936	\$1,794	52%
1971	\$275	\$2,475	11%
1975	\$125	\$3,772	3%
1976	\$145 rebate	\$4,091	4%
1977	\$155 rebate	\$4,708	3%
1978	\$125 rebate	\$5,400	2%
1981	nil	\$9,596	-

Between 1950 and 1960 the General Exemption was higher for taxpayers over 65 years of age. An additional £15 exemption was permitted from the 1952 tax year,⁷⁷ which was increased to

⁷⁵ The justification for this will be discussed in chapter 5.

⁷⁶ For details of the source and significance of the Hairdresser's award rate refer Chapter 5.

⁷⁷ Land and Income Tax Amendment (No. 2) Act 1950, s. 4.

£45 between 1955 and 1960,⁷⁸ before this short-lived attempt at age discrimination was discontinued from 1961.⁷⁹

As initially enacted, the General Exemption resulted in only high income earners being subject to personal income tax. A tax-free threshold was set at a level well above a liveable wage. Over time this threshold was eroded until New Zealand had no tax-free threshold, unlike many overseas jurisdictions.⁸⁰

(b) Child/Dependent Exemption

The Land and Income Assessment Act 1891 made no allowance for dependents. Such an allowance was first introduced into the Land and Income Assessment Amendment Act 1913, which provided for a Child Exemption of £25 per child for up to five children under 16 years of age, subject to an income limit of £460.⁸¹ The limitations on numbers of children and income were scrapped from 1918.⁸² The rate was increased to £50 per child and the age limit increased to 18 from 1922.⁸³ From 1947 the Dependent Relative Exemption was merged with the Child Exemption.⁸⁴

As with the General Exemption, the rate of the Child Exemption was changed several times, and the value of the benefit relative to a hairdresser's award rate declined over the years, as indicated in Table 4.6. A low to middle income earner would not have benefited from this exemption, as their whole income would have been exempted by the General Exemption. This Exemption was abolished from 1974.

⁷⁸ Land and Income Tax Act 1954, s. 80.

⁷⁹ Land and Income Tax Amendment Act 1960, s. 5.

⁸⁰ Many nations have a significant initial zero rate bracket, including the United Kingdom, United States, and Australia: refer: OECD, *OECD Tax Database Table I.5, Central Government Personal Income Tax Rates and Thresholds (Excel File)*, <http://www.oecd.org/dataoecd/44/3/1942514.xls> (accessed 6 May 2009). New Zealand now achieves a tax free minimum for lower income families by means of transfer payments.

⁸¹ Section 82(1).

⁸² Finance Act 1917, s. 28.

⁸³ Land and Income Tax Amendment Act 1920, s. 11.

⁸⁴ Land and Income Tax Amendment Act 1945, ss. 6-7.

Table 4.7 Child Exemption (1915-1974)

Year	Child/Relative Exemption (per person)	Hairdresser's award rate	Percentage of award rate
1915*	£25	£143	17%
1922*	£50	£213	23%
1925	£50	£254	20%
1935	£50	£215	23%
1945	£50	£307	16%
1954*	£65	£563	12%
1955*	£75	£579	13%
1965	£75	£784	10%
1967	\$156	\$1,794	9%
1970	\$135	\$2,080	6%
1973	\$35	\$2,746	1%
1974	nil	(upon increase in Family Benefit)	-

* Year of change in exemption

(c) Spouse Exemption

An exemption for married men of £50 was introduced in 1933,⁸⁵ and rebated to nil where the husband's income was between £725 and £800, or where the wife's "income in her own right ... amounted to or exceeded fifty pounds."⁸⁶ A mirror provision in the case the wife was the income earner was enacted in 1933.⁸⁷ No rebate applied from 1937 to 1946.⁸⁸ From 1947 the wife's income determined the rate at which this Exemption was rebated.⁸⁹ This Exemption was finally abolished in 1984⁹⁰ (refer Table 4.7).

⁸⁵ Land and Income Tax Amendment Act 1932-33, s. 4.

⁸⁶ Ibid.

⁸⁷ Land and Income Tax Amendment Act 1933, s. 2.

⁸⁸ Land and Income Tax Amendment Act 1936, s. 12.

⁸⁹ Land and Income Tax Amendment Act 1945, s. 3.

⁹⁰ Income Tax Amendment Act 1982, s. 9(1).

Table 4.8 Dependent Spouse Exemption (1933-1984)

Year	Dependent Spouse Exemption	Hairdresser's award rate	% of award rate
1933	£50	£260	19%
1943	£50	£307	16%
1947*	£100	£364	27%
1953	£100	£512	20%
1955*	£125	£579	22%
1959*	£162	£635	26%
1960*	£200	£694	29%
1963	£200	£740	27%
1967	\$312	\$1,784	19%
1970	\$240	\$2,080	12%
1971	\$275	\$2,475	11%
1975	\$125	\$3,772	3%
1976	\$145	\$4,091	4%
1977	\$155	\$4,708	3%
1978	\$156	\$5,400	3%
1983	\$78	\$11,223	1%
1984	nil	\$11,223	-

(d) Insurance Exemption

An exemption was given on life insurance premiums from the beginning of the income tax.⁹¹ Unlike the previous family-based exemptions this exemption would generally favour those with the surplus income that enabled them to take out life insurance.

4.2.2.8.2 Rebates

During the second half of the twentieth century, there was a trend toward the removal of exemptions and the enactment of rebates. Unlike exemptions, the cash value of rebates does not increase as a taxpayer's marginal tax rate increases.

⁹¹ Land and Income Assessment Act 1891, schedule F.

A General Rebate was introduced in 1949, and was amended almost annually thereafter (refer Table 4.8).

Table 4.9 General Rebate (1949-1979)

Year	Maximum General Rebate
1949-55	£10 per person, £20 married couple
1956-58	£75
1959	£37s. 10d.
1960	£30
1961	nil
1962-3	£50
1964	£75
1965-6	£100
1967-9	\$200
1970-4	nil
1975	\$125
1976	\$145
1977-8	\$155
1979	\$77.50

Additional family friendly rebates were introduced in the 1970s and 1980s. These included the Young Family Rebate (1977-83), the Low Income Family Rebate (1981-83), the New Family Rebate (from 1983), and the Principal Income Earner Rebate (from 1983). These were targeted at low income families, and abated as the level of family income rose.

4.2.2.8.3 Negative taxes

Negative taxes are a form of tax expenditure whereby the government makes a direct grant to the taxpayer. The prime example of this for a personal income earner over the period was the Family Benefit, whose means-tested predecessor was introduced from 1 April 1927.⁹² Family Benefit, at a rate of 10 shillings per child per week, was made universal from 1 April 1946.⁹³ Family Benefit

⁹² Family Allowances Act 1926.

⁹³ Social Security Amendment Act 1945, s. 13, effective 1 April 1946.

was usually paid to the mother of the child and collected at the local Post Office. The rate was increased to 15 shillings per child from 1 October 1958⁹⁴ and then doubled in 1982.⁹⁵

4.3 Summary

Vertical equity suggests that unequals should be treated unequally. The New Zealand personal income tax has always manifested vertical equity in a number of ways. Aside from a progressive rates structure, a variety of measures brought about an unequal taxing of equals. Any depiction of the relative amounts of tax payable by individuals needs to take into account the range of measures listed above, which distinguished between individuals, not merely based on income levels, but also domestic situation. The following chapter illustrates the effect of the income tax on differing wage and salary earning taxpayers.

⁹⁴ Social Security Amendment Act 1958, s. 10, effective 1 October 1958.

⁹⁵ Social Security Amendment Act 1981, schedule 5, effective 21 July 1982.

Chapter 5

Income Taxation on Wage and Salary Earners to 1984

In the end, the choice of a tax rate structure is a normative choice reflecting the deep-rooted political values about the role of government and how the cost of government should be shared by the citizenry.

Sheldon D. Pollack¹

5.1 Introduction

Tax legislation has a very direct effect on the lives of taxpayers, yet few wage or salary earners ever consult the black letter of taxation law. If they hear of new tax initiatives, most taxpayers are primarily concerned not with the wording of the Act, but rather its effect on their disposable income, and how the change might affect them compared with others. The latter reflects a concern for vertical equity, that is, how individuals are made to differ.

The previous chapter provided a summary of the legislative measures that alter the incidence of income taxation between persons. In this chapter the focus shifts from the legislation itself to the actual effect of that legislation on the taxpayer, and defines the scope of this enquiry. The chapter commences by defining the time period under review, and justifies starting at 1891 and ending in 1984. Next, since vertical equity involves distinctions between persons, a range of cases needs to be considered so that these differences can become evident. Thus certain income levels and the domestic situations are defined and justified as surrogates to allow tax calculations. The resulting income tax as a percentage of gross income is then calculated and graphed. Finally, the period is divided into a sequence of episodes for a more detailed consideration in subsequent chapters of how vertical equity has been practised and justified in the New Zealand income tax.

5.2 Scope

The Land and Income Assessment Act 1891 introduced the first successful income tax in New Zealand and so provides an appropriate starting point for this study. From small beginnings the income tax grew to become the primary source of government revenue.

¹ Sheldon D. Pollack, *The Failure of US Tax Policy* (University Park, PA: Pennsylvania State University Press, 1996), 280.

Although the income tax continues to provide the lion's share of taxation revenue, the discussion ends in 1984. That year marked the start of a significant shift in New Zealand economic and taxation policy. Coming to power in 1984, the Fourth Labour Government implemented the economic policies commonly referred to as "Rogernomics," after its Finance Minister Roger Douglas. As far as income taxation was concerned, this involved a considerable rates flattening as a highly progressive multi-rate scale was replaced with a low-rate, broad-based two step structure. In fact, New Zealand came very close to having a flat (that is single rate) income tax.² This reflected a trend in the 1980s toward broad-based, low-rate income tax systems, which started with the United States' Economic Recovery and Tax Reform Act 1981,³ before becoming a "worldwide phenomenon in the last half of the 1980s."⁴

Not only did income tax policy change after 1984; so too did welfare policy. After 1984 a form of income-tested negative taxes became the primary means whereby the government effected income redistribution. Specifically the flat rate universal Family Benefit was replaced by an income-tested payment from the state to families commonly referred to as Family Support.⁵ Until 1984, the vertical equity of the income tax system could be evaluated in terms of the income tax legislation itself, adjusted for the Family Benefit. After the introduction of Family Support, both the income tax impost *and* the welfare transfers need to be taken into account in considering the impact of direct taxation between different taxpayers.

The Fourth Labour Government's changes to the taxation system went beyond the income tax. The introduction from 1 October 1986 of a value added tax known as the Goods and Services Tax marked a significant shift back to indirect and flat rate taxes. King notes that the 1984 election had "swept out of office a generation of politicians whose views and values had been formed by the Great Depression and participation in World War One."⁶ Sinclair goes further,

² A contemporary account of the role the proposed flat tax played in the eventual dissolution of the Fourth Labour Government is found in Brian Easton, "The Unmaking of Roger Douglas?" in *The Making of Rogernomics*, ed. Brian Easton (Auckland: Auckland University Press, 1989). Douglas' own account of events is found in Roger Douglas, *Unfinished Business* (Auckland: Random House New Zealand, 1993), chapter 3.

³ W. Elliot Brownlee and C. Eugene Steuerle, "Taxation," in *The Reagan Presidency: Pragmatic Conservatism and Its Legacies*, ed. W. Elliot Brownlee and Hugh D. Graham (Lawrence, KS: University Press of Kansas, 2003), 155-181.

⁴ Joel Slemrod, *Do Taxes Matter? The Impact of the Tax Reform Act of 1986* (Cambridge, MA: MIT Press, 1990).

⁵ The Family Support Tax Credit was introduced with effect from the income year commencing 1 April 1986 by the Income Tax Act 1976, part XIA. The Family Benefit was eventually repealed effective 1 April 1991 in the Social Security Amendment Act 1982, s. 7.

⁶ Michael King, *The Penguin History of New Zealand* (Auckland: Penguin, 2003), 489.

suggesting that these were the biggest taxation reforms since income tax was first introduced in 1891.⁷ These reforms overturned two longstanding features of New Zealand income taxation by reducing progressivity and shifting back from direct to indirect taxation. Hooper notes the significance of the changes in the 1980s:

From 1915, New Zealand politicians, up to and including Sir Rob Muldoon, would grow up in a New Zealand aware of the great political legacy left by New Zealand's first Liberal government. It was as if New Zealand's tax policy had been set in stone. As the role of government in the economy expanded, so additional revenue would be obtained by direct taxation. This became the conventional wisdom.

The younger politicians of the third [sic] Labour Government, perhaps unaware of the conventional wisdom and seduced by the Thatcherite initiative in Britain, changed the overriding tax policy of previous decades. They broke the mould ...⁸

This “breaking of the mould” is worthy of a study of its own.⁹ The significance of the shift may be assessed against what it replaced, namely the income tax-based system instituted in 1891. Given the significant changes made to the system after 1984, the election of the Fourth Labour Government in 1984 provides the cut-off point for this study.

5.3 Incomes and Domestic Situations

In theory, there is any number of ways to distinguish between taxpayers within a society, such as citizenship status,¹⁰ ethnic origin,¹¹ or place of abode.¹² However, the previous chapter suggests

⁷ Keith Sinclair, *A History of New Zealand* (Auckland: Penguin, 1991), 323.

⁸ Keith C. Hooper, “Tracing the Origins of Taxation,” in *Tax Policy and Principles: A New Zealand Perspective*, ed. Keith C. Hooper et al. (Wellington: Brookers, 1998), 19-20. The reference is, in fact, to the fourth Labour Government (1984-1990). Elsewhere Hooper speaks of the shift to direct taxation under the Liberal Government of the 1890s as inaugurating “a taxation policy that lasted for over eighty years,” refer Keith C. Hooper, *Taxation as a Social Phenomenon: An Historical Analysis: Discussion Paper No. 93* (Palmerston North: Massey University Department of Accounting, 1989), 17.

⁹ In part this is provided by the essays in Richard Krever and David White (eds.), *GST in Prospect and Retrospect* (Wellington, New Zealand: Brookers, 2007).

¹⁰ James Coffield, *A Popular History of Taxation: From Ancient to Modern Times* (London: Longman, 1970), 3: “The ancients, and especially the Romans, took a very natural, if selfish view of taxation. The main burden of their taxes did not fall on Roman citizens. It fell on those who were not citizens, their subject peoples living in the provinces. That was what the provinces were for ... We have a long way to travel before we reach the modern notion that a citizen is born in order to be taxed”.

¹¹ The Chinese poll tax is a case in point: Manying Ip, *Dragons on the Long White Cloud: The Making of Chinese New Zealanders* (Birkenhead: Tandem Press, 1996), 108.

that two main factors have differentiated individuals for income tax purposes, namely income level and domestic situation. The first has mainly been effected by some form of progressive rates structure, whereby those on higher incomes are levied income tax at a higher rate of tax, and by way of a general exemption from tax on incomes below a particular level. The second, domestic situation, has been effected by means of various exemptions or rebates that depend on the taxpayer's marital status (such as the Dependent Spouse or Child Exemption), or by way of a redistribution (notably Family Benefit).

Vertical equity suggests that individuals are distinguished on the basis of particular characteristics. In the case of the income tax there is a variety of ways in which taxpayers might be distinguished. Given this variety, a range of cases needs to be considered to illustrate the effect of the income tax on differing individuals. This will provide an indication of the shape of vertical equity in the income tax in New Zealand over the period as a whole, and also give an indication of significant episodes of change in the New Zealand personal income tax. Given the significance of (pre-tax) income level and domestic situation on taxation, the income tax will be calculated at three income levels and in three domestic situations as follows:

- Income level: Low, Medium, High
- Marital status: Single, Married with no children, Married with three children under sixteen years of age.¹³

This yields a matrix of nine scenarios, as per Figure 5.1.

¹² An example of geographical differentiation is provided by the regional petrol tax introduced to the New Zealand Parliament on 25 October 2007 in the Land Transport Management Amendment Bill.

¹³ The terms "marital" and "married", and the related "husband" and "wife", are appropriate in this context. Not only were they used in tax legislation throughout the period, they also reflected both the social expectation of marriage as the appropriate form of intimate domestic arrangement throughout the period, but also the fact that, as in the United States Federal law today, tax law did not allow for non-marital intimate arrangements.

		Domestic situation			
		Single	Married, no children	Married, two children	Married, three children
Income level	Low income				
	Medium income				
	High income				

Figure 5.1 Matrix of taxpayer situations

5.3.1 Income

If a taxpayer's level of income determines their level of taxation, what might constitute a low, medium, and high level of income? The definition of each presents a number of challenges, particularly for the early years. This is partly due to a shortage of aggregated data,¹⁴ particularly in the years prior to the compulsory filing of income tax returns. In attempting to survey New Zealand income distribution, economist Brian Easton comments that, "Despite being a central concept in economics, an individual's income is by no means easily defined,"¹⁵ before proceeding, with difficulty, to define income for his purposes using various official sources.¹⁶ However, he limits his research to the post-World War Two era.

Historian David Thomson notes the same problem. Writing in 1986, he uses official sources from the New Zealand Inland Revenue Department and the Department of Statistics, but again only from 1945 onwards, when records became more comprehensive and reliable. Yet he notes that, "All household surveys must disappoint the historian of generations ... Even the best of series as yet encompasses only a fraction of an individual lifetime."¹⁷ Going further back in time, a research project on the working class in Caversham, Dunedin focused on class rather than

¹⁴ G. W. Clinkard, "Wages and Working-hours in New Zealand 1897-1919," in *New Zealand Official Yearbook 1919* (Wellington: NZ Government Printer, 1919), 860-935.

¹⁵ Brian Easton, *Income Distribution in New Zealand* (Wellington: New Zealand Institute of Economic Research, 1983), 8.

¹⁶ *Ibid.*, 14-20.

¹⁷ David Thomson, *Selfish Generations? How Welfare States Grow Old* (Knapwell, Cambridge: White Horse Press, 1996), 124.

income, and does not appear to have published any income data as such.¹⁸ Greasley and Oxley produced an incomes series going back to 1873.¹⁹ However, although their series provides some evidence as to the relative movement in wages, it does not identify actual levels of income, and is limited to wages income only.

Such income data as is available often begs questions concerning the definition of income (for example, are only fulltime workers included?), completeness, and reliability (since taxpayers may be motivated to either understate or overstate their income in census returns). Yet given that this thesis is focused on the concept of vertical equity and not on actual income levels as such, the focus is on relative rather than absolute differences in income. Further, given that the focus is on those who *do* pay tax, extremely low income earners are excluded from the review: at least until the 1960s they would not have been liable to much, if any, income taxation.

In calculating effective rates of tax, a simple case is considered, namely a pre-tax employment income comprising solely salary or wages. This notional taxpayer had no passive, or as the New Zealand legislation put it, “unearned” income. There was also no business income from partnership or self-employment, and the effect of owner-occupied housing or fringe benefits and other such income substitutes is ignored – not because they are irrelevant to the issue of vertical equity, but rather to enable a clearer focus on the legislative intent. Given this simple case, what might represent a low, a middle, and a high income earner?

5.3.1.1 Low income earner

The award rates confirmed by the Court of Arbitration provide a reliable indicator of full-time male wage levels in mainly blue collar-type industries. These awards were compulsory, and covered industrial unions, initially particularly those comprising lower paid workers. In 1919, the *New Zealand Official Yearbook* published G. W. Clinkard’s Honours thesis on wages and working-hours in New Zealand from 1897-1919. Clinkard noted that:

The [Industrial Conciliation and Arbitration] Act was originally designed to prevent the payment of unduly low wages in the few “sweated” industries of the colony, and for some

¹⁸ Miles Fairburn, *The Ideal Society and Its Enemies* (Auckland: Auckland University Press, 1989); Erik Olssen, *Building the New World: Work, Politics and Society in Caversham 1880s-1920s* (Auckland: Auckland University Press, 1995).

¹⁹ David Greasley and Les Oxley, “Globalization and Real Wages in New Zealand 1873-1914,” *Explorations in Economic History* 41 (2004): 26-47.

*years the tone and extent of the industrial agreements and awards registered under the Act were in marked contrast to the spirit and comprehensive nature of awards made in recent years.*²⁰

These award rates provide “a final resource embodied in the officially recorded *minimum rates of wages* as determined under the various wage laws.”²¹ However, the limitations of award rates must be noted.

First, they cover only a segment of the population, particularly unionised and generally blue-collar workers. They provide no evidence of incomes of professional or self-employed persons.

Second, the wage rates given are minimum rates. Clinkard provides anecdotal evidence, however, that the minimum rates tended to become the actual rates in many industries, although he considered that “official statistical evidence ... proves conclusively that *in the skilled and semi-skilled trades* a large proportion of the workpeople receive more than the minimum rates.”²²

Third, the weekly rates calculated were based on the full week being worked. Overtime, short-time, or lost time may have increased or decreased the worker’s income.

These matters are significant. However, notwithstanding these reservations, the award rates do provide an officially confirmed and enforceable indication of wage rates. Further, they provide official evidence of what a full-time rate of income was for all of the period under review, barring the first decade. As such, they provide reliable evidence of blue-collar wages.

Of these awards, the hairdresser’s assistant award wage will be used as a surrogate for a low income level. Their first award was effective from 22 July 1901,²³ and a continuous series may be obtained for the whole period under review. Although this award rate was always (of necessity) at or above minimum wage rates, it was merely 15 percent above the Arbitration

²⁰ Clinkard, *Wages and Working-hours*, 861.

²¹ *Ibid.*, (emphasis in original).

²² *Ibid.*, p. 898 (emphasis in original).

²³ New Zealand Department of Labour, “Wellington Hairdressers’ Award (22 July 1901 to 21 July 1903)” in *Awards, Recommendations, Agreements, etc. Made under the Industrial Conciliation and Arbitration Act, New Zealand, from 1st July, 1900, to 30th June 1901* (Wellington: Government Printer, 1902).

Court's basic wage of 1936,²⁴ and around 30 percent above the low legislated minimum wages between 1951 and 1966.²⁵ Comparisons with quinquennial census median income data as reported in the *New Zealand Official Yearbook* are indecisive, due to the limitations of the self-reported data, and the lack of clarity as to whether only full-time earnings were included.

Compared to the 22 awards in force in 1911 surveyed by Clinkard,²⁶ the hairdressers' award was third equal lowest, being on a par with flour mill employees, even though the hairdressers' award specified the second longest prescribed working hours (55 per week – butchers worked 56). It was higher only than the awards for drivers and bootmakers. Weighting all awards listed by Clinkard for the number of employees affected yields a mean award rate of £146, compared with the hairdressers' award of almost £125, a variance of almost one standard deviation (standard deviation = 22.2).

Hairdressing continued to be a low paid occupation to the end of the period under review. As late as 2005, a New Zealand Department of Labour report spoke of difficulty in recruiting hairdressers, as individuals were not prepared to take up the positions on offer at current wages and working conditions. It went on to suggest that “wages for hairdressers were more than 30 percent lower than the average wage of all trade occupations in 2004.”²⁷ These considerations suggest that a hairdresser's assistant's award rate provides a suitable surrogate for a lower income earner.

5.3.1.2 Middle income earner

As a surrogate for a middle income, the hairdresser's award rate was doubled. Middle income earners would include middle management and some employed professionals, and it is difficult to determine what their income might have been, given the mixed nature of the income, the various deductions they might have claimed, their concern for secrecy, and the likelihood of avoidance and evasion.

²⁴ The Basic Wage for an adult male was set at £197 12s. by the Arbitration Court – refer *New Zealand Official Yearbook 1937* (Wellington: NZ Government Printer, 1936), 670.

²⁵ Peter Brosnan and Frank Wilkinson, *Low Pay and the Minimum Wage (Vol. 2)* (Wellington: New Zealand Institute of Industrial Relations Research, 1989).

²⁶ Clinkard, *Wages and Working-hours*.

²⁷ Department of Labour, *Skill Shortage Assessment, Occupation: Hairdresser*, <http://www.dol.govt.nz/PDFs/trade-report-hairdresser.pdf> (accessed May 16, 2008).

Median wage figures might have provided a surrogate for a middle income, but such data are lacking in the early years. It is also subject to definitional problems: full-time versus part-time, the effect of age-related wage rates (such as apprentice or youth rates), and male versus female rates would all need to be distinguished. It is not clear that these distinctions are made in the series that are available. Further, the effect of outliers would likely exaggerate the median.

Given that the hairdresser's award rate was a little, though not significantly, over the minimum wage rate, a doubling of this rate would suggest a comfortable living standard. It also provides a wage that in 1911 was 34 percent above that of waterside workers award, which was the highest award rate included by Clinkard.²⁸

By way of comparison, in 1991 the hairdresser's award rate of \$17,705 adjusted by the CPI movement yields an income of \$24,500 in June 2007. The average hourly earnings for workers receiving wages and salaries in the June 2007 quarter of \$21.41,²⁹ or \$42,820 per annum based on a forty hour working week. This is 75 percent higher than the adjusted hairdresser salary, and suggests that a doubling of the hairdresser award rate provides a not unreasonable surrogate for a medium income, certainly at the end of the period under review. It also marks a distinct increase on the assumed low income figure, which allows comparisons of taxation to be made with a low income.

5.3.1.3 High income earner

A number of avenues were investigated to identify an appropriate surrogate for a high income. The salaries of certain high officials were noted from the several Civil List Acts. The Prime Minister's salary was set at £1,000 in 1887,³⁰ although this may not have reflected a "market" rate, given the *pro bono* public service expectations of leaders at the time.³¹ At the same time the

²⁸ Clinkard, *Wages and Working-hours*, 917-32.

²⁹ Department of Statistics, *Hot Off the Press: New Zealand Income Survey: June 2007 Quarter* (Wellington: Department of Statistics, 2007).

³⁰ Civil List Act 1873.

³¹ Martin notes that, "In 1892 the Payment of Members Act replaced the honorarium with an annual salary. This recognised that politicians worked year-round, and at £240 was sufficient to enable working men to enter the House." John E. Martin, *The House: New Zealand's House of Representatives 1854-1990* (Palmerston North: Dunmore Press, 2004), 100. Inadequate parliamentary wages remained a serious bone of contention; only in the late 1970s was this matter resolved (p. 247).

Chief Justice's salary was set at £1,700, and the other Supreme Court judges received £1,500.³² The governor, however, received £5,000 (tax free!)³³ in 1891 – a princely sum indeed.

An initial attempt was made to use the Supreme Court justice's salary of £1,500 in 1892 as a surrogate for a high income. Such a salary was just over 13 times the hairdressers' award rate in 1892. However, the results proved to be unsatisfactory. Adjusting this £1,500 salary by the CPI yielded an income that fluctuated from seven to twenty times the hairdresser's income. This highlights the fact that prices and wages do not move in tandem – in part due to external factors such as world prices, or war affecting prices well before any impact on wages may be evident; in part due to regulatory factors restraining wage movements, such as the workings of the industrial arbitration system, or the effect of incomes policy.³⁴

A second attempt at indexing involved calculating a wages index from a variety of sources. Applying this index (rather than the CPI) to the Supreme Court Justice's salary again provided a range from the hairdresser's wage between 11 and 17 times. Comparing the resulting incomes from either the CPI or the wages index series against the income data included in the Department of Statistics *Incomes and Income Tax*³⁵ series suggested that these incomes fell within the top 1 percent, and in some years the top one-tenth of one percent of incomes returned by individuals in New Zealand. Certainly the Department of Statistics data needs to be treated with caution: it includes both part-time and full-time incomes, but excludes any incomes which fall below the return threshold. It is also not possible to isolate the effect of income splitting by the use of trusts or companies, or of tax avoidance and evasion. On balance, however, it seems likely that the calculated high income surrogate would be excessive vis à vis the medium or low income.

Vertical equity is defined in relative, rather than absolute, terms. For the purposes of this thesis, interest lies in the relativities of income taxation on low, medium, and high incomes. A high income might be popularly described as any income that exceeds mine – although this is a better definition of envy than of a high income. Rather, for the purposes of comparison, a high income

³² Supreme Court Judges' Salaries Act 1904, s. 3.

³³ Member of Parliament Taylor objected to the Governor's tax exemption – refer *New Zealand Parliamentary Debates*, vol. 73 (18 August 1891), 343.

³⁴ Jonathon Boston, *Incomes Policy in New Zealand: 1968-1984* (Wellington: Institute of Policy Studies, Victoria University, 1984).

³⁵ See, for example, Department of Statistics, *Statistics of Incomes and Income Tax of Persons: A Volume of Statistics Consolidating Earlier Releases, with Some Additions* (Wellington: Department of Statistics, 1984).

should be recognised as such qualitatively, though it might also be confirmed quantitatively. By way of example a mean hourly earnings rate of \$21.41 in June 2007 translates in to an annual income of approximately \$43,000. The median of \$18.00 per hour translates to an annual income of \$36,000. On this basis, any income of over \$100,000, or 2½ times the average income, might be considered to be high. However, it would not be sufficiently high to demonstrate the progressivity of the rates scale, particularly as the original exemption level of £300 in 1892 essentially shielded incomes even of this magnitude from any income tax. Even setting the “high” income at ten times the hairdresser’s wage does not subject the high earner to the highest marginal tax rate in all years.

Given the significant uncertainties as to what might constitute a high income, it was decided to use the hairdresser’s income as a base, and to multiply this ten-fold, rounding the result to avoid unnecessary complexity of calculation. The results permit a comparison to be made between a low, medium, and high income, defined as once, twice, and ten times the basic hairdresser’s award wage rate respectively. The starting point falls below some known incomes at the start of the period, such as the Prime Minister’s, Supreme Court Justices’, or Governor’s. However, it considerably exceeded an ordinary worker’s wages. As a check, an hourly rate of \$13.83 in June 2004³⁶ and a move in the wages index of approximately 20 percent from then until 2007 yields a hairdresser’s wage of \$16.60 per hour. Given a 40 hour week indicates a hairdresser wage of \$33,200. Ten times this yields a high salary of some \$332,000 in 2007 – clearly a very high, though not unrealistic, income level for that year.

5.3.2 Family situation

Besides income level, the income tax liability was also affected by the taxpayer’s domestic situation. Taxpayers were mainly distinguished in two ways: marital status, and children.³⁷ This suggests three typical cases: single, married with no children, and married with children.

A male breadwinner is assumed. Where the male is married, it is assumed that his wife has no independent assessable income. This assumption reflects aspects of the tax structure which included features such as the Dependent Spouse and Child Exemptions, and the Family Benefit. It also reflects the wages award setting process, which in the words of the President of the

³⁶ Department of Labour, *Skill Shortage Assessment*.

³⁷ Other provisions addressed age, live-in dependents other than children, and housekeepers.

Arbitration Court based award rates on the worker's being "regarded as a social unit, rather than as an economic unit."³⁸ The Industrial Conciliation and Arbitration Amendment Act 1936 codified this norm:

*The basic rate of wages for adult male workers fixed under the authority of this section shall be such a rate as would, in the opinion of the Court, be sufficient to enable a man in receipt thereof to maintain a wife and three children in a fair and reasonable standard of comfort.*³⁹

The *Australian Harvester Case* of 1907 had set this pattern:

*Somewhat arbitrarily, he [Mr Justice Higgins in the Harvester case] settled on three children as the average number of offspring that his basic wage was meant to maintain, and he based all subsequent awards on his family of five.*⁴⁰

Castles refers to the *Harvester Case* in arguing that Australasian welfare policy was based on:

*... family policy in the sense that it assumed that wages should be set at a level sufficient to support the wage-earner and a number of dependents. Such an assumption may have been a natural one in the context of systems devised at the turn of the century, when families were both larger than today and married women were less frequently a part of the workforce.*⁴¹

³⁸ James Holt, *Compulsory Arbitration in New Zealand: The First Forty Years* (Auckland: Auckland University Press, 1987), 157.

³⁹ Section 3(4).

⁴⁰ Stuart MacIntyre, *Winners and Losers: The Pursuit of Social Justice in Australia* (Sydney: Allen and Unwin, 1985), 57. This norm was not fixed: In 1925 the President of the Arbitration Court had declared that "When a trade is prospering the worker can still obtain, and does obtain, the current market value of his work, but he must not, in times of trade depression, be paid less than the wage which is regarded for the time being as sufficient for the maintenance of himself, a wife and two children, plus an additional payment based on his skill and certain other factors." See also Holt, *Compulsory Arbitration*, 157f.

⁴¹ Francis G. Castles, *The Working Class and Welfare: Reflections on the Political Development of the Welfare State in Australia and New Zealand, 1890-1980* (Wellington: Allen and Unwin, 1985), 88.

This pattern continued beyond World War Two, when:

Social policy, for both Maori and Pakeha, for all were equally eligible [after World War Two], was directed to a family wage that enabled a man (for it was very gender specific) to maintain adequately a wife and three children.⁴²

This pattern remained the norm at least until the end of the “Baby Boom” in the early 1970s:

At least for Pakeha ... given the maintenance of a gender division of labour within the family – the wife staying at home and the husband being the wage earner – individual incomes given some general notions of household [income] levels and patterns.⁴³

Certainly, women were employed in the workforce. However, married women in particular had relatively low, though increasing, participation rates in the full-time workforce during the period under review. Davies comments, “Throughout history, men have always held the dominant share of the full-time labour force. In 1975, women represented only 29 percent of the full-time labour force.”⁴⁴ It had been considerably lower before then. The selection of a male breadwinner reflects their predominance in the New Zealand full-time workforce and in social policy; the income taxation of (married) women is beyond the scope of this thesis.

5.4 Effect of the Income Tax on Taxpayers

Given these surrogates for income levels and domestic situations, what did the income tax look like to a range of taxpayers from 1892 to 1984? The graphs that follow illustrate the effect of income levels, and then the effect of family situation, on income taxation during the whole period under review. These graphs include the effects of all surtaxes and levies, as well as all the deductions and rebates permitted to taxpayers that were detailed in the previous chapter. They also include the effect of Family Benefit in the case of a married taxpayer with children. Bearing in mind the simplifying assumptions made, they provide an indication of how the legislation, as

⁴² Ian Pool, Arunachalam Dharmalingham and Janet Sceats, *The New Zealand Family from 1840: A Demographic History* (Auckland: Auckland University Press, 2007), 201.

⁴³ *Ibid.*, 173.

⁴⁴ Lisa Davies, *Women’s Labour Force Participation in New Zealand: The Past 100 Years* (Wellington, Social Policy Agency, 1993), p. 117.

drafted, intended to differentiate between differently situated taxpayers. To put it simply, they reflect how the income tax reflected vertical equity, and how this changed over time. Figures 5.2 through 5.4 indicate the effect of income level on a taxpayer, holding the domestic situation constant. Figures 5.5 through 5.7 show the effect of domestic situation on vertical equity, this time holding income level constant.

In presenting these charts as evidence of the practice of vertical equity, certain simplifying assumptions are made concerning the tax legislation. First, it is assumed that the legislation reflects the intention of the majority of the Legislature. This does not mean that it perfectly reflects the view of Parliament: clearly there will always be a discrepancy between what is intended (or even desired) and what is enacted. This may result from administrative or informational limitations, or simply fiscal constraints that prevent the ideal from being attained. It may arise from the compromise that is inherent in a democratic parliamentary system: there will always be a degree of give and take, and also of dissent. There may also be drafting errors or failings that require subsequent amendment. However, in broad terms, what *was* legislated is taken to be what was *intended* to be legislated.

Secondly, it is assumed that the tax rates, as legislated, reflect what was considered appropriate by Parliament; assuming complete compliance, the resulting tax impost would reflect what Parliament intended. This assumption avoids the need to address the (important) questions of the effect of tax avoidance and evasion.⁴⁵ Although it may be true that tax rates are set higher than would be necessary were there no evasion or avoidance, the presence of anti-avoidance sections and the enforcement of taxation as enacted suggest that Parliament intended all to pay the legislated amount of income tax – that Parliament considered the resulting tax structure to be fair, or at least the fairest possible. Besides, simple wage and salary earners are least able to avoid or evade income tax on their incomes, particularly where tax is withheld at source.

5.4.1 Effect of income level on taxation

Figure 5.2 illustrates the effective rate of income tax on a single low, middle, and high income earner.

⁴⁵ Patrick J. Caragata, *The Economic and Compliance Consequences of Taxation: A Report on the Health of the Tax System in New Zealand* (Boston, MA: Kluwer Academic Publishers, 1998).

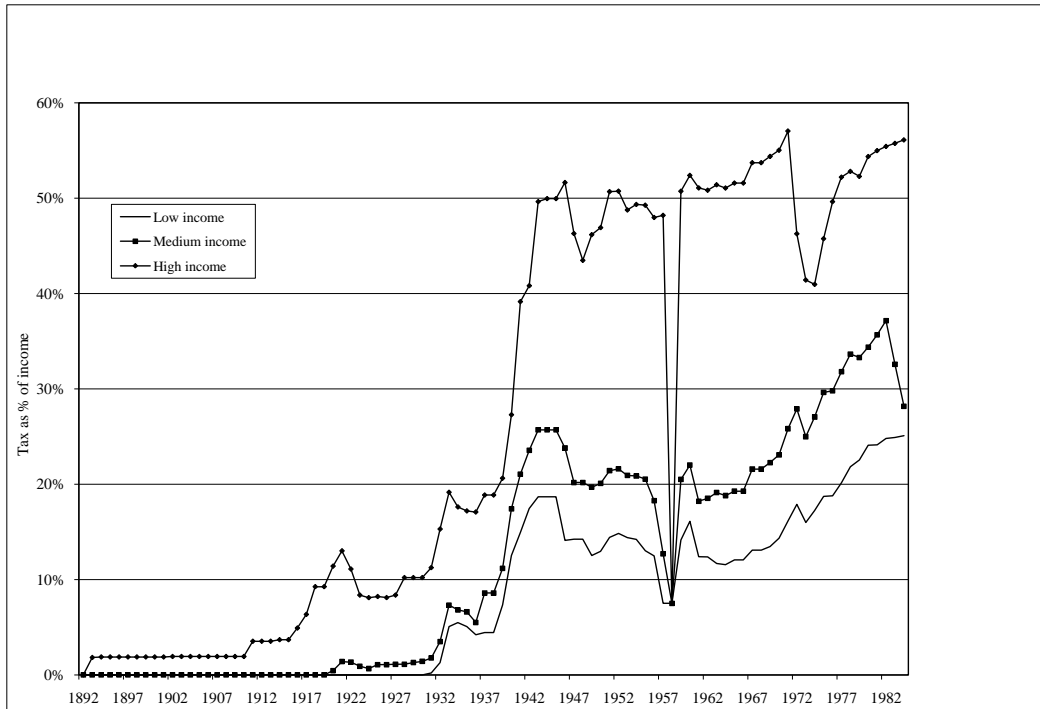


Figure 5.2 Rate of tax on a single income earner at three income levels

Low income earners effectively remained exempt from the income tax until the 1930s, and those on median incomes paid minimal amounts of tax before then. Both were caught in the tax net during the depression, and faced higher rates during World War Two, with rates not falling back to previous levels following the war.

Single high income earners paid income tax at a rate below 5 percent until the later years of World War One, after which the tax fell. The income tax started to rise again during the Depression and following the introduction of Social Security, and particularly during World War Two. It fell slightly following the cessation of hostilities, though it eventually rose to levels previously unreached. The significant dip in the late 1950s, around the time of the introduction of PAYE, is discussed in chapter 12.

A similar pattern holds for married taxpayers as illustrated in Figure 5.3. The only difference is the effect of the Dependent Spouse Exemption from 1933.

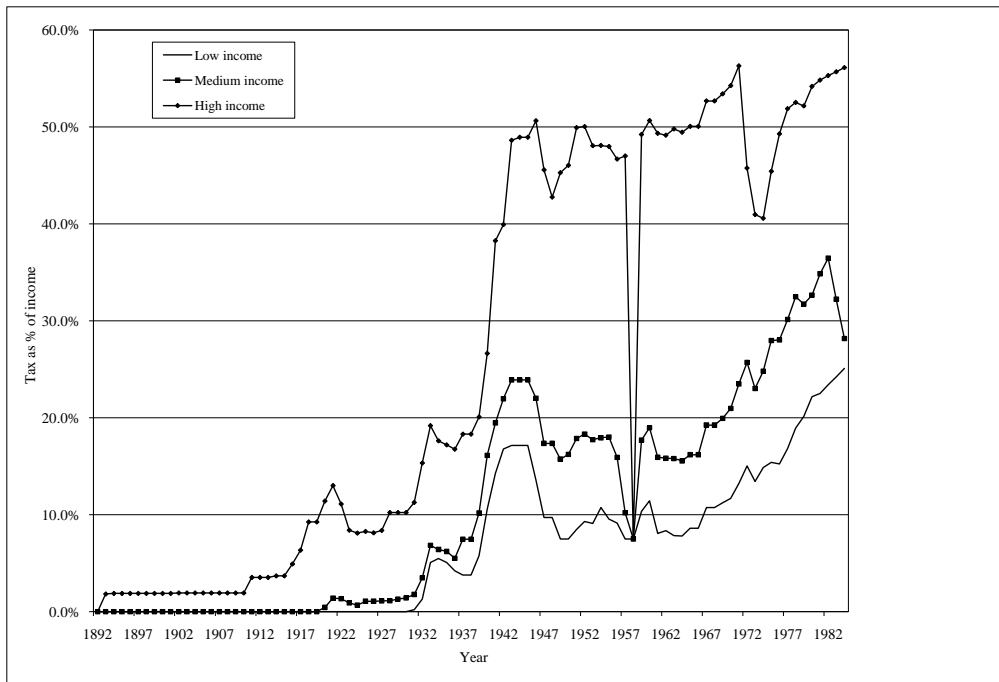


Figure 5.3 Rate of tax on a married income earner with no children at three income levels

The effect on taxpayers with three children is illustrated in Figure 5.4. The effect of the Child Exemption, and more particularly of Family Benefit, is clearly evident in the case of low and middle income earners. The pattern remains similar for high income earners. A hairdresser with three children earning the award rate effectively had a net negative amount of tax to pay from 1947 to 1971.

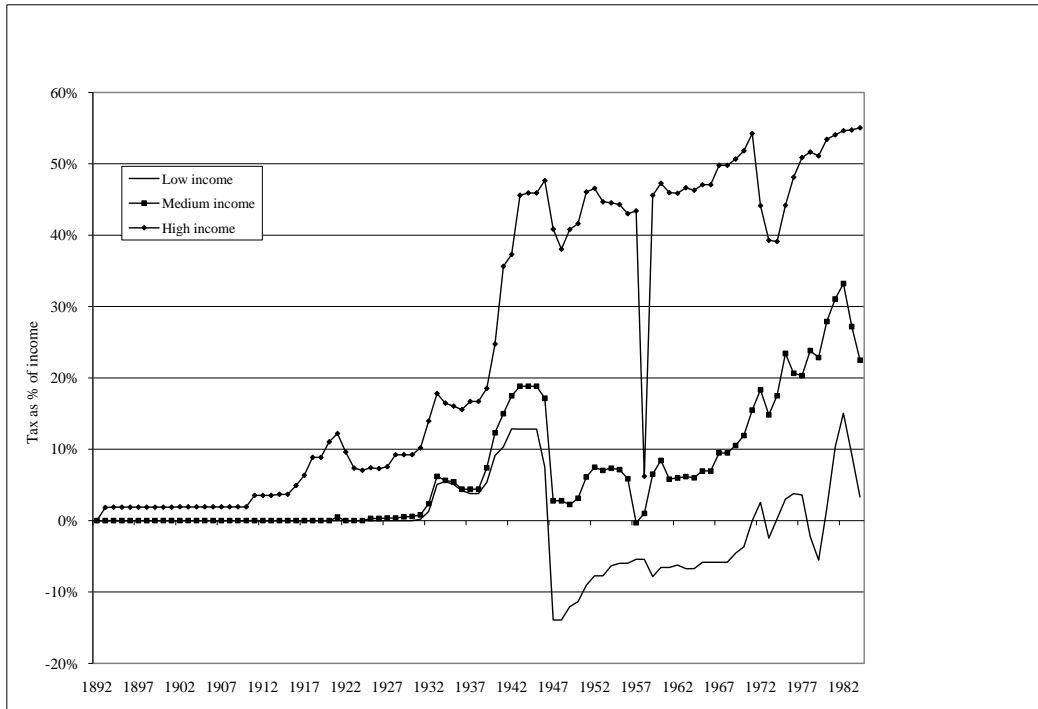


Figure 5.4 Rate of tax on a married income earner with three children at three income levels

5.4.2 Effect of domestic situation on taxation

The effect of family circumstance may be illustrated by comparing the effect of differences in family circumstances on various levels of income. A pattern is evident from the 1930s; single taxpayers have a higher tax liability than married taxpayers, who in turn face a higher impost than low income earners. This is due to the effect of the various rebates, and, since 1947, of Family Benefit.

Figure 5.5 illustrates the effect of different domestic situations on a low income. No tax was payable until the early 1930s, as the income was below the general exemption level. From 1 December 1930 the unemployment levy (subsequently the Social Security Levy) came into effect.⁴⁶ Two significant changes are evident: the increase in direct taxes on low income earners in the 1930s and 1940s, and the effect of Family Benefit on taxpayers with children from 1 April 1946.

⁴⁶ Unemployment Act 1930, s. 6.

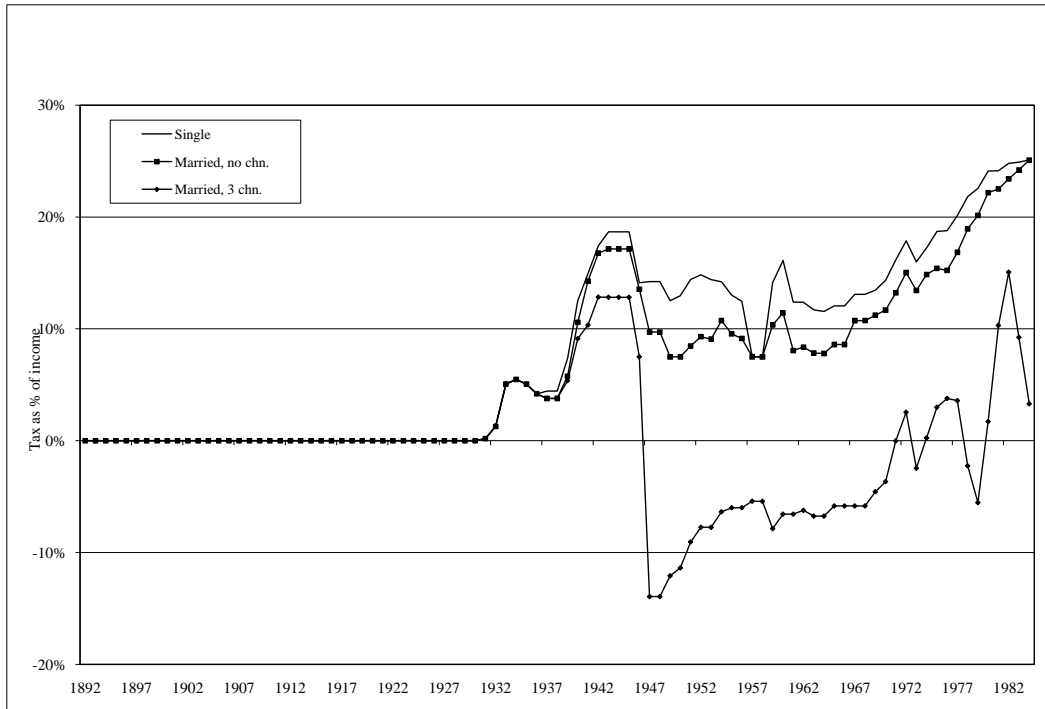


Figure 5.5 Rate of tax on a low income earner in three household situations

A similar pattern is evident for a middle income earner in Figure 5.6, but at a higher tax level.

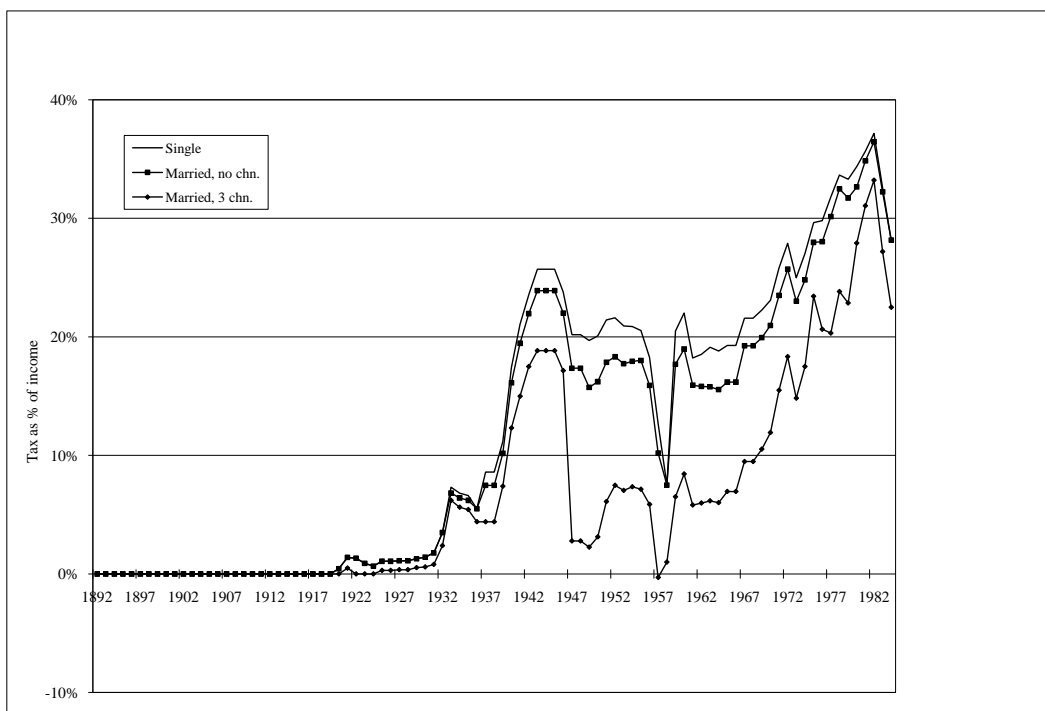


Figure 5.6 Rate of tax on a medium income earner in three household situations

The effect of Family Benefit is muted in the case of a high income earner, as this benefit constituted a very minor percentage of total income. However, Figure 5.7 indicates that families were taxed more lightly than those without children, due initially to the Child Exemption, and then the Family Benefit, and that this was the case even for high income earners.

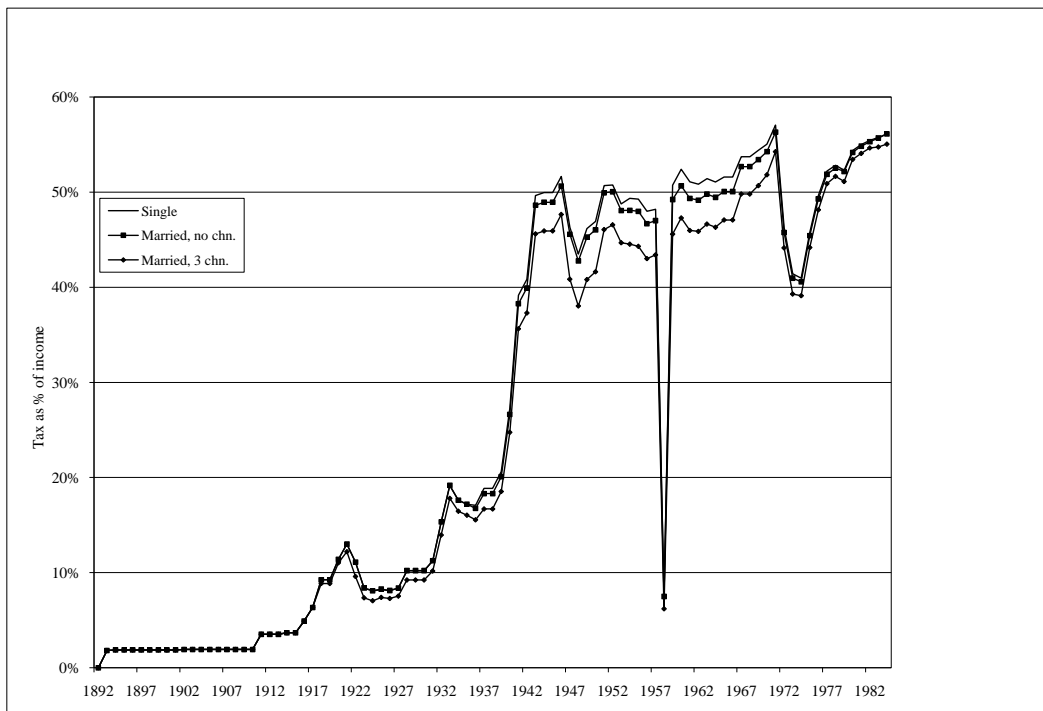


Figure 5.7 Rate of tax on a high income earner in three household situations

5.5 Identification of Key Episodes

The above graphs indicate a sustained increase in the income tax over the short century from 1891 to 1984. However, a closer look indicates spurts of rapid increase interspersed with sustained periods of relative stability. These times of change generally correlate with major external events such as war or economic depression. The latter, in particular, motivated a significant change in the role of government.⁴⁷ In general, governments undertook a much larger share of the nation's economic activity, and focused increasing attention on distributive concerns. As the role of the income tax increased, interpersonal concerns magnified in importance.

⁴⁷ Buchanan critically refers to the Twentieth Century as the "socialist century," refer James M. Buchanan, *Why I, Too, Am Not a Conservative: The Normative Vision of Classical Liberalism* (Cheltenham: Edward Elgar Publishing, 2005), 9.

5.5.1 The increasing significance of the income tax

These graphs indicate changes in the practice of vertical equity. Most obviously, at the beginning of the period the income tax was levied only on high incomes. By the end of World War Two almost all earners were subject to the income tax. Further, the rate of tax multiplied. The Parliamentary Debates will provide some insight into the thinking behind changing practice of vertical equity. To structure this discussion, the period is divided into episodes. After the initial introduction of the income tax, successive periods reflect either a period of stability in the income tax, or of change.

Taxation as a whole increased during the twentieth century. Figure 5.8 indicates the increasing ratio of total taxation to GDP. This ratio remained below 10 percent until World War One. It increased during World War One, before slowly falling following the 1918 Armistice, though not back to pre-war levels. It again increased during the Depression years, and particularly during World War Two. Although it fell after both world wars, the income tax did not fall back to pre-war levels, and subsequently surpassed wartime levels during peacetime.

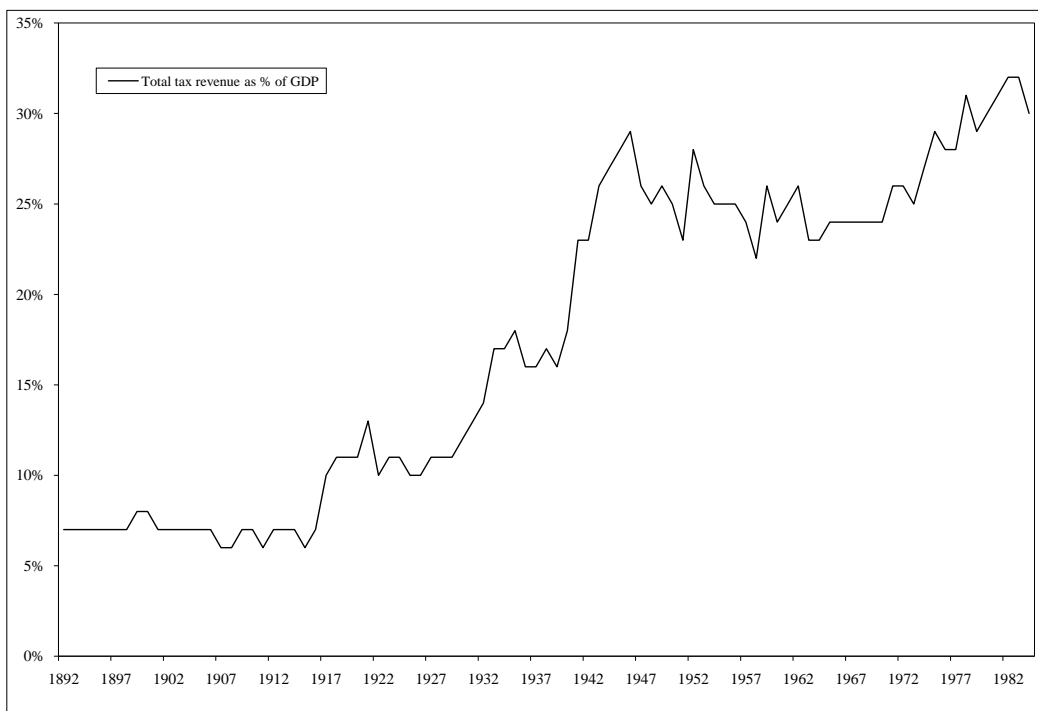


Figure 5.8 Total tax revenue as a percentage of GDP

Source: *New Zealand Official Yearbooks*

This growth in overall taxation was fuelled by the increase in the income tax. World Wars One and Two and the Great Depression occasioned massive increases in the government's reliance on the income tax, and that reliance grew even further after World War Two. By the early 1980s, around three-quarters of total tax revenue was derived from income taxation.

Over the period the income tax grew to become the most significant source of government taxation revenue. In the year to 31 March 1893, the first year it was collected, income tax comprised a mere 3 percent of total government taxation revenue, of which the *personal* income tax contributed about half. By 1984 it amounted to more than 70 percent of total tax revenue (Figure 5.9), of which the personal income tax contributed some 82 percent.⁴⁸ The income tax also became a universal or democratic tax: whereas in 1892 only high income earners were subject to it, by 1984 all earners paid income tax, as there was no tax-free threshold or exemption level.

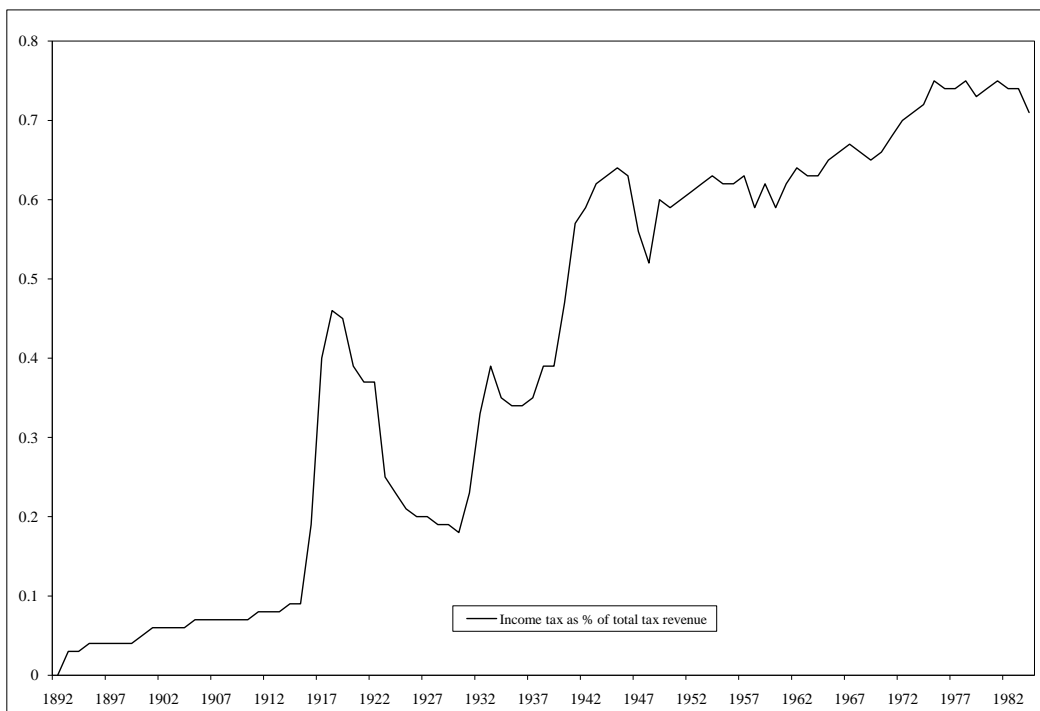


Figure 5.9 Income tax revenue as a percentage of total tax revenue

Source: *New Zealand Official Yearbooks*

⁴⁸ Derived from *New Zealand Official Yearbooks*. The analysis of company versus personal tax in 1984 derived from: Department of Statistics, *Statistics of Incomes and Income Tax of Persons 1983-84* (Wellington: Department of Statistics, 1987); and Department of Statistics, *Incomes and Income Tax of Companies 1983-84* (Wellington: Department of Statistics, 1987). Companies' income tax assessed 1983-84: \$1,261,810,000, whereas total all persons (non-company) tax assessed of \$5,626,360,000.

Meantime, the Land Tax was eclipsed as a source of revenue. Although it contributed around three-quarters of the direct tax revenue before 1900, by 1945 it provided barely 1 percent, and was never resuscitated. It was abolished effective 1 April 1992.⁴⁹

As the size of the income tax grew during the twentieth century, popular discussions of taxation effectively became discussions of the income tax, except when the annual budget periodically increased the excises on beer, cigarettes, and petrol. Yet unlike indirect taxes which were almost always levied at flat rates, the New Zealand income tax has always been progressively structured. Hence, while discussions about the equity of a particular excise tended to focus on the legitimacy of the tax itself, discussions of the income tax were more focused on interpersonal fairness. The income tax provides a means of distinguishing between persons, and increasingly so as its significance increased during the twentieth century.

5.5.2 Splitting into episodes

Despite the appearance of almost constant change in the income tax at least since 1910, certain patterns are evident. In part these may reflect changes in Parliament's views as to what distributive justice, and vertical equity in particular, should look like; indeed, Parliamentarians expressed substantial differences on this matter at the introduction of the income tax, and continued to do so. Figures 5.2 to 5.7 indicated certain key periods of change in the income tax. After its introduction, the tax increased significantly during World Wars One and Two, and during the early 1930s. Aside from those flash points, it remained relatively stable, though far from static. In particular, the effective rates of tax crept upwards after World War Two, especially for low and middle income earners. These periods of change suggest changes in the philosophy of the income tax, and particularly in beliefs as to how unequals should be treated.

5.5.2.1 Governments

Election manifestoes often proclaim how a party's ideology will affect taxation policy and at times the rhetoric is enacted, as it was by the Liberals in 1891 and again by the Fourth Labour Government after 1984. However, any government is constrained in various ways: by macro-economic considerations, by world events that are often beyond its control, and, not least, by the

⁴⁹ Land Tax Abolition Act 1990. See also Barry F. Reece, "The Abolition of Land Tax in New Zealand: Searching for Causes and Policy Lessons," *Australian Tax Forum* 10 (1993): 223.

need for a mandate from the electorate every three years. Yet despite a three year parliamentary term, Table 5.1 indicates that most governments survived for longer than a single term. Besides, under New Zealand's then "first-past-the-post" electoral system, most elections were "two-horse races," which also resulted in policy platforms tending to converge.

Table 5.1 Governments of New Zealand (1891-1984)⁵⁰

Government	Years	Tenure (years)	Prime Ministers⁵¹
Liberal	1891–1912	21	Ballance (1891-93) Seddon (1893-1906) Ward (1906-12)
Reform	1912–1928	16	Massey (1912-25) Coates (1925-28)
United	1928–1931	3	Ward (1928-30) Forbes (1930-31)
Liberal-Reform Coalition	1931–1935	4	Forbes (1931-35)
First Labour	1935–1949	14	Savage (1935-40) Nash (1940-49)
First National	1949–1957	8	Holland (1949-57) Holyoake (1957)
Second Labour	1957–1960	3	Nash (1957-60)
Second National	1960–1972	12	Holyoake (1960-71) Marshall (1972)
Third Labour	1972–1975	3	Rowling (1972-74) Kirk (1974-75)
Third National	1975–1984	8	Muldoon (1975-84)

The election of the Liberal Government in 1890 heralded the arrival of party politics in New Zealand. The income tax introduced by the Liberal Government in 1891 was maintained at a low rate and only on high income earners throughout the Liberals' stay on the Treasury Benches.

⁵⁰ King, *Penguin History of New Zealand*, 533-5.

⁵¹ Excluding any holding office for less than six months.

From July 1912 until December 1928 the more conservative Reform Party was in power, first under Prime Minister William Massey until his death in 1925, and then under Gordon Coates from 1925 to 1928. Although the income tax had been introduced by the Liberal Party, it was extended under Massey and Forbes, and began to affect middle income, though not lower paid, earners. World War One significantly affected the tax payable by high income earners, with the income tax peaking at 7s. 6d. in the pound (37½ percent) in 1918 to 1920, only to track down again in the 1920s. Admittedly, the top rate only affected extremely high incomes.⁵² However, the rates never returned to pre-World War One levels. Certainly, the Child Exemption was introduced from 1915, but this did not affect a low income earner.

Three parties were in power during the Depression years: the United Party was a short-lived reincarnation of the Liberals, and was followed by a Coalition of the United and Reform Parties in the face of the economic Depression and the growth of the political wing of the Labour movement. Significantly, direct taxation rose during this economically depressed time, and affected all income earners, due to the imposition of a flat rate unemployment tax on all levels of income from 1 December 1930.⁵³

Although increased tax on higher incomes is evident following the election of Labour in 1935, any longer term effects consequent upon Labour's introduction of the Social Security Act in 1938 is disguised by the onset of World War Two and the consequent financial demands of war. Following the war, tax rates again fell slowly with the cessation of hostilities, though again not to pre-war levels.

The period from the end of World War Two to around 1970 was generally a time of prosperity in New Zealand. Although they fluctuated from year to year income taxes continued to rise. The universalisation of the Family Benefit in 1947 significantly altered the net tax payable by families with children as opposed to singles or couples without children. For most of this period, the more conservative National Party, with its rural roots, was in power, and New Zealand enjoyed consistent prosperity, interrupted by the occasional crisis, often related to export prices or balance of payments issues.

⁵² This highest rate only applied to incomes in excess of £6,400, which is 4 ½ times the high income used in this thesis. Adjusting a £6,400 income by the CPI would yield an income of over \$700,000 p.a. in 2007.

⁵³ Unemployment Act 1930, s. 6.

Finally, the 1970s and 1980s were times of economic difficulty. External economic shocks such as Britain's entry into the European Economic Community in 1973, the oil shocks in that same year and in 1979, and the advent of stagflation, a situation where inflation and economic stagnation occur at the same time, impacted on the government's fiscal position. The National Party, dominated by its Finance Minister and then Prime Minister Robert Muldoon, was in power for most of this period, with the exception of the Labour Party's one three year term under Norman Kirk from 1972 until his death in 1974 and Bill Rowling from 1974 to 1975.

In general, conservative parties (such as Reform, National) rarely innovated in taxation matters, but usually retained and tweaked policies first introduced by the Liberal and then the Labour Party. Hence the income tax introduced by the Liberals was not repealed by the Reform Party in 1912. Nor was Social Security repealed by the National Party in the 1950s, despite their vocal opposition to it whilst on the Opposition benches. Yet some changes may be related to political considerations. Certainly the original introduction of the income tax by the Liberals was consistent with their social reformist mindset. The universalisation of Family Benefit, not to mention the earlier introduction of Social Security and its consequent fiscal demands, is another instance of a political party's policy directly affecting taxation. Further, the Labour Party favoured rebates over exemptions, while the National Party tended to micro-manage the income tax by constant tweaking of the rates scale and of incentives, particularly for the rural sector.

5.5.2.2 Selection of episodes

A number of considerations point to a division of the period into episodes, given the actual practice of vertical equity evident in Figures 5.2 to 5.7, political change, and significant national and global events. Based on these, the following periods will be reviewed in more detail in the following chapters:

1891: Introduction of the income tax

1892-1913: Bedding in of the income tax

1914-1924: World War One and its aftermath

1925-1930: Post war stability

1930-1940: The Great Depression and the Labour Party response

1940-1950: World War Two

1950-1970: Post war prosperity

1970-1984: Economic malaise

Certainly this division, like any other, is artificial and open to question: History does not divide itself into neat packages awaiting analysis. So, for example, the introduction of Social Security in 1938 and preparation for World War Two occurred concurrently. For this reason there is some overlap in the dates. However, this division does permit a more in-depth review of the development of vertical equity in the New Zealand income tax.

5.6 Summary

At its introduction, New Zealand's income tax already distinguished taxpayers based on their income. Over time a variety of measures were introduced that nuanced the Income Tax Act and resulted in increasing differentiation of taxpayers on the basis not only of income, but also domestic situation.

The following chapters consider each of the above episodes in more detail. By setting each episode in its historical and taxation context, and then reviewing the Parliamentary Debates, some idea may be gained as to the rationale behind the practice of vertical equity in the New Zealand income tax. Chapter 6 considers the introduction of the income tax in the Land and Income Assessment Act of 1891. This innovation in New Zealand taxation, brought about in the context of an extended franchise and a change in government, was extensively debated in parliament. Subsequent chapters trace the development of the income tax from then until 1984.

PART C

VERTICAL EQUITY IN THE NEW ZEALAND INCOME TAX 1891-1984

Chapter 6

The Introduction of the Income Tax in 1891

No system of taxation can be perfect – that is, no new system of taxation can be perfect – and almost any system is sure to need amendment.

John Ballance, Premier and Colonial Treasurer¹

6.1 Introduction

At half-past seven on 16 June 1891, after the House of Representatives had gone into Committee of Supply, Premier and Minister of Finance John Ballance addressed the Chairman of the Committee:

*Mr. Perceval, in asking the attention of the Committee while I place before it a plain unvarnished statement of the finances of the colony, I hope to be as brief as the nature of the subject will permit, and not to weary honourable members by unnecessary detail.*²

One hundred minutes later, Ballance concluded the newly elected Liberal Government's first Financial Statement, or what would now be called the Budget address. Whether the honourable members were wearied by his speech is unknown; but over the ensuing century, generations of taxpayers have been affected by a measure foreshadowed that evening; the replacement of the existing property tax with a land and income tax assessed on a progressive scale. Although the land tax was abolished in 1991,³ the income tax remains the mainstay of New Zealand's revenue system.

The previous chapters have discussed the background to the income tax, and then outlined what this tax looked like to a variety of taxpayers from its introduction in 1891 to 1984. This chapter returns to 1891, and considers the introduction of the income tax in New Zealand. Given that the income tax was a significant innovation in taxation policy, this chapter starts by addressing two questions; first, why could an income tax, which was a significant change, be successfully

¹ *New Zealand Parliamentary Debates (NZPD)*, vol. 73 (18 August 1891), 372.

² *NZPD*, Vol.71 (16 June 1891), 57.

³ Barry F. Reece, "The Abolition of Land Tax in New Zealand: Searching for Causes and Policy Lessons," *Australian Tax Forum* 10 (1993): 223.

introduced then? Second, what were the *ethical* considerations behind this innovation, particularly as they affected vertical equity?

Discussions on the ethics of taxation require consideration of the nature of property, and the relationship between the individual and the group (as represented by the state). In discussing equity in the context of taxation, two key questions must first be considered. For taxation to be equitable, taxation per se must be considered to be legitimate. Put simply, taxation must not be considered to be (legalised) theft.⁴ Secondly, the particular manifestation of taxation must be regarded as equitable. As far as taxation equity is concerned, not only must taxation per se be considered legitimate, so too must its apportionment between taxpayers.

Taxation fairness is not an objective scientific category. Not only are considerations of taxation fairness affected by individual ethical commitments, the practice of taxation itself is affected by the contingencies of national life, such as the economic situation, wars, individual preferences and interests. Besides, in the context of a democracy such as New Zealand's, taxation will necessarily be politicised: in principle at least, voters have the opportunity to vote out any government that enacts unpopular taxation, no matter how much it might be (ethically) justifiable.

The *Parliamentary Debates* provide some indication of the conception of ethics held by Parliamentarians. Notwithstanding the polemical and political nature of Parliamentary debate, the cut and thrust of the House of Representatives provides an opportunity for those with the power to legislate to justify the fact and nature of taxation. These debates provide primary evidence of the justification for taxation policy, and of the ethical thinking of Parliamentarians in the area of taxation policy. To the extent that Parliament is representative of the population, the views of the constituents should, at least in measure, become evident through the Parliamentary Debates. Further, the Liberal Party victory of 1890 marked the inauguration of party politics in New Zealand.⁵ Until the first Mixed Member Proportional election in 1996, debates in the House of Representatives reflected the adversarial two-party constitution of Parliament. Debates on

⁴ Robert W. McGee, "Is Tax Evasion Unethical?" *Kansas Law Review* 42 (1994): 425

⁵ David Hamer, "Centralization and Nationalism (1891-1912)," in *The Oxford Illustrated History of New Zealand*, ed. Keith Sinclair (Melbourne: Oxford University Press, 1996), 125. Richard G. Mulgan, *Politics in New Zealand* (Auckland: Auckland University Press, 2004), 233, notes that historians usually trace the beginning of the modern party system in New Zealand to the Liberal Party, which coincided with the introduction of full adult suffrage in 1893.

taxation measures should thus provide reasonably direct arguments for and against underlying positions.

This chapter focuses on the debates at the introduction of the first New Zealand personal income tax. After outlining the background to the introduction of the Land and Income Assessment Act 1891, it distils aspects of the ethical thinking evident in the Parliamentary Debates of the time of its enactment, before summarising.

6.2 Background

The Land and Income Assessment Act 1891 was hardly a New Zealand innovation. A “modern” income tax was introduced in the United Kingdom in 1799 to finance the Napoleonic Wars. It eventually expired in 1816 on the cessation of hostilities, but was reintroduced as a temporary measure in 1842, never to be repealed.⁶

Nor was New Zealand’s Land and Income Assessment Act 1891 the first attempt to introduce an income tax in New Zealand. As early as 1845, William Brown, a member of Governor Fitzroy’s Legislative Council, proposed radical tax reform involving the abolition of customs duties and the imposition of a mixture of a poll tax, a property tax, and an income tax. This, he argued, was:

*... founded on the principle that ‘everyone who lives under a Government and enjoys protection for life and property, ought to contribute towards defraying the expenses of that Government, in proportion to the extent of property and income which he may possess’.*⁷

This argument is almost a classic statement of the benefits principle, whereby tax is apportioned based on the value of the life and property that is protected by the state. Although this principle

⁶ A review of the history of the British income tax is beyond the scope of this study. For a thumbnail sketch, refer Keith C. Hooper, “Tracing the Origins of Taxation,” in *Tax Policy and Principles: A New Zealand Perspective*, ed. K Hooper et al. (Wellington: Brookers, 1998). A detailed account is provided by Stephen Dowell, *History of Taxation and Taxes in England* (London: Frank Cass and Co, 1965). F. Shehab, *Progressive Taxation: A Study in the Development of the Progressive Principle in the British Income Tax* (Oxford: Oxford University Press, 1953), focuses specifically on the development of progression. Martin Daunton provides a contextualised review of the development of the income tax, focusing particularly on the question as to how it came to be accepted in British society, in his two works: Martin Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge: Cambridge University Press, 2001), and *Just Taxes: The Politics of Taxation in Britain 1914-1979* (Cambridge: Cambridge University Press, 2002).

⁷ *Great Britain Parliamentary Papers* 1845/247, 139, cited in Paul Goldsmith, *We Won, You Lost, Eat That: A Political History of Tax in New Zealand since 1840* (Birkenhead: David Ling Publishing, 2008), 23.

was almost *de rigueur* at the time, and free trade theories were popular, his intention was not fulfilled.

An income tax bill was introduced in 1866/67, but not enacted.⁸ The Grey Government proposed a Land and Income Tax in 1879. However, this measure was unpopular: Although the land tax was enacted, the income tax was not. Taxation policy contributed to the fall of the Grey Government in 1879.⁹

The Land and Income Assessment Act 1891 was enacted by a sizable majority of 16 votes in a House comprising 74 members.¹⁰ Reasons for the passage of this Act reflect reasons for the rise of the Liberal Party. Hamer suggests three major political explanations for their rise: the consequences of the collapse or discrediting of Vogelism between 1884 and 1887, the collapse of the “Old Order” or the “establishment,” and the rise of “democracy”.¹¹ These factors, which are discussed below, also resulted in pressure for a land and income tax. The first of these factors points to the economy, the second and third to questions of social structure, highlighted by changes in the franchise.

The Liberals came to power at the end of an economically difficult time. In the 1870s, Julius Vogel, Colonial Treasurer from 1869 and subsequently Premier between 1873 and 1876, had:

*adopted a bold expansionist policy with plans to bring thousands of assisted immigrants to New Zealand, to construct roads, railways, bridges and telegraph lines, and to purchase Maori land for European settlement. His aim was to renew ‘colonisation’ and to stimulate economic growth. The programme was to be financed by borrowing, by paying for works with land grants, and by increases in government revenue resulting from the expanding economy.*¹²

⁸ Malcolm McKinnon, *Treasury: The New Zealand Treasury 1840-2000* (Auckland: Auckland University Press, 2003), 49; Edmund Bohan, *Edward Stafford: New Zealand's First Statesman* (Christchurch: Hazard Press, 1994), 194, 259.

⁹ Peter A. Harris, *Metamorphosis of the Australasian Income Tax: 1866-1922* (Sydney: Australian Taxation Research Foundation, 2002), 50-51.

¹⁰ *NZPD*, vol. 73 (18 August, 1891), 375.

¹¹ David Hamer, *The New Zealand Liberals: The Years of Power, 1891-1912* (Auckland: Auckland University Press, 1988), 24.

¹² Raewyn Dalziel, “Vogel, Julius 1835 – 1899,” in *Dictionary of New Zealand Biography* (Wellington: Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 11 July 2010).

Vogel's policy was adopted by the House in 1870 and implemented during the seventies. The failure of Vogel's overseas-debt financed public works of the 1870s to sustain economic growth was evident in the depression of the 1880s, which resulted in significant financial hardship and consequent emigration from the Colony. The government debt also created pressure on government revenue to service the national debt.

In the context of a depressed economy and related hardship, the property tax of 1879 was widely regarded as exacerbating the difficulties faced by small-holders and merchants. Being levied on property rather than income, it was payable even in the absence of profits. The abolition of the property tax as a means to relieve hardship on workers and small-holders was a key election platform of the Liberals. Its replacement by a graduated land tax was also seen as a means to deal with, as Ballance put it, "the two great evils in this country, the absentee evil and the monopoly evil".¹³

Economic conditions thus provided the background for the election of the Liberals and their consequent tax policy. However, changes in the franchise made the change possible at the elections.¹⁴ Although universal male suffrage had been introduced for non-Maori males in 1879, plural voting – the ability of a landowner with land in more than one electorate to cast more than one vote – was not abolished until 1889. The 1890 election was therefore the first under a true "one man one vote" franchise – women (including Maori) did not receive the vote until 1893. Country districts did, however, retain an advantage through the country quota until 1945, whereby rural electorates comprised 28 percent fewer people than urban electorates.¹⁵

The 1890 election marked the first appearance of party politics. Although policy positions were not clearly defined in most areas, one issue on which most candidates were prepared to be specific was taxation, with the Liberal candidates favouring a graduated land tax, whilst their opponent tended to favour a continuation of the property tax, which assessed both real and personal property.¹⁶ However, the debates at the time of the introduction of the Land and Income

¹³ Ibid., 29.

¹⁴ Neill Atkinson, *Adventures in Democracy: A History of the Vote in New Zealand* (Dunedin: University of Otago Press, 2003), chapter 2.

¹⁵ Ibid., 156ff. The country quota was finally abolished by the first Labour government in 1945.

¹⁶ Hamer, *New Zealand Liberals*, 31.

Assessment Act 1891 demonstrate that party lines were far from clearly drawn. This is indicated by the inconsistent voting on any amendments to the Land and Income Tax Assessment Bill 1891.¹⁷ Just as the New Zealand land and income tax was in an early stage of evolution, so too were political parties and party discipline.

That the election of the Liberals was highly significant is seen in the “stiff rearguard action”¹⁸ of the outgoing government which appointed additional members to the non-elective Legislative Council of Parliament. This was an attempt to stack the Upper House of Parliament in order to impede the passage of what the outgoing government might have considered to be “radical” legislation. The Upper House did, indeed, forestall a number of the Liberal’s legislative measures. However, it could not amend taxation measures, but only reject them outright¹⁹ – something it was loath to do, even though members baulked at the Liberals’ proposed “system of experiments”, as Opposition Member McLean termed them.²⁰ So, even if the “old order”, entrenched in the non-elective Legislative Council, objected to the Land and Income Assessment Act 1891, it could not reject it. Revenue measures were the preserve of the elected Lower House, a legacy traceable to Magna Carta and the Bill of Rights of 1689.

The Land and Income Assessment Act 1891 had a lengthy gestation in the House. The Liberals announced their intention to introduce this measure during the 1890 election campaign. It was formally heralded in the 1891 Financial Statement, as the government’s Budget statement was then known. The subsequent Committee of Supply debate lasted from 23 June to 10 July 1891. The land and income taxes themselves were enacted in the Land and Income Assessment Act 1891. The debate on this measure was shorter, as the main issues of principle had been canvassed in the course of the lengthy Financial Statement debate. Finally, the tax rates were set in the (annual) Land-tax and Income-tax Act 1892, effective for the year commencing 1 April 1892.

¹⁷ The Act itself passed with a majority of 16 votes. Voting on the amendments varied: 20 for, 12 for, 3 against, 12 for, 7 against, 12 against, 5 for, 27 for, tied, 24 for, 25 for, 15 for; refer *NZPD*, vol. 73 (7, 11, 12 August 1891), 251f, 269, 279.

¹⁸ Keith Sinclair, *A History of New Zealand* (Auckland: Penguin, 1991), 170.

¹⁹ William K. Jackson, *The New Zealand Legislative Council* (Dunedin: University of Otago Press, 1972), 104ff. New Zealand’s Parliament currently comprises the Queen of New Zealand and the elected House of Representatives. Prior to 1951, New Zealand’s Parliament was bicameral. The Upper Chamber of Parliament, known as the Legislative Council, was abolished in 1951.

²⁰ *NZPD*, vol. 74 (26 August 1891), 2.

The newly elected Liberal Government presented its achievements in the 1891 Financial Statement, and outlined its financial priorities and policies for the year ahead. Under the heading “Revenue resources”, Premier and Colonial Treasurer Ballance noted that it would be impossible in the future to depend on the increased consumption of alcoholic liquor to strengthen the Consolidated Fund. Similarly, the Railways could never be relied on for revenue purposes, though “stamps will, as greater wealth is diffused among the community, continue to give a yearly increase”.²¹

Against this background, Ballance introduced the major taxation innovation of the new government with the statement:

*Direct taxation in the way of a land- and income-tax must remain, with the development of our industries, a fruitful source of income, and an equivalent of the amount obtained from the present property-tax may for some time be a necessity.*²²

The property tax produced only a small portion of total ordinary government revenue of £3,994,504 in 1891. Excluding territorial revenue (land licences and rents) of £186,282 and railways and stamps revenue of £1,123,321 and £631,190 respectively, direct and indirect taxation revenue came to £2,053,711. Of this, the property tax comprised £357,348, or around 17 percent.²³ Only some £55,000 was budgeted to be raised by means of the income tax on trade and commerce (Schedule C) and from professions and salaries (Schedule D).

Later in the statement, Ballance spoke on the “incidence of taxation, more especially its relation to taxes on land and incomes.”²⁴ He clarified what a land tax was: “the popular and, I believe, the correct answer to the question is, a tax on the value of land less improvements.”²⁵ However, it was not economically possible to reach this ideal:

²¹ *NZPD*, vol. 71 (16 June 1891), 63.

²² *Ibid.*

²³ *Appendices to the Journals of the House of Representatives*, vol. B6 (1891), 18.

²⁴ *NZPD*, vol. 71 (16 June 1891), 65.

²⁵ *Ibid.*

*... the necessity of stopping short of this ideal must be found in the imperative requirements of our finance – the need for providing sufficient revenue to meet our obligations without unduly weighing the necessities of life through the customs.*²⁶

Ballance sought a balance between taxing consumption which affected all classes in society, especially those on lower incomes given that taxes on necessities bear more heavily on them, and taxing wealth, within the constraints of fiscal requirements; or as he put it, the “Incidence of Taxation.”²⁷ Yet as far as an income tax was concerned, he suggested that, “The abstract fairness of an income-tax on profits has never been questioned.”²⁸

6.3 Equity Considerations in the Debates

The introduction of income tax in New Zealand as part of the Land and Income Assessment Act 1891 provided an opportunity for the ethics of taxation to be considered at a broader level than is likely when an existing revenue statute is merely being amended. Further, the progressive principle, which the Liberals introduced in both the land and the income tax, provided an occasion where the manner of taxation could be evaluated.

The 1891 debates provide an insight into the ethical thinking of the Parliamentarians concerning equity in taxation. Three issues in particular will be considered: the legitimacy of taxation per se, the focus of equity concerns, and the question of graduation.

6.3.1 Legitimacy of taxation

For any particular manifestation of taxation to be considered fair, taxation in general must be accepted as legitimate. To put it negatively, there must be agreement that taxation does not constitute (legalised) theft.²⁹ In a society where corruption is minimal and the Rule of Law is seen to apply, taxation itself may generally be taken for granted. Where corruption reigns and taxation is considered extortionary or excessive, this may no longer be the case, as evidenced by avoidance, evasion, and ultimately revolt.

²⁶ Ibid.

²⁷ Ibid.

²⁸ *NZPD*, vol. 71 (16 June 1891), 67.

²⁹ Compare McGee, *Is Tax Evasion Unethical?* 425.

A stated opposition to taxation per se certainly could be useful in debate. Opposition leader John Bryce introduced his discussion on the incidence of taxation by stating:

*I should like to say at the beginning that theoretically and constitutionally I am opposed to all taxation. Nothing, in my opinion, will justify the imposition of a tax except the necessities of the State, which requires money or money's worth to carry on the government of the country.*³⁰

Despite this “theoretical” and “constitutional” objection, Bryce continued, “I came to the conclusion that the property-tax was, on the whole, a fair tax,” although he admitted that it “lends itself, as it were, to bad valuation.”³¹ In theory he believed it should not have allowed any exemptions, though he conceded that the exemption of £500 that applied to the property tax seemed necessary. He went on to explain that the property tax was fair because “all property requires the protection of the State, and it appears to be fair that all property should pay for this protection.”³²

Bryce’s comments reflect the benefits theory of taxation in a nutshell: Taxation is the price paid for the protection of life and property provided by government. As the level of property increases, the amount of protection provided by the government also increases. Taxation is thus the cost of the “contract” between the individual and society whereby the latter secures the former in his or her possessions.

This benefits view of taxation was also clearly enunciated by the Liberal Meredith, which indicates the anachronism of speaking of any clear “party line” in the debate. He justified taxation on what might now be called a user pays basis:

I hold it to be a fundamental principle of political economy that all those who hold wealth are in duty bound to contribute towards the expense of good government. Good government means the protection of life, liberty and property; so that, in whatever shape

³⁰ NZPD, vol. 71 (23 June 1891), 180.

³¹ Ibid., 181.

³² Ibid.

*wealth or property may be found, I hold and contend that it is the duty of that wealth to contribute towards the taxation of the country.*³³

Thomas Mackenzie, who later joined the Liberals, strongly opposed the Land and Income Tax Bill, and argued similarly:

*One of the first principles of taxation ... is that a man shall contribute towards the management of the State in proportion to the benefit he receives from the State.*³⁴

He backed this contention with a quote from Montesquieu: “the public revenues are not to be measured by what the people are able, but by what they ought to give.”³⁵ This is a clear denial of the ability to pay conception of taxation; what people ought to give would, presumably, be based upon the benefits they received in return for the tax. In this view, taxation had only one justification. Bryce asked:

*What is the tax wanted for? Is it for revenue, or for some other purpose such as punishment? If we are to argue the matter logically, let us keep the two things separate.*³⁶

John Duthie, a Wellington businessman who had stood in the 1890 election as a “Conservative Independent,”³⁷ put the matter even more clearly, arguing that taxation should only be levied for fiscal, not for social purposes:

*No man can object to taxation if it is necessary for the State, but when, in addition to that, are introduced other objects, it then becomes a species of modified confiscation, and it is grounded on dishonesty.*³⁸

³³ NZPD, vol. 71 (2 July 1891), 489.

³⁴ NZPD, vol. 73 (18 August 1891), 355.

³⁵ Ibid. The citation is from Charles Montesquieu, *The Spirit of the Laws*, trans. A. M. Cohler, B. C. Miller and H. S. Stone (Cambridge: Cambridge University Press, 1989), chapter 13: “On the Relations that the Levy of Taxes and the Size of Public Revenues have with Liberty,” p. 213.

³⁶ NZPD, vol. 71 (23 June 1891), 181f.

³⁷ Hamer, *New Zealand Liberals*, 36.

³⁸ NZPD, vol. 71 (25 June 1891), 275.

To use taxation as a tool of social policy, such as the bursting up of the great estates and the encouragement of the closer settlement and improvement of land, would constitute confiscation, which is tantamount to theft.³⁹ Such taxation could not be ethical, irrespective of how it were levied.

In contrast, proponents of the land and income tax questioned the legitimacy of land title. Here the influence of J. S. Mill was evident,⁴⁰ and more particularly the Single Tax ideas of Henry George.⁴¹ George agreed with Locke that it was exertion that justified (land) ownership.⁴² However, most of the increase in the value of land was due not to personal exertion, but rather to the growth in population and the improvements that had been effected by, for example, the Vogelian public works schemes. As this excess value was socially created, George argued that it did not belong to the legal owner but rather to the society that created it, and it was therefore appropriate that it be taxed.

Nor was the tenure of property seen as inviolable. Far from the unwritten contract with the early settlers being considered sacred and thereby stymieing any attempt to extract tax from the land, land was regarded as the natural property of all. T. L. Buick, a backer of the Liberal government who regarded himself as one of a group of “Labour” Members of Parliament,⁴³ argued:

How can you prove that land is the common property of all? We can prove it by the simple fact that land is necessary to our life ... If the land is not the common right of all, and if there is anything in natural or divine law by which some few individuals may own all the land, then it follows that all the rest of humanity must be only trespassers and

³⁹ McGee, *Tax Evasion*, 425.

⁴⁰ John S. Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (London: Longmans, Green, and Co, 1909).

⁴¹ Henry George, “The Common Sense of Taxation,” (1881) 133 *The North American Review*: 65; Henry George, “Land and Taxation: A Conversation between David Dudley Field and Henry George,” in *Taxation: Critical Perspectives on the World Economy (Vol. 1)*, ed. Simon James (London: Routledge, 2002), 250-261; Henry George, *Progress and Poverty: An Inquiry into the Cause of Industrial Depressions and of Increase of Want with Increase of Wealth – The Remedy* (London: Kegan Paul, Trench, Trubner and Co, 1922); but compare Frank Rogers, “The Influence of Political Theories in the Liberal Period 1890-1912: Henry George and John Stuart Mill,” in *Studies of a Small Democracy: Essays in Honour of Willis Airey*, ed. Robert M. Chapman and Keith Sinclair (Auckland: Paul’s Book Arcade for the University of Auckland, 1965), 153-174.

⁴² John Locke, *Two Treatises of Government, Edited with an Introduction by Peter Laslett* (Cambridge: Cambridge University Press, 1988).

⁴³ J. E. Traue, “Buick, Thomas Lindsay 1865 – 1938,” in *Dictionary of New Zealand Biography* (Wellington, Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 17 August 2009).

*vagabonds on the face of the earth ... And I say that no government in any part of the world is justified in selling to private individuals that which rightly belongs to the whole people.*⁴⁴

Like Buick, and unlike the conservative Opposition, Ballance himself questioned the inalienability of land. He argued:

*I say that the State should own all land. I believe in the nationalisation of land. I say that the State should not part with a single acre more of its land, for I believe thoroughly in land-nationalisation.*⁴⁵

Taxation policy, then, might quite legitimately aim to rectify inequities in the possession of land,⁴⁶ something the Liberals were keen to address as part of their overall programme. Fairburn suggests this was part of the Liberals' Utopianism:

*One thrust of the state experiments in the Liberal period was directed at rectifying the allocative deficiencies of past Arcadianism. The Land and Income Tax Act of 1891, the Lands for Settlement Act of 1894 (and subsequent amendments), and the lease-in-perpetuity were all designed to break up the large estates and prevent individuals with superior social capital from ever again destroying equality of opportunity. Another thrust had as its objective the containment and mitigation of the social problems arising from defective allocation (the factory and trade union legislation) – and this, too, was Utopian, not Arcadian. The most important thrust of state socialism, however, was to provide the landless and the small settler with greater equality of opportunity – by advancing them cheap mortgage money, giving them easy access to Crown land, vigorously servicing their districts with roads and bridges – which was also Utopian, not Arcadian.*⁴⁷

⁴⁴ NZPD, vol. 71 (2 July 1891), 511.

⁴⁵ NZPD, vol. 73 (18 August 1891), 373.

⁴⁶ Tom Brooking, *Lands for the People: The Highland Clearances and the Colonisation of New Zealand: A Biography of John McKenzie* (Dunedin: University of Otago Press, 1996), 97-130.

⁴⁷ Miles Fairburn, *The Ideal Society and Its Enemies* (Auckland: Auckland University Press, 1989), 264.

For the Liberals, taxation might be used not only for revenue purposes, but also to effect a redistribution of wealth, at least in the form of land, by forcing the “bursting up” of large estates. If the distribution of property was not equitable, taxation need not be patterned on pre-existing property holdings.

The Liberals further justified the income tax on the grounds that it was only levied when a man had the wherewithal to pay it. Minister of Education W. P. Reeves interestingly analogised taxation with an insurance policy: the taxpayer only pays when he can afford it in return for not doing so when he cannot:

*... the tax itself is equivalent to an insurance premium, which he pays for an entire relief from taxation when he is not in the position of being able to pay it. If we oblige him to pay the tax while he is in the enjoyment of a high income, the tax does not disturb him at all when bad times come, for it then relieves him from taxation almost or altogether.*⁴⁸

For the Liberals, then, the land and income tax aimed at “equality of sacrifice”⁴⁹ based on ability to pay. These two concepts were conflated by Ballance in his reply to the Financial Statement debate:

*We say we want justice first ... And we are doing only justice in asking that these large estates should pay on a principle well known to every economist and writer and thinker on this subject – to make them pay according to the equality of sacrifice. If that be done, justice will be done. We want to do justice in the first place, and that means that these estates should pay their fair proportion, and according to their ability, to the revenue of the country.*⁵⁰

The focus here, then, is on the apportionment of the tax charge, not on the legitimacy of the application of the tax revenue, as it was with the Opposition. Certainly the primary focus was on land, not on income; however, the replacement of the property tax necessitated an income tax to prevent some larger incomes (such as professionals’) from escaping untaxed.

⁴⁸ NZPD, vol. 71 (23 June 1891), 190f.

⁴⁹ NZPD, vol. 71 (2 July 1891), 149.

⁵⁰ NZPD, vol. 72 (10 July 1891), 127.

The 1891 discussions highlighted the difference between a conservative, benefits-based justification of taxation, and a consequentialist, ability to pay/equal sacrifice theory of taxation. Instead of tax only being justified for revenue purposes and particularly to protect property, the Liberals argued that taxation might be used for social purposes. The focus thus shifted from what was right (namely private property) to what was useful or good (namely a “fairer” distribution of property and the tax impost). This was an early manifestation of the concern for a “Fair Go”,⁵¹ which became a catch-cry of Australian and New Zealand social (and also taxation) policy. This same idea was expressed by Member of Parliament Taylor:

*I am one who is here to do one duty, and one duty only, and that is to do my best to assist the Government in or any Government in bringing about such a result that the bulk of the people of this colony shall receive fair-play. That is all.*⁵²

6.3.2 Unit of assessment

Equity suggests a balancing of interests, of fairness. But fairness can be assessed at the level of the individual, or at the level of the group. The enlargement of the franchise altered the social balance, a fact recognised by Liberal Member Rees who commented that, “This is the first Parliament which has been elected upon any franchise that is approximately equal among the people.”⁵³ The trade unionist Tanner went further: in terms more reminiscent of Rousseau and Hegel than of Locke, he exclaimed that the government had “a solid majority behind them, who are the expression of the will of the sovereign people.”⁵⁴

⁵¹ Marian Sawer, *The Ethical State: Social Liberalism in Australia* (Melbourne: Melbourne University Press, 2003), 36. The catch-cry has been used as recently as 2007 by the (then) Leader of the (National Party) Opposition, John Key in his keynote speech: “The Kiwi Way: A Fair Go for All” (30 January 2007), <http://www.national.org.nz/Article.aspx?ArticleID=9215> (accessed 20 November 2009). Refer also, Elizabeth and Harry Orsman, *The New Zealand Dictionary* (Takapuna: New House Publishers, 1995), s.v. fair; G. A Wilkes, *A Dictionary of Australian Colloquialisms*, (Oxford: Oxford University Press, 1996), s.v. fair go.

⁵² *NZPD*, vol. 71 (26 June 1891), 316.

⁵³ *Ibid.*, 319.

⁵⁴ *NZPD*, vol. 72 (9 July, 1891), 70. The influence of Hegel on Christian and Fabian socialists in Australasia is noted in Sawer, *The Ethical State*, 15. Note also, James M. Buchanan, *Why I, Too, Am Not a Conservative: The Normative Vision of Classical Liberalism* (Cheltenham: Edward Elgar Publishing, 2005), 56: “From the middle of the nineteenth century onward, classical liberalism retreated into a defensive posture, struggling continuously against the reforms promulgated by utilitarian dreamers who claimed superior wisdom in discovering routes to aggregate happiness, as aided and abetted by the Hegelian-inspired political idealists who transferred personal realization to a collective psyche and away from the individual. The soul of socialism, even in contradiction to scientific evidence, was variously successful in capturing adherents to schemes for major institutional transformation.”

The Opposition certainly did not consider itself to be included in this “will of the sovereign people”. Both the Liberals and the Opposition sought to alter the incidence of taxation. Although himself a member of the Liberal caucus, Walter Carncross argued that those voting should also bear the tax:

*I think, seeing that the great mass of people have representatives in this House, it is only fair to the country and to themselves that they should contribute more directly to the taxation than they do at present.*⁵⁵

The cry of “no taxation without representation”, heard in the days of a limited franchise, was thus replaced with its opposite: “no representation without taxation”. Indeed some argued that taxation should be levied as directly as possible so that Government expenditure would be watched more carefully.⁵⁶

Current discussions of taxation equity tend to focus on inter-personal fairness, as defined in terms of *individual* income. The horizontal and vertical equity norms tend to be expressed in individualistic terms: individuals with the same income should be taxed equally, those with differing incomes should be taxed differently. Yet although the 1891 debates did include discussions on the effect of the tax on individuals, the primary focus of the discussion was on relativities between groups rather than individuals. This may reflect the novelty of the income tax, and the fact that the proposed changes were at the level of the tax type itself, rather than adjustments to a particular tax. It also reflected the emerging blocks that comprised Parliament, namely the Liberal majority in power for the first time, and the conservative Opposition.

In assessing a new tax type, questions of tax incidence are more likely to be considered on a global rather than an individual basis. Ballance commented, “... we have tried to make this bill apply as fairly as we possibly can to all classes of the community.”⁵⁷ If the tax is considered to be fair in principle and across groups, specific anomalies in incidence at the individual level may subsequently be remedied by amendment.

⁵⁵ NZPD, vol. 73 (6 August 1891), 190.

⁵⁶ NZPD, vol. 71 (1 July 1891), 459.

⁵⁷ NZPD, vol. 73 (4 August 1891), 99.

This concern for fairness across classes reflected the commonly held view that there should be a balance of taxation between classes. Labour was assessed by means of indirect taxation, whereas capital was touched by direct taxes on wealth or income, with a balance sought between the two. An income sufficient to maintain a family should, in any event, be exempted from taxation. At the introduction of the tax, Parliament discussed the impact of taxation on a number of groups in society.

6.3.2.1 Class

The English focus on class was certainly evident in New Zealand. In moving the second reading of the Land and Income Assessment Bill, Ballance commented, “we have tried to make this Bill apply as fairly as we possibly can to all classes of the community”; yet he recognised that:

*... no new scheme of taxation when first introduced has been absolutely fair apparently to every class of the community. It never was done yet, and never will be done. Such a thing as an absolutely fair tax has never been conceived in the mind of man.*⁵⁸

Henry Fish, a self-proclaimed Independent, commented, “With regard to the income-tax, whilst I approve entirely of its principle, its incidence as between classes must be fair.”⁵⁹ The farmer Thomas Mackenzie, then in Opposition but later Liberal Prime Minister in 1912, demurred: “The tax from beginning to end is essentially a class tax.”⁶⁰

6.3.2.2 Town and Country

Perhaps the dominant focus of the debates was not on class per se, but on town versus country, with the latter favouring the property tax as better distributing the burden of taxation. Wilson, a Member of the House of Representatives, suggested that “the proposals of the Government are in the direction of taxing the country for the benefit of the towns.”⁶¹ Conservative T. Mackenzie lamented that:

⁵⁸ Ibid.

⁵⁹ *NZPD*, vol. 71 (30 June 1891), 387.

⁶⁰ *NZPD*, vol. 73 (5 August 1891), 142.

⁶¹ *NZPD*, vol. 71 (7 July 1891), 581.

*... if you remove the property tax and put on land- and income-taxes we shall certainly have to pay what we paid before, and, as many city men will perhaps escape, we shall have to make up the difference.*⁶²

The demographic and thence political shift from country to town clearly concerned him:

*What is clearly before us now is this: that the towns are influencing the legislation of this country, and, if country interests are to be represented at all in Parliament, then we must have a country party.*⁶³

Balancing was also required, however, within the groups of country voters: the interests of land owners had to be balanced against those of would-be land owners. Hogg, a Liberal, declared, “We will have the land unlocked ... unlock the lands we cry, let none our rights deny.”⁶⁴ For a Liberal government committed to bursting up the great estates, taxation provided a means by which to re-nationalise the land. For Ballance, “pauperism and poverty depend on the state of the land laws of any country.”⁶⁵ Given that the land had, in his opinion, been illegitimately “monopolized and stolen from the people,”⁶⁶ it was only just that taxation be used to reclaim it for the people.

How might this be done? If the tenure of the land was unjust, taxation provided a justifiable means to effect the bursting up of the estates. In typically strident style, Reeves argued for a progressive tax:

*I think these estates, whether partly or almost entirely unimproved, are a social pest, an industrial obstacle, and a bar to progress. I say the party we represent do not want large estates, and this graduated tax is a finger of warning held up to remind them that the colony does not want these large estates. This graduated tax is not so large a thing in itself, but it is the assertion of a great principle.*⁶⁷

⁶² NZPD, vol. 73 (5 August 1891), 145.

⁶³ Ibid., 143.

⁶⁴ NZPD, vol. 71 (26 June 1891), 356.

⁶⁵ NZPD, vol. 73 (18 August 1891), 373.

⁶⁶ Ibid.

⁶⁷ NZPD, Vol. 71 (23 June 1891), 191.

His colleague, Earnshaw, concurred:

*... these large landed estates are pests; I do not want to mince matters – I say that the workers are determined that these estates shall be burst up: if 1d. will not do it, then we will try 2d., and if 2d. will not do it, then we will try 3d.; but we are determined that the large estates shall be broken up by any means by which it can be done.*⁶⁸

6.3.2.3 Maori and Pakeha

The Land and Income Tax Bill exempted Maori, as had the Property Tax Act 1879. Some, such as Opposition Member Wilson, argued that this was inconsistent:

*There are a number of Maori leaseholders who do not pay taxation, but who derive considerable incomes from their land. These persons are not touched under the proposals of the Government – neither under the land-tax nor under the income-tax.*⁶⁹

In other words, they were not taxed on the benefit of the “unearned increment” that arose from state-funded development expenditure,⁷⁰ and also contributed but little through the Customs. For the Maori as for the Pakeha, representation and protection justified taxation, as MacDonald argued:

*Surely if the Maoris are sufficiently advanced in civilisation as to be returned as members to the House of Representatives, and hold seats in the Legislative Assembly ... they surely ought to pay towards the support of the State and local bodies, as the struggling settler has to. The Natives enjoy the same protection as regards life and property...*⁷¹

There were, however, reasons why this might not be feasible, including the Treaty of Waitangi, to which Ballance alluded in his Financial Statement:

⁶⁸ NZPD, vol. 71 (1 July 1891), 448.

⁶⁹ NZPD, Vol. 71 (7 July 1891), 582.

⁷⁰ NZPD, Vol. 73 (6 August 1891), 203.

⁷¹ Ibid., 197.

*Whatever is done [in respect of the necessity of providing for the extension of settlement by the purchase of native lands], the rights of the native under treaty, in accordance with the principles of justice, must be strictly maintained.*⁷²

There were also questions as to the legitimacy of the Pakeha's taking of Maori land, and the absence of individual title among the Maori complicated their assessment.⁷³ Ballance concluded that, "I can assure the House that it would be quite impossible to bring the Native lands under this [Land and Income Assessment] Bill."⁷⁴

6.3.2.4 Absentees

The taxation of absentees also exercised the mind of Parliament. Absentees paid no indirect tax. If they owned land in New Zealand they would be subject to the property or the land tax. However, if they owned financial instruments, they would be exempt from tax, unless subject to the income tax. Aside from the question whether the tax was indeed "catching absentees,"⁷⁵ two issues arose in this regard, the one ethical, the other pragmatic. First, government stock had been issued tax-free. Could the government retrospectively tax the interest, or was it in contract bound not to?⁷⁶ Secondly, would such taxation result in a flight of capital from the colony?⁷⁷ Despite Ballance's claim that the Land and Income Assessment Act 1891 addressed the absentee evil,⁷⁸ the taxation of absentees has continued to exercise legislators.

6.3.2.5 Moral characteristics

Fairness was not only determined on a group basis. Certain personal characteristics were considered to have a bearing on the practice of tax.

Ballance considered settlers who improved their land to be "a good class of settler, and we should adapt our tax to make it fall as lightly as we can upon him." He further argued that "it will

⁷² NZPD, Vol. 71 (16 July 1891), 65.

⁷³ NZPD, Vol. 73 (6 August 1891), 197.

⁷⁴ Ibid., 207.

⁷⁵ NZPD, vol. 71 (26 June 1891), 343.

⁷⁶ Ibid., 329.

⁷⁷ NZPD, vol. 71 (23 June 1891), 181f.

⁷⁸ Hamer, *The New Zealand Liberals*, 24. Indeed the Land and Income Assessment Act 1891, schedule B did levy a 20 percent surcharge on the graduated land tax on absentees.

be recognised that possessors of [incomes from professions and salaries] should not be asked to contribute the same proportion as those who derive their incomes from property.”⁷⁹ In part this was because such incomes were seen to be more precarious in a pre-Social Security society. Somehow active income was morally superior to passive income.

Fairness in taxation was still considered to relate to factors other than the quantum of income alone. There is no evidence in the debates of a Simons-type definition of income upon which taxation fairness might be evaluated.⁸⁰ Unlike the current income tax, taxation fairness in general was not evaluated in terms of an abstract notion of income derived by individuals, but rather in terms of the relative burdens on various groups in society. However, the introduction of the progressive principle did shift the focus to the impost on individual taxpayers.

6.3.3 Graduation

Progression is effected on individuals, or possibly households, and not at the level of the group. The Land and Income Assessment Act 1891 introduced progression in both the land and the income tax. This principle was regarded as consistent with the concept of ability to pay. However, as previously noted, it was also intended to achieve non-revenue effects, notably the bursting up of the large estates in the case of the Land Tax.

The principle of graduation was not universally accepted. For some, the progressive principle was simply objectionable. Duthie was adamant, “The main objection to the proposed system is that it is progressive taxation.”⁸¹ His concern was not only that a progressive tax might result in a redistribution of resources, but more that such a tax was not proportioned on the benefits received by the taxpayer.

Progression undermined the social contract. Holders of large estates had lawfully acquired their holdings from the state; on what basis should they now be deprived of these holdings? If a redistribution of land were required, the proprietors should be paid the legitimate value of the

⁷⁹ *NZPD*, vol. 72 (8 July 1891), 15; vol. 71 (16 June 1891), 67.

⁸⁰ Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), 49.

⁸¹ *NZPD*, vol. 71 (25 June 1891), 275.

lands so taken. To use a progressive tax for this purpose appears “to savour of confiscation rather than of justice to the holders of these lands.”⁸²

Sir John Hall, the “leading ‘conservative’ politician in nineteenth century New Zealand,”⁸³ suggested that graduation had been attempted and rejected as unworkable in the United Kingdom.⁸⁴ Citing the Home Country’s history, M. J. S. Mackenzie, a staunch opponent of the Liberal government,⁸⁵ spoke of “the downright pernicious policy” of graduation as leading to “confiscation” and “tyranny”.⁸⁶ Reflecting a focus on groups rather than on individuals, and on the basis of property rights, the conservative Buchanan argued that the graduation principle would mean “nothing short of confiscation and spoliation by a majority as against a minority.”⁸⁷ His colleague Carncross concurred, and suggested that there should be a direct link between representation and direct taxation.⁸⁸

Conversely, proponents of graduation argued that it was necessary to ensure equality of sacrifice. Citing J. S. Mill,⁸⁹ Harkness clearly stated their position:

Now, having direct taxation, you cannot possibly make it bear with equal pressure on all classes of the community if you have what is called a proportionate tax; but to make it bear with equal pressure upon all – to use an expression which has been used by those who have given the subject much consideration, to have equality of sacrifice – you must have progressive taxation, for this reason: When a man possesses only the necessaries of life, taxation to him is a positive sacrifice, but when men are asked to give out of their

⁸² NZPD, vol. 71 (1 July 1891), 443.

⁸³ W. J. Gardner, “Hall, John 1824-1907,” in *Dictionary of New Zealand Biography* (Wellington: Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz> (accessed 17 August 2009).

⁸⁴ NZPD, vol. 71 (7 July 1891), 612. Great Britain’s income tax was degressive from the outset: F. Shehab, *Progressive Taxation: A Study in the Development of the Progressive Principle in the British Income Tax* (Oxford: Oxford University Press, 1953), 46f. Hall is referring to the first income tax introduced during the Napoleonic Wars by the Prime Minister William Pitt the Younger, which was in effect from 1798 to 1802. Graduated rates were not introduced in Britain until 1910.

⁸⁵ Tom Brooking, “Mackenzie, Mackay John Scobie 1845-1901,” in *Dictionary of New Zealand Biography* (Wellington: Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 17 August 2009).

⁸⁶ NZPD, vol. 73 (4 August 1891), 113.

⁸⁷ NZPD, vol. 73 (6 August 1891), 193.

⁸⁸ *Ibid.*, 190.

⁸⁹ Mill, *Principles*, 5.2.2.

*luxuries or hoards there is no sacrifice in the truest sense of the word if you have proportionate taxation.*⁹⁰

Graduation was thus necessary to ensure equality of sacrifice. Practically, it was also needed to accomplish certain social objectives. Reeves listed three such objects of a graduated tax: to discourage monopolies and to encourage subdivision, to get revenue, and to charge those who had benefited from the public works.⁹¹ Graduation could be justified as a means to bring about such desirable ends.

Attitudes towards progressive taxation reflect attitudes towards the justification for taxation itself. If taxation is understood as justifiable only in terms of the benefits it confers on the taxpayer, graduation is unlikely to be favoured. Conversely, where taxation is justified in terms of ability to pay or sacrifice theories and as a means to social ends, graduation may be a more effective means to this end.

6.4 Summary

The 1891 Parliamentary Debates provide a useful starting point for discussions of the practice of vertical equity in the New Zealand income tax. The land and income taxes of 1891 were not a mere tinkering with an existing tax, but rather represented a substantial change in New Zealand taxation policy. As a result, the debates highlighted differences in taxation principle at a broad level, rather than merely changes in the practice of an existing tax.

Key areas of difference relevant to the equity question included the justification of taxation per se, the basis upon which taxation might be assessed to be fair, and the legitimacy of graduation. Views as to the propriety of private property affected views as to the legitimacy of taxation. Defenders of private property argued for minimal and proportional taxation on a benefits basis: taxation was legitimate as the cost for the protection of life and limb. Defenders of taxation on an ability to pay/sacrifice basis nuanced this right to private property, particularly in land, and allowed for a consequentialist view of taxation.

⁹⁰ NZPD, vol. 73 (6 August 1891), 192.

⁹¹ NZPD, vol. 73 (5 August 1891), 160.

Equity in taxation also tended to be evaluated on a group, rather than an individual, basis. The role of government was to ensure fairness between various sectors in society. Further, different groups or even income types were assessed on a moral basis, with some deserving preferential treatment.

Graduation was eschewed by those who held to a benefits view of taxation and who argued for the sanctity of private property. Progressive taxation, in their view, constituted a breach of contract. Proponents of graduation regarded it as a means to ensure equality of sacrifice, and to effect social, redistributive policy.

The 1891 debates focussed not merely on the income tax, but also on the significant land tax component of the new tax act. A result of these debates was that an income tax was introduced. General issues pertaining to taxation equity were addressed in the debates, but no clear philosophy of vertical equity in the income tax was promoted. This left a range of questions pertaining to vertical equity open for discussion. Musgrave has put the matter well: “Vertical equity, after all, is part of the larger problem of distributive justice, an issue that has no simple answer.”⁹² Distributive justice has to do with the allocation of economic burdens and benefits within a society, and though it suggests a final state, gives rise to a number of questions:

- What should be subject to income tax? In other words what should be included in the tax base: all income, or only extra-subsistence income? What other exemptions should be allowed?
- Who should be distinguished – individuals or groups?
- How should they be assessed? In practical terms, what rates scale should be applied, and can this be justified – on a benefits received basis, or an equality of sacrifice basis, or based on ability to pay?
- Why should the government assess tax – for revenue only, or also for other purposes?

The review of the history of the income tax over the ensuing nine decades indicates that these questions remained live, though at certain times one or other of these might be prominent. However, certain overarching themes are evident which suggest that the concept of equity, let alone vertical equity, remained an aspirational, but also an elusive, goal.

⁹² Richard A. Musgrave, “Equity and the Case for Progressive Taxation,” in *Tax Justice: The On-going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002), 9.

Chapter 7

1892-1913: Bedding in the Income Tax

I am only sorry that it is necessary to collect land and income tax; but I suppose it will be a very long time before we shall be able to do without the one or the other.

W Massey, Leader of the Opposition¹

7.1 General Context

The years around the turn of the nineteenth century were prosperous for New Zealand. The reverses of the 1880s, which had contributed to the election of Ballance's Liberal Government, had passed. The government borrowed freely to finance development, particularly of the railways. Internationally, New Zealand played its part: as a loyal Dominion² in the British Empire it sent troops to the Boer War, and in the lead up to World War One gifted the costly battleship "New Zealand" to the British Government in 1911.³

The Liberal Government reported consistent surpluses in the Consolidated Fund. It also managed to implement legislation designed to improve the lot of the working person, including industrial relations reforms. These were labelled "state socialist" by both supporters and opponents. Hamer comments that, "Vogel even in the 1890s spoke and wrote in England on 'state socialism' in New Zealand, and Reeves picked up the theme in promoting an image for New Zealand."⁴ Indeed Reeves subsequently publicised these measures in his two volumes entitled *State Experiments in Australia and New Zealand*.⁵ The conservative Opposition was not impressed. Rolleston damned the Liberalism of the 1892 Financial Statement as consisting of "State interference at every turn. It is tinged throughout – I may say it brims over – with washy, diluted State socialism."⁶

¹ *New Zealand Parliamentary Debates (NZPD)*, vol. 142 (29 Oct. 1907), 266.

² New Zealand's progress towards political independence is summarised in W. D. McIntyre, "The Development and Significance of Dominion Status," (paper presented at the Dominion Status Symposium, Parliament, Wellington, 26 September 2007), <http://www.nzhistory.net.nz/files/documents/DavidMcIntyre-Dominion-Status.pdf> (accessed 24 August 2009).

³ *NZPD*, vol. 148 (10 November 1909), 48ff.

⁴ David Hamer, *The New Zealand Liberals: The Years of Power, 1891-1912* (Auckland: Auckland University Press, 1988), 23

⁵ William Pember Reeves, *State Experiments in Australia and New Zealand* (South Melbourne: Macmillan, 1969).

⁶ *NZPD*, vol. 75 (15 July 1892), 518.

Yet the measures appear rather modest compared to those of the mid-twentieth century. Aside from an increased involvement in industrial regulation, the government's main focus was on infrastructure development and defence. The Old Age Pensions introduced in 1898,⁷ and in a small though deliberate way the progressive land and income tax, involved the government in some wealth redistribution. Yet the idea that distributive justice implied a guarantee of aid to the poor irrespective of merit is a recent idea.⁸ In New Zealand a non-merit based idea of welfare dates only from the twentieth century. In contrast, Colonial New Zealand has been characterised as a "world without welfare."⁹ Even the Old Age Pensions Act 1898 retained merit-based eligibility criteria,¹⁰ and rates of progression in the land and income tax were light by current standards.

7.2 Taxation Context

The income tax remained a minor, though visible, source of government revenue. The earlier Property Tax, which was replaced by the Land and Income Tax, had yielded 17 percent of the 1892 total tax revenue. The land and income taxes combined yielded the same percentage in 1893, rising to 21 percent by 1913. Of this, income tax, as opposed to land tax, produced only 3 percent of total taxation revenue in 1893, rising steadily to 8 percent by 1913. Most of the balance of tax revenue was derived from flat rate customs and excises; indirect, rather than direct, taxes predominated.

The gradual increase in the income tax take may be attributed to a number of factors. First, it took time to determine just who ought to be assessed, and the machinery provisions of the Land and Income Assessment Act 1891 were amended and expanded to make the tax workable. Finance Minister Ballance noted these teething problems in his 1892 Financial Statement:

*... obtaining returns of income has been a difficult matter, chiefly because there is no trustworthy information as to persons who should pay income-tax, and consequently forms could not be delivered.*¹¹

⁷ Old Age Pension Act 1898. Refer David Thomson, *A World without Welfare: New Zealand's Colonial Experiment* (Auckland: Auckland University Press, 1998).

⁸ Samuel Fleischacker, *A Short History of Distributive Justice* (Cambridge, MA: Harvard University Press, 2004).

⁹ David Thomson, *A World without Welfare: New Zealand's Colonial Experiment* (Auckland: Auckland University Press, 1998).

¹⁰ Old Age Pensions Act 1898, s. 8.

¹¹ *NZPD*, vol. 75 (30 June 1892), 127.

As time progressed, a more complete assessment of incomes became possible.

Secondly, the New Zealand economy had been depressed in the late 1880s. The Liberals had come to power towards the end of the “Long Depression” which lasted from around 1879 to 1896,¹² near the time the economy turned, and benefited from two decades of economic advance. This translated into rising incomes, and hence an increase in the income tax revenue.

Thirdly, as discussed below, tax rates were amended with effect from the 1910 year. The filling out of the personal income tax rates schedule discussed below was estimated at the time to raise an additional £80,000 of revenue.¹³

Although a main stated aim of the land and income tax was to break up the large estates, some form of income tax was necessary to catch the higher incomes of traders and professionals following the abolition of the property tax. Still, the income tax was secondary to the land tax, and remained so throughout the period prior to World War One. Parliamentary discussions focused more on the land than on the income component of the Land and Income Assessment Act 1891.

The income tax comprised revenue from companies as well as from individuals. The data series distinguishing individuals from companies is incomplete, but in 1893 the individual income tax comprised 49 percent of the total income tax, but only 39 percent in 1908. This indicates the significant contribution made by companies, since they were not entitled to any exemptions, and paid at a flat rate of one shilling per pound on their incomes. It also reflects the high incomes made by some of the larger companies, and may provide evidence of New Zealand’s early decision “to go down a path of low personal income tax for most people and much higher tax on bigger companies.”¹⁴

¹² Gary R. Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985), 82.

¹³ *NZPD*, vol. 152 (20 October 1910), 665.

¹⁴ Paul Goldsmith, “How Taxes Stymied Pro-Business Culture,” *National Business Review*, 19 May 2008 http://www.nbr.co.nz/comment/paul-goldsmith/how-taxes-stymied-pro-business-culture#Scene_1 (accessed 21 May 2008).

7.3 Income Tax Legislation

If the income tax take grew slowly, the Land and Income Tax Assessment Act 1891 itself did not, increasing from the 48 sections of the 1891 Act to 112 sections in the consolidating Land and Income Assessment Act 1908, with a further 67 sections being added by the 1912 Land and Income Assessment Amendment Act. The inherent complexity of direct taxation, and particularly of income taxation, has meant that the enlargement of the income tax legislation has continued ever since.¹⁵

The most significant amendments related to the land tax provisions; all improvements were exempted from land tax in 1893¹⁶ resulting in a decrease in the land tax collections in 1893-1894.¹⁷ As a result, the land tax came closer to the “single tax” ideal of the followers of Henry George, at least in terms of the form of the land tax. However, New Zealand taxation never came close to a *single tax*; nor was such legislation ever introduced.¹⁸ Further, the progressivity of the graduated land tax was increased in 1893,¹⁹ and again in 1903.²⁰ It was further increased by the addition of a 25 percent surcharge in 1907.²¹ Joseph Ward, who had succeeded John Ballance as Finance Minister following Ballance’s untimely death in April 1893 and was Liberal Prime Minister from 1906 to 1912, considered that it “has probably been too light for the purpose [of inducing owners of great estates to subdivide and sell], especially having regard to the general prosperity of the colony.”²² Significant amendments were also made to the income tax provisions as they related to companies. In particular, banks were subjected to a form of presumptive taxation²³ in an attempt to ensure that they did not escape the tax.²⁴

¹⁵ John Prebble, *Why Is Tax Law Incomprehensible? Inaugural Address Delivered on 7 August 1991* (Wellington: Victoria University Press, 1993).

¹⁶ Land and Income Assessment Acts Amendment Act 1893, s. 11(1).

¹⁷ New Zealand Parliament, “Report B20: Land Tax and Income Tax,” *Appendices to the Journals of the House of Representatives* (Wellington: Government Printer, 1898).

¹⁸ Frank Rogers, “The Influence of Political Theories in the Liberal Period, 1890-1912: Henry George and John Stuart Mill,” in *Studies of a Small Democracy: Essays in Honour of Willis Airey*, ed. Robert M. Chapman and Keith Sinclair (Auckland: Paul’s Book Arcade for the University of Auckland, 1965), 153-174.

¹⁹ Land and Income Assessment Acts Amendment Act 1893, s. 11(2).

²⁰ Land and Income Assessment Act Amendment Act 1903, s. 5(1) and schedule.

²¹ Land and Income Assessment Act 1907, s. 7(1).

²² *NZPD*, vol. 141 (18 September 1907), 36.

²³ The Land and Income Assessment Acts Amendment Act 1893, s. 11(3)(b), provided that the income of banking companies was to be assessed at not less than £10,000. This was found to be inequitable and modified in 1894. The Land and Income Assessment Act 1900, s. 52, provided that a bank’s income “shall be deemed to be a sum equal to ten shillings in every one hundred pounds of the average of its total assets and liabilities for the four quarters of the year, according to the sworn statements published in the *New Zealand Gazette* as required by law, and income tax

In contrast to the land and company tax, there were no significant changes in the structure of the personal income tax. No changes were made to the exemptions; the two exemptions in the original 1891 Act – a general exemption of £300²⁵ and an exemption for life insurance premiums to £50²⁶ – remained in effect.

The one significant change affecting individuals was the replacement of the original two-step rates scale with a nine rate scale in 1910 Act. This new scale involved three changes. First, the scale was smoothed by the insertion of intermediate rates between the original sixpence and shilling rates, as indicated in Table 7.1.

Table 7.1 Personal income tax rates (1892-1913)

Years	Taxable income (£)	Rate of tax	Rate of tax (%)
1892-1910	≤1,000	6d.	2½
	>1,000	1s.	5
1911-1913	≤400	6d.	2½
	≤600	7d.	2 ¹¹ / ₁₂
	≤700	8d.	3 ¹ / ₃
	≤800	9d.	3 ³ / ₄
	≤900	10d.	4 ¹ / ₆
	≤1,000	11d.	4 ⁷ / ₁₂
	≤1,250	1s.	5
	≤2,000	1s.1d.	5 ⁵ / ₁₂
	>2,000	1s.2d.	5 ⁵ / ₆

shall be payable accordingly.” The taxation of banks was again amended as late as 1941 – refer Land and Income Tax Amendment Act 1941, s. 3.

²⁴ Refer Ward: *NZPD*, vol. 82 (11 September 1893), 137.

²⁵ Land and Income Assessment Act 1891, Schedule D, s. 2.

²⁶ Land and Income Assessment Act 1891, Schedule F, s. 7.

Secondly, the tax rate now peaked at a rate two-pence higher than before, making for a top rate of $5\frac{5}{6}$ percent rather than 5 percent. In introducing this amendment, Finance Minister Ward rather hopefully suggested that:

*I think the maximum amount is as high as we ought to go ... as a general rule, 1s. 2d. as a permanent tax for a country such as this is, in my opinion, as high as we ought to be expected to go.*²⁷

The Opposition was not impressed. In the Legislative Council, Reynolds commented that “such a heavy income-tax he never knew to be imposed in any part of the world,” and that “all chance of progress would be hindered while it continued in force.”²⁸

Thirdly and significantly, Minister of Finance Ward announced that, “This Bill gives the authority for the change I indicated [in the Financial Statement] in the direction of graduation.”²⁹ The new scale was graduated rather than stepped, as the land tax had been since its inception. Whereas previously the higher rate only applied to income above each threshold, under the new structure each successive rate applied to the total income. Hence, the whole of a £1,100 taxable income was taxed at 11 pence per pound, and not just the £100 of income between £1,000 and £1,100, resulting in a tax bill of £55, rather than £36 8s.³⁰ Consequently, the total income tax take was budgeted to increase by £80,000 per annum,³¹ and actually did increase by some £90,000 from £316,835 in 1910 to £407,235 (or by 28.5 percent) in 1911.³²

7.4 Effect on Taxpayers

In contrast to the present income tax, the £300 exemption meant that most individuals were not subject to the income tax in this period. Despite a wages movement of around 11 percent between 1893 and 1913,³³ resulting in an increase in the hairdressers’ award wage from £113 to

²⁷ *NZPD*, vol. 152 (20 October 1910), 664.

²⁸ *NZPD*, vol. 78 (8 October 1892), 803.

²⁹ *NZPD*, vol. 152 (20 October 1910), 663.

³⁰ This change in method of calculation is evident both from the wording of the Act, but also from the calculations of its effect provided by the Minister of Finance Ward in *NZPD*, vol. 152 (20 October 1910), 663.

³¹ *NZPD*, vol. 152 (20 October 1910), 663.

³² *New Zealand Official Yearbook 1914* (Wellington: New Zealand Government Printer, 1914), 833.

³³ The CPI movement between 1893 and 1913 was 23 percent as calculated using the Reserve Bank of New Zealand CPI Inflation Calculator, <http://www.rbnz.govt.nz/statistics/0135595.html> (accessed 8 September 2009).

£125 in that same period, neither they, nor someone earning twice their wage (a medium income earner), paid taxes on their wages.

High income earners (as previously defined)³⁴ paid roughly the same tax until 1910. The small increase in taxation was due to an increase in income and consequent bracket creep, since the income tax was not indexed for inflation. The amended rates scale in 1911 resulted in their tax almost doubling from that year, since the new higher nominal rate applied to the whole income, and not merely to the final step. Given the lack of any exemptions for dependents, the rate of tax would have been the same for a single person as for a married person with or without children (refer Figure 7.1).



Figure 7.1 Personal income tax for a high income taxpayer (1893-1913)

7.5 Vertical Equity

The limited changes in the Land and Income Assessment Act 1891, and in the rates of tax applying to individual taxpayers in the period from 1891 to 1913, indicate a degree of stability in the practice of vertical equity during those two decades, and reflects the long Liberal hold on the Treasury Benches. However, although discussions of the (larger) land tax predominated, the income tax, too, was considered.

³⁴ Refer chapter 5 above.

7.5.1 How to tax: Basis of assessment

The introduction of the Land and Income Assessment Act 1891 saw a shift in the basis of taxation from a benefits secured basis to an ability to pay basis. Both bases had had their proponents in those initial debates, and subsequent discussions indicate that members continued to hold either view. However, an identification of benefits theory as the conservative view, and ability to pay with the Liberals, is too simplistic. Since different groups made use of either as it suited them, the distinction between the two is far from clear-cut.

The radical independent Member of Parliament, T. E. Taylor, provides a case in point. An Independent in Parliament, he was a Methodist who espoused numerous social causes including prohibitionism and social reform, supported the proposed introduction of old-age pensions and land reform, and opposed participation in the Boer War.³⁵ Yet despite this far from conservative background, he used the benefits principle to argue against the 1910 rates amendment in the context of a fiscal surplus:

*Those surpluses ought to remain in the pockets of the people, and ought to be spent by the people at their will. They have no right to be taken by the power of the government, and used in directions that do not benefit the people from whom the taxes are taken.*³⁶

This did, however, beg the question as to what in fact benefited the people. Taylor had opposed the gift of a Dreadnought class battleship to Britain,³⁷ while others might have lauded this as enhancing the people's security of life and property, both basing their views on the same benefits principle.

At times, both benefits *and* ability were appealed to, as is evident in the opinion of Legislative Councillor, E C J Stevens, that the labour class both should, and wanted to, contribute its "mite". Until it did so, "we shall never have anything like honest financial legislation in this colony."³⁸ Making the working man contribute his mite would "produce great criticism, and more careful scrutiny of the Treasurer's announcement each year," presumably because the working classes

³⁵ Grigg, A. R. "Taylor, Thomas Edward 1862 – 1911," in *Dictionary of New Zealand Biography* (Wellington: Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 24 August 2009).

³⁶ *NZPD*, vol. 152 (20 October 1910), 667.

³⁷ Grigg, *Taylor*.

³⁸ *NZPD*, vol. 78 (4 October 1892), 603.

would not wish to pay for that from which they derived no benefit. Yet in the same speech Stevens could claim that, based on personal communication with labour members, they were “quite prepared to pay their fair proportion [of direct tax] on the principle of equality of sacrifice.”³⁹

The concept of benefits was also linked with that of ability to pay in Colonial Treasurer Ward’s opinion that:

*The status in civilisation of a country may be gauged roughly by the proportion of its revenue applied to useful public purposes and the equitable incidence of taxation – that is, the proportion of revenue collected from those best able to bear it.*⁴⁰

Applying revenue to public purposes suggests a benefits view of taxation, while the phrase, “those best able to bear it,” suggests the bearing of burdens, and may refer to ability to shoulder the impost (that is, ability to pay), or to bear the pain involved in so doing (that is, sacrifice theory). The bases of ability to pay and benefits are related, and each was appealed to by both conservatives and liberals in discussions of the income tax.

7.5.2 How to tax: The practice of graduation

The Land and Income Assessment Act 1891 introduced progressive taxation rates. Although most evident in the land tax, the income tax was also graduated from its inception. Yet the progressive principle continued to be derided in some quarters. Bruce stated in reference to this graduated land tax that it was “confiscation.”⁴¹ However, this was a minority view.

Instead, discussion focused on improvements to the graduation to enhance fairness. As early as 1894 there were calls for a graduation between the six pence and the shilling rates of income tax.⁴² This was eventually effected in part by the revised scale introduced in the Land-tax and Income-tax Act 1910, which, according to Finance Minister Ward, sought to achieve “a more equal graduation.”⁴³

³⁹ *NZPD*, vol. 78 (4 October 1892), 603.

⁴⁰ *NZPD*, vol. 155 (5 September 1911), 477-8.

⁴¹ *NZPD*, vol. 82 (11 September 1893), 152.

⁴² *NZPD*, vol. 84 (10 July 1894), 364.

⁴³ *NZPD*, vol. 148 (10 November 1909), 65.

Opposition to the Land-tax and Income-tax Act 1910 was led by Opposition Member James Allen, who would become the Reform Minister of Finance in 1912 following the defeat of the Liberals. Allen deprecated the increase in the income tax, but not the principle of progression:

*I am not going to oppose the principle of a graduated income-tax, because I have supported it from the very first day I came into the House. But what I want to know from the right honourable gentleman is why he wants practically £100,000 more money by way of taxation today.*⁴⁴

Progression may have been accepted on both sides of the House, but disagreement remained as to the whether the degree of progression was sufficient. Allen's Opposition colleague Herries complained that those earning £10,000 paid the same rate of tax as those earning £2,000, and that the changes hit those in the lower graduations.⁴⁵ Interestingly, despite his outspoken criticism of Ward's policy, "both political necessity and development imperatives demanded the continuation of the Liberal policy,"⁴⁶ even under a Reform Government. A change in government did not result in a change in tax policy. Reality trumped rhetoric; the pattern of what constituted a "normal" tax was already in place.

7.5.3 What to tax: Tax base

Members were not yet unanimous in accepting income as the appropriate basis for taxation. Other bases for the apportionment of the income tax were suggested in the debates; thus elder Statesman Sir George Grey⁴⁷ argued that:

Those now seeking the freedom of mankind, and to set all classes on a fair and equal footing, have laid down the rule that no man should be taxed for that which he has

⁴⁴ NZPD, vol. 152 (20 October 1910), 664.

⁴⁵ NZPD, vol. 152 (20 October 1910), 674.

⁴⁶ Ian McGibbon, "Allen, James 1855 – 1942," in *Dictionary of New Zealand Biography* (Wellington: Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 24 August 2009).

⁴⁷ Sir George Edward Grey (1812-1898) had been Governor of New Zealand from 1845 to 1853, and again from 1861 to 1868, Member of the House of Representatives for no less than seven different seats between 1875-1895, and Premier and Colonial Treasurer from 1877 to 1879.

*produced by his own labour or skill, or with his own capital. That should be freed from taxation.*⁴⁸

Although Grey was speaking on the land tax, consistency would suggest an opposition to taxation on income as well. Presumably consumption or windfalls should be taxed, but not labour.

Grey also argued that taxation should be in terms of means, that is, wealth, rather than income:

*Why not have recourse to some means by which you may properly and justly require the wealthy to pay taxation upon the houses they occupy, and to pay in exact proportion to their means?*⁴⁹

This was also suggested by Bruce, a conservative. In opposing the Land and Income Assessment Bill 1893, he argued that:

*I like to take a higher stand; I should like to see every man pay according to what he is worth. I should like to see the principle of the great statesman, Gambetta,⁵⁰ carried out – that is, that a man should pay on what he owns, rather than on what he uses.*⁵¹

This was consistent with his preference for “the least objectionable of all taxes,” the property tax.⁵² Such a view may be consistent with ability to pay; as wealth increases, resources increase, and also the ability to pay the tax. Alternatively it might be aligned with benefits theory: the more wealth, the more benefit derived from the government, at least prior to the advent of social security.

⁴⁸ *NZPD*, vol. 78 (20 September 1892), 235.

⁴⁹ *NZPD*, vol. 78 (20 September 1892), 234.

⁵⁰ Léon Gambetta (1838-82) was a French statesman prominent after the Franco-Prussian War of 1870-71, and the 45th Prime Minister of France from November 1881-January 1882.

⁵¹ *NZPD*, vol. 82 (11 September 1893), 152.

⁵² *Ibid.*

7.5.4 Whom to tax: Relativities between groups

A focus in the 1891 debates was on fairness between groups rather than individuals. This focus remained in the subsequent debates to 1913. It was considered unfair if certain groups avoided paying the tax at all. The presumptive taxation of banks noted above was an attempt to prevent this, but other groups were also addressed at various times.

First, moves were proposed to tax absentees. As they were non-resident they did not contribute to the customs revenue. As a quid pro quo it was only fair that they should pay more by way of a higher absentee land tax. This was foreshadowed in the 1903 Governor's Speech:

*The owners of large areas of land resident outside of the colony are not taxed through the Customs, and, seeing the aggregation of large estates continues, my Ministers conclude there will not be any serious objection to increasing the present absentee-tax. The graduation of the land-tax, as now assessed under the existing law, also requires amendment to make the same fair in its incidence.*⁵³

Secondly, the taxation of Maori remained a thorny question. Ward recognised that they had to be treated somewhat differently from Europeans: "You cannot levy the graduated land-tax on individual owners on account of the system by which lands are held by the Natives."⁵⁴ Communally-held property muddies the tax question: aside from begging the question as to what rate to apply in a progressive system, it is unclear just *who* should be liable for the tax. Whilst a company may be deemed to be a legal person by law, the status of Maori tribal groupings was far from clear: Should the income be divided amongst all the members of the group, or should the group be taxed as a single unit? Stevens, a Member of the Legislative Council, highlighted the concern raised by the Public Trustee that the £500 land tax exemption applying to a sole owner did not apply to tribally-held land:

I strongly urge that the Land and Income Assessment Act be amended so that the present heavy taxes on Natives interested in the reserves administered under the administration of this office be removed. It may be argued that no distinction is made between Natives

⁵³ NZPD, vol. 123 (30 June 1903), 7. This was effected by adding a surcharge of 50 percent to the graduated land tax payable by absentee owners; refer Land and Income Assessment Act Amendment Act 1903, s. 5.

⁵⁴ NZPD, vol. 90 (12 September 1895), 161.

*and Europeans. The answer is that the lands of Europeans are not in the same position. ... It is an unfair tax, accidental in its application.*⁵⁵

Maori Member Kapa concurred. Although he did not suppose that the land and income tax would remain confined to the Europeans, he argued against its extension to Maori. There could not be one law for the two races, given variations in education, and the nature of land tenure.⁵⁶ Concern was also expressed at relatively shady land transactions.⁵⁷ The spectre of the Treaty of Waitangi was also present.⁵⁸

In the case of the Maori, discrimination was justified not to remedy a past injustice, but to prevent a new one. Just as the franchise is typically regarded as a prerequisite for fair taxation (“no taxation without representation”), so full integration into a society, including a commonality of social forms, is necessary for a tax to be practicable and fair. Adjustments or exemptions might be needed to ensure fairness in taxation where this is not the case.

A third group that was distinguished, though by way of a poll tax rather than the income tax, was the Chinese. The poll tax of £10 imposed under the Chinese Immigrants Act 1881, was increased to £100 under the Chinese Immigrants Act Amendment Act 1896, and not finally abolished until 1944.⁵⁹ In their case, fairness was assessed not on the basis of the equal treatment of individuals, but rather on racial grounds. The immigration of Chinese was regarded as a threat, which had to be controlled.⁶⁰ In what amounted to an inversion of a “benefits” justification for taxation, the poll tax was used as a punitive attempt to neutralise a perceived threat. Social policy considerations overrode other equity (and humanitarian) considerations.

⁵⁵ *NZPD*, vol. 138 (5 October 1906), 142.

⁵⁶ *NZPD*, vol. 76 (5 August 1892), 448f.

⁵⁷ *NZPD*, vol. 90 (12 September 1895), 172.

⁵⁸ *NZPD*, vol. 86 (11 October 1894), 885: Maori Member of Parliament Heke, grand-nephew of his more famous namesake, raised the Treaty of Waitangi in objecting to the Sea-fisheries Bill, 1894.

⁵⁹ Manying Ip, *Dragons on the Long White Cloud: The Making of Chinese New Zealanders* (Birkenhead: Tandem Press, 1996). On Chinese New Year (12 February) 2002, Prime Minister Helen Clark offered a formal apology to the Chinese community: “I wish to announce today that the government has decided to make a formal apology to those Chinese people who paid the poll tax and suffered other discrimination imposed by statute and to their descendents.” Helen Clark, “Prime Minister's Speech to Chinese Community,” (Wellington: Office of Ethnic Affairs, 2002), http://www.dia.govt.nz/oeawebsite.nsf/wpg_url/Advisory-Services-Consultations-Prime-Ministers-speech-to-Chinese-Community (accessed 13 June 2008).

⁶⁰ Ip, *Dragons on the Long White Cloud*, chapter 6. Reeves, a Liberal, reflects strong anti-Asian sentiment in a chapter entitled “Exclusion of Aliens and Other Undesirables,” Reeves, *State Experiments*, 2:325-64.

The growth and continuance of the national debt also resulted in discussions pertaining to inter-generational equity. During this relatively prosperous period the question arose whether to finance development by means of taxation or borrowing. Fish, who portrayed himself as the workingman's champion,⁶¹ stated the issue clearly; if the government ran a surplus, this should be devoted to the reduction of taxation rather than to increased spending. If governments wanted to prosecute public works which were for the benefit not only of current but also future generations, they should borrow as much money as is required, because in failing to do so, "they throw burdens upon the present generation for works which are for the benefit of posterity."⁶²

Other themes which were already evident in the 1891 debates continued to be canvassed in the years to 1913, notably the divide between town and country. This divide subsequently came to the fore during World War One when farmers' incomes were subjected to income tax. Until then farmers were exempt from income tax, but subject to land tax.

Interpersonal considerations also focused on the type of income received. On the one hand, the Finance Minister argued that the income tax should not discriminate. In rejecting appeals by the Kauri Timber Company for relief from taxation, he argued, "the Government could not make an exception of the company in this case, otherwise all other companies, independent of timber companies, would be able to claim similar exemptions."⁶³ The same argument would apply to the taxation of individuals. Fairness usually meant the application of the Rule of Law: one law for all.

On the other hand, some suggested that discrimination *was* required for fairness to obtain. The income of a widow *should* be treated differently from that of a businessman, particularly in the absence of any state provision for widows.⁶⁴ Thomas Mackenzie, a future Liberal, but opponent of the land and income tax, argued that it was "most inequitable in its operation," in that it taxed:

⁶¹ F. R. J. Sinclair, "Fish, Henry Smith 1838 – 1897," in *Dictionary of New Zealand Biography* (Wellington, Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 10 September 2009).

⁶² *NZPD*, vol. 78 (20 September 1892), 245.

⁶³ *NZPD*, vol. 78 (30 September 1892), 543.

⁶⁴ *NZPD*, vol. 79 (11 July 1893), 236.

*... income from brain, bone and muscle in the same manner as that derived from accumulated wealth, and accumulated wealth will, upon the death of the owner, continue in the family, but upon the death of the bread-winner, whose health and life cause the income, the income ceases entirely. Yet the two classes of income, under this crude unworkable taxation which is thrown upon the country, are treated exactly alike.*⁶⁵

He argued that a system of taxation should distinguish by source, which, he claimed, was the opinion of every political economist whose opinion can be valued at all, including John Stuart Mill and Adam Smith.⁶⁶

By 1913 the personal income tax was still a minority tax, affecting only high income earners. Perhaps because of its limited impact and minimal rates, no clear philosophy of income taxation had emerged. Certain high income earners remained exempt from the income tax, notably farmers. Internationally, too, the practice of the income tax, and particularly of progressive income tax, was in its infancy, and the seminal works on the income tax of as Seligman⁶⁷ and Simons⁶⁸ were still some years away.

7.5.5 Why tax: The role of government

The accepted role of government changed little during this time. Certainly, the Liberals did introduce a number of innovations in the 1890s, particularly in the area of labour relations. However, aside from the Land and Income Assessment Act 1891 itself, few innovations were made in the area of taxation.

The Liberal Government was accused of practising State Socialism, and in measure it accepted this charge. McLintock comments:

Ballance's Government was accused of being socialist. The term "State Socialism" was frequently used by the Opposition press as a term of opprobrium. But Ballance and his

⁶⁵ NZPD, vol. 82 (11 September 1893), 147.

⁶⁶ NZPD, vol. 90 (12 September 1895), 183.

⁶⁷ Edwin R. A. Seligman, *The Income Tax: A Study of The History, Theory, and Practice of Income Taxation at Home and Abroad* (New York: Macmillan, 1911)

⁶⁸ Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938).

colleagues were really concerned with “legislating for the masses” in what they believed to be a practical way rather than with implementing plans to erect a socialist State.⁶⁹

The meaning of this label is far from clear; any interference in individual activity by the state might be labelled “socialist”. Perhaps the more meaningful question is what the government actually did. Under the Liberals it largely focused on land and labour reform, the former in part by means of (land) taxation.⁷⁰ Any evidence of income redistribution at this time is notable for its absence. The exception that proves the rule was the introduction of the Old Age Pension in 1898, a move which represented a “critical shift” in New Zealand’s welfare policy,⁷¹ and yet provided only a hint of the Social Welfare to be introduced by the Labour Government forty years later.

Although the land and income tax was levied for revenue purposes, it did have a social purpose, namely the redistribution of the land. Prior to the introduction of social security, and in the context of a newly settled country with a “frontier” of sorts,⁷² the tax system was intended to effect a measure of redistribution – albeit of land rather than incomes. To the extent that this policy goal was accepted, and the tax practice contributed to this end, to that extent could the income tax be regarded as fair. Fairness might then be evaluated in terms of the (social or distributional) outcomes, rather than in terms of the taxation itself.

The Liberals had justified the land tax on this basis; it was intended to “burst up” the large estates. For this reason the Prime Minister and Finance Minister Ward opposed the suggestion that interest rather than the tax on mortgages be replaced with an income tax on mortgage interest:

I do not know whether honourable gentlemen wants to be kept in mind of what the graduated land-tax is principally in operation for in this country – namely to prevent the growth of large estates, and to ensure the cutting-up of large estates. If you change it to

⁶⁹ A. H. McLintock, “Ballance, John,” in *An Encyclopaedia of New Zealand* (Wellington: Government Printer, 1966), <http://www.teara.govt.nz/en/1966/ballance-john/1>, (accessed 9 September 2009).

⁷⁰ Erik Olssen and Marcia Stenson, *A Century of Change: New Zealand 1800-1900* (Auckland: Longman Paul, 1989), 389 provide a summary of the Liberal reforms.

⁷¹ Thomson, *World without Welfare*.

⁷² Brian Easton, “A New Economic History of New Zealand,” (paper presented at the Asia-Pacific Economic and Business History Conference, Sydney, 12-14 February 2007), <http://www.eastonbh.ac.nz/?p=823> (accessed 19 November 2009).

*income-tax ... then, in the event of revenue not being received from the graduated tax, the growth of these large estates might be very great indeed, and you could not stop it.*⁷³

In its early years the income tax was not intended to have drastic redistributive effects, whereas the land tax was. A tax on interest would provide little disincentive to the mortgagees who were accumulating large estates, contrary to the government's intent.

7.6 Summary

By 1913, the income tax had been in place for two decades. Although the share of total taxation revenue derived from the income tax had more than doubled, it still contributed only a small part of the total tax take. Aside from changes to the rates structure introduced in 1910, the personal income tax as it affected wage and salary earners had changed little. Due to the high £300 exemption level, only those on high incomes paid any income tax. In reality, it was a tax on high incomes only.

However, the stability of the tax did not mean that there was a consensus as to either the basis or the form of the tax. Although many may have considered the tax to have been fair in conception, suggestions were made to improve it. During the debates on the 1910 amendments, Liberal Member Steward outlined what he considered to be improvements that should be made to the tax, most of which were subsequently attempted. Each of these changes reflects a desire to match the taxation impost with the taxpayer's ability to pay.

First, anticipating to some extent the work of Simons,⁷⁴ he would "treat income, from whatever source derived – whether from land or from business – in the same way."⁷⁵ Steward would abolish the ordinary land tax in favour of using income as the basis of the tax system. In this way a taxpayer would only be liable for tax when he could afford to pay, that is, when there actually was an income.

⁷³ *NZPD*, vol. 147 (29 October 1909), 719.

⁷⁴ Simons, *Personal Income Taxation*.

⁷⁵ *NZPD*, vol. 152 (20 October 1910), 678.

Secondly, Steward would distinguish between “assured and precarious income.”⁷⁶ Incomes from personal exertion should pay at a much lower rate than income from fixed investments. He would also make allowance for family size, “to equalize the burden as between the man who has many mouths to feed and the man who has nothing to do but feed his own mouth.”⁷⁷

Steward called for a steeper graduation, especially of higher incomes. A person with an income of £2,000 a year paid the same rate of taxation as the man with £20,000 a year – “but it does not represent his fair contribution to the burdens of the country.”⁷⁸ Steward suggested taking up to one-fourth of a man’s income over, say, £10,000 a year.⁷⁹

Steward also suggested a truly stepped system, as had originally been the case, whereby only the marginal, rather than the whole, income is taxed at the higher rate:

*Every man’s first taxable £100 should pay so-much, the next £100 so-much more, and the next taxable £100 so-much, so that each man, as regards the various stages of income, should pay on each stage the same as other men – that is to say, that only on the increased income should he pay the increased rate.*⁸⁰

Like Adam Smith over a century before, Steward justified this approach on a mixture of bases: strains of ability to pay, sacrifice, and benefits theory echo in his conclusion:

*A tax of 1s. 2d. in the pound does not hurt such a man in the least degree – not that I want to hurt him; but it does not represent his fair contribution to the burdens of the country. Surplus wealth like that should bear the lion’s share of the taxation of the country.*⁸¹

⁷⁶ Ibid.

⁷⁷ Ibid.

⁷⁸ Ibid. His colleague Herries asked the same question: “The man with £5,000 a year pays the same rate of taxation as the man with £2,000 a year. ... Why, I ask, are the gradations not carried up to the higher incomes?” *NZPD*, vol. 152 (20 October 1910), 674.

⁷⁹ Ibid., 678.

⁸⁰ Ibid.

⁸¹ Ibid.

All of these proposals would be adopted and then abandoned during the history of the New Zealand income tax. Nearly two decades after its introduction, Steward's suggestions evince the relative novelty of the progressive principle and of the income tax itself. In subsequent years significant changes would be made to the tax. However, the main impetus for the growth of the income tax would not come from philosophical or equity concerns, but rather from the same cause that gave rise to the original English income tax: war.

Chapter 8

1914-1924: World War One and Its Aftermath

After all, the fundamental principle underlying the whole Budget from beginning to end is to provide the necessary money to meet a very difficult position, and at the same time to keep off the shoulders of those who are least able to bear it the extra taxation, and to avoid placing impositions on the necessities of life.

Finance Minister Joseph Ward¹

8.1 General Context

Britain declared war on Germany on 4 August 1914. As a loyal Dominion, the New Zealand Parliament immediately supported Britain by approving the formation of an Expeditionary Force to serve wherever it was needed.² Prime Minister William F. Massey was upbeat:

*I hope and believe that the war which has just broken out will not last long, and I hope and believe that within a comparatively few months – to say weeks would be too much to expect – within a very few months the Imperial authorities will be able to announce to us that peace with honour has come to the British Empire.*³

His hope was ill-founded; the war dragged on for four years. Despite living half a world away, over 10 percent of New Zealand's population served overseas. The high number of casualties constituted a massive sacrifice for a small country: of a total population of just over one million at the start of the war, 120,000 New Zealanders enlisted, of whom 103,000 served overseas. A total of 18,500 New Zealanders died in or because of the war, and nearly 50,000 more were wounded.⁴

Although the most direct cost of the war was in terms of flesh and blood, like all wars it also had significant social and economic effects, not least in respect of taxation. With the benefit of

¹ *New Zealand Parliamentary Debates (NZPD)*, vol. 173 (3 September 1914), 538.

² *NZPD*, vol. 169 (5 August 1914), 399.

³ *Ibid.*

⁴ New Zealand Ministry for Culture and Heritage, "New Zealand and the First World War," *New Zealand History Online* (Wellington: NZ Ministry for Culture and Heritage, 2009), <http://www.nzhistory.net.nz/war/first-world-war-overview/introduction> (accessed 3 February 2009).

hindsight, it would appear that the Government was slow to adjust taxation to meet this cost, partly due to a belief that the war would be short. The costs of war increase with its duration, as Finance Minister Ward indicated in 1917:

*We might as well make up our minds to face boldly and placidly the fact that if this war goes on for a year after next year we shall have to have very much heavier taxation than is proposed at the present moment.*⁵

In part the delay in increasing taxation reflected an aversion to taxation; an aversion that was clearly expressed by Ward even in the midst of the war:

*Mr Speaker, this debate on the Finance Bill clearly demonstrates what we all know – that taxation in any form is objectionable, and it is only a question of degree in adjusting the taxation as to how far it can be made acceptable to meet the necessities of the country.*⁶

The delay in raising taxes also reflected the hope that the war debt would be covered by the spoils from the enemies once victory was gained, as anticipated by the Government on the cessation of hostilities. The New Zealand Government had submitted estimates of the cost of the war to the Imperial authorities. As Ward put it, “the loser always pays.”⁷ Labour Member John Payne shared his view:

*We must exact the to the uttermost farthing out of Germany the fullest reparation we can for the loss she has inflicted and the wrongs she has committed upon the people whose territories and homes she has overrun.*⁸

This hope largely remained just that; a hope.⁹ Although the Armistice was signed in November 1918, taxation remained high. Five years after the war, Prime Minister and Minister of Finance Massey commented that the “admittedly high taxation necessitated by the war is still pressing on

⁵ NZPD, vol. 179 (31 August 1917), 861.

⁶ Ibid., 860.

⁷ NZPD, vol. 183 (9 December 1918), 950f.

⁸ NZPD, vol. 183 (1 November 1918), 178.

⁹ NZPD, vol. 224 (24 July 1930), 581.

enterprise and retarding development”.¹⁰ It was his intention “to get back as soon as possible to the rates of taxation which were in operation prior to the war.”¹¹ His intention was never fulfilled.

Although the nation’s attention was focused on winning the war and also on the future “after the war,” the cost of war did have to be borne by the population. In a war setting, the question of vertical equity takes on an added poignancy. If considered in terms of benefits, what link was there between the tax paid and any benefit that might arise from the war? What was the benefit to wage earners of a war fought on the other side of the world, and why should they have to pay for it? Furthermore, how should the cost be shared between generations? If war benefited present generations, tax funding was appropriate; if it benefited future generations, then debt funding was only fair.

Conversely, what might “equality of sacrifice” mean in a war context, and how could it be measured? If “cannon fodder” was predominantly provided by the poor, how high should taxes on the wealthy who remained behind go in order to secure an equality of sacrifice? How can ability to pay be translated into tax policy when that ability is enhanced due to (difficult to measure) super-profits resulting from war demand and war inflation? And, in the context of compulsory conscription from 1916,¹² can the “conscription of men” balance the “conscription of capital” by means of higher tax rates?

War certainly provided a catalyst for change. In his President’s Address to the 1917 Annual General Meeting of the New Zealand Society of Accountants, J. S. Barton discussed the effects of the war in modifying society, including new ideas and bases for taxation. In the first place, he expected that all taxation would be much heavier in the future than it had been in the past. It was also clear to him that it would be:

... imposed on new principles. The principles and spirit of the excess profits tax and other war taxes have come to remain with us, they are a complement of the movement towards nationalisation of industries and business. ... in the matter of taxation, we have got far

¹⁰ NZPD, vol. 200 (3 July 1923), 607.

¹¹ Ibid.

¹² Ian McGibbon, “Conscription,” in *The Oxford Companion to New Zealand Military History*, ed. Ian McGibbon (Auckland: Oxford University Press, 2000).

*away from the primitive form of taxation which may be stated as “pay the State a small levy for the upkeep of public conveniences,” so far away, in fact that the State now says, “I can claim half the profit you have made, because the people as a whole are vitally interested in, and contribute to maintain the peculiar circumstances which make those profits possible.”*¹³

Although, unlike the United Kingdom’s income tax, New Zealand’s was not birthed in war, it matured and grew in that context. In peaceful 1910, Prime Minister and Finance Minister Ward had suggested that 1s. 2d. was as high a level as a permanent tax should go.¹⁴ War presents a non-permanent emergency, and during the war the top rate would increase more than sixfold, to as high as 7s. 6d. (37½ percent) once surcharges were added. Issues of fairness that affect relative financial sacrifices in peacetime have an edge in wartime where the requirements are much higher, and the costs are measured not only in dollars, but in blood.

8.2 Taxation Context

War, typically, results in significant increases in government expenditure and hence in taxation, and New Zealand’s experience in World War One was no exception. Government revenue as a percentage of GDP rose from 7 percent in 1913, and reached a peak of 13 percent in 1921 before dropping back to 10 percent by 1923. It would never again return to single figures. Harris aptly commented that, “After five years of war we think and speak in millions whereas formerly we thought and spoke in thousands,”¹⁵ and feared that familiarity might breed contempt also in money matters.

From 1914 to 1923, New Zealand’s population increased by some 18½ percent to 1,340,000. Wartime inflation was significant, with the CPI index rising some 89 percent from 1913 to its wartime peak in 1921, only to fall sharply in the following two years. Despite this fall, prices were still 58 percent higher in 1923 than in 1913.¹⁶

¹³ J. S. Barton, “Presidential address,” in *New Zealand Society of Accountants Handbook 1916, 17, 18*. (Wellington: New Zealand Society of Accountants, 1918).

¹⁴ *NZPD*, vol. 152 (20 October 1910), 664.

¹⁵ *NZPD*, vol. 184 (23 September 1919), 1125.

¹⁶ Reserve Bank of New Zealand CPI Inflation Calculator, <http://www.rbnz.govt.nz/statistics/0135595.html> (accessed 4 March 2009).

Prior to the war, the combined Land and Income Tax had provided around one-fifth of total government taxation revenue, with the income tax accounting for about two-fifths of this. The yield of the income tax leapt subsequent to the enactment of the 1915 Finance Act, which effectively levied a 100 percent surcharge and an additional one third war tax (increased to one half in the Finance Act 1917) on top of the base rates. Total tax revenue increased by 275 percent from £5.9 million in 1913 to £22.2 million in 1921, before falling back to £16 million by 1923. Even adjusting for the (inevitable) wartime inflation, taxation revenue in real terms in 1921 was still double that of 1913, falling back to two-thirds higher in 1923.

The composition of taxation revenue shifted dramatically from land to income taxation. During the war the income tax surpassed the land tax in yield. Although the nominal land tax-take more than doubled by 1921, the income tax take increased some 15 times. For the first time, income tax revenues exceeded those of the land tax in 1916, and thereafter the land tax progressively lost significance as a source of revenue.¹⁷ Income taxes rose from 9 percent of total tax revenue in 1914 to 46 percent in 1918, but dropped back to 18 percent by 1930, or double the pre-war amount. As in the past, direct taxes on incomes provided an excellent source of revenue in wartime. The twentieth century proved to be no exception.

Non-income taxes continued to provide the majority of the New Zealand's tax revenue. However, following a surge in import duties immediately after "the many delayed orders"¹⁸ that had been filled subsequent to the war, their contribution to total tax revenue also declined over time.

8.3 Income Tax Legislation

Although the rates structure of the income tax changed little, significant changes were made to the progressive rates scale and to exemptions. Further, the tax base was extended by subjecting farmers to the income tax. Although this measure was reversed after the war, it signalled the move towards the universalisation of the income tax; that all income, irrespective of source, should be subject to the income tax.

¹⁷ Reasons for the supersession and eventual abolition of the land tax are discussed in Barry F. Reece, "The Abolition of Land Tax in New Zealand: Searching for Causes and Policy Lessons," *Australian Tax Forum* 10 (1993): 223.

¹⁸ Noted in the 1921 Financial Statement: *NZPD*, vol. 192 (3 November 1921), 24, cf. the following year's Financial Statement *NZPD*, vol. 196 (15 August 1922), 300.

8.3.1 Tax rates

The “filled out” rates scale introduced in 1911 was replaced in 1914 by a truly graduated scale, whereby each increase of a pound of income between minimum and maximum thresholds resulted in the total income being taxed at a higher rate.¹⁹ As a result, but for the effect of exemptions the marginal tax rate equalled the average tax rate. Table 8.1 displays the scale which applied for the 1914 and 1915 tax years.

Table 8.1 Tax rates scale 1914

Taxable income	Tax rate	Tax rate (%)
Up to £400	6d.	2½
£1,400	6d. plus $\frac{3}{400}$ d. per pound after £400	2½ to $5\frac{5}{8}$
£2,400	13½d. plus $\frac{1}{400}$ d. per pound after £1,400	$5\frac{3}{8}$ to $6\frac{2}{3}$
>£2,400	1s. 4d.	$6\frac{2}{3}$

For any one pound increase in income between £400 and £1,400, the *total* income would be taxed at a rate $\frac{3}{400}$ of a penny higher, to a maximum rate of 1s. 4d. The adoption of this new scale permitted greater flexibility in adjusting income tax revenue. This was achieved in three ways. First, the rate of graduation at a particular income level could be increased or reduced. For example, in 1918 the first step graduation reduced from $\frac{3}{400}$ d. to $\frac{1}{200}$ d. per pound.²⁰ Secondly, the brackets themselves were altered. Thus in 1916, a rate of 13½d. plus $\frac{1}{400}$ d. per pound on incomes above £1,400 was extended from incomes between £1,400 and £2,400, to those between £1,400 and £5,600, resulting in a top rate of two shillings rather than 1s. 4d.²¹

Finally, surcharges were added to the amount of tax that was calculated according to the schedule. By labelling the surcharge a “War Tax” or a “War Levy,” taxpayers were reminded of the reason for the additional tax, arguably resulting in increased (and willing) compliance. Taxation continued to have to be “sold” to the public to ensure greater compliance. Such income tax add-ons are listed in Table 8.2.

¹⁹ Land and Income Tax Act 1913.

²⁰ Finance Act 1917.

²¹ Finance Act 1915.

Table 8.2 Income tax surcharges (1914 to 1925)

Years	Surcharges
1914	None
1915	One third super tax (that is, on top of the basic income tax)
1916	War Tax: one third super tax War Duty: assessable income to £300: nil, income between £300 and £1,200, 6d. per pound, income thereafter: one shilling per pound
1917-20	War Tax: income to £300: nil, income between £300 and £1,200, graduated from 6d. to 3s. per pound Plus: 50 percent of the War Tax
1921	20 percent additional (i.e. super) tax
1922	None
1923	20 percent reduction of total tax
1924	One third reduction
1925	New rates scale

The abolition of the War Tax and War Duty by 1922 coincided with the replacement of the tax scale: whereas the previous nominal scale had peaked at three shillings in the pound (15 percent), the new scale peaked at 7s. 4d. (37½ percent) – effectively the same as the older scale once the War Duty and Levy were added.

8.3.2 Adjustments

The two original exemptions, namely the General Exemption of £300 and the Life Insurance Exemption, remained in effect. However, the former was income tested from 1918; diminishing £1 per £3 for incomes from £600, leaving no rebate after £900.²²

A Child Exemption of £25 per child was introduced from 1915.²³ Families with children were now differentiated for income tax purposes. Initially, this exemption was limited to five children and only applied to incomes below £425. From 1918, both the limits on numbers of children and on income were removed,²⁴ and the rate was doubled to £50 per child in 1922.²⁵

²² Finance Act 1917, s. 27.

²³ Land and Income Assessment Amendment Act 1913.

²⁴ Finance Act 1917, s. 28.

8.3.3 Income source

Two adjustments were introduced that affected the income tax payable by many taxpayers. In 1915 farmers were subjected to the income tax for the first time.²⁶ The taxation of farmers' incomes reflects a basic split in New Zealand society throughout most of its history: that between town and country. Farmers were subject to the land tax from its inception, but exempted from income tax. This exemption was removed in 1915. However, farmers were permitted to deduct 5 percent of the value of their land. The result was that, despite concerns expressed by farmers, few were subject to the income tax. Farmers were again exempted from income tax in 1923, only to be assessed again during the 1930s.²⁷

During the war there was pressure for unearned incomes to be distinguished from earned (or precarious) incomes, with the former taxed at a higher rate. In 1916, Thomas Wilford urged the Government "to reconsider the question of earned and unearned income,"²⁸ a call repeated by Charles Talbot in 1917.²⁹ This was finally implemented from the 1921 year.³⁰ Until 1930, earned incomes received a 10 percent reduction. From 1931 unearned incomes were subject to a 33½ percent surcharge. This distinction was contentious. On the one hand, unearned income tended to be received by the wealthy, who could afford to pay the extra tax. Besides, such incomes continued to be received even when employment ceased. On the other hand, some of the elderly and widowed would not have been wealthy and would have subsisted on their investment incomes – to tax such was to tax thrift. Arguments that taxing unearned income also harmed the poor were somewhat moot while incomes below a reasonably high level remained exempt from income tax. However, as the benefit of the exemption fell due to inflation, the cry that it discriminated against provident widows rang increasingly true. The distinction was finally abolished in 1951.³¹

²⁵ Land and Income Tax Amendment Act 1920, s. 11.

²⁶ Finance Act 1915, s. 6.

²⁷ A summary of the liability of farmers to income tax is provided by L. N. Ross, *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington: Government Printer, 1967), 477.

²⁸ *NZPD*, vol. 176 (6 June 1916), 563.

²⁹ *NZPD*, vol. 179 (15 August 1917), 299.

³⁰ Land and Income Tax (Annual) Act 1920, schedule.

³¹ Land and Income Tax Amendment Act 1950.

Both the taxation of unearned income and farmers' incomes raise equity concerns at the level of tax base, prior to the application of any rates schedule. However, the focus of this thesis is not on the income taxation base as such, but on the specific case of a wage or salary earner, who was neither a farmer (or indeed self-employed), nor in receipt of any investment income. Thus vertical equity will be considered in terms of income level and domestic situation, but the equally interesting question of income source or type is not discussed; income type is not relevant in the case of the notional taxpayers, given the assumptions made.

8.4 Effect on Taxpayers

8.4.1 Income level

World War One affected the notional taxpayers in two ways: the tax liability of high income earners increased, and medium income earners paid income tax for the first time – though not until the war was over and wage inflation had pushed them above the exemption level. However, since the rate of tax paid by the medium income earner remained very low (below 2 percent), the income tax effectively remained a tax on high incomes. Low income earners were exempt from the income tax, as the general exemption exceeded their income.

Prior to the post-war reductions, higher income earners experienced a threefold increase in their income tax bill, from 4 percent in 1913, to around 12 percent for a single taxpayer in 1920. In large measure this resulted from increases in the tax rates. Given that salaries did not change little during the war, the wartime increases were not due to wage inflation.³² The hairdressers' award rate (and thus also the medium and high income earners' remuneration) did not change between 1914 and 1919. After that the award increased significantly, thereby mitigating the fall in tax consequent upon the peace: bracket creep caused by wages inflation preserved a measure of the government's revenue despite nominal tax rate reductions.

Figure 8.1 indicates the change in taxation as a percentage of income for a high income earner in three domestic situations.

³² Award rates did not increase during the war. Immediately following the war, the hairdresser's award increased by 27 percent (from £143 to £182) in 1920, and again by 14 percent in 1920 to £208. Meantime, the CPI had increased by some 80% between 1913 and 1920.

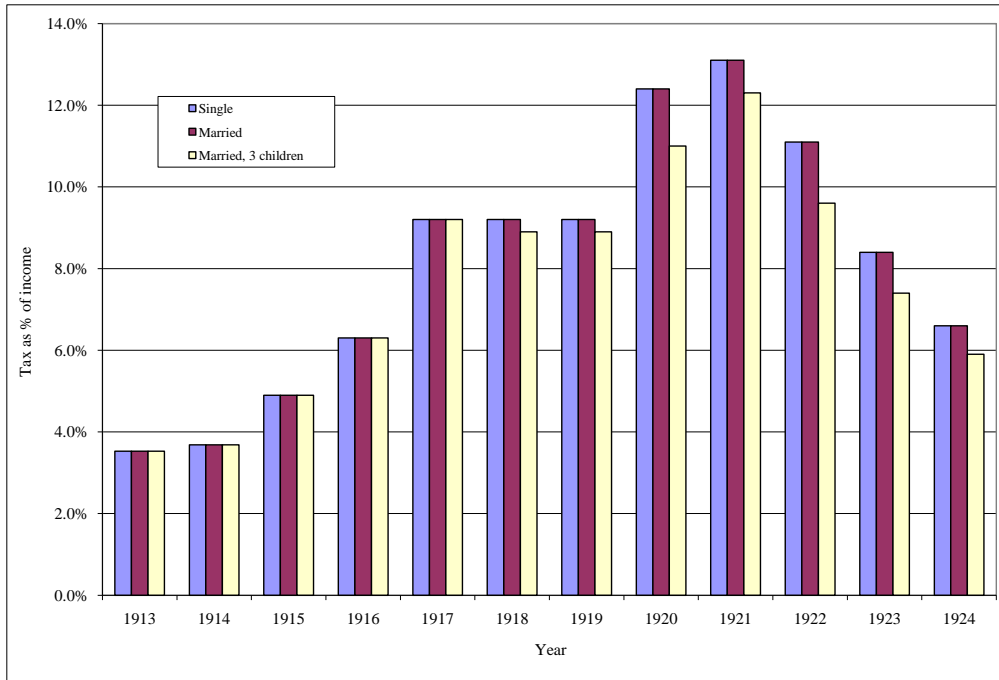


Figure 8.1 Personal income tax for taxpayers on a high income (1913-1924)

Even with the wartime rates increases, the rate of progression was not steep; the notional high income earner's income did not exceed £2,000 by 1924, and did not pay tax at the top rate, which only applied to incomes above £5,600 in 1917, and above £10,000 in 1922. The maximum income tax rate represents 39 and 47 times the hairdresser's award rate respectively. By contrast, in 1917 the high income earner received a "mere" £1,400, and £2,100 in 1922.

Medium income earners with children paid tax for the first time in 1921, largely due to the post-war wages inflation noted above. However, the doubling of the Child Exemption from £25 to £50 per child from 1922 eliminated their taxable income that year. Their childless peers, whether single or married, paid less than 2 percent tax from 1920 (refer figure 8.2).

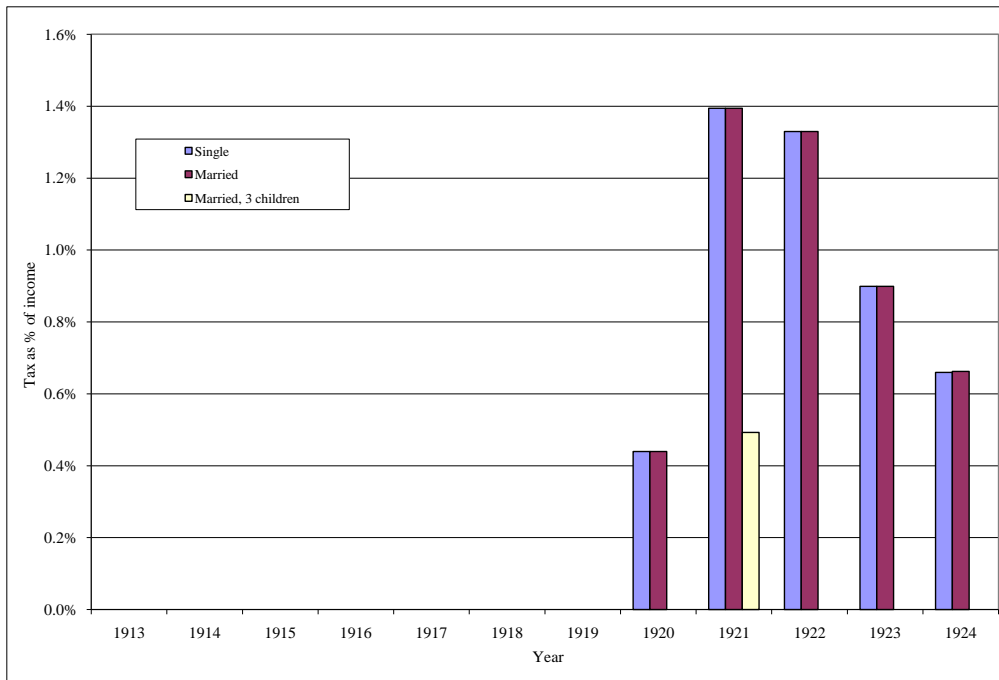


Figure 8.2 Personal income tax for taxpayers on a medium income (1913-1924)

8.4.2 Domestic situation

Since exemptions reduce the taxable income, the introduction of the Child Exemption in 1917 benefited those on the highest incomes most, shifting a person down the progressive rates scale. Thus a higher income earner derives a greater benefit from an exemption than does a lower income earner. In 1922, the high income earner's £150 of Child Exemption (three child exemptions at £50 each) translated to a tax saving of £21 16s. 6d.; for a medium income earner that same year it amounted to a mere £5 13s. 5d. The low income earner, who paid no tax, received no benefit at all. The child rebate adjusted the tax burden of families by recognising their reduced ability to pay given the cost of children, but it did not redistribute wealth from the wealthy to the poor.

8.5 Vertical Equity

Although the increases in taxation were largely motivated by the war-induced revenue demands, the theme of fairness underpinned Parliament's taxation discussions throughout and beyond World War One. In his 1914 Financial Statement immediately prior to World War One, Finance Minister James Allen submitted "a proposal for graduating the income-tax on a more equitable

basis than the present system.”³³ Concluding the debate on the 1915 Finance Act, which significantly increased the income tax, Finance Minister Ward commented that, “What the government has to do is to make its assessment on a fair and defensible basis.”³⁴ In Opposition, Labour Member Payne declared that:

*I reiterate that the main object of parties is to control taxation; but when there is a Labour Ministry on the Treasury benches, which I hope the good sense of the country will soon demand, there will be a Government that will be animated by one desire, and by one desire only – that of levying taxation equitably.*³⁵

Although the income tax still provided a minority of total tax revenue, Payne looked forward to the day when “the main burden of taxation will be placed on incomes, as it ought to be.”³⁶

By now the income tax as such was not questioned. Since it was the most significant direct tax, and also the most significant non-proportional tax, Parliamentarians frequently discussed how to assess this tax fairly. Yet despite the Liberal Wilford’s suggestion that, “The principle upon which the income tax is founded is broad, honest, and straight-forward, and must commend itself to all fair-minded men,”³⁷ translating this straightforward principle into an acceptable actual tax was far from simple. If anything, World War One complicated matters.

8.5.1 How to tax: Basis of assessment

The war was supported by most New Zealanders, as the jingoism, voluntary contributions to the war effort,³⁸ and high levels of conscription indicate. In this context, income tax fairness continued to be debated in terms of benefits received, ability to pay, and the idea of equality of sacrifice. Yet, as before, these were not rigid categories. Rather, discussions moved beyond the confines of the apportionment of the tax burden itself, to questions of ability to serve or sacrifice for the community, and the benefit derived from communal efforts. The focus shifted from fairness within taxation, to fairness between persons more generally. The income tax was both a

³³ NZPD, vol. 163 (6 August 1913), 478.

³⁴ NZPD, vol. 173 (9 September 1915), 553.

³⁵ NZPD, vol. 177 (14 July 1916), 121.

³⁶ NZPD, vol. 176 (11 July 1916), 653.

³⁷ NZPD, vol. 179 (9 August 1917), 47.

³⁸ NZPD, vol. 173 (1 September 1915), 278.

means and a measure: a means to ensure equality of sacrifice of blood and of profits, and a measure of the sacrifice made by the latter.

8.5.1.1 Benefits theory

Some argued that the war benefited the wealthy more. Not only did it secure their property – they had the most to lose if New Zealand were invaded or their English investments were affected – it also provided the opportunity for business gains as demand for manufactures and for farming products increased during the war. This justified raising the income tax, which at the time was levied only on high income earners. As the conservative Finance Minister Ward put it in his 1916 Financial Statement:

*It is only right that those who are well-to-do or possessors of wealth should contribute the greater proportion of the cost of this war, the successful winning of which means such enormous advantages to them as well as to every other sector of the economy.*³⁹

Labour Member Wilford concurred. He argued that the war created benefits not only in terms of excess profits, but also in terms of the protection of property. Farming profits were made on exported foodstuffs, “when these foodstuffs are exported to England to feed the boys who are going to fight to keep the land for [the farmer] from which he has made his money!”⁴⁰ Maori MP Taare Parata noted that, although the 1917 Finance Act was going to tax all sections of the community, by including farmers “it is touching also those people holding large areas of land, and who are getting large incomes therefrom.”⁴¹ Conversely, those who had little or no property did not derive this benefit from the war.

There was pressure for a short-lived and relatively ineffective Excess Profits Duty, which was enacted in 1916,⁴² even though Ward argued that the British had found their Excess Profits Tax to be ineffective.⁴³ Additional funds were also sought by way of compulsory subscriptions to war loans by all taxpayers whose income for the year ended 31 March 1916 was not less than £700,

³⁹ *NZPD*, vol. 176 (16 June 1916), 37.

⁴⁰ *NZPD*, vol. 173 (31 August 1915), 237.

⁴¹ *NZPD*, vol. 179 (30 August 1917), 822.

⁴² Finance Act 1916, part II.

⁴³ *NZPD*, vol. 176 (6 July 1916), 551.

in terms of the War Purposes Loan Act 1917.⁴⁴ Since the Excess Profits Duty was a tax on business, not on employment income, it is beyond the scope of this thesis, as is the War Loan contribution which, arguably, was not a tax at all.

8.5.1.2 Ability to pay theory

Although the benefits basis was used to justify changes to the income tax, a repeated refrain in the debates was that the government should “put the burden on the shoulders best able to carry it.”⁴⁵ Such persons had the faculty or ability to pay the tax. In replying to the debate on the Finance Act 1915, Ward picked up on this theme:

*After all, the fundamental principle underlying the whole budget from beginning to end is to provide the necessary money to meet a very difficult position, and at the same time to keep off the shoulders of those who are least able to bear it the extra taxation, and to avoid placing impositions on the necessities of life.*⁴⁶

This, of course, begged the question as to how to measure the burden-bearing capacity of any particular pair of shoulders. Talbot conflated ability to pay with sacrifice theory by suggesting that “we are all agreed that there must be equality of sacrifice, that we must put the largest burden upon the broadest shoulders,” before asking the obvious question: “how are we going to do it?”⁴⁷ Thomas Field highlighted the same issue, but then suggested that the government had got it about right:

*The great problem, of course, is to place the taxation equally upon the shoulders of all according to their means, and I think the country as a whole is satisfied with the taxation proposals of the Right Hon. the Minister of Finance, who deserves our hearty congratulations.*⁴⁸

Later in the war, following the significant income tax increases of the Finance Act 1917, the question whether the tax had truly been levied based on ability to pay was still being raised.

⁴⁴ Finance Act 1917, s. 40.

⁴⁵ *NZPD*, vol. 173 (3 September 1915), 395 (Hudson); *NZPD*, vol. 173 (7 September 1915), 419 (Field).

⁴⁶ *NZPD*, vol. 173 (9 September 1915), 538.

⁴⁷ *NZPD*, vol. 173 (7 September 1915), 413.

⁴⁸ *NZPD*, vol. 173 (7 September 1915), 419.

Liberal Member Anstey congratulated the government for the 1917 Finance Bill, which he regarded as:

*... the first real attempt to call upon wealth to bear its share of carrying on this war. Up to the present time, we have been engaged in sending men, more men, and still more men, without making an equal draft upon the wealth of the Dominion to pay the cost of this war.*⁴⁹

However, he continued: “I do not think the best attempt has been made to put the heaviest weight on the shoulders best able to bear it.”⁵⁰ This same theme was expressed in the context of a tight economy following the war. In arguing against a tariff on tea, the workers’ drink, Labour leader Harry Holland asked, “Is that putting the tax on the shoulders of those best able to bear it?”⁵¹

The breadth of a person’s shoulders should not only determine how much tax a person should pay; Labour Members argued that it should also determine where tax relief should be given, namely to those who could not pay. Labour leader Holland gave two reasons why the Labour Party opposed proposed tax remissions in 1925. First, “money is needed for our own local and social wants.”⁵² But secondly, “the proposed remissions do not give relief to those who need it most.”⁵³ Taxation fairness was thus evaluated not simply in terms of the tax paid. Were this so, the focus of fairness concerns would only be on taxpayers. Instead, Holland suggested that fairness needed to be considered between citizens, and not merely as between taxpayers, and with a global view that took into account all taxes.

Holland had earlier summarised this shift in focus by arguing that the appropriate metric was not how much taxation people paid, but rather, how much they were left with:

⁴⁹ *NZPD*, vol. 179 (30 August 1917), 805.

⁵⁰ *Ibid.*

⁵¹ *NZPD*, vol. 192 (10 November 1921), 191.

⁵² *NZPD*, vol. 208 (9 September 1925), 132.

⁵³ *Ibid.*

*Therefore, proceeding on the principle that it is not what you take from a man but what you leave him that counts, the man with the smaller income is the one who is far more heavily taxed.*⁵⁴

Rather than compare the tax bills of two individuals, their post-tax residue should be the standard of fairness comparisons. When it came to evaluating a tax measure, he suggested that the appropriate measure was the effect on the taxpayer's post-tax income. On this basis, income tax reduction measures failed in equity, as higher income earners gained the most benefit from them, and low income earners gained nothing. Labour Member James McCombs sought to demonstrate that the more a person earned, the greater the tax reduction, whereas a person earning below the exemption level received nothing.⁵⁵ Labour Members saw these adjustments as simply tweaking an unsatisfactory tax system. Thus Armstrong argued that:

*The effect of taxation reduction is to relieve the wealthy people – the people who are best able to carry the burden of taxation – for the purposes of increasing the burdens on the shoulders of the mass of the working people.*⁵⁶

One part of the problem was that income tax, which was paid by the wealthy, was reduced after the war, whereas customs and excises remained high. Holland provided a table to show that between 1918 and 1925, customs and excise revenues had increased, whereas income tax had substantially decreased.⁵⁷ Another part of the problem was the idea that income tax (notably on the wealthy) was only to be used for emergencies such as war, whereas indirect taxes, which were flat rate, were payable by all.

A conservative ability to pay theory limits its focus to a limited range of costs, typically those of a night watchman state, and apportions these costs across the shoulders best able to bear them. In a time of war the costs go up. Once the crisis is over, an attempt is made to return to the pre-crisis status quo. The radical extends the vision of what the role of the state is, limits the claims of property, and seeks not merely to apportion burdens upon shoulders best able to bear, but also to

⁵⁴ NZPD, vol. 188 (5 October 1920), 265.

⁵⁵ NZPD, vol. 208 (9 September 1925), 125.

⁵⁶ Ibid., 129.

⁵⁷ Ibid., 134.

alter the status quo so that more are able to do the bearing. So, in opposing the 1925 tax reductions, Holland put it succinctly:

*Sir, the Labour party is opposing these reductions in taxation because money is needed for our own social and local wants, and also because the proposed remissions do not give relief to those who need it most.*⁵⁸

At root was a difference in how taxation was viewed. F. J. Rolleston suggested a blurring of the boundaries:

*We know that there are two views on taxation – the view of the Conservative and the view of the Radical in politics. ... It is always amusing to hear taxation discussed in this House. Any one who knows anything about the subject at all knows that taxation can be used as a medium for the more even distribution of wealth. That is the opinion of sound economists. When we look at the proposals brought down tonight, instead of a more even distribution of wealth, being brought about through the incidence of taxation, we find the opposite result.*⁵⁹

8.5.1.3 Sacrifice theory

War and sacrifice go hand in glove. In introducing the 1916 Finance Bill, Finance Minister Ward declared that “I feel it is the duty of everybody to make great sacrifices at this time.”⁶⁰ Riccarton Member Witty, a Liberal, echoed this theme:

*I say, therefore, it is for us to bear cheerfully any taxation that is put upon us, so long as it is for the benefit of the community and for our protection ... So it is for us all to do our duty.*⁶¹

Whereas before the war there had been calls for the working classes to pay their fair share, during the war cries were raised for the wealthy to do theirs: for a balance between sacrifice of blood and of profits, given the contention that there was a high percentage of labour men enlisted

⁵⁸ Ibid., 132.

⁵⁹ Ibid., 161.

⁶⁰ NZPD, vol. 176 (6 July 1916), 550.

⁶¹ NZPD, vol. 173 (1 September 1915), 272.

– according to Labour Member Payne, 96 percent of the men enlisting came from the ranks of labour.⁶² Like men, so too wealth should be conscripted. Opposition Members like James Craigie argued that this had not occurred. Citing Professor Pigou of Cambridge University, he called for “conscription in the matter of wealth as we did in the matter of lives,” before denouncing the wartime Coalition Government which “evidently have [sic] an inflexible determination to sacrifice men, and an equally inflexible determination to protect property.”⁶³

Labour Member Wilford, for one, argued that “though we hear of sacrifice, there is no such thing as equal sacrifice between the rich and the poor.”⁶⁴ For one thing, the issue of unearned versus earned income needed to be addressed for there to be any such equality. Instead, not only was unearned income taxed at the same rate as earned incomes, the government had issued tax free war bonds, with the result that, “What is lent in loan subscriptions by the rich is taken without interest from the poor.”⁶⁵

Specific proposals were made (and rejected) as to how to better ensure equality of sacrifice. Witty argued for taxes on luxuries such as theatre tickets and cigars.⁶⁶ Also within his sights were those bachelors over twenty-five years of age who were fit to go to the front and did not go there.⁶⁷ Bachelors were fair game: they did not fit the model of domesticity that was the social norm. They also were perceived as being well-resourced and under-taxed: “they escape taxation in every direction. They are not like married men, who have to pay it through the Customs.”⁶⁸ Not having wife or children to support, bachelors could easily bear a heavier burden. Pressure to differentiate bachelors was firmly resisted by Finance Minister Ward, since:

*... the cardinal feature of the basis of taxation is that it does not differentiate, and there ought not to be exception in this case so far as individuals are concerned ... to put a tax on bachelors would be a very great mistake indeed.*⁶⁹

⁶² NZPD, vol. 175 (17 May 1916), 196.

⁶³ NZPD, vol. 179 (31 August 1917), 850.

⁶⁴ NZPD, vol. 176 (6 June 1916), 563.

⁶⁵ Ibid., 564, citing Professor Pigou.

⁶⁶ NZPD, vol. 173 (1 September 1915), 269ff.

⁶⁷ Ibid., 272.

⁶⁸ NZPD, vol. 173 (7 September 1915), 421.

⁶⁹ NZPD, vol. 179 (31 August 1917), 862.

Some fifteen years would pass before the income tax would be differentiated based on marital status, though by means of the Dependent Spouse Exemption, rather than a surtax on bachelors.⁷⁰

No single principle animated the income tax during the war years. Labour's McCombs commented on the 1915 Finance Bill: "Well, I have examined the Bill very carefully, and I have failed to discover any basic principle."⁷¹ The primary principle was fiscal necessity in the context of a Great War. Parliamentarians appealed to a range of principles: benefits, ability to pay, and sacrifice, in justifying this increased taxation. Nor are these principles mutually exclusive. However, the absence of a clear principle meant that the practice of taxation remained a matter of social norms, circumstances, political expediency, and moral intuitions.

8.5.2 How to tax: The practice of graduation

Graduation was a key area of contention at the introduction of the income tax. By the outbreak of World War One graduation appears to have been accepted, or at least acquiesced in; no one argued for a proportional income tax. But acceptance of the principle of progression provides little guidance as to the shape progression should take.

As noted in the previous chapter, Finance Minister Allen did not justify the significant shift to a truly graduated income tax in 1911 on fiscal grounds, but on the grounds of fairness. He commended the shift to a fully graduated system effective from the 1914 tax year on the grounds that this was "a more equitable basis than the present system ... with each pound of increase in taxable income there will be a corresponding increase in rate."⁷² Effectively, the new scale increased revenue derived from the graduated income tax,⁷³ but also removed the anomaly of the 1911 amendments whereby a pound's increase in income could result in an eight pound increase in tax.⁷⁴ Despite this change, Parliamentarians questioned two aspects of the rates curve: its extent, and its shape.

⁷⁰ Married Men Exemption of £50, introduced Land and Income Tax Amendment Act 1932-33, s. 4.

⁷¹ *NZPD*, vol. 173 (1 September 1915), 259.

⁷² *NZPD*, vol. 163 (6 August 1913), 478.

⁷³ *NZPD*, vol. 163 (9 September 1913), 493.

⁷⁴ *Ibid.*, 494.

The graduation of the new 1914 rates scale extended only to a rate of 1s. 4d. on incomes over £2,400. The Finance Act 1915 brought a more significant increase, with rates peaking at two shillings on incomes over £5,600. The scale was extended to £6,400 from 1917. Agreement that there should be graduation does not determine how much graduation there should be. Perhaps fuelled by war, a number of members pressed for an extension of the scale beyond this maximum. Reform Member Thomas Rhodes saw no valid reason why the graduation of income should not continue beyond the limit of £6,400.⁷⁵ Young argued that the graduation may be increased somewhat and not cease at £6,400,⁷⁶ and Field, likewise, would increase the graduations on incomes over £6,400.⁷⁷ After the war, when the limit had been increased, Labour Member Wilford questioned why the graduation was limited to £10,000.⁷⁸

Besides progression, Parliamentarians also discussed the shape of the rates curve. Payne argued that there was not enough progression as there were anomalies in the tax scale whereby the average rate dropped as the income increased.⁷⁹ Wilford similarly questioned why the rate of graduation reduced as the income increased.⁸⁰

As World War One progressed, the government came to realise that the war would not be over quickly. An additional income Special War Tax⁸¹ was added in the Finance Act 1915 effective the year ended 31 March 1916. This comprised an additional tax calculated in a similar manner to the income tax,⁸² plus a 33⅓ percent addition (increased to 50 percent the following year).⁸³

The Child Exemption was introduced in 1915.⁸⁴ The simple motivation for this was to recognise the additional costs faced by families with children. Because of these costs, a taxpayer with

⁷⁵ *NZPD*, vol. 179 (7 August 1917), 59.

⁷⁶ *NZPD*, vol. 179 (21 August 1917), 445.

⁷⁷ *NZPD*, vol. 179 (30 August 1917), 823.

⁷⁸ *NZPD*, vol. 187 (7 September 1920), 696.

⁷⁹ *NZPD*, vol. 176 (11 July 1916), 652.

⁸⁰ *NZPD*, vol. 188 (5 October 1920), 244.

⁸¹ The calculation of the income tax is illustrated in Wilfrid H. Hemingway, *The N. Z. Land and Income Taxpayers' Guide with the Finance Act Explained and Illustrated* (Auckland: Hemingway and Robertson's Correspondence Schools, 1917), 6-8.

⁸² Finance Act 1915, s. 2.

⁸³ *Ibid.*, s. 4.

⁸⁴ Land and Income Assessment Amendment Act 1913, s. 2.

children and one without children should not be considered equal, and thus, in terms of vertical equity, should be distinguished. The exemption of £25 per child, increased to £50 in 1916, was considered a token measure, as calls for its increase suggest.⁸⁵ The Child Exemption was also criticised by some members on equity grounds; only the wealthy benefited from the rebate. In order to claim the rebate, a taxpayer first had to be liable for tax.⁸⁶ Given the £300 General Exemption, only the wealthy could claim the Child Exemption. Rather than alleviate need, the Child Exemption thus further reduced the income tax payable by those who were not needy. Those on lower incomes received no exemption in respect of the customs they paid on necessities. Any real redistribution awaited the universalisation of the Family Benefit in 1946.

8.5.3 What to tax: Tax base

World War One confirmed income as an appropriate basis for taxation. Direct taxes had always been tapped to finance war,⁸⁷ and this was accepted even by sturdy opponents of the taxation. Reform Member Alexander Harris noted that the “stupendous” increase in taxation during the war was almost all in income tax. Given that income tax was not levied on the lower-waged, the tax was indeed being imposed on the shoulders best able to bear it. Income provided a surrogate for personal capacity to pay tax.⁸⁸ Since the income tax predated the war, there were no calls for it to be abolished. However, there were still dissenters; the conservative Dr Edward Newman suggested that economy, rather than increased taxation, was what was required.⁸⁹

8.5.4 Whom to tax: Relativities between groups

Farmers were included in the income tax net for the first time in 1915. This measure gave rise to considerable debate. Non-farmer Payne could “rejoice because for the first time in this country an equitable system of taxation is being levied upon the farmer.”⁹⁰ Yet Anstey, though a farmer, suggested that “the payer of land-tax and the payer of mortgage tax is not asked in this Budget to do his fair share.”⁹¹

⁸⁵ *NZPD*, vol. 184 (1 October 1919), 1059; *NZPD*, vol. 185, (3 October 1919), 16.

⁸⁶ *NZPD*, vol. 162 (18 July 1913), 657; vol. 165 (23 September 1913), 125.

⁸⁷ James Coffield, *A Popular History of Taxation: From Ancient to Modern Times* (London: Longman, 1970), notes that in antiquity, “Direct taxation was paid only in time of emergency and sometimes it was repaid after the emergency was over” (p. 3).

⁸⁸ *NZPD*, vol. 184 (2 October 1919), 1126.

⁸⁹ *NZPD*, vol. 174 (28 September 1915), 337.

⁹⁰ *Ibid.*, 321.

⁹¹ *NZPD*, vol. 173 (1 September 1915), 279.

The taxing of farmers was significant. It pointed toward a truly universal income tax, where no exceptions were made based on income source, as the Liberal Member James Craigie indicated:

*There is one thing I wish to compliment the government on, and that is they have proposed what I shall refer to as the thin edge of the wedge of what may be called a universal income tax. I am very pleased that this method of taxation has been extended to the farmers, because by so doing, every one in the country will pay according to his means, whether on income or wealth.*⁹²

Considerable time was spent debating this taxation of farmers.⁹³ In concluding, Finance Minister Ward reminded the House that there had been opposition to the land tax in 1891.⁹⁴ However, it was noted that, given a deduction of 5 percent of the value of their land, few if any farmers would actually pay any income tax.⁹⁵ Previously they had been exempted on the grounds that they paid the land tax. Further, there were serious misgiving as to a farmer's ability to keep financial records – one farming member suggested that an improvement in farmers' record keeping would be a side benefit of the tax.⁹⁶

8.5.5 Why tax: Role of government

Despite a significant increase in government expenditure during World War One, there was little change to the basic functions of government; the increase being due to the requirements of war. There were murmurings for an increased role for government, particularly from the Labour Party. This had remained neutral, not as its members argued because of disloyalty, but rather on the basis that “if the war required such a desperate measure as the conscription of men's lives, then the situation clearly necessitated also the conscription of their surplus wealth”⁹⁷ – a view consistent with the Labour Party's socialist basis, as emphasised by Harry Holland, its leader.⁹⁸

⁹² NZPD, vol. 173 (7 September 1915), 409.

⁹³ NZPD, vol. 173 (2 September 1915), 306ff.

⁹⁴ NZPD, vol. 173 (9 September 1915), 549.

⁹⁵ NZPD, vol. 173 (31 August 1915), 241; (7 September 1915), 410.

⁹⁶ NZPD, vol. 173 (7 September 1915), 413.

⁹⁷ Barry Gustafson, *Labour's Path to Political Independence: The Origins and Establishment of the New Zealand Labour Party 1900-19* (Auckland: Auckland University Press, 1980), 110.

⁹⁸ P. J. O'Farrell, *Harry Holland: Militant Socialist* (Canberra: Australian National University, 1964) commences his biography of Holland: “Henry Edmund Holland lived and died a militant socialist.” Yet though this may be true of

Besides, Labour pointed to domestic priorities that needed to be addressed such as the need for decent pensions and wages.⁹⁹

This theme pervaded the debate on the Land and Income Tax (Annual) Bill 1925, by which time the rates of income tax had fallen to their post-war low. Labour opposed any further reduction on the grounds that there was a need to maintain tax as expenditure remained high. Besides, as Labour's McCombs put it, any reduction in tax would go to the "big man ... This government is not attempting to deal with the inequalities of Dominion taxation."¹⁰⁰ The inequality of the income tax was clear to Labour's Hubert Armstrong, who suggested that the effect of this change:

*... is to relieve the wealthy people – the people who are best able to carry the burden of taxation – for the purposes of increasing the burdens on the shoulders of the mass of the working people.*¹⁰¹

Moving from taxation per se, Holland commented:

*Sir, the Labour party is opposing these reductions in taxation because money is needed for our own local and social wants and also because the proposed remissions do not give relief to those who most need it.*¹⁰²

McCombs aptly summed up the matter, claiming to:

*... stand up for the interest of the great mass of the people as against class legislation of this sort – legislation which is deliberately designed to secure and give advantages to the privileged few who stand behind and support the present Government on the Treasury benches.*¹⁰³

Holland, O'Farrell indicates that the Labour Party shifted from this militancy and dogmatism in the late twenties and early thirties (refer chapter 11: "A New Policy").

⁹⁹ Ibid., 112.

¹⁰⁰ NZPD, vol. 208 (9 September 1925), 124, 126.

¹⁰¹ Ibid., 129.

¹⁰² Ibid., 132.

¹⁰³ Ibid., 143.

Labour would have its opportunity within a decade.

8.6 Summary

New Zealand's income tax was not born in wartime; however, war catalysed its growth. By the end of World War One, the income tax was assuming a more modern form. The progressive scale was now unquestioned and the maximum rate of tax had increased from 1s. 2d. ($5\frac{5}{6}$ percent) in 1913 to 7s. 4d. or $36\frac{2}{3}$ percent in 1925. The tax also affected more New Zealanders: farmers were now included, and middle income earners were increasingly affected. The Child Exemption introduced the practice of favouring families. However, the income tax was still by no means universal: most wage and salary earners remained below the income tax threshold. Further, aside from the Old Age Pensions, the tax was not used to finance direct income redistribution.

Although the income tax may have become a permanent part of the tax landscape, there was no consensus as to what a fair income tax would look like. There was no clear principle to justify the shape of the income tax. The familiar terms of ability to pay, benefits, and sacrifice provided useful rhetorical devices, but hardly reflected fixed positions. Although ability to pay, often phrased as "placing the burden upon the shoulders best able to bear it," provided the basic justification for the income tax, just what this meant in practice differed from speaker to speaker.

That the practicalities of financing a polity, rather than the ethics of tax policy, predominated, is clear from the reports of two Commissions of Enquiry in the early 1920s. The first was appointed by Prime Minister Massey to inquire into the taxation of the Dominion of New Zealand, and reported in 1922.¹⁰⁴ As no order of reference was provided, the Committee set its own broad agenda, namely "to inquire into the taxation of the Dominion of New Zealand in all its respects."¹⁰⁵ It concluded that "the limits of taxation that this country can bear have been reached

¹⁰⁴ W D Hunt, "Report B5: Report of the Committee Appointed to Enquire into the Taxation of the Dominion of New Zealand," *Appendices to the Journals of the House of Representatives* (Wellington: New Zealand Government, 1922). The membership of this Committee and of subsequent Committees referred to in this thesis may be found in Appendix 2.

¹⁰⁵ *Ibid.*, 1.

– indeed exceeded – and that there is now practically no reserve of taxable capacity,”¹⁰⁶ and suggested that company tax should not exceed five shillings in the pound (25 percent).¹⁰⁷ Indeed:

*... the higher graduated rate of income-tax has reached such a point that it is drying up the sources of revenue, and, if continued, must result in a reduction of revenue from these sources, must stop progress and enterprise, and impede production and industry.*¹⁰⁸

Despite this, the Committee commented that “the rate of taxation on smaller incomes is lower, and the exemptions on these smaller incomes higher, than in any other part of the Empire.”¹⁰⁹ The report repeated Adam Smith’s four maxims of taxation, but suggested that they were hardly sufficient to cover all the problems involved in dealing with the very heavy graduated system of taxation that then obtained, since “inequalities and anomalies that were not seriously felt when the tax was smaller and proportional become very serious matters when it is heavy and steeply graded.”¹¹⁰ Broad support was expressed for the progressive principle on an ability to pay basis:

*The principle of graduated income-tax is that the individual with a larger income can spare a larger proportion of each pound for taxation purposes than can the individual with the smaller income. It is submitted that if this principle is right it should apply to all concerned.*¹¹¹

However, the Committee felt that lower incomes were undertaxed, higher incomes were overtaxed, and that economies in public expenditure were required.¹¹²

The recommendations of the Committee focused particularly on the company tax – that it should be abolished, and the land tax – it, too, should be abolished. Yet aside from arguments based on economic consequences, there is no discussion as to how a particular tax rate or rates scale was justified. Vertical equity, and even the progressive rates scale, seemed to be taken for granted,

¹⁰⁶ Ibid., 2.

¹⁰⁷ Ibid., 10.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid.

¹¹⁰ Ibid., 5.

¹¹¹ Ibid.

¹¹² Ibid, p. 2.

but only to a point. As far as the Committee was concerned, income tax should not exceed a rate of 25 percent; anything over this might be appropriate in a war setting, but was penal in a different context.¹¹³ Further, it believed that “the scale of progression rises too steeply in New Zealand,”¹¹⁴ since the scale kept rising right up the level of the highest incomes in New Zealand. The understanding clearly was that the tax should not be used to punish the highest incomes.

Two years later in 1924, a Royal Commission was appointed to inquire into the subject of land and income taxation in New Zealand.¹¹⁵ This Commission concluded that “the graduated system of income-tax is sound in principle and necessary in practice.”¹¹⁶ But again, no justification was provided for this conclusion. Rather than confirm this contention, the Commission went on to consider improvements to the income tax. Their prime focus was the company income tax which had served well during the war, but, “with a return to more normal conditions of trade and industry,”¹¹⁷ should now be abolished as soon as reasonably practicable.

As for the personal income tax, the Commission advocated a comprehensive base:

*... every individual's income from all sources (income from tax-free war loans excepted) should be brought together in one amount, so that the graduated rate of tax that applies to the whole income may be fixed.*¹¹⁸

Not only would this protect the graduated scale, it would also lighten the weight of the tax. No distinction should be made based on income source, since “It is wrong in principle to vary the rate of taxation according to the source from which it is derived.”¹¹⁹ As regards the rates of tax, it noted that “Income-tax on the smaller incomes in New Zealand is on a low scale as compared with the rates in Great Britain and Australia.”¹²⁰

¹¹³ Ibid., 10.

¹¹⁴ Ibid.

¹¹⁵ W. A. Sim, “Report B5: Report of the Royal Commission Appointed to Inquire into the Subject of Land and Income Taxation in New Zealand,” in *Appendices to the Journals of the House of Representatives* (Wellington: New Zealand Government, 1924).

¹¹⁶ Ibid., 3.

¹¹⁷ Ibid.

¹¹⁸ Ibid.

¹¹⁹ Ibid., 4.

¹²⁰ Ibid.

These two parliamentary reports confirmed the absence of a clear principle to guide vertical equity considerations in the income tax. In measure the reports reflected the views of their members, who, according to Reform Member Francis Rolleston, “represented big vested interests, and were very wealthy men.”¹²¹ The affairs of the day (economic events, fiscal need, war), rather than a specific ethical basis for taxation, determined taxation policy. Yet fairness continued to be the goal; each should pay his or her fair share of tax. Despite the continued use of the language of benefits, faculty, and sacrifice, none of these terms provided any clear guidance as to what this “fairness” should look like. In the absence of any such understanding, dramatic shifts in income tax practice were possible in response to specific events, such as a world war.

It was in response to the crisis of World War One that the income tax, previously introduced, was fundamentally changed. The pattern established during the war circumscribed the new income tax norm. War may not have been the occasion for the introduction of the income tax in New Zealand as it had been in the United Kingdom; however, war so radically changed the income tax that the relationship between its pre-war and post-war manifestations is more one of cousins than of direct descendants. Even if it is not the case that nothing is certain in this life besides war and taxes, it certainly is true that war both necessitates and facilitates changes in taxation.

¹²¹ *NZPD*, vol. 208 (9 September 1925), 161.

Chapter 9

1925-1930: Interlude

I hope this year to effect some improvement in the graduation with a view to remedying the anomalies mentioned, so that when a reduction is feasible it can be made on an equitable and scientific basis.

William Downie Stewart, Minister of Finance¹

9.1 General Context

It took some years for life in New Zealand to return to “normal” following World War One. The repatriation of soldiers, inflation due to pent-up demand, and then economic depression, followed the cessation of hostilities.

During these years the Labour Party came to increased visibility. Although there had been Members of Parliament representing the Labour movement since the turn of the century,² the Labour movement itself had been divided: in the 1914 election the United Labour Party won three seats and the Social Democrats two in an 80 Member House. The 1919 election was the first election where a unified Labour Party stood, and it won eight seats. After the 1928 election, Labour held the balance of power, with 19 seats in a Parliament of 80 members. United (formerly the Liberal Party) and Reform each won 27 seats.³

9.2 Taxation Context

After the war, taxation revenue settled at between 10 and 11 percent of GDP, rising to 12 percent in 1930. This was significantly higher than the 7 percent that had obtained from 1893 to 1913. One cause of this increase was the significant debt burden accrued during the war; Finance Minister Downie Stewart provided figures which indicated that war pensions and debt charges accounted for “nearly the whole of the increase in the taxation receipts per head.”⁴ The hope that reparations would mitigate this debt burden proved to be in vain. Meantime, New Zealand’s

¹ 1927 Budget Speech, *New Zealand Parliamentary Debates (NZPD)*, vol. 213 (2 August 1927), 161.

² Barry Gustafson, *Labour’s Path to Political Independence: The Origins and Establishment of the New Zealand Labour Party 1900-1919* (Auckland: Auckland University Press, 1980), chapter 1.

³ Neill Atkinson, *Adventures in Democracy: A History of the Vote in New Zealand* (Dunedin: University of Otago Press, 2003), 248.

⁴ *New Zealand Parliamentary Debates (NZPD)*, vol. 209 (8 July 1926), 585.

population increased by some 140,000 to around 1½ million by 1930, and there was little inflation (about 1 percent) between 1925 and 1930.

The share of total tax revenue contributed by the income tax declined from a wartime high of 46 percent to 18 percent of total tax revenue by 1930 – still more than double the 8 percent it comprised prior to the War. Since the New Zealand income tax had not been birthed in war, there was no clamour to abolish it, as the British had done at the end of the Napoleonic War.⁵ If anything, the war had demonstrated the versatility of the income tax as an easily amended, high yield tax. Meantime, the land tax returned a consistent quarter of the total direct tax revenue, while the proportion of revenue raised by direct taxes fell by about a fifth.

The general tax scenario, then, comprised a reliance on indirect taxes (mainly Customs Duty, Sales Tax, and Motor Vehicle and Beer Duties) for about three-quarters of taxation revenue, and direct taxes (predominantly income tax, plus some land tax) for the remainder. Everyone was liable for the former, which were regressive in effect. In contrast, the latter were progressive by design, and did not affect most low to medium wage earners.

9.3 Income Tax Legislation

9.3.1 Tax rates

Although the form of the rates structure remained largely intact from 1925 to 1930, the details were changed almost annually. The rate of progression was altered in several ways: by changing the cut-off point for the minimum and maximum rates (the lowest rate cut in at £400 to 1925, thereafter from £300; the top rate applied to incomes over £10,000 to 1925, then £8,700), and by altering the rate of progression between these points by adding additional steps (two steps in 1923, eight in 1928), or changing the steepness of any particular step (the bottom step was one shilling plus $\frac{1}{100}$ d. per pound for incomes between £400 and £6,000 in 1924; 7d. plus $\frac{2}{300}$ d. per pound for incomes between £300 and £6,000 in 1926). However, despite the abolition of the War Duty and War Tax, the nominal rates scale remained subject to overriding adjustments. Aside from the 10 percent reduction for earned income, reductions of 20 percent and 33⅓ percent applied in 1924 and 1925, before a revised scale was introduced in 1926.

⁵ Arthur Hope Jones, *Income Tax in the Napoleonic Wars* (Cambridge: Cambridge University Press, 1939).

9.3.2 Adjustments

The £300 General Exemption remained in effect, rebating to nil on incomes over £900. However, from 1929 the abatement of this exemption started on incomes of £450 (previously £600). Significantly the nominal amount of this rebate had not been adjusted since its introduction, despite the hairdressers' award rate increasing 130 percent between 1893 and 1929. The Child Exemption also remained unchanged at £50 per child.

The Insurance Exemption was modified from 1922. Previously a £50 rebate was available against any income. From 1922 the rebate was calculated as the actual premiums up to 15 percent of total income up to £2,000. Where income exceeded £2,000 a deduction was permitted only for premiums up to 15 percent of earned income. This significantly increased the tax benefit of this deduction; however, this benefit was only gained by those who paid tax.

9.4 Effect on taxpayers

9.4.1 Income level

Despite these changes in the rates structure, the income tax was relatively stable during the late 1920s once society had returned to a peace-time footing. Two features are noteworthy. First, the income tax remained a tax on higher incomes. The high income earner paid about 8 percent from 1923 to 1927, and about 10 percent in 1928 to 1930, following an amendment to the rates scale.

Secondly, the income tax had changed markedly compared to the pre-war situation. The middle income earner *did* now pay tax, albeit a very small amount, and so the income tax was no longer just a tax on the wealthy. Furthermore, higher income earners now paid more than double what they had in 1913. The Child Exemption offset this slightly, providing an early glance at the needs of (albeit relatively well-off) families. Figure 9.1 indicates the tax payable by medium and high income earners who were married but had no children.

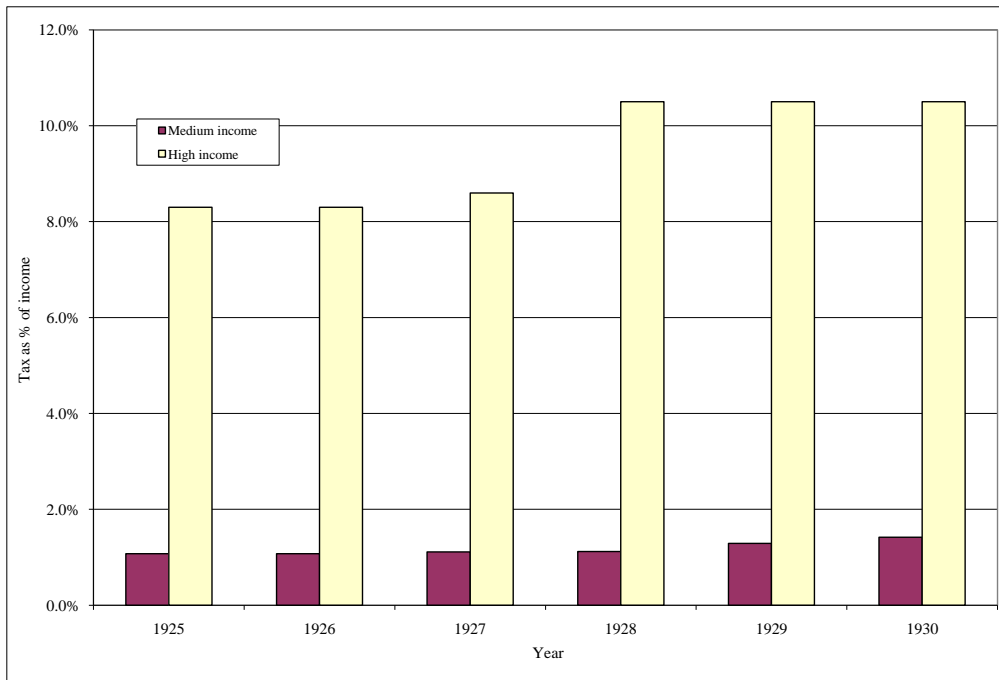


Figure 9.1 Personal income tax for medium and high income earners who were married but had no children (1925 to 1930)

If there were children, the rate dropped by about a percent due to the Child Exemption (refer Figure 9.2).

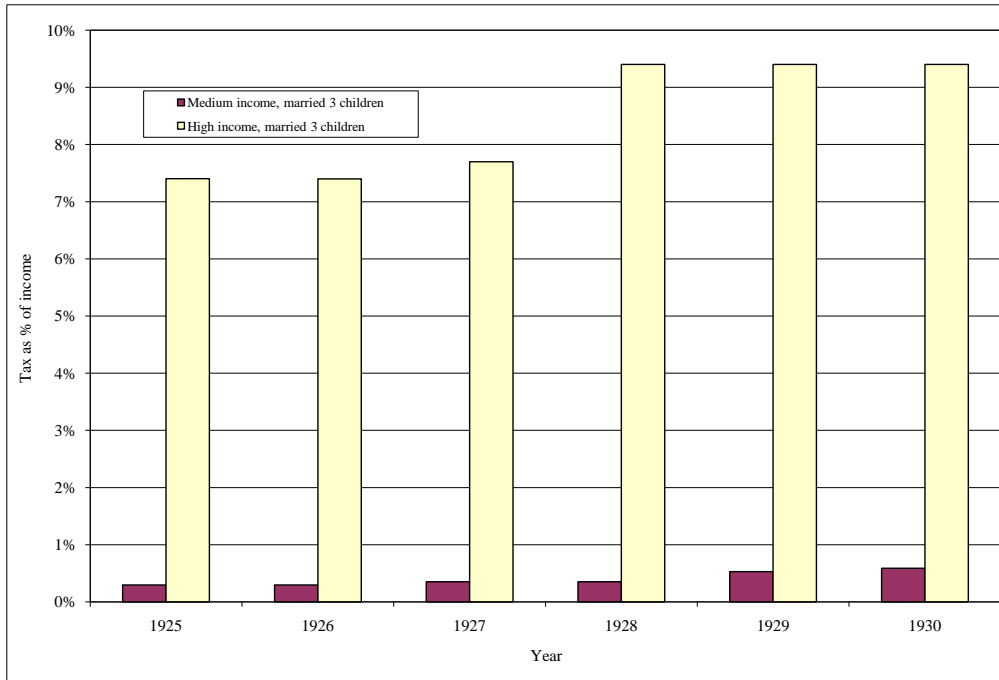


Figure 9.2 Personal income tax for medium and high income married taxpayers with three children (1925 to 1930)

9.4.2 Domestic situation

The only family-friendly measure remained the Child Exemption, which reduced the income tax of families with children on both middle and high incomes. It resulted in significant percentage savings for the medium income taxpayer though in absolute terms the savings were minor. For the high income earner the savings were not particularly significant. Since the actual rates of tax on the middle income earner did not exceed 2 percent of the income. Figure 9.3 illustrates the two-tiered structure that prevailed: one rate for medium income families with children, and a higher rate for single and married without children.

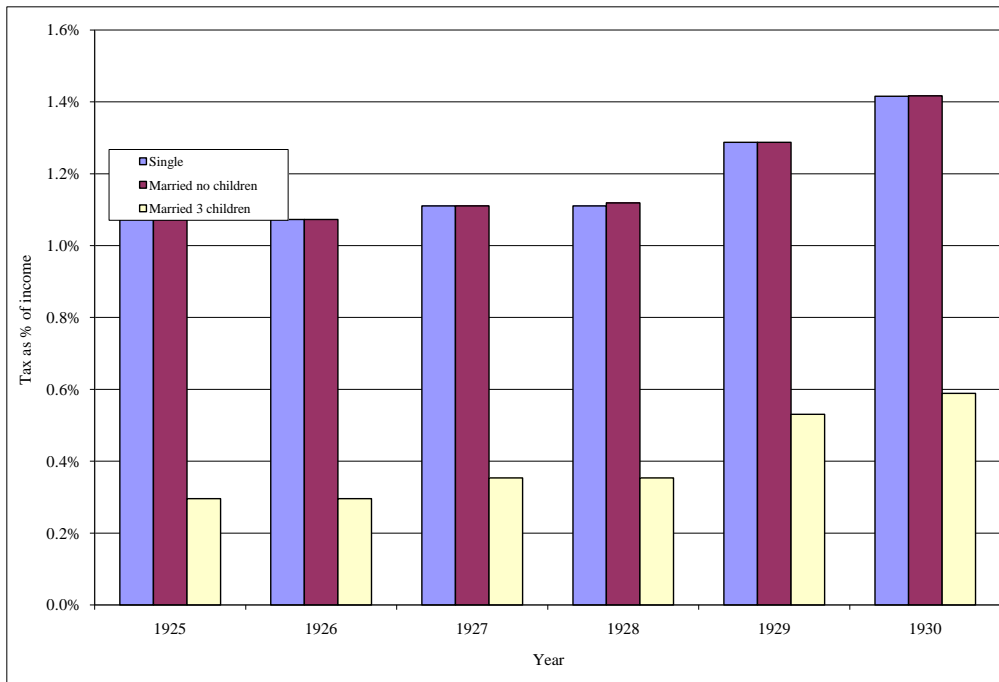


Figure 9.3 Personal income tax for taxpayers on a medium income (1925-1930)

Figure 9.4 indicates that the same pattern was evident for high income earners, except that the tax was at a higher effective rate.

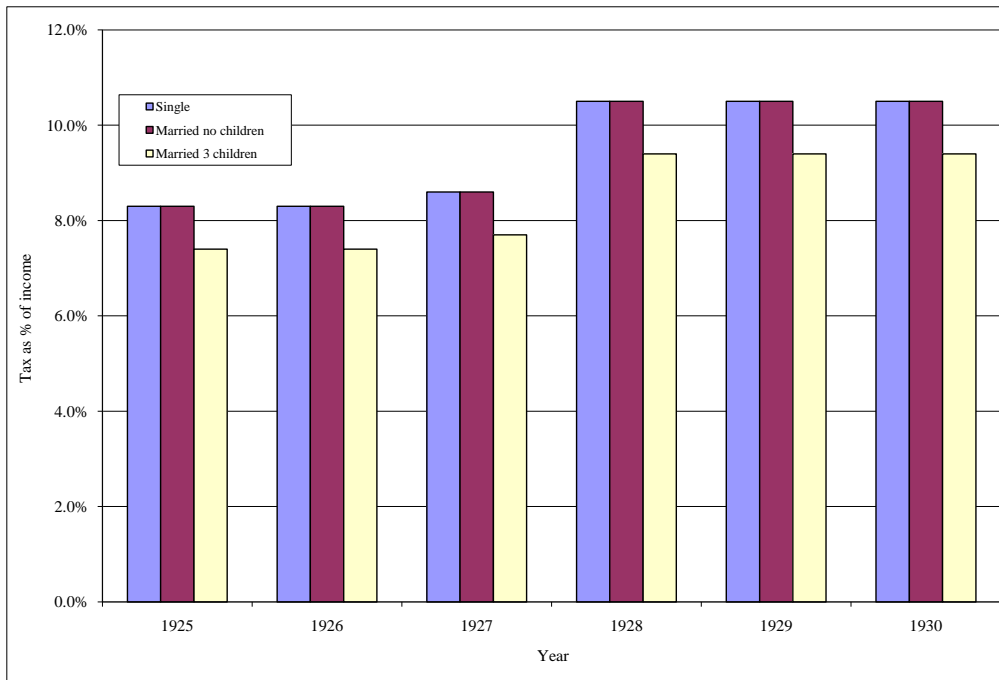


Figure 9.4 Personal income tax for taxpayers on a high income (1925-1930)

9.5 Vertical Equity

By 1925, the income tax had reached a relatively stable state. As in the two decades from its introduction to the outbreak of World War One, changes were relatively minor; the only significant change being the rates increase effective in 1928, which is curiously reminiscent of the 1911 increase. However, unlike the previous period, this “steady state” only lasted for half a decade, before the Great Depression and political change of the 1930s followed by World War Two occasioned significant changes to the income tax.

Compared to the pre-war situation, overall rates of tax settled much higher. The top marginal rate was now 4s. 6d, which was almost four times the top rate of 1913. However, this rate only applied to incomes some 33 times a hairdresser’s award wage, compared to 16 times in 1913. In practice, a single high income earner who had paid income tax of around 3½ percent in 1913 was paying just over 10 percent in 1929. This increase reflected the falling benefit derived from the General Exemption, and the effect of the steeper progression.

Low income earners remained exempt from the income tax. Middle income earners were barely affected by it. The income tax remained largely a tax on high income earners, a group which

presumably had the shoulders to bear it. In the absence of Social Security provision, it also derived the most benefit from taxation revenue in terms of infrastructure and protection of property.

Despite this apparent stability, there was little by way of a clearly stated basis for vertical equity in the income tax. Pragmatism, rather than principle, determined taxation practice. Nor was the status quo uncontentious; the low tax rhetoric of the ruling party was contested by the increasingly powerful Labour Opposition, which did not hesitate to voice its concerns in Parliament.

The Government's annual Budget statements emphasised economy over equity. In 1926, Finance Minister Downie Stewart noted that "the principle of enforcing economy and effecting savings has been sustained, and in this respect I will adhere to the established policy."⁶ He repeated this theme in subsequent years: in 1927, he noted that "the policy of economy was strictly pursued throughout the year,"⁷ and in 1928 he reiterated a focus on balanced budgets.⁸ In 1930, by which time the Great Depression had set in, Prime Minister Forbes emphasised increasing tax as a top priority, since maintaining a surplus was essential if the budget were to be balanced.⁹ Almost as an afterthought, Forbes noted that:

*... the most the Government can do is to endeavour to place the additional burdens as equitably as possible and in such a way as to cause as little economic disturbance as possible, in order that a return to more prosperous times may not be hindered more than can be helped.*¹⁰

Although the shape of the income tax had changed markedly since its introduction, the rationale for the income tax had not. As far as the government was concerned, the income tax was intended for revenue purposes. The several bases for the apportionment of the tax burden could be understood in these terms: ability to pay (and sacrifice) referred to the ability to pay (or sacrifice) toward the costs of government, which should be kept to a minimum; benefits theory

⁶ NZPD, vol. 209 (8 July 1926), 582.

⁷ NZPD, vol. 213 (2 August 1927), 165.

⁸ NZPD, vol. 218 (7 August 1928), 24.

⁹ NZPD, vol. 224 (24 July 1930), 566.

¹⁰ Ibid., 591.

was understood essentially in quid pro quo terms, but did not extend to redistribution. The role of government was limited, and taxation should be minimised.

Although there may have been agreement on the need for balanced budgets, this limited focus was questioned. Anstey, a Reform Party Member of Parliament, derided the membership of the 1924 Royal Commission on Taxation appointed by the Government as those who “represented big vested interests, and were very wealthy men.”¹¹ He also noted that matters affecting those on lower incomes had not been addressed, even though “any one who knows anything about the subject at all knows that taxation can be used as a medium for the more even distribution of wealth.”¹² This “knowledge” was not being applied.

Previously the Liberals’ taxation policy and graduation had been castigated by the Conservatives as “class legislation”. Now, in criticising the post-war tax reductions, Labour’s McCombs returned the charge. The Labour Party would:

*... stand up for the interest of the great mass of people as against class legislation of this sort – legislation which is deliberately designed to secure and give advantages to the privileged few who stand behind the present Government on the Treasury benches.*¹³

Labour Members argued for a redistributive use of taxation in both negative and positive terms. Negatively, the government was not dealing with the inequalities of Dominion taxation. Rather, the policy seemed to be that “to him that hath shall be given.”¹⁴ The tax cuts only benefited the wealthy, and the wealthier one was, the greater the benefit of any tax cut. Low income earners, on the other hand, received no benefit at all from the income tax cuts, since they paid no tax in the first place. Although the lower income earner might benefit from reductions in customs duties, these benefited the rich just as much, since customs and excises were levied at flat rates. Hence tax relief was being given to the very persons who were best able to bear the tax. With reference to the 1927 tax increase, Labour leader Savage argued:

¹¹ *NZPD*, vol. 208 (9 September 1925), 161.

¹² *Ibid.*, (F J Rolleston).

¹³ *Ibid.*, 143.

¹⁴ *Ibid.*, 125.

*The general impression is that it is those in the middle class of taxpayers who are going to bear the burden of taxation under this proposal. The big taxpayers are not affected by it at all. How does that square with the Minister's statement that the individual best able to bear the burden should do so?*¹⁵

Rather, he argued that “we ought to commence at the other end ... [income] ought to be taxed according to the capacity of the owner of that income to pay.”¹⁶

By 1930, the concept of ability to pay, of “placing the burden on the shoulders best able to bear it,” was accepted by all parties, as was a progressive income tax. However, it meant different things to different parties. For the Government, it meant minimising the cost of tax to those who paid the income tax: reductions could and should only go to those who paid the tax in the first place. In contrast to this focus on the individual taxpayer, the Labour Opposition adopted a communal perspective: no tax cuts should be made to the wealthy unless the livelihood of the poor was secured.

9.6 Summary

If the period from 1925 to 1929 provided a post-war tax paradigm, what did this look like? Figure 9.5 indicates the prevailing tax rates scale as first introduced in 1892, then again immediately prior to World War One, and finally in 1929. Prior to the War, only a high income earner paid income tax. The 1911 amendments had increased the rate payable at all points on the scale. Notably, the high income earner, who received ten times the hairdresser's award rate, paid close to the top of the scale. By the end of the war, a medium income earner was paying tax, and due to the combined effects of a reduction in the General Exemption, inflation-induced bracket creep, and income tax rates rises, a hairdresser was earning close to the minimum income upon which income tax was payable.

¹⁵ *NZPD*, vol. 213 (1 September 1927), 938.

¹⁶ *Ibid.*

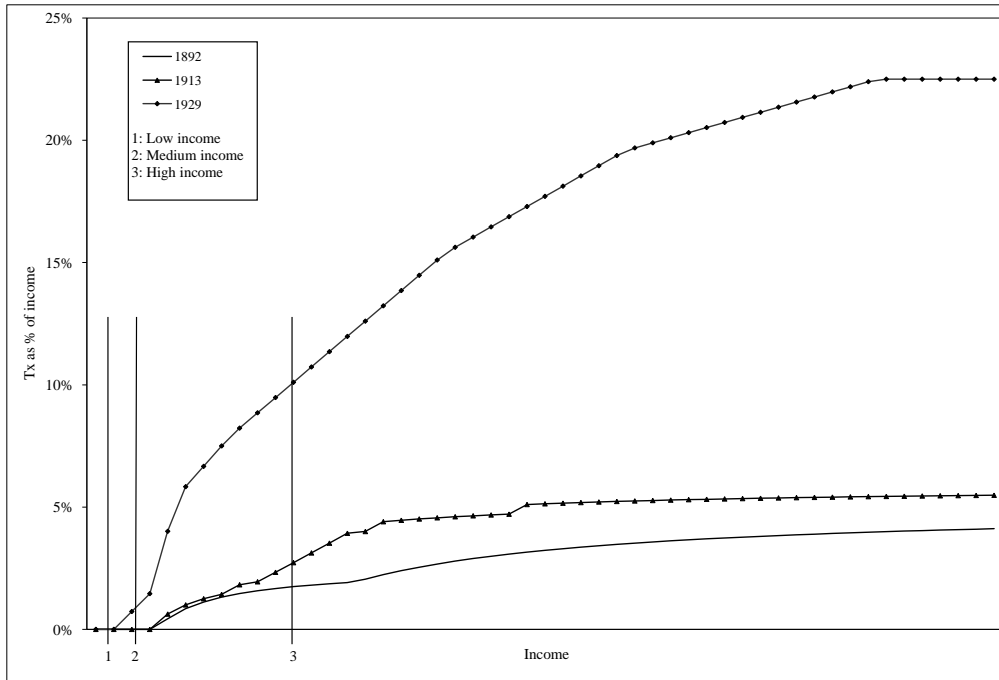


Figure 9.5 Taxation rates scales 1892, 1913, and 1929 (real) for an income earner who was single¹⁷

A significant shift had occurred in the income tax rates scales by 1929. Whereas before World War One the high income earner was paying near the top of the scale, in 1929 the high income earner only paid tax at about half the highest rate even though the rates scale had been considerably extended. Further, the rate of progression decreased markedly as income increased. Since higher income earners are more likely to be able to structure their affairs to avoid taxation, it is possible that few taxpayers were actually affected by the top rate.

The peace-time patterns of the income tax are summarised in Table 9.1. Compared to the two pre-war situations (1892 and 1913), by 1929 only the lowest incomes were exempt from income tax, and above average incomes were taxed on a progressive scale.

¹⁷ Adjusted to real terms based on the Hairdresser's award rate.

Table 9.1 Summary of taxation on a single person's income, 1892, 1913, and 1929 (nominal)

Year	1892	1913	1929
Income tax threshold	£300 ¹⁸	£300 ¹⁸	£300 ¹⁸
Tax rate at income tax threshold	6d. (2½%)	6d. (2½%)	7d. (2 ¹¹ / ₁₂ %)
Income threshold for top marginal rate	£1,300 ¹⁸	£2,300 ¹⁵	£8,700
Top marginal tax rate	1s. (5%)	1s. 2d. (5 ⁵ / ₆ %)	4s. 6d. (22½%)
Low income	£113	£125	£260
Tax on low income	nil	nil	nil
Middle income	£225	£250	£520
Tax on middle income	nil	nil	1.3%
High income	£1,100	£1,300	£2,600
Tax on high income	1.8%	3.5%	10.2%
Effect of marriage on income tax	None	None	Child rebate

In the absence of any major shocks or political change, this tax pattern might have endured for some years. Yet it may be questioned whether this pattern represented taxation assessed on the “equitable and scientific basis”¹⁹ promoted by Finance Minister Downie Stewart. Indeed, the debates suggest a lack of consensus as to what this might mean. However, unlike the two decades following 1891, any post-war stability was short-lived. Barely a decade after the Armistice, New Zealand again faced a severe economic depression, and a decade later World War Two. In this context the Labour Party also came to power. These critical events were to have a direct effect on the practice of personal income taxation.

¹⁸ Allowing for the £300 General Exemption.

¹⁹ 1927 Budget Speech, *NZPD*, vol. 213 (2 August 1927), 171.

Chapter 10

1930-1940: The Great Depression and the Labour Party Response

In my opinion, when we have a democratic State, in which every one has an individual say in the government of the country, he should accept a certain reasonable amount of responsibility in return for the privilege of being one of the governors of the country.

Adam Hamilton, Coalition Minister of Labour 1931-35¹

The thing that matters most is how much he has got left over when he has paid the tax. Now the people are going to have something left over after they have paid the tax, and that is what they have not had for years past.

H. T. Armstrong, Labour's Minister of Labour 1935-38²

10.1 General Context

The decade following the Wall Street Crash was characterised by economic depression and hardship, but the tough times were already evident prior to the October 1929 Stock Market Crash.³ Two months before that event Ward, who was both the Prime Minister and the Finance Minister, noted “urgent economic problems facing the country;”⁴ yet he suggested that:

Given a little enterprise on the part of the producers and the business community generally – and they have not been lacking in this respect in the past – I feel assured that all obstacles will be overcome; unemployment will disappear, and all will be well in this Dominion. It has certainly been slow in coming, but signs are not wanting now that we are on the eve of a big forward movement in business.⁵

¹ *New Zealand Parliamentary Debates (NZPD)*, vol. 224 (23 July 1930), 511.

² *NZPD*, vol. 247 (24 September 1936), 379.

³ The New Zealand economy was marked by depression from the early 1920s; Greasley and Oxley label the period from 1923 to 1931 a “long depression”: David Greasley and Les Oxley, “Regime Shift and Fast Recovery on the Periphery: New Zealand in the 1930s,” *The Economic History Review* 55 (2002): 718. Greasley and Oxley also argue that the recovery in the economy in the 1930s predated the election of Labour, and had monetary rather than political causes.

⁴ *NZPD*, vol. 221 (1 August 1929), 840.

⁵ *Ibid.*, 841.

He was not alone in his optimism. Shortly before the 1929 Stock Market Crash, economist Irving Fisher famously declared that, “Stock prices have reached what looks like a permanently high plateau.”⁶ Like Ward, his prophetic skills proved to be deficient.

Hard cases may make for bad law, and tough economic times may force difficult policy options. Political responses to the Depression reflected two contrasting economic approaches: belt-tightening and budget-balancing by the Coalition Government before 1935; and pump-priming by the Labour Government after its first electoral success in 1935. Although both governments increased taxation, the rationale for the increases differed, as is evident by comparing the Budget presented by the Coalition’s Minister of Finance Coates in 1935 with that of Labour’s Finance Minister Nash the following year. Coates looked back, noting that:

*As a result of the stern measures adopted we have regained budgetary stability without a legacy of accumulated debt, which is a point that will doubtless be noted with envy by some of our less fortunate neighbours.*⁷

His comparison was with Australia in general, but particularly with New South Wales, which had twice defaulted on its debts under Premier Jack Lang.⁸ In contrast, Nash looked forward, painting a future of increased production and a happy home life:

The aim of this government as expressed in a paragraph was and is –

*To organise an internal economy that will distribute the production and services of the Dominion in a way that will guarantee to every person able and willing to work an income sufficient to provide him and his dependents with everything necessary to make a “home” and “home life” in the best sense of the meaning of those terms.*⁹

⁶ Cited in John K. Galbraith, *The Great Crash of 1929* (Boston, MA: Houghton Mifflin, 1954), 75.

⁷ *NZPD*, vol. 242 (17 September 1935), 413.

⁸ Manning Clark, *A Short History of Australia* (Sydney: Mead and Beckett, 1983), 201; Malcolm McKinnon, *Treasury: The New Zealand Treasury 1840-2000* (Auckland: Auckland University Press, 2003), 117: “Debt repayments, which accounted for nearly half of all expenditure, could not be cut because this would breach the ‘sanctity of contract’ – or, more potently, the ability to borrow in the future. The determination of New South Wales’ Labor Premier, Jack Lang, to suspend all overseas debt was abhorred.”

⁹ *NZPD*, vol. 246 (4 August 1936), 262.

Both needed finance: Coates to balance the budget and minimise debt; Nash to provide the income he sought to guarantee to each home. This necessarily meant increased taxation. Although the shape of taxation may have looked little different under either government, the rationale did differ significantly. By the end of decade, Labour held a firm grip on power, having been re-elected in 1938, and was able to start implementing its social security policy.

Yet before it could complete its programme, the nation again faced the prospect of an overseas conflict; as during World War One, increased taxation would be required to fund another World War. Unlike then it would also be needed to finance increased social spending.

10.2 Taxation Context

Tax revenue as a percentage of GDP increased consistently throughout the 1930s. Although total tax revenue fell by some 11 percent between 1930 and 1933, GDP contracted at a faster rate, dropping 30 percent in nominal terms from 1930 to 1933.¹⁰ The United (1928 to 1931), and Coalition (1931-1935) Governments responded to the Great Depression by increasing taxes to ensure that the country paid its way by balancing its budgets.

In contrast, the First Labour Government, elected in 1935, found itself in a similar situation to that faced by Liberals in 1891, entering office in the context of, though towards the end of, a depression. Labour attempted to stimulate demand by boosting spending, and introduced “cradle to grave”¹¹ social welfare measures. Despite this, tax as a percentage of GDP actually fell slightly during the first five years under Labour. This was largely due to post-depression increases in GDP: nominal GDP reached its depression low-point in 1933, surpassed its pre-depression highpoint in 1937, and more than doubled between 1933 and 1939.¹² In part, too, increases due to social security did not impact until late in the decade, since the Social Security Act was not enacted until 14 September 1938.

¹⁰ Total (nominal) GDP sourced from Statistics New Zealand, New Zealand Long Term Data Series (LTDS), Table E.1.1, Series: National Income, Sub-series: Gross Domestic Product, Title: National Gross Domestic Product, <http://www.stats.govt.nz/tables/ltds/ltds-national-income.htm> (accessed 5 February 2009), using Column 8.

¹¹ Barry Gustafson, *From the Cradle to the Grave: A Biography of Michael Joseph Savage* (Auckland: Reed Methuen, 1986).

¹² GDP figures as provided by Statistics New Zealand: New Zealand Long Term Data Series, Series: National Income, Subseries: Gross Domestic Product, Table E.1.1, Title: Nominal Gross Domestic Product, using NZIER data Column 8. See also David Greasley and Les Oxley, “Regime Shift and Fast Recovery on the Periphery: New Zealand in the 1930s,” *The Economic History Review* 55 (2002): 700.

The composition of taxes changed significantly during this period. The progressive element of the land tax was removed in the Land and Income Tax (Annual) Act 1931, effectively halving the amount of land tax assessed. Thereafter the land tax contributed less than 10 percent of all direct taxes (that is, land tax, income tax, and social security-type taxes) in 1932, and half that again by 1940. By 1945, it had fallen to less than 1 percent. Whereas the land tax had been the dominant partner in the original Land and Income Assessment Act 1891, the income tax had assumed this role during World War One. By 1939 it comprised two-fifths of total tax revenue and over 90 percent of direct tax revenue.

10.3 Income Tax Legislation

10.3.1 Tax rates

Although the basic structure of the income tax did not change, several significant alterations were made that affected employees. The Coalition Government responded to the Great Depression by increasing taxation to ensure a balanced budget. After all, as Forbes, the Finance Minister and Prime Minister, put it in his 1930 Financial Statement, “A country dependent on overseas investors for the greater part of the capital required for developmental purposes cannot afford to impair its credit by deficits.”¹³ For this reason “it was found necessary to reduce expenditure and increase taxation in order to ensure a balanced Budget.”¹⁴ Indeed, during the early years of the Great Depression:

*Belief in the desirability of a balanced budget was almost universal, overseas as well as in New Zealand. To be radical was to suggest that the deficit should be eliminated gradually rather than immediately.*¹⁵

The Conservative United Party’s Forbes thus concluded his 1930 Budget by reemphasising the need for fiscal restraint:

*In order that this Dominion should maintain its credit on the world’s money-market, the Government would be failing in its duty to the country if it did not bring down proposals to balance the budget.*¹⁶

¹³ NZPD, vol. 224 (24 July 1930), 566.

¹⁴ Ibid.

¹⁵ Gary R. Hawke, *Depression and Recovery in New Zealand: VUW Working Paper in Economic History 85/2* (Wellington: Victoria University, 1985), 9.

Several of these measures affected a wage or salary earner. First, although the 1928 rates scale remained in effect, a 10 percent super tax was imposed in 1931,¹⁷ which was increased to 30 percent for the income years from 1932 to 1936.¹⁸ Further increasing the tax, the 10 percent reduction for earned income was replaced by a 33⅓ percent “emergency tax” on unearned income in 1931.¹⁹ A taxpaying wage earner thus lost the benefit of the earned income rebate, and by these two measures a taxpaying employee saw rates increase by over 40 percent.

Secondly, the government addressed the economic crisis with an additional tax to cover the extra cost of unemployment schemes – leaving posterity to question the wisdom of taxing wages while trying to expand employment.²⁰ A levy of 30 shillings per annum on male workers over 20 years of age applied effective 1 December 1930.²¹ This levy took the form of a poll tax. At its introduction Smith, the Minister of Labour, noted that:

*The Unemployment Committee in its recommendation regarding the raising of the money for this [Unemployment] fund stressed the point that it had in view the distributing of the burden as equitably as possible, and when the Government’s full proposals have been revealed it will be found that the recommendation of the Committee has been carried out, but in a different way.*²²

From 1 August 1931 the Government renamed this levy the General Unemployment Levy and reduced it to 20 shillings. However, it added an Emergency Unemployment Charge of three pence in the pound, which was deducted at source.²³ This rate was altered to a shilling in 1932,²⁴ ten pence in 1934,²⁵ and eight pence in 1935.²⁶ In addition an Emergency Tax, being a special

¹⁶ Ibid., 594.

¹⁷ Land and Income Tax (Annual) Act 1930, schedule.

¹⁸ Land and Income Tax (Annual) Act 1931, schedule.

¹⁹ Ibid.

²⁰ Hawke, *Depression and Recovery*, 3.

²¹ Unemployment Act 1930, s. 6.

²² *NZPD*, vol. 224 (18 July 1930), 396.

²³ Unemployment Amendment Act 1931, s. 4(2).

²⁴ Unemployment Amendment Act 1932, s. 8, effective 1 May 1932.

²⁵ Order in Council, *New Zealand Gazette* (Wellington: Government Printer, 1934), 3005, effective 1 October 1934.

²⁶ Order in Council, *New Zealand Gazette* (Wellington: Government Printer, 1935), 2696, effective 1 October 1935.

flat rate tax of four pence per pound on income over £500, was introduced from the 1932 tax year.²⁷

A significant change in philosophy occurred with the election of the First Labour Government in 1935. Labour did not initially alter the tax, but then significantly increased the income tax rates in 1937.²⁸ The initial tax rate increased from seven pence (or just over nine pence once the 30 percent surcharge was added) to 20 pence in the pound, while the top rate went from 4s. 6d. (or 5s. 10d. once the 30 percent surtax was included) on incomes over £8,700, to 8s. 7d. on incomes over £8,950.²⁹ The one-third surcharge on unearned income remained.

Comparing the new 1937 rates scale with its predecessor, the main effect was the inclusion of the middle income earner in the income tax net. Meantime, the low income earner was not subject to income tax – though only just: the hairdresser’s 1937 award rate was £228 as against a General Exemption of £260. By 1939, when the award rate had increased to £273, the low income hairdresser, too, was subject to income tax proper. From its origins as a direct tax on high incomes, New Zealand’s income tax had become democratic: the payment of tax was a concomitant of communal responsibilities, citizenship, and fiscal virtue.³⁰

The Government sought to protect the progressive scale by including all tax-free income and income taxed at source in assessments in fixing the rate of tax and the level of special exemption that applied to the taxpayer. Dividends remained exempt income, but their recipients now paid income tax at higher marginal rates on their assessable income.³¹ Since the notional employees considered in this thesis derived only taxable income, this change had no effect on their tax calculations.

Labour retained the unemployment levy and charge but, significantly, renamed the former the “Registration Levy,” and the latter the “Employment Charge,” which it increased to one shilling

²⁷ Land and Income Tax (Annual) Act 1931, schedule. This levy applied for the 1932 to 1936 tax years inclusive.

²⁸ Land and Income Tax (Annual) Act 1936.

²⁹ Ibid.

³⁰ Dennis J. Ventry Jr., “Equity versus Efficiency and the U.S. Tax System in Historical Perspective,” in *Tax Justice: The Ongoing Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: The Urban Institute Press, 2002), 28.

³¹ Land and Income Tax Amendment Act 1931, s. 6. Refer ‘Adjuster’, “Land and Income Tax Notes,” *Accountants’ Journal* 10 (1931): 107-8.

per pound in 1939.³² In keeping with this more optimistic nomenclature, these measures were introduced in the Employment Promotion Act 1935, which was superseded in Labour's second term by the Social Security Act 1938. In contrast, the Coalition's measures had been enacted in what was called the Unemployment Act 1930.

10.3.2 Adjustments

In 1932, the Coalition Government reduced the General Exemption to £260, abating to zero once the income reached £800.³³ In 1937 the Labour Government further reduced it to £210;³⁴ however, the abatement provisions were removed. The Child Exemption of £75 per child remained unchanged.

One new allowance, the Dependent Spouse Exemption, was introduced in 1933.³⁵ Set at £50, this initially abated at a rate of one pound for every 30 shillings of income where the income exceeded £725, disappearing for incomes over £800. From 1937 the abatement provision was removed.³⁶

Although the forerunner of the Family Benefit was introduced in the Family Allowances Act 1926,³⁷ this benefit was means-tested such that not even a low income earner would have been eligible. It was clearly intended to assist families on subsistence incomes only. The Family Benefit will be discussed when it was extended to all families irrespective of income level in 1946.

10.4 Effect on Taxpayers

10.4.1 Income level

A result of the Coalition Government's measures was that all earners, regardless of income, paid direct taxation by way of the unemployment charge and levy. Arguably, these levies were akin to an insurance policy; the unemployment levies were to fund the cost of the "dole". However, these levies were compulsory, did not create any individual entitlements, and the Unemployment

³² Social Security Act 1938, s. 113.

³³ Land and Income Tax Amendment Act 1931, s. 3.

³⁴ Land and Income Tax Amendment Act 1936, s. 6.

³⁵ Land and Income Tax Amendment Act 1932-33, s. 4.

³⁶ Land and Income Tax Amendment Act 1936, s. 12.

³⁷ Family Allowances Act 1926.

Fund proved inadequate to meet the needs of the day. To all practical intents, it constituted a direct tax. Notably, it comprised both a flat rate levy or poll tax and a proportionate tax on income.³⁸ Meantime the income tax scale remained progressive albeit with a still substantial exemption level.

Taking all direct taxes and levies into account, the income tax remained progressive. With relatively minor differences, the overall pattern evident in Figure 10.1 held for all three domestic situations: at the beginning of the decade, a low income earner paid little if any tax, and the middle income earner paid a token percentage. By the end of the period, the low income earner paid more than half what a middle income earner did as a percentage of income, and the high income earner around twice as much. For all income levels the rate of tax had more than doubled over the decade. Significantly, the increase largely preceded Labour's coming to power in 1935 and the passage of the Social Security Act 1938.

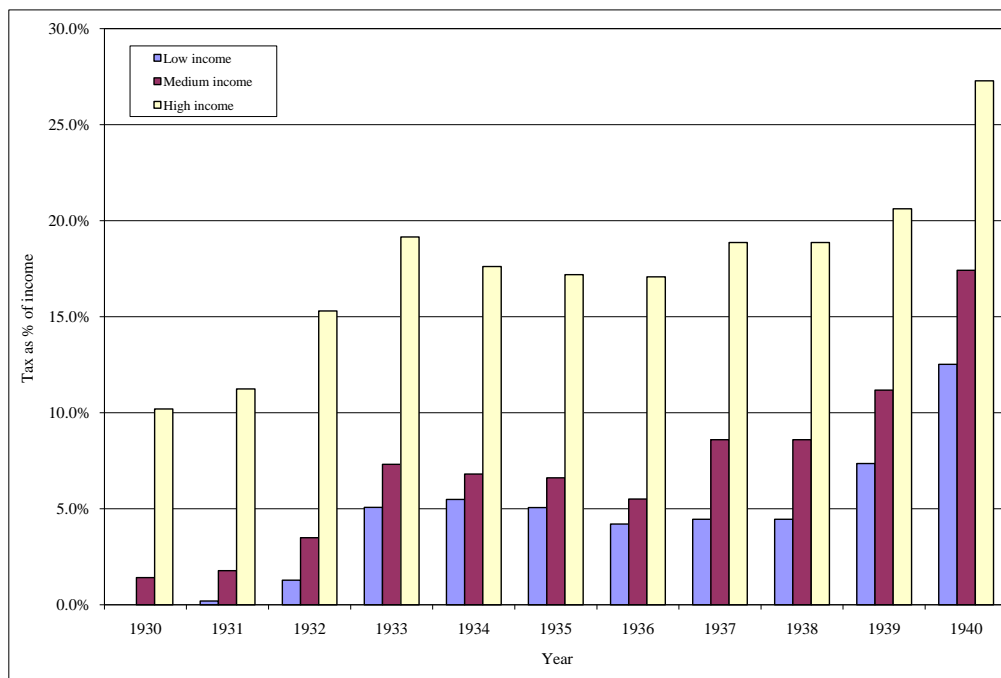


Figure 10.1 Personal income tax for single taxpayers at three income levels (1930-1940)

The same pattern is evident regardless of the domestic situation. Figure 10.2 shows the effect of differentiation based on income for married taxpayers with no children.

³⁸ Hawke, *Depression and Recovery*, 3.

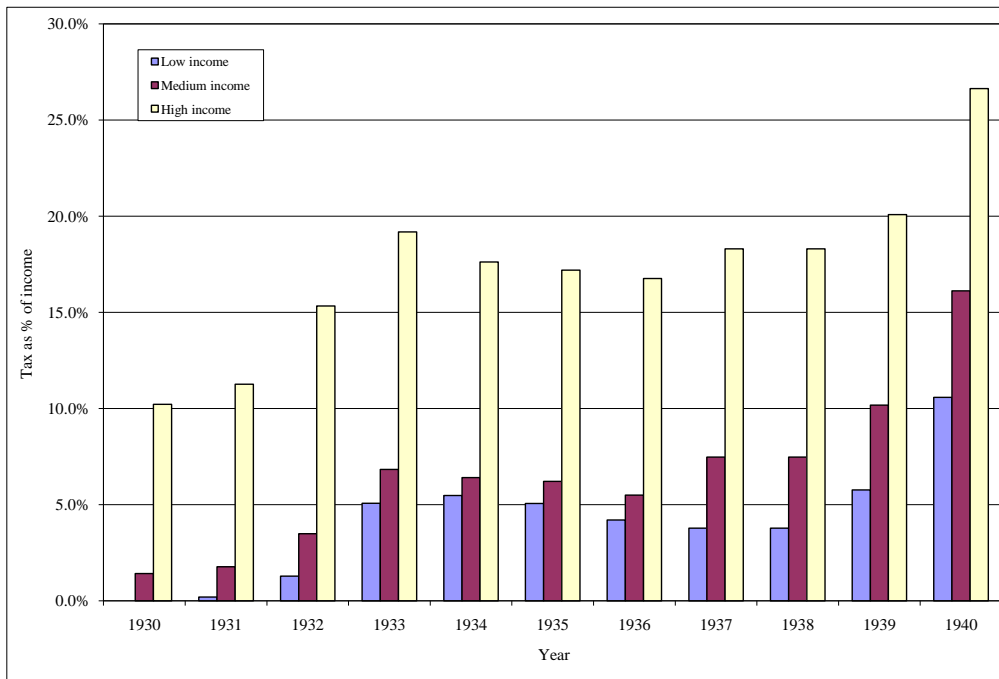


Figure 10.2 Personal income tax for married taxpayers with no children at three income levels (1930-1940)

Figure 10.3 shows the effect of children on the tax payable at each income level. In each case, the average rate of tax increasing as income increases. As the Great Depression ended, the effective average tax rate also levelled off.

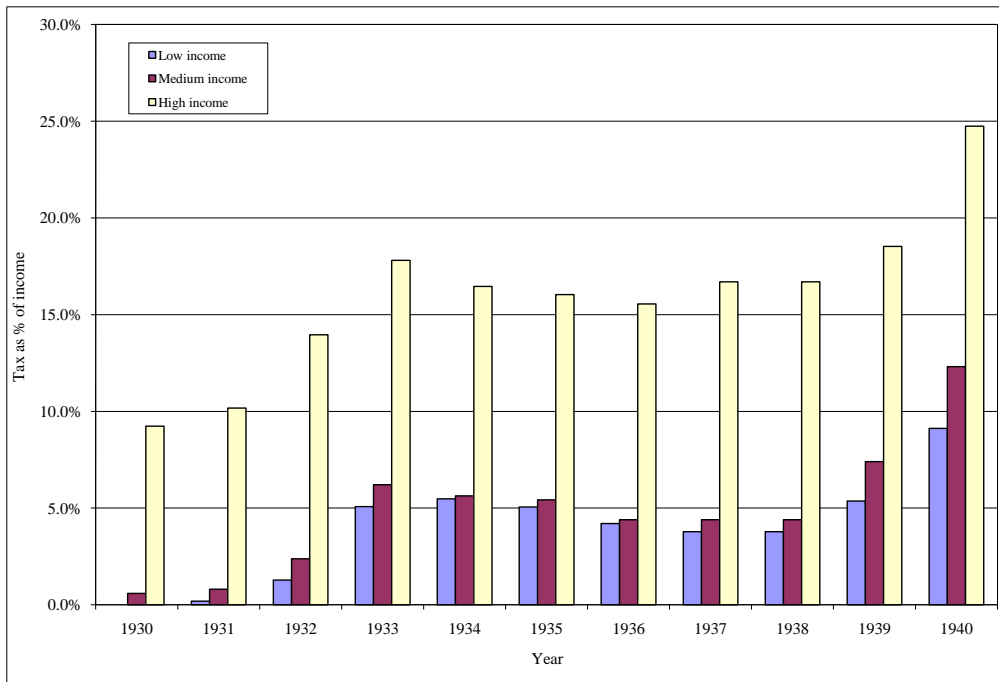


Figure 10.3 Personal income tax for married taxpayers with three children at three income levels (1930-1940)

10.4.2 Family circumstances

Certain higher income taxpayers with children had benefited from the Child Exemption since World War One. The introduction of the Dependent Spouse Exemption further differentiated taxpayers based on domestic situation. Those with children paid less tax than couples without children, and couples without children paid less tax than singles. During World War One there was pressure in Parliament to extract more from bachelors; the Dependent Spouse Exemption accomplished a similar effect by reducing the tax on married persons.

These two exemptions had little effect on a low income earner until the end of the period as they only applied to the income tax, and not to the unemployment levies; until 1936 the flat rate unemployment levies were the only direct tax paid by the low income earner. From 1937, the low income single taxpayer became liable for income tax, due to an increase in the award rate and a decrease in the general exemption. A married person became liable for income tax in 1939 whereas a low income earner with three children remained exempt from the income tax during the Thirties. The effect of the Dependent Spouse and Child Exemptions is evident in Figure 10.4, but only after the low income earner actually had income tax to pay.

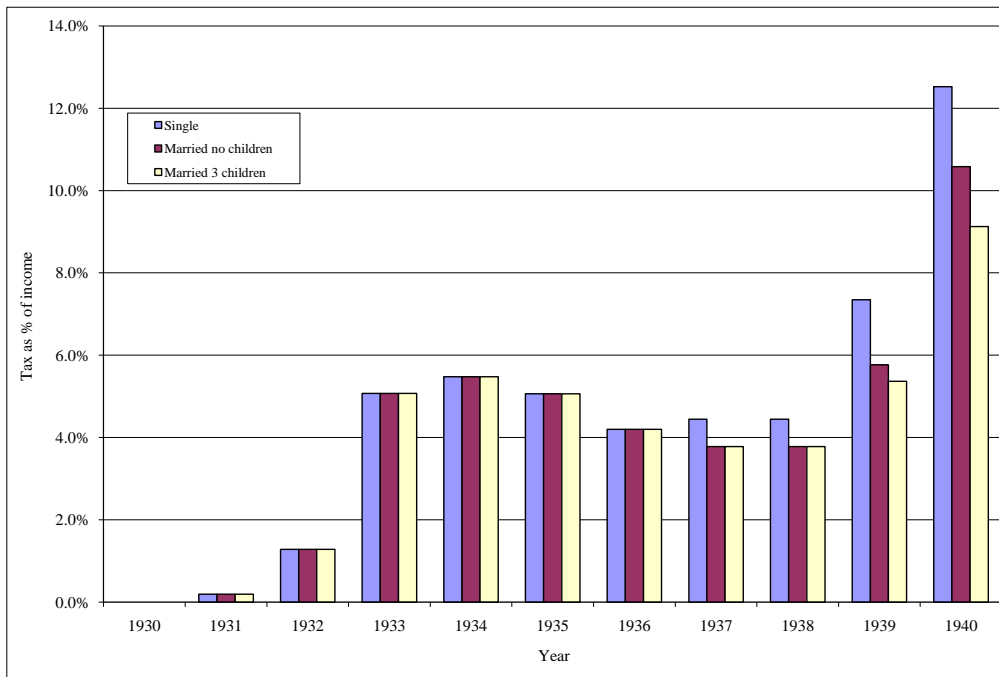


Figure 10.4 Personal income tax for low income earner in three domestic situations (1930-1940)

Medium income earners started to pay income tax in 1920 but their rate of tax had not exceeded 2 percent before 1930. Their tax increased significantly during the 1930s, due to the levies introduced by the Coalition Government, and then the increased tax rates imposed by the Labour Government. Compounding this was the post-Depression increase in wage rates. Since the medium income earner was liable to the income tax throughout this period, the Dependent Spouse's Exemption reduced the total direct tax payable by a married taxpayer without children from its inception in 1933, as is evident in Figure 10.5.

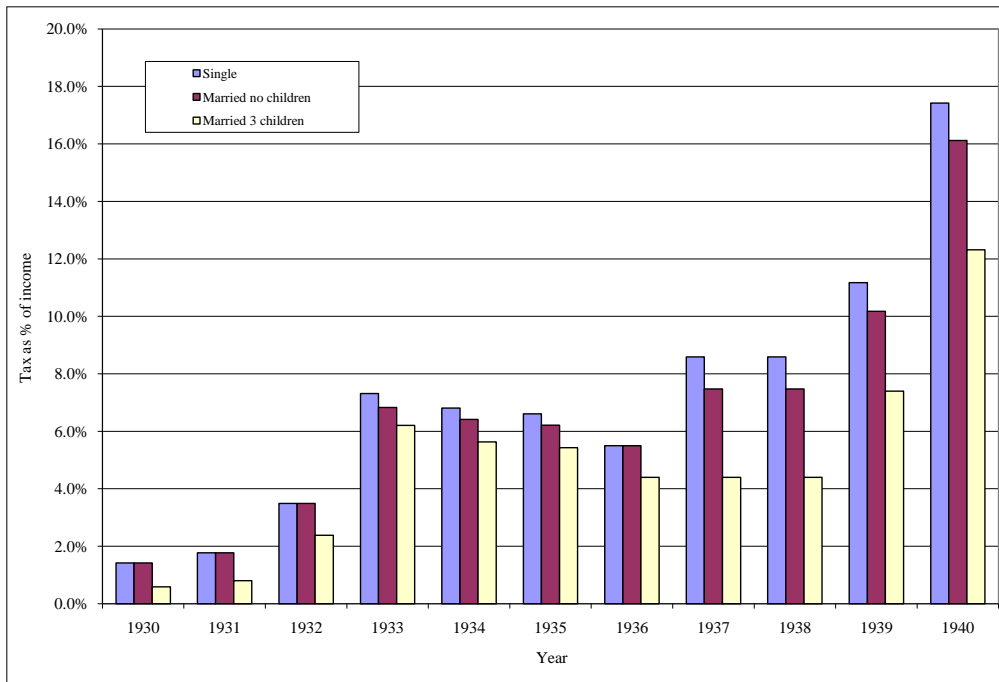


Figure 10.5 Personal income tax for medium income earner in three domestic situations (1930-1940)

Unlike low and high income earners, medium income earners did pay significantly higher tax following Labour's election. The lowest rate of a flat 7d. per pound on incomes up to £300, increased to 20d. plus $\frac{1}{100}$ d. per pound on incomes to £5,500 in 1937. The further increase evident in 1939 reflected a significant increase in income that year following an increase in the hairdresser's award rate, rather than a change in tax rates, since these did not change that year. This is an example of bracket creep, that is, an increase in effective tax rates that results when inflation-induced wage increases push a taxpayer into a higher tax bracket.

The introduction of social security was not accompanied by a separate levy; instead, the previous Government's "Emergency Unemployment Charge" was continued by Labour at the same rates, though renamed the Employment Charge. This was again renamed the Social Security Levy in the Social Security Act 1938, and increased by 4d. per pound effective 1 April 1939.³⁹

The effect of the additional levies and the Dependent Spouse's Exemption is evident, though less pronounced, on a high income earner, as depicted in Figure 10.6. Although it was introduced from 1933, a high income earner did not gain any benefit from this allowance until the means-

³⁹ Social Security Act 1938, s. 113.

testing provision was removed from 1937.⁴⁰ Again, it is notable that Labour's election had a relatively minor effect on a high income earner's tax; the level of tax payable by a high income earner in 1939 was little different from that of 1933.

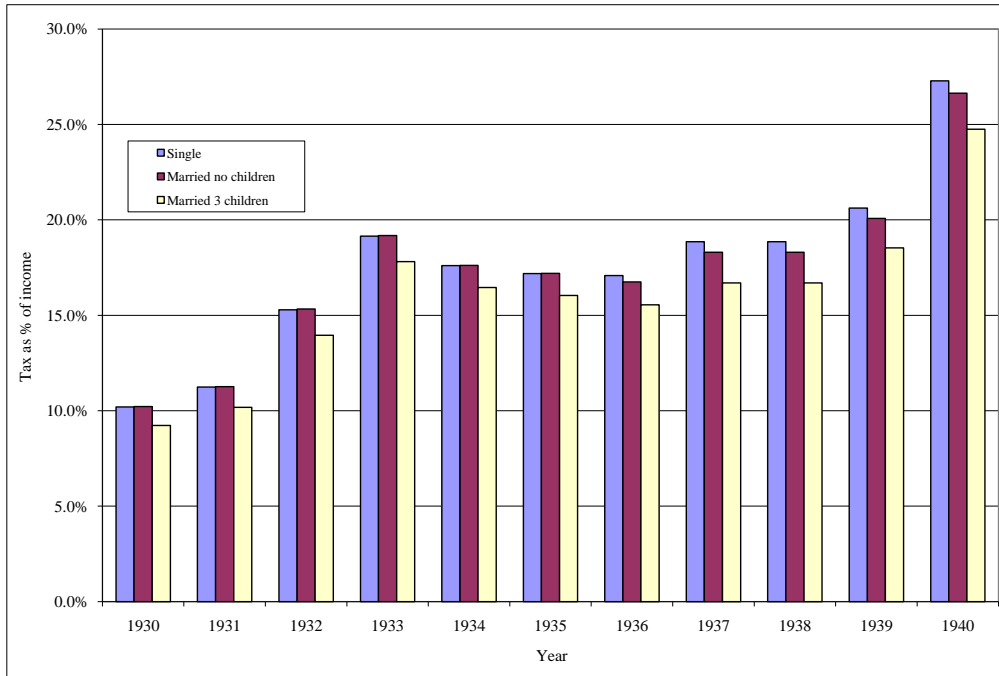


Figure 10.6 Personal income tax for high income earner in three domestic situations (1930-1940)

10.5 Vertical Equity

10.5.1 How to tax: Basis of assessment

The language of sacrifice had been prominent in discussions of the income tax during World War One; since so many were sacrificing their lives on the battlefields of Europe, those back home should sacrifice their means to fund the war effort. Yet the sacrifice should be apportioned based on the taxpayer's ability to pay; the tax should be placed on those shoulders best able to bear it. Certainly the notion of taxing in terms of benefits received was not forgotten; those who benefited from war should contribute to its cost.

After the cessation of hostilities, the income tax eventually returned to its pre-war form, although it affected lower incomes than before and at higher and more progressive rates. The focus of debate in the 1920s had been not so much on how to tax, but rather on the uses of the tax.

⁴⁰ Land and Income Tax Amendment Act 1936, s. 12.

Whereas the ruling Reform Party (to 1928) and United Party (from 1928) sought to minimise tax and use the revenue exclusively for government purposes, the Labour Opposition had argued for an increase in the responsibilities of government to alter the distribution of wealth. The Great Depression of the 1930s brought the parties' differing philosophies into sharper relief. However, the debates again evinced the lack of any clear basis for equity in income taxation, beyond the vague notion that the tax should be fair.

10.5.1.1 Reform Party

Waging war had always been regarded as a legitimate function of government, and redistributing income from individuals to the military in times of war had long been accepted; the introduction of the British income tax to finance the Napoleonic Wars provides a case in point. In contrast, the idea that the Great Depression was a type of (economic) war that justified the mobilisation of resources and their redistribution to those in need was not generally held. Economic downturns were considered a matter for households, rather than for governments, to address. The President of the New Zealand Society of Accountants encapsulated this view in the midst of the Depression in his 1931 President's Address:

I may be considered to be old-fashioned and out-of-date when I state that I am an ardent admirer of the self-reliant man who prides himself on surmounting his own problems, as against the man who first looks to Government or outside help to provide him with often the luxuries of life ... It has become a growing practice to appeal to Government in all kinds of circumstances ... Are we not losing much of the self-reliance of our forefathers?⁴¹

The government's speeches repeated the same refrain. In a context of rising unemployment, Prime Minister Coates argued strongly for "no work no pay," and indeed for lower rates of pay for relief work.⁴² Government salaries and services were cut. Government Member Hall suggested that the government had two options in addressing the economic crisis; economy, or

⁴¹ W. D. Revell, "President's Address," in *New Zealand Society of Accountants Yearbook 1931* (Wellington: New Zealand Society of Accountants, 1931), 45. Self-help and family duty, rather than dependence on the community, characterised New Zealand society in the nineteenth century: see David Thomson, *A World without Welfare: New Zealand's Colonial Experiment* (Auckland: Auckland University Press, 1998), 5.

⁴² *NZPD*, vol. 224 (18 July 1930), 402.

increasing tax. He favoured economy, that is, cutting expenditure.⁴³ In fact, the government did both.

Balancing the Budget was perhaps the Reform Government's leading priority. This indeed had been the economic orthodoxy prior to the Great Depression. McKinnon speaks of the nineteenth century "Tripod" of economic orthodoxy: the gold standard, free trade, and balanced budgets, with the latter being overtaken by the events of the Great Depression.⁴⁴

Forbes, and his successor Coates, repeated this theme almost annually.⁴⁵ By 1935, in an election year and after the economy had turned a corner, Coates could summarise his government's achievement: "As a result of the stern measures adopted, we have regained budgetary stability without a legacy of accumulated debt."⁴⁶ Although the form of the income tax remained unchanged, rates were increased, roughly doubling as a percentage of income for middle and high income earners between 1930 and 1933. As in a military crisis, an economic crisis required greater sacrifices.

The income tax rates scale introduced in 1928 was not replaced until 1937. Hence, as far as the basic income tax was concerned, the progressive principle applied, and the General Exemption meant that low income earners paid no income tax. However, both high and low income earners faced increases in the direct tax they had to pay. Those paying income tax were levied a surcharge of 10 percent in 1931, which increased to 30 percent from 1932 to 1936. High income earners also faced a flat rate emergency tax of four pence per pound on incomes over £500. By means of a progressive income tax (supplemented by a progressive emergency tax), the government sought to balance the budget.

On the face of it, Labour had no objection in principle to this increase in taxation; following its election in 1935, it maintained, and then increased, the income tax on low and middle incomes. However, it was in the area of social welfare that a significant difference between the

⁴³ *NZPD*, vol. 224 (5 August 1930), 869.

⁴⁴ McKinnon, *Treasury*, 11-21, 116-24.

⁴⁵ This theme is alluded to in each successive Budget speech: refer *NZPD* vol. 228 (30 July 1931), 871 (Forbes); vol. 233 (4 October 1932), 236 (Forbes); vol. 237 (9 November 1933), 129 (Coates); vol. 239 (23 August 1934), 399 (Coates); and vol. 242 (17 September 1935), 407 (Coates).

⁴⁶ *NZPD*, vol. 242 (1 September 1935), 407.

Government and its Labour Opposition was evident, as the debates on the Unemployment Bill of 1930 highlight.

The Unemployment Bill of 1930 introduced the Unemployment Levy and Charge. At its introduction, Coates, then in Opposition, expressed his strong distaste for anything resembling a dole. He suggested instead that Parliament “might very well go further and declare that there shall be no pay if there is no work.”⁴⁷ As for providing such work, he indicated his general agreement with “a policy of endeavouring to provide the money in this country for the purpose of employing men ... and as far as possible resting the burden on the shoulders of those who can afford to contribute for such purposes.”⁴⁸ In return for this payment, a contributor to the Unemployment Fund was entitled to subsistence relief for a limited period, if required.⁴⁹ Subsequently, the Government reduced this levy to twenty shillings per annum, but added a flat rate levy with no de minimis limit.⁵⁰

The measures enacted by the Government were not social security measures whose cost was to be shared by the whole community. Rather, the government applied a social insurance model: each earner would pay into a fund which would then pay for the costs of unemployment. The intention was for unemployment relief to be self-funding. The Unemployment Levy was effectively a poll tax on earners, as Labour was quick to point out. Labour leader Holland urged that “we do not agree with this flat rate tax,”⁵¹ and Labour’s Rev. Carr protested against “the proposals of this Bill that go in the direction of a poll-tax,” before reminding the members that poll-taxes and pole-axes were closely linked in history.⁵² Instead, he argued that:

⁴⁷ *NZPD*, vol. 224 (18 July 1930), 492.

⁴⁸ *Ibid.*, 401.

⁴⁹ Unemployment Act 1930, s. 20. The relief specified in that section was for a male: 21s. per week; his wife 17s. 6d. per week; and for each child 4s. per week. This equates to £1 1s. for a single person, £1 18s. for a married person with no children, and £2 10s. for a married man with three children. By comparison, a hairdresser’s award wage in 1930 was £5 per week in 1930.

⁵⁰ The Unemployment Amendment Act 1931 introduced this at a rate of 3d. per pound, effective 1 August 1931. This was subsequently increased to a shilling per pound effective 1 April 1932 (Unemployment Amendment Act 1932), and then reduced to 10d. per pound from 1 October 1934 (Order in Council, *New Zealand Gazette* (1934), 3005), and to 8d. per pound from 1 October 1935 (Order in Council, *New Zealand Gazette* (1935), 2696).

⁵¹ *NZPD*, vol. 224 (18 July 1930), 405.

⁵² *NZPD*, vol. 224 (23 July 1930), 496, harking back to the Peasant’s Revolt against the King’s Poll Tax led by Wat Tyler in 1381.

*Whoever carries on any form of business in this country should be interested in the proposition that every one capable of working shall have the opportunity to do so. However we want a graduated scale of taxation instead of a flat rate tax.*⁵³

The Unemployment Levy and Charge differed in principle from the Income Tax. The government did not see the provision of unemployment relief as an ordinary legitimate application of tax revenue. Had it done so, it could have simply added a surtax to the income tax akin to the War Tax and War Levy applied in World War One. This was suggested by Labour Member Chapman:

*I would suggest that a fund be raised by a surtax on incomes, and that the surtax should not operate on incomes under £400 per annum. I would further suggest that the tax be steeply graduated.*⁵⁴

In this way, the cost of unemployment relief would be shared across the community on the same basis as other government costs were apportioned, that is progressively. As far as Labour was concerned, this would have better placed the weight of unemployment relief upon the shoulders best able to bear it. Instead, a benefits concept prevailed; each should pay for their own (social) protection. The government did not analogise social provision during a depression with war, or even consider such provision to be an ordinary component of government expenditure. Rather, it was a personal responsibility which, though met by concerted action, was at individual expense. Hamilton, leader of the United Government, echoed both benefits theory and the notion of no representation without taxation:

*In my opinion, when we have a democratic state, in which every one has an individual say in the government of the country, he should accept a certain reasonable amount of responsibility in return for the privilege of being one of the governors of the country.*⁵⁵

⁵³ NZPD, vol. 224 (18 July 1930), 406.

⁵⁴ NZPD, vol. 224 (24 July 1930), 565.

⁵⁵ NZPD, vol. 224 (23 July 1930), 511.

These contrasting approaches to war and unemployment financing reflect differing evaluations of the two; the government saw fighting a war as a legitimate government activity. It called for sacrifice on the part of all. As such, ability to pay or sacrifice theory provided the best model for taxation. Conversely, unemployment was a personal, rather than a social, matter. Ideally each individual or family should provide for themselves. Any government involvement should be minimal. Benefit theory better reflected this viewpoint; like an insurance policy, a person only derives the benefit, meagre though it might be, in return for having made their contribution. As Hamilton put it, “If the workers are going to get the benefits from [the flat tax], they ought to accept their full measure of responsibility.”⁵⁶

The Labour Opposition weighed in against the flat rate tax. Its leader, Harry Holland, argued that it “would throw a heavier burden on the rank and file of the people than on those who have large incomes.”⁵⁷ Savage contrasted the enacted flat tax with a tax graduated in accordance with ability to pay.⁵⁸ Nash restated the earlier Labour theme that taxation should be evaluated in terms of what is left over, not what is paid:

*We ought definitely to assess the payments into the [unemployment] fund on the basis of what a person has left when he has made his payment, and not provide for the payment of a flat rate by everyone.*⁵⁹

Subsequently, Labour Member Armstrong made the same point:

*It is not how much a person pays in taxation that matters to him. The thing that matters most is how much he has got after he has paid the tax.*⁶⁰

Labour Members questioned both the efficacy and the equity of the policy of casting the burden of unemployment relief on low income earners. Wright opposed the flat tax on the grounds that

⁵⁶ Ibid.

⁵⁷ *NZPD*, vol. 224 (18 July 1930), 405.

⁵⁸ Ibid., 415.

⁵⁹ Ibid., 431.

⁶⁰ *NZPD*, vol. 247 (24 September 1936), 380.

he did not think the money could be raised in that way due to the hardship on those on lower incomes.⁶¹ This poll tax put the burden on those who could least afford it.⁶²

The conservative United (to 1931) and Reform (1931-1935) Government's response to the Great Depression was to focus on balancing the budget. This was evident in the raising of taxes and the introduction of a poll tax to cover unemployment costs on a user-pays basis. Whereas a war called for a communitarian response, an economic downturn called for self-reliance.

10.5.1.2 Labour Party

The concepts of ability to pay, benefits, and sacrifice could be used by both sides of the House as slogans when it suited their argument. Two other terms were also often heard during the Thirties: Socialism, and Christian.

As had the Liberals, so the Labour Party was regularly accused of promoting socialism. This accusation was not unfair: the Labour Party did promote the socialisation of the means of production, as the Labour masthead proclaimed. It may have been true that, "New Zealand had for some time tended toward Socialism,"⁶³ as opposition Member Edean claimed; yet Opposition leader Sidney Holland could still goad Labour on this basis:

*I would like to ask whether any member of the Labour government will deny that the objective of the Government is the socialisation of the means of production.*⁶⁴

The term "socialism" required definition. Gustafson comments:

... from the first election in 1919, socialism was defined in terms of humanitarian liberalism and Fabian collectivism rather than scientific Marxism. The 1951 Labour party conference rather belatedly recognised this and deleted reference to the NZLP's

⁶¹ NZPD, vol. 224 (23 July 1930), 522.

⁶² Ibid., 496.

⁶³ NZPD, vol. 253 (12 September 1938), 295.

⁶⁴ NZPD, vol. 247 (24 September 1936) p. 368.

aims to the passing and administering of laws 'to socialise the means of production, distribution and exchange'.⁶⁵

Progressive taxation was consistent with Labour's Fabian socialist roots. Yet given its negative connotations, Labour shifted away from the use of the term "socialist; rather, reflecting the religious views of a number of its members,⁶⁶ a number of Labour Members promoted its measures – both the social welfare but also its taxation policy – as consistent with Christianity, albeit reflecting liberal Christian views.⁶⁷ During the debate on the Land and Income Tax Act 1936, Labour's James Thorn weighed in against the post-war income tax reductions which favoured the wealthy:

I say that any system which allows a comparatively small handful of people to possess tremendous wealth while their fellow-countrymen suffer poverty is economically unjust and morally indefensible. It is absolutely un-Christian. It cannot be defended by any principle in any decent religion.⁶⁸

Prime Minister Savage was more direct. A form of tax was needed that would take from the rich and give to the poor, thereby placing "taxation on the shoulders of those best able to bear it" and manifesting "Christianity in practice".⁶⁹ Savage thus baptised increased progression in the

⁶⁵ Barry Gustafson, "Labour Party," in *New Zealand Politics in Perspective*, ed. Hyam Gold (Auckland: Longman Paul, 1992), 268. Hirschfeld comments: "At the first conference of the Labour Party following this (1935) election the stated object of the party – the socialisation of the means of production, distribution and exchange – was changed; with the new objective being the far vaguer 'to secure by constitutional means the adoption of the party's platform and objective', Michael A. Hirschfeld, *The New Zealand Labour Party in Office 1957-60*, (MA Thesis, Victoria University, 1970), 1.

⁶⁶ A number of the leaders of the Labour Party had Christian convictions: for example, Walter Nash was a practising Anglican: Keith Sinclair, *Walter Nash* (Auckland: Auckland University Press, 1976), chapter 2; Arnold Nordmeyer had been a Presbyterian minister: Keith Eunson, *Mirrors on the Hill: Reflections on New Zealand's Political Leaders* (Palmerston North: Dunmore Press, 2001), 71ff; and Michael Savage was a lapsed Catholic who returned to the church near the end of his life: Barry Gustafson, *From the Cradle to the Grave: A Biography of Michael Joseph Savage* (Auckland: Reed Methuen, 1986), 212.

⁶⁷ O'Farrell devotes a chapter of his biography to the shifting religious views of the early New Zealand Labour Party leader Harry Holland, tracing his move from Christian evangelicalism in the Salvation Army, to Socialist evangelicalism: P. J. O'Farrell, *Harry Holland: Militant Socialist* (Canberra, Australian National University, 1964), chapter 5.

⁶⁸ *NZPD*, vol. 247 (24 September 1936), 363.

⁶⁹ *NZPD*, vol. 247 (25 September 1936), 422-3.

income tax in the same terms as he had baptised the Social Welfare system in general as “Applied Christianity”.⁷⁰ For Armstrong, vertical equity could be summarised as sharing:

*We are taking it [revenue] from people who have money to spare in order to relieve distress in the ranks of the people who are living on the poverty line. Surely that is strictly in accordance with Christian principles.*⁷¹

It was also “the first duty of any government to see, for instance, that the children of the country are decently housed, clothed and fed,”⁷² and taxation was necessary to achieve this. Labour’s social approach to hardship contrasts with its predecessor’s individualistic response to the Great Depression.

Later, the Social Security Act 1938 was promoted in similar terms. Legislative Councillor Lark suggested that rather than calling such measures ‘Communism’, “our opponents should recognise that the highest Christian principles are being carried into effect by people who are undoubtedly imbued with a sense of idealism.”⁷³ This represented a shift in benefits theory. Nash noted both the give and the take of Labour’s policy; the government would take “when the taxpayer can spare them without its hurting him, and provided it is for the benefit of those who most need it.”⁷⁴

Just as ability to pay, benefits and sacrifice could be interpreted in different ways, so could the adjective “Christian”. The conservative Legislative Councillor Carrington noted that, “The Parliament of this country acknowledges that it is a Christian country,”⁷⁵ and would offer his cordial support to the humanitarian proposals of the Labour Government, which, after all, were “an extension of such legislation already placed on the statute-book of this country by past Liberal and Reform governments.”⁷⁶ However, he could not support such proposals when they

⁷⁰ *NZPD*, vol. 252 (18 August 1938), 423. For further discussion see Robert M. Chapman, “From Labour to National,” in *The Oxford History of New Zealand*, ed. Geoffrey W. Rice (Auckland: Oxford University Press, 1992), 362.

⁷¹ *NZPD*, vol. 247 (24 September 1936), 381.

⁷² *Ibid.*

⁷³ *NZPD*, vol. 251 (29 June 1938), 10.

⁷⁴ *NZPD*, vol. 252 (16 August 1938), 336.

⁷⁵ *NZPD*, vol. 251 (29 June 1938), 75.

⁷⁶ *Ibid.*

were promoted by a government “pledged to the Communist principle of the socialisation of the means of production, distributions and exchange,”⁷⁷ and which supported the views of Lenin who urged the abolition of religion.⁷⁸ In the House, National’s leader Sidney Holland was no less scathing, calling the financing of the proposed social security scheme, “applied lunacy”.⁷⁹

That there was an overt Biblical tinge to the debates at the time of the First Labour Government is unsurprising; “the reading they quoted ranged from Bellamy, Hobson, and Blatchford to Henry George, John Stuart Mill, and Bernard Shaw,” yet, “their most frequent source was certainly the Bible.”⁸⁰ This religious strand in Labour continued through to the 1980s:

*As Arnold Nordmeyer, himself a former Presbyterian minister, observed, ‘the idealism that inspired Labour’s leaders, the humanitarianism that moved them, was essentially Christian – not always recognised as such, but undoubtedly Christian in essence’. Thus, Savage could refer to the first Labour government’s social security scheme as “applied Christianity”; Nash could consistently portray himself as creating Christ’s Kingdom on earth; and Lange [Labour Prime Minister from 1984 to 1989] could preach in stirring Methodist phraseology his message of love, peace and reconciliation.*⁸¹

Certainly, too, it questioned the ethics of the previous government, which, it said, had taxed the poor. Looking back, Labour Member Langstone taunted the Opposition, “What a kind, Christian Government it was, to treat itself and its friends so well, and to take it out of the pockets of the poor!”⁸²

Although far from the only influence, Christian Socialism had been a major influence on the Labour Party.⁸³ It did find a basis for ethics, including taxation ethics, in the teachings of Jesus Christ. However, given the varieties of Christian teaching, it could not provide a uniting ethic

⁷⁷ Ibid.

⁷⁸ *NZPD*, vol. 251 (30 June 1938), 77.

⁷⁹ *NZPD*, vol. 252 (25 August 1938), 556.

⁸⁰ Chapman, *From Labour to National*, 354.

⁸¹ Gustafson, *Labour Party*, 269f.

⁸² *NZPD*, vol. 253 (12 September 1938), 300.

⁸³ The link between Fabian Socialism and Christianity is already evident in S. D. Headlam, *Fabian Tract 42: Christian Socialism* (London: Fabian Society, 1899).

that might be adopted by Parliament as a whole. Certainly Parliament used the language of fairness; the problem was a lack of agreement as to just what that might mean. An appeal to Christianity did reflect the beliefs of some of Labour's Members. It did, also, resonate with a nation that thought of itself as Christian,⁸⁴ suggesting a practical outworking of the Sermon on the Mount⁸⁵ and the Golden Rule.⁸⁶

Yet for all this, the Labour Government did not radically overhaul the tax system upon assuming power in 1936. Indeed, the tax payable by low and middle income earners actually increased after Labour's accession to power, while a high income earner only saw a modest increase in tax. In part, Labour benefited from excellent timing; by the time of their election the worst of the Great Depression was over. The Labour Party, like the Liberal Party in 1891, entered office at the end of a crisis, not at its start. Like the Reform Party after its election victory in 1911, Labour did not radically alter the taxation policy of its predecessor. Its tax policy reflected what had already been accepted by the community.

The subsequent history of the Labour Party in government suggests that its major innovation was not so much in taxation; by 1935 the progressive principle was pretty well entrenched. Even low income earners were paying direct taxation by way of the unemployment levy and charge. Rather, its innovation was in expenditure with the introduction of comprehensive social security.

10.5.2 How to tax: The practice of graduation

The propriety of progression in the income tax was not questioned. Significantly, though, Labour increased the progression on lower income levels, particularly with its new rates scale in 1939 which was needed to meet the increased costs of social security. The original £300 exemption remained in place, with the progression increasing particularly on higher incomes.⁸⁷

This increase of tax on those with lower incomes may be interpreted in various ways. Since social security provides a safety net, there was less need to save for the future, and thus a greater ability to pay tax. Alternatively, in return for the benefits of social security, a taxpayer should pay

⁸⁴ *NZPD*, vol. 251 (29 June 1938), 75.

⁸⁵ Matthew 5-7.

⁸⁶ Luke 6:31: "Do to others as you would have them do to you" (New International Version).

⁸⁷ *NZPD*, vol. 254 (1 August 1939), 890.

more tax, which is an application of benefits theory to those on lower incomes. However, those on lower incomes would still have only a limited ability to pay tax.

Interestingly, Labour had derided the flat rate levy at its introduction, yet now retained it. In 1930, Harry Holland had objected on the grounds that it “would throw a heavier burden on the rank and file of the people than on those who have large incomes,”⁸⁸ and Savage had argued that ability to pay should be the basis.⁸⁹ The shift between Labour’s rhetoric while in Opposition, to its practice while in power, reflects both the realities of having to ‘balance the books’,⁹⁰ but also a change in context; Labour’s social security measures enhanced the ability of those on lower incomes to pay the tax.⁹¹ Further, it might be argued that the social security taxes were akin to an insurance premium, and were not really a tax all.⁹²

A similar shift is evident in the Opposition, who now argued for taxation based on “a fair and equitable basis,”⁹³ namely ability to pay rather than benefits received. Opposition leader Forbes put it succinctly: “Nobody likes paying taxes, but provided they are graduated according to the ability of those who have to pay, there cannot be the same objection.”⁹⁴ Yet the old question remained: what does “ability to pay” mean?

10.5.3 What to tax: Tax base

The tax base changed little during the 1930s. However, many farmers were once again subjected to income tax in 1929, depending on the unimproved value of their land.⁹⁵ As a result, the base of the income tax became more comprehensive in the sense that almost all earners were again subject to the income tax.

⁸⁸ *NZPD*, vol. 224 (18 July 1930), 405.

⁸⁹ *Ibid.*, 415.

⁹⁰ Note Labour Member James Barclay’s comment linking the need for revenue with the government’s social programme: “The point is that the Government wants money to pay the pensioners” – which indicates the tension between the provision of social programmes and the need to pay for them via taxes: *NZPD*, vol. 247 (24 September 1936), 371.

⁹¹ However, not all Labour members agreed with this shift. In particular, John Lee subsequently castigated his colleagues for failing to conscript wealth and for deserting their socialist principles: *NZPD*, vol. 257 (1940), 609, 611.

⁹² *NZPD*, vol. 257 (18 July 1940), 613.

⁹³ *NZPD*, vol. 248 (13 October 1937), 827.

⁹⁴ *Ibid.*

⁹⁵ For a summary of the liability of farmers to income tax, refer Taxation Review Committee, *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington: Government Printer, 1967), 477-8.

10.5.4 Why tax: Role of government

At the introduction of the Unemployment Act 1930, the United and Reform Governments did not consider the provision of unemployment relief to be a government function. Individuals should take care of themselves. Certainly, the government might facilitate relief, but it should be on a user-pays basis. The Social Security Act 1938 changed this focus. Labour introduced the legislation prior to the 1938 election, with the intention to pass it after the election. In a sense, that election was a referendum on Labour's social security policy.⁹⁶ The landslide victory that Labour gained indicates that a majority of New Zealanders no longer accepted the conservative view of a limited role for government.

With an increased role for government came an increased need for revenue. However, since government expenditure now benefited all income levels – those on lower incomes by means of social security, those on higher incomes in terms of protection and infrastructure – it was not unfair for all sectors of society to contribute to the taxation revenue. Labour Member Langstone put this clearly:

*The government in its justice says, 'According to the benefits and the privileges and the other advantages you receive, you are called upon to contribute that amount of income tax which is necessary and essential for the running of New Zealand.'*⁹⁷

This extended role of government reflected another shift. Taxation equity no longer was focused on the apportionment of the tax between individual taxpayers or groups of taxpayers, but increasingly became a matter of fairness between taxpayers and the government.

10.6 Summary

Following a short period of relative calm following World War One, the income tax changed substantially during the 1930s. Prompted by the Great Depression, the government moved tentatively into providing social welfare for the unemployed. However, this was not financed by means of the income tax, but rather by way of a flat rate levy.

⁹⁶ Tom Brooking, *Milestones: Turning Points in New Zealand History* (Palmerston North: Dunmore Press, 1999), 157-62.

⁹⁷ *NZPD*, vol. 253 (12 September 1938), 301.

Upon coming to power, the Labour Government maintained the flat rate levy, but also significantly increased the income tax – but particularly on lower and middle incomes. Interestingly, the conservative notion of ability to pay seems to have been accepted by Labour once social conditions were such that the lower classes were in a position to pay. The provision of social welfare removed the risks to which the higher tax would otherwise have exposed these workers.

Taxation policy in the 1930s evolved as a response to a crisis as it had in the past: in 1891 as a response to a cry for land and a change in the franchise, in the 1910s as a response to war, and in the Thirties as a response to the Great Depression. Whether the tax structure of 1939 would have endured as a new paradigm had World War Two not intervened cannot be known; a paradigm comprising a flat rate element to cover much of the cost of social welfare, and a progressive rate to cover the balance of government expenditure. Given that the social security charge only paid for about 70 percent of the disbursements from the Social Security Fund in the period from 1940 to 1951,⁹⁸ it is likely that direct taxation would have been subject to substantial change. That change did occur is clear, but to what extent this resulted from Labour's social welfare policy, and to what extent it was due to World War Two, must remain a moot question.

The political changes of the 1930s, which involved a shift from a user-pay to a social welfarist approach to welfare provision, reflects a change in the justification for taxation. Ability to pay was still the watchword. However, the introduction of social security significantly altered the implications of this phrase. As a result, the government became an increasingly significant player in discussions of taxation fairness. Certainly, inter-personal comparisons remained important, and distinctions were made based on income level and domestic circumstances. However, fairness between a taxpayer and the state came increasingly into view, as the government not only taxed more, but also engaged in redistribution of income. Higher direct taxation had always been a consequence of war; it now also became a norm in peacetime.

⁹⁸ T. N. Gibbs, *Report of the Taxation Committee*, (Wellington: Government Printer, 1951), para. 191.

Chapter 11

1940-1950: World War Two and Security

As it is the most equitable form of taxation, income tax will be considered first.

Prime Minister Peter Fraser¹

11.1 General Context

Like a loyal child, New Zealand followed Britain in declaring war on Germany in September 1939.² Labour's Prime Minister Savage moved the motion confirming the existence of a state of war between His Majesty and the Government of the German Reich as from half past nine on 3 September 1939.³ Following a unanimous vote, the national anthem was sung and three cheers were given for His Majesty the King. The easy part done, the country was set on a war footing. World War Two dominated the decade of the 1940s. Although never itself invaded, New Zealand operated a war economy, with a significant reduction in personal and economic freedoms.⁴

The Labour Party was in power throughout the war years, only losing control of the Treasury Benches in the 1949 elections. Despite, or perhaps because of, the war, GDP more than doubled in nominal terms from 1940 to 1950, while inflation totalled a remarkably low 38 percent during the same period. Given an 18 percent increase in population from 1,634,000 in 1940 to 1,928,000 in 1950, real GDP per head of population increased by over a third during the war, in large measure because within a week of the outbreak of war Britain agreed to buy New Zealand's entire exportable surplus of meat, butter, cheese and wool for the duration of the war at favourable prices.⁵ In the midst of the loss of freedom and other deprivations, New Zealand's economy taken as a whole benefited from World War Two, having the world's third highest per-capita GDP after the USA and Canada in 1953.⁶

¹ *New Zealand Parliamentary Debates (NZPD)*, vol. 261 (30 April 1942), 195. Prime Minister Fraser read the 1942 Financial Statement in the absence of Minister of Finance Nash.

² Gerald Hensley, *Beyond the Battlefield; New Zealand and Its Allies 1939-45* (Auckland: Penguin, 2009), 17-22, provides a detailed review of the New Zealand Parliament's process of declaring war.

³ *NZPD*, vol. 256 (5 September 1939), 20.

⁴ Gary R. Hawke, *Government in the New Zealand Economy* (Wellington: New Zealand Planning Council, 1982), 39-40.

⁵ Hensley, *Beyond the Battlefield*, 55.

⁶ John D Gould, *The Rake's Progress? The New Zealand Economy since 1945* (Auckland: Hodder and Stoughton, 1982), 21.

11.2 Taxation Context

On the face of it, tax-wise World War Two followed a pattern similar to World War One; a massive increase in taxation, which was only slowly reversed once the war was over, though again not to pre-war levels. However, unlike during World War One, the government more speedily put the economy and taxation on a war footing in an endeavour to avoid the high debt levels and inflation that had occurred during the First World War. Finance Minister Nash summarised his Government's policy in the 1940 Financial Statement. He first outlined the options of increased taxation, inflation, and debt as means to finance the war. He then clearly stated his preference: "Following the principles outlined in my opening observations, as much as possible of this [expenditure] should be found from taxation," since war expenditure was destructive, not productive.⁷

Following World War Two, Nash proudly announced that of the total war expenditure of £507 million, only 43 percent remained outstanding, and noted that this was "no mean achievement for a population of only one million and three quarters."⁸ Nash took the opportunity to remind the members of the House of what he had said in his first war budget:

It is infinitely better for everybody that the measure of the sacrifice required from each and every one to carry on the war should be made out of our current income either by way of taxation or of savings ... The Government's policy for financing the national effort on the war front and the home front may be concisely stated as to tax to the economic limit for war purposes and borrow for essential productive works and for any balance of war requirements.⁹

This policy approach resulted in a remarkably conservative tax policy. Income tax affected all earners, with increasingly lower levels of income entering the income tax net. Certainly it was prudent; by focusing on raising taxation, the government sought to limit the other two means of financing a war: inflation, and debt. It also reflected the tight controls over New Zealand society, and especially over the economy during the war and beyond.¹⁰

⁷ NZPD, vol. 257 (27 June 1940), 304.

⁸ NZPD, vol. 269 (9 August 1945), 107.

⁹ Ibid., 108.

¹⁰ Gary R. Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985), chapter 9, entitled: "Controlled Economy, 1938 to about 1968 and after."

Total taxation as a percentage of GDP increased from 16 percent in 1939 to 29 percent in 1946, and dropped back to 25 percent by 1950. By contrast, in World War One tax as a percentage of GDP peaked at 13 percent in 1921. As for the composition of the tax, World War Two put the income tax on centre stage, both as the main source of revenue, and as a mass income tax. Whereas during World War One the share of tax revenue provided by the income tax had peaked at 46 percent in 1918, this increased from 39 percent in 1939 to 64 percent in 1945. Meantime, the income tax all but superseded the by now vestigial land tax.

A similar pattern of growth in the income tax during World War Two was evident in Britain,¹¹ Australia,¹² and the United States of America.¹³ In the case of New Zealand, lower income earners were already subject to taxation on their income by way of the Unemployment and then Social Security levies from the early 1930s. World War Two pushed almost all earners into the income tax net, establishing income tax (broadly defined) as the main tax in New Zealand, and as a virtually universal tax. High rates of taxation were only slowly reduced after the War, but by no means to pre-war levels.

A significant change shortly after the end of World War Two was the universalisation of the Family Benefit from 1 April 1946. This continued the social security innovations of the Labour Government. Although a form of Family Allowance had been introduced from 1 April 1927,¹⁴ this had been means-tested, with the cut-off income level being set quite low. Certainly, family circumstances had been recognised for tax purposes since the introduction of the Child Exemption in 1915. Whereas the Dependent Spouse and Child Exemptions reduced the assessable income, and thus only provided assistance to those who were liable to income tax, the Family Benefit was paid irrespective of income level. The Family Benefit was a type of demogrant, a fixed payment from the government to the taxpayer, or, in this case, to his or her

¹¹ Roy Douglas, *Taxation in Britain since 1660* (London: Macmillan: 1999).

¹² Stan Ross and Philip Burgess, *Income Tax: A Critical Analysis* (Sydney: LBC Information Services, 1996).

¹³ Witte speaks of the United States' income tax developing from a class tax to a mass tax during World War Two: John F. Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985), 110.

¹⁴ Family Allowances Act 1926.

children.¹⁵ Although it was administered by the Social Security Department independently of the taxation system, it effectively reduced the net tax a family paid to the government. A payment by the government to a taxpayer is, in practical terms, merely the flipside of a tax paid by the taxpayer to the government. The Family Benefit involved redistribution irrespective of need, with an increased priority given to families.

11.3 Income Tax Legislation

11.3.1 Tax rates

In 1940 the rates of the graduated income tax scale were sharply increased in response to World War Two. The scale had two steps: starting at two shillings per pound, then rising by $\frac{1}{100}$ d. per pound to a maximum of 8s. 7d. (43 percent).¹⁶ A War Tax surcharge of 15 percent was then added,¹⁷ which was credited to the War Expenses Account.

In 1941 the government replaced the graduated rates with a stepped scale “to obviate certain anomalies which would have been accentuated by increasing the rates under the graduated system used during the last few years.”¹⁸ Termed “Basic Rates,” the first £100 of income was taxed at 30d. per pound, with each successive £100 income step being levied at a rate three pence higher. Income over £3,800 was assessed at 12 shillings in the pound (60 percent). A 15 percent surcharge was then added with the proviso that the final rate not exceed 15s. 6d. (77½ percent).¹⁹ The Social Security charge was then added.

To preserve the progressivity of the rates scale where a taxpayer received non-assessable income, the Finance Act 1942 introduced what it termed a “simple system” of income taxation,²⁰ the so-

¹⁵ Rankin argues for the reintroduction of a Family Benefit type measure, and suggests that it is akin to a demogrant: Keith Rankin, “An Income Tax Proposal for New Zealand,” *New Zealand Journal of Tax Law and Policy* 13 (2007): 10.

¹⁶ Land and Income Tax (Annual) Act 1939.

¹⁷ War Expenses Act 1939.

¹⁸ *NZPD*, vol. 257 (27 June 1940), 304.

¹⁹ Land and Income Tax Amendment Act 1940, s. 2(4). A rate in excess of this was otherwise quite possible: a person taxed on unearned income exceeding £3,800 would pay income tax at 12 shillings per pound, plus a fifteen percent War Tax, plus an unearned income supplement of 33½ percent. All up this would come to 92 percent. When the war tax supplement increased to 33½ percent, potential rates in excess of 100 percent would have been possible.

²⁰ This “simple system” also led Opposition leader Holland to call for “the writing of our legislation in clearer language.” *NZPD*, vol. 261 (8 May 1942), 295. The simplification of New Zealand’s tax legislation was not commenced until the 1990s: refer Adrian Sawyer, “New Zealand’s Tax Rewrite Program – In Pursuit of the (Elusive) Goal of Simplicity,” *British Tax Review* 4 (2007), 405.

called A+B+C system of assessment, which was a modification of the system in place since 1931. Although non-assessable income (including company dividends) was not taxed as such, it was included in determining the rate of tax to apply.²¹ The intention was to protect the rates scale from abuse. Given the simplifying assumption that the notional taxpayers only derived wage or salary income, the A+B+C system had no effect on the calculation of tax for the purposes of this thesis. Nevertheless, it did indicate a continued desire to maintain progressivity within the income tax.²²

The 1941 Basic Rates remained in effect until the 1955 tax year. The 15 percent War Tax was increased to 33⅓ percent in 1943, dropping back to 15 percent in 1947, 10 percent in 1952, 5 percent in 1953, and 2½ percent in 1954, before being eliminated with the introduction of an amended Basic Rates scale in 1955.²³

A new war tax, the National Security Tax, was introduced effective 21 July 1940.²⁴ Initially levied at a flat rate of a shilling per pound, this was increased to 1s. 6d. per pound in 1942,²⁵ and reduced to 6d. per pound in 1946,²⁶ before finally being repealed in 1947.²⁷

The Social Security Tax continued in effect from 1939 to 1946 at a rate of one shilling per pound along with the Registration Levy of one pound per annum. From 1 April 1946, the rate was increased to 18 pence per pound, and the Registration Levy was repealed.²⁸

²¹ Put simply, the effect of the new method was to apply the “step” rates in the following order to taxable and non-taxable income:

1. Non-assessable income.
2. Earned taxable income.
3. Unearned taxable income.

Thus, if a person had £1,000 of non-assessable income and only £100 of earned taxable income, the step rate applying to income in the £1,000 to £1,100 band of income would be applied the £100 of taxable income, rather than the band applying for income between £0 and £100.

²² Note discussions of this system in ‘Editor’, “Editorial: New Technique in Income Tax Assessment,” *Accountants’ Journal* 20 (1942): 269-70: “Tax legislation should be designed only to produce revenue on a basis equitable to all sections. It should not attempt to accomplish social reforms, however desirable they may be.”

²³ Refer successive Land and Income Tax (Annual) Acts. See also E. P. Wills, “Indirect Taxes on Income,” *Accountants’ Journal* 28 (1949): 29; and ‘Assessor’, “Explanatory Notes on Proprietary Taxation,” *Accountants’ Journal* 29 (1951): 346.

²⁴ Finance Act 1940, ss. 16-17.

²⁵ Finance Act 1942, s. 8.

²⁶ Finance (No. 2) Act 1945, s. 19.

²⁷ Finance Act 1947, s. 11.

²⁸ Finance (No. 2) Act 1945, s. 23.

11.3.2 Adjustments

The familiar General, Child,²⁹ Dependent Spouse's, and Insurance Exemptions continued through this period. However, the General Exemption was reduced by £10 to £200 in 1940.³⁰ The Dependent Spouse's Exemption was doubled to £100, but was again rebated from 1947, reducing by £2 for every pound of the wife's income in excess of £50, and subject to the reduction in tax being no more than £26.³¹ The Child Exemption remained constant, other than being merged with the Dependent Relative Exemption in 1945.³² The Insurance Exemption was limited to 15 percent of assessable income with maximum exemption of £150. Except for the Dependent Spouse's Exemption, the value of these exemptions was falling; yet Table 11.1 indicates that the first three exemptions remained significant for a low income earner.

Table 11.1 Exemptions as a percentage of a low income earner's income

	1940 (%)	1950 (%)
General Exemption (£200)	71	48
Dependent Spouse's Exemption ³³	18	24
Child/dependent Exemption (£50)	18	12

A general rebate of £10 per person or £20 per couple was introduced in the Land and Income Tax (Annual) Act 1948. Unlike an exemption, the rebate reduced the tax payable, rather than the income that was taxable. Consequently, the value of the rebate was independent of an individual's progressive tax rate. Labour had previously complained that tax reductions or exemptions benefited those on the lowest incomes either not at all or less than those on higher incomes. Labour's Finance Minister Nash indicated that the intention behind this rebate was "to give some relief to individual taxpayers and particularly to those on lower incomes."³⁴ The subsequent debate highlighted the difference between this rebate, which provided a fixed benefit,

²⁹ The Child Exemption was merged with the similar Dependent Exemption in 1947. The Dependent Exemption related to the care of relatives other than spouses or children: Land and Income Tax Amendment Act 1947, ss. 6f.

³⁰ Finance Act 1939, s. 13.

³¹ Land and Income Tax Amendment Act 1945, s. 3.

³² See note 27.

³³ The Dependent Spouse's Exemption was increased from £50 to £100 from the 1947 tax year per the Land and Income Tax Amendment Act 1945, s. 3, with some changes to its provisions.

³⁴ *NZPD*, vol. 282 (19 August 1948), 1621.

and a percentage reduction or exemption whereby the benefit increased depending on income level.³⁵

11.4 Effect on Taxpayers

11.4.1 Income level

During the Great Depression, all wage and salary earners had become liable for direct taxation due to the unemployment charge. In the case of low income earners this was initially due to various flat rate or proportional levies to which no exemption level applied. Towards the end of the 1930s, this was compounded by the joint effects of increased incomes and increases in tax rates. However, even though the maximum tax rate (which was both the marginal and the average rate) for the income tax was 8s. 2d. (40⁵/₆ percent), to which must be added the Social Security Levy, even the high taxpayer paid no more than 20 percent of his income in total, since his income was well below that at which the top marginal tax rate applied. The scale of progression was not steep and continued to rise to very high incomes – in 1939 the top rate applied to an income 33 times that of a hairdresser.

This changed during World War Two. By 1950 a high income earner was paying at the top marginal rate, which now applied to incomes a mere nine times a hairdresser's. Indeed, all taxpayers were paying actual income tax (and not merely the Social Security Charge), except for the low income taxpayer with three children, due to the effect of the Child Exemption. Figure 11.1 indicates that the percentage income paid in direct tax had doubled for a single taxpayer at any income level from 1940 to 1950. Before the post-war drop in income tax, a single high income taxpayer's rate of tax had increased by around 250 percent.

³⁵ *NZPD*, vol. 282 (16 September 1948), 2319.

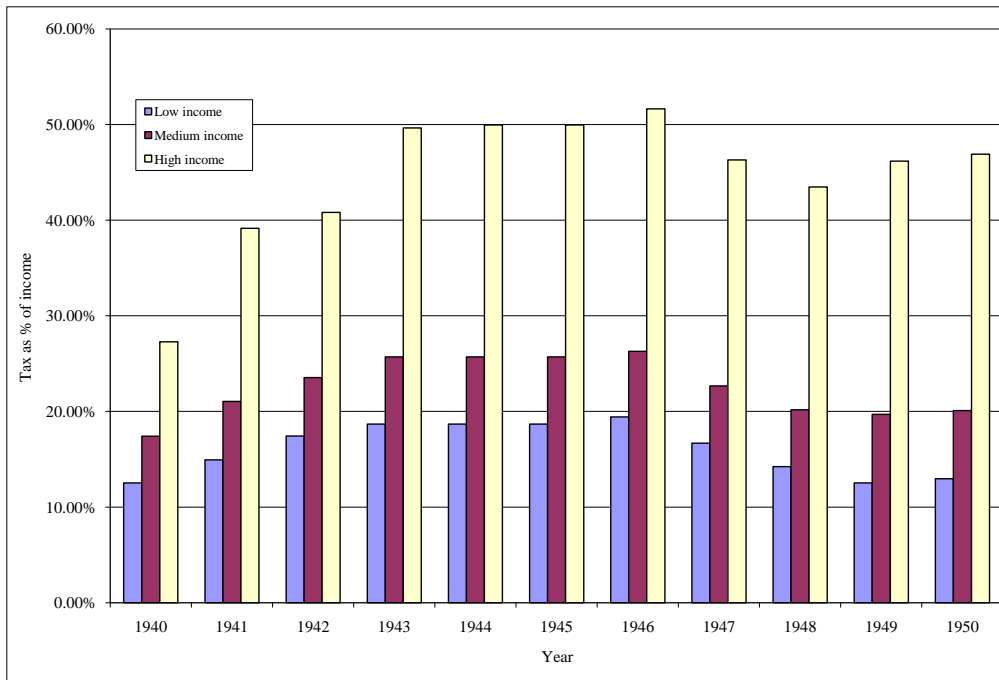


Figure 11.1 Personal income tax for a single taxpayer at three income levels (1940-1950)

The pattern was similar for the married taxpayer without children, except for the effect of the Dependent Spouse's Allowance. As with the single taxpayer, the progressivity of the rates scale is clearly evident in Figure 11.2.

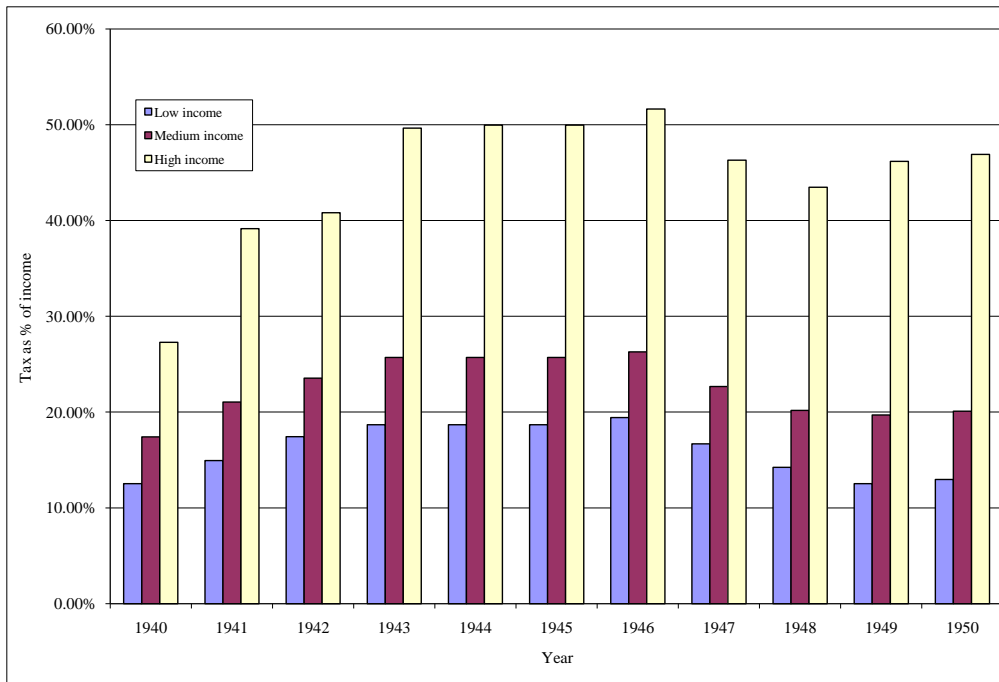


Figure 11.2 Personal income tax for a married (no children) taxpayer at three income levels (1940-1950)

This progressivity is again evident in the case of a taxpayer with three children. Here the effect of Family Benefit is obvious. Given that the Family Benefit comprised a fixed lump sum payment per child, its effect is most noticeable on the lowest income, where it more than offset the income tax due. It almost did so also for a medium income earner. Rather than a low, medium, and high income earner being taxed at a low, medium and high tax rate, for a family with children the pattern become negative, break-even, and high tax as a percentage of income. Redistribution in its simplest form was occurring – not so much to the poor per se, but to families regardless of income level.

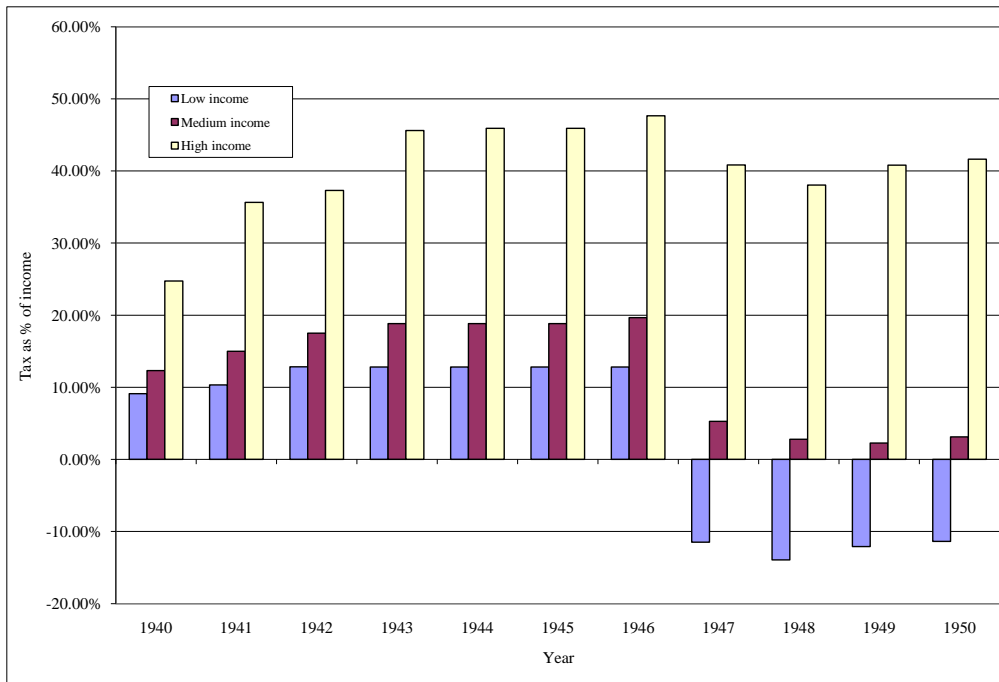


Figure 11.3 Personal income tax for a married taxpayer with three children at three income levels (1940-1950)

11.4.2 Family circumstances

That the Family Benefit assisted families, and not only lower income earners, is clearly evident in Figure 11.4. A low income earner (whether married or not) who had no children derived no benefit from the Family Benefit. The extra ten shillings per child per week that the Family Benefit put into the hands of families with children more than offset the income tax and related levies that a low income family would otherwise have paid. Even a middle income family enjoyed a substantially reduced net tax cost. Although a high income family received the same monetary benefit (£26 per child per annum) as a low income earner, the effect on the total tax bill was more muted.

For a family of three, the Family Benefit amounted to £78 per annum. This represented 24 percent of a hairdresser's 1946 gross income, and some 26 percent of his 1946 post-tax income. The presence of children had previously affected the actual tax liability somewhat due to the Child Exemption; their presence now had a more significant effect on low and medium income households, as Figure 11.4 indicates. The Family Benefit was rather more than a mere token gesture.

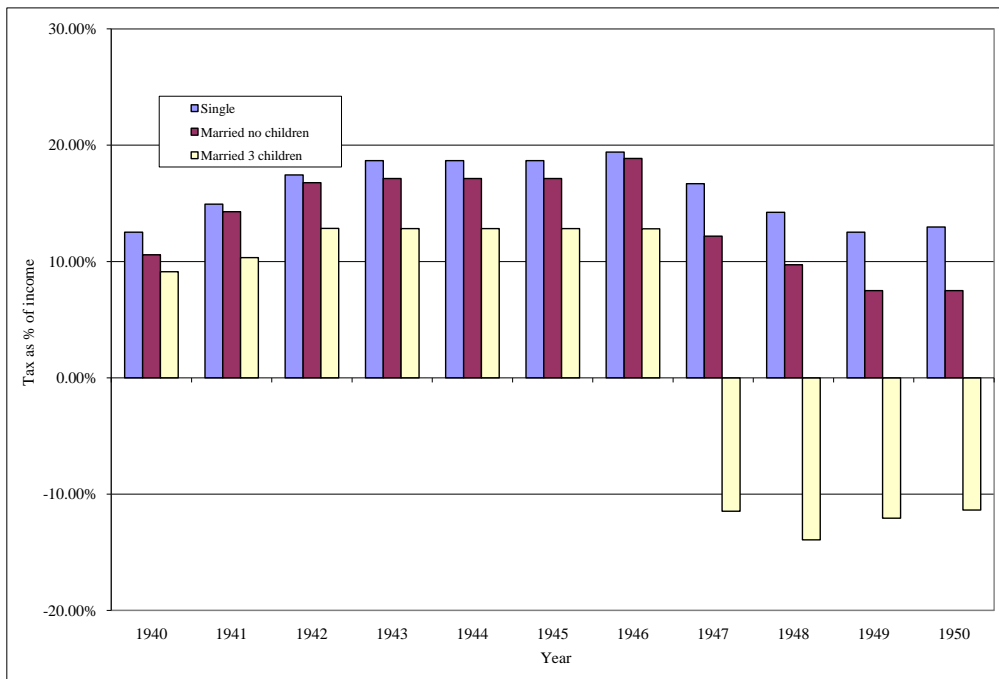


Figure 11.4 Personal income tax on a low income earner in three domestic situations (1940-1950)

The effect of domestic situation on vertical equity is also evident in the case of middle and high income taxpayers. Figure 11.5 indicates that while in 1946 a middle income taxpayer with three children had paid 80 percent of the tax paid by a person without children at the same income level, in 1947 this fell to 27 percent.

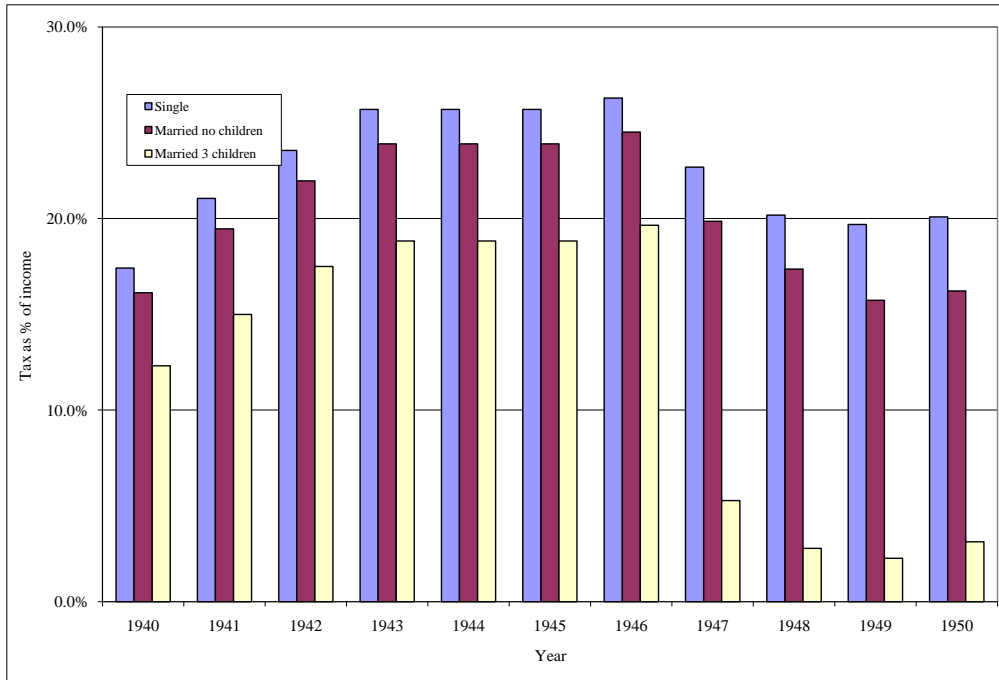


Figure 11.5 Personal income tax on a medium income earner in three domestic situations (1940-1950)

The effect on a high income earner was much more muted; Family Benefit amounted to less than 2 percent of what the high income earner earned in 1947, as is evident in Figure 11.6. Accordingly, a middle income taxpayer with three children had paid 94 percent of the amount of tax of a person at the same income level without children in 1946; in 1947 this fell to 90 percent.

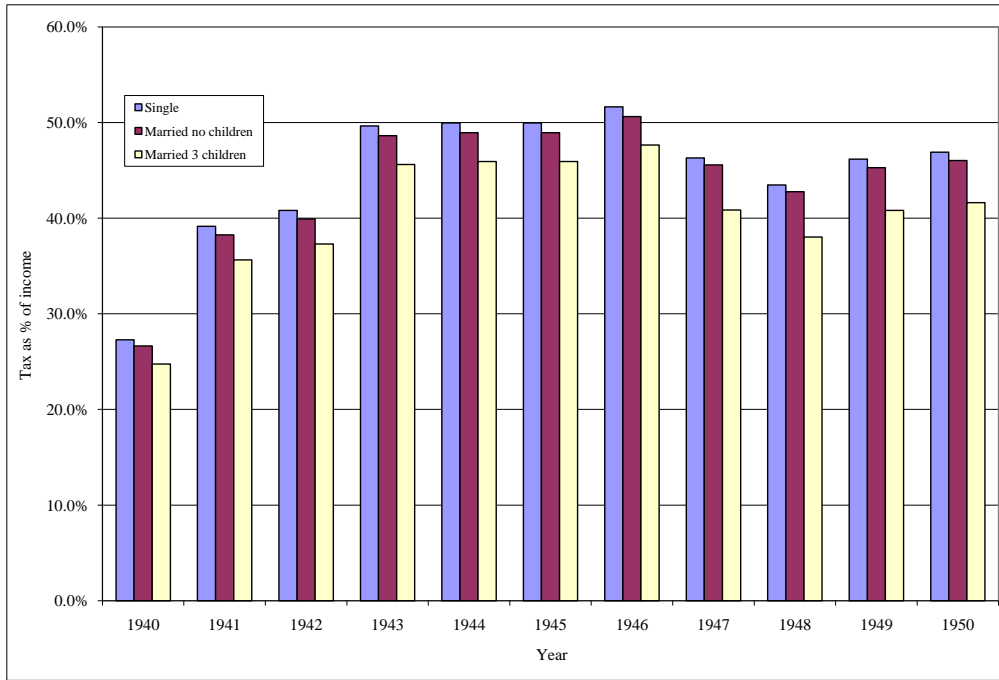


Figure 11.6 Personal income tax on a high income earner in three domestic situations (1940-1950)

11.5 Vertical Equity

11.5.1 General

Delivering the 1942 Budget, Prime Minister Fraser declared: “As it is the most equitable form of taxation, income tax will be considered first.”³⁶ Typically, he did not say *why* it was the most equitable form of taxation, or even what this might mean. By this time, the propriety of the income tax was almost beyond question. Discussions focused on the practice of the income tax and not on whether to tax income; on how to graduate the income tax, and not on graduation per se.

In five decades, the income tax had grown from being a minor and contested part of the government’s revenue, to becoming its cornerstone. Despite frequent changes to the income tax, adjustments subsequent to 1940 did not alter the basic structure of the tax, which might be described as universal and as progressive in two dimensions: as to income, and as to family status. In short, all earners were subject to direct taxation, and the level of taxation depended on the taxpayer’s income level; however, at any income level, a single taxpayer was taxed higher than a married taxpayer, who in turn was taxed more than a taxpayer who had children.

³⁶ *NZPD*, vol. 261 (30 April 1942), 195.

This structure had not arisen overnight. Nor did it evolve gradually. Rather, the shape of the income tax reflected contextual responses to specific events, notably economic depression at its inception and in the 1930s, and war in the 1910s and now again in the 1940s. With the benefit of hindsight, the introduction of the income tax in 1891 might be described as the “toe in the door”; the focus then was certainly on the land tax, with the income tax providing a balance between sectors in society, as well as providing a small amount of revenue. World War One resulted in significant quantitative and qualitative change in the income tax. The Great Depression, likewise, spurred a paradigm shift not merely in terms of the level of income taxation, which was increased by both the belt-tightening conservative government and the social-welfarist Labour Government.

During the years of World War Two the income tax attained the form it would retain for the next four decades. World War Two, with its unprecedented demand for funds, provided New Zealanders with the experience of a steeply progressive and almost universal income tax, which could be continued after the war to finance the rapid escalation of the cost of social welfare provision.³⁷ It would also come to play a part in the government’s increasing management of the economy whether in controlling inflation during wartime, or in promoting industry following the war.

The meaning of fairness changed with the context. 1891 had witnessed a shift from a focus on benefits received to ability to pay as the basis for taxation. World War One highlighted the need for sacrifice; the sacrifice of blood for the benefit of society in Gallipoli and on Flanders Fields being balanced by a sacrifice of wealth by those back home. Such sacrifice should be apportioned in proportion to the shoulders best able to bear it. Yet Labour’s social welfare reforms of the late 1930s also made benefits theory relevant to low income earners; since all now benefited from society - the wealthy through infrastructure and protection of property, the poor through social security – all should contribute to the cost. Besides, (Christian) socialist thinking suggested that all, and particularly the wealthy, should sacrifice as they were able.

The focus of tax fairness also shifted. At its introduction the concern was to ensure fairness between various groups in society, since the income tax affected only the wealthy. As it became

³⁷ T. N. Gibbs, *Report of the Taxation Committee* (Wellington: Government Printer, 1951), para. 21-38.

more universal, the focus shifted toward inter-personal fairness at the level of the individual. Now, both in the context of war and given the provision of social welfare by an impersonal state, fairness might be assessed between the state and the individual: does the (social welfare providing) state provide “value for money”; and do the benefits received from the state justify the tax paid to it? The language of discussion was changing. Thus, in introducing the Land and Income Amendment Bill in 1940, Walter Nash did not speak of fairness between taxpayers. Instead he noted that, “This Bill covers various amendments required in our land and income tax laws in order to bring about equity as between the taxpayer and the Government.”³⁸ With the expanding role of government, a balance was sought between government and the taxpayer. This dimension eclipsed the inter-taxpayer equity focus that had previously prevailed.

In evaluating this balance, both the tax paid, but also the benefits received, needed to be taken into account. “Fairness,” always a fuzzy concept, become even more so; not only must the claims between various individuals and various groups be considered, but the claims of an impersonal government against an individual must also be taken into account. Nash summarised this twofold focus; Tax evaders defraud not the government only, but also the people.³⁹ Taxation affected how property was viewed; rather than taxation being a taking of private resources for public purposes, it was referred to in terms of redistribution. As the 1951 Gibbs Taxation Committee put it, “A third objective which has been increasingly prominent in recent years is redistribution of incomes,”⁴⁰ the other two being the raising of revenue for government, and the protection of industries or the control of spending.

Only in the year ended 31 March 1941 did income tax receipts surpass other tax types as a source of government revenue. Since then the income tax has provided the majority of government revenue. The acceptance of the income tax by both political parties had taken about fifty years.

11.5.2 Effect of war

There are significant parallels between the two world wars as far as taxation is concerned. Both saw a significant increase in tax revenue, particularly in direct taxation, and these increases were sustained following the war. Both were the occasion for debates as to fairness in taxation as the

³⁸ *NZPD*, vol. 257 (18 July 1940), 600.

³⁹ *NZPD*, vol. 266 (12 September 1944), 241.

⁴⁰ Gibbs, *Report of the Taxation Committee*, para. 60.

government strove to find the necessary revenue. In both wars, the general population supported the war, and contributed vast amounts of blood, sweat, and money to ensure its prosecution.

However, there are also significant contrasts between the two world wars. Labour was fledged during World War One, whereas it was in power during World War Two. The social welfare measures it introduced prior to World War Two reflected a changed role for government; from a limited night watchman state, to a much more active role in the lives of its citizens. World War Two itself necessarily involved an enlarged role for the government. Following the war, government continued to redefine its role in the economy. Finance Minister Walter Nash summarised this in the 1947 Financial Statement when he stated that the “basic objectives in the Government’s economic policy are full employment and a rising standard of living in terms of real wealth.”⁴¹ To achieve these objectives, he stated Labour’s policy as involving the development of natural resources, the organising of (export) marketing, the avoidance of inflation, and ensuring reasonable sustainability of individual incomes. Whether the focus was on social security, war, or economic development, the income tax had a role to play. Although the war suggested the need for a temporary increase in taxation, the peacetime income taxation of 1950 more closely resembled the wartime situation in 1941 than it did the earlier peacetime tax of 1925, aside from the effect of the Family Benefit. The norm of self-reliance promoted less than two decades earlier was supplanted by a more communal ethic.

Subsequently, the 1951 Taxation Committee highlighted the growth of social security in its report.⁴² Though recommending that a Royal Commission be empowered “to examine all matters arising out of the social welfare programme,”⁴³ it recognised that significant change was unlikely:

*The Committee is fully conscious that social security and the welfare programme have become part of the national economy, and that the country is committed to a continuation of the programme.*⁴⁴

⁴¹ NZPD, vol. 277 (21 August 1947), 550.

⁴² For discussion of this committee’s report, refer 11.5.7 (pp. 285-88) below.

⁴³ Gibbs, *Report of the Taxation Committee*, para. 198.

⁴⁴ *Ibid.*, para. 195.

A wartime tax footing was continued during peacetime to finance social security and promote economic development. The experience of the war affected public attitudes to the role of government and of taxation, and these attitudes did not reverse once the war was over.

11.5.3 How to tax: Basis of assessment

World War Two justified significant increases in the income tax. However, although the progressive principle was accepted, the justification for progression was still unclear: appeals continued to be made to the three principles of sacrifice, ability to pay, and benefits.

11.5.3.1 Sacrifice theory

Reflecting Labour Party arguments during World War One, John A Lee, recently evicted from the Labour Party,⁴⁵ castigated the Labour government for not conscripting wealth: “The Labour movement used to say that there could be no conscription of man-power until there was conscription of wealth.”⁴⁶ The subsequent interchange between Lee and Nash illustrates the shift in thinking of the Labour Party from its ideals when in Opposition to its practice whilst in Parliament. It also illustrates the fluidity of labels; both identified themselves as socialists,⁴⁷ but their policy prescriptions differed. Lee, arguably, had the luxury of an idealism not tempered by the responsibility of rule borne by Nash.

11.5.3.2 Ability to pay theory

Opposition leader Keith Holyoake could declare that, “I think most people believe in the ‘ability to pay’ principle in taxation”.⁴⁸ On this basis National opposed the distinction between earned and unearned incomes. As National’s Ronald Algie put it:

*This taxation of unearned income is a very unfair and unjust thing and people resent it. First of all, the tax that is charged bears no relation ... to the ability of the taxpayer to pay.*⁴⁹

⁴⁵ For details of the conflict within the Labour party and of Lee’s eviction, refer Barry Gustafson, *From the Cradle to the Grave: A Biography of Michael Joseph Savage* (Auckland: Reed Methuen, 1986).

⁴⁶ *NZPD*, vol. 257 (18 July 1940), 610.

⁴⁷ *NZPD*, vol. 260 (7 October 1941), 1005.

⁴⁸ *NZPD*, vol. 274 (6 September 1946), 756.

⁴⁹ *NZPD*, vol. 277 (28 August 1947), 681.

Later, National's Neale questioned whether income derived on the savings of a retired person indeed was unearned, suggesting that "it is absolutely unjust that they should be taxed an extra amount on what is miscalled 'unearned income.'"⁵⁰ Once elected, National promptly scrapped this distinction.⁵¹

11.5.3.3 Benefits theory

Appeal continued to be made to the notion of benefits. Since profits depended on state financed infrastructure or war, taxation might fairly be levied on those who derived the benefit. Labour emphasised this point; the country was protecting the corporations, and therefore it rightly expected them to pay what they ought to pay.⁵² With the introduction of social security, all were benefiting directly from the state, and so should also pay. If the universalisation of the franchise in the early 1890s put paid to an objection to taxation on the basis of non-representation, social welfare did so to an objection based on non-benefit.

Certainly complaints were aired that some who benefited from the war were not contributing their fair share. Labour's leader Fraser commented that large companies were protected by the war and therefore they ought to pay more tax.⁵³ His colleague, Rev. Carr, asked what profits would be if it were not for taxation, suggesting that it was not just private enterprise, but also government spending such as state railways and roads that had built up the country.⁵⁴ The tax should follow the benefit.

Inter-generational equity also was touched on in two areas. First, Nash argued that as much of the war expense as possible should be financed by taxation, as it was non-productive expenditure.⁵⁵ The cost should not be passed on to future generations. Fraser repeated the same theme; the high burden of taxation during wartime was necessary "so that there will not be an impossible burden upon the people when they emerge from the war."⁵⁶ Second, although not expressed in those terms, the post-war Taxation Committee expressed concern about the unfunded cost of social

⁵⁰ *NZPD*, vol. 282 (14 September 1948), 2261.

⁵¹ *NZPD*, vol. 291 (1 September 1950), 2103.

⁵² *NZPD*, vol. 263 (22 July 1943), 304.

⁵³ *Ibid.*

⁵⁴ *NZPD*, vol. 266 (1 September 1944), 40.

⁵⁵ *NZPD*, vol. 257 (27 June 1940), 305.

⁵⁶ *NZPD*, vol. 263 (28 July 1943), 377.

security. If the economy did not continue to expand, the welfare programme might be endangered. The expansion of the government's role from mere night watchman and infrastructure development focus to include long term social provision required a perspective beyond a focus on annual budget balancing.⁵⁷

Although appeal continued to be made to the traditional categories of taxation fairness – sacrifice, ability to pay, and benefits – none of these bases provided a comprehensive basis for taxation. At most they served as rhetorical devices to justify taxation, which in reality was adjusted to meet the pragmatic need for revenue to fund expenditure. It would seem that, as income tax became familiar, there was felt to be less need to justify it.

11.5.4 How to tax: The practice of graduation

That the income tax should be graduated was taken for granted. When the Labour Government introduced a new stepped rates scale in 1939, there was no discussion as to the legitimacy of graduated rates as such. Changes since 1892 had increased the progression, and the new rates scale was a further refinement of the scale which would “obviate certain anomalies”⁵⁸ of the existing graduated system.

The effective progressivity of an income tax is only hinted at by the rates scale. The enacted progression may be mitigated where items of income are exempted from the tax. Where tax is successfully evaded, the income is subject to no tax at all. To reduce this loss of revenue, the Act had included anti-avoidance provisions from the outset,⁵⁹ and the Government provided ever-increasing resources to the Income Tax Department to administer and audit the tax. The staff of the Land and Income Tax Department⁶⁰ had increased to 1,485 officers in 14 branch offices and the Head Office in Wellington in 1949/50, from the 170 officers centralised in Wellington 25

⁵⁷ Gibbs, *Report of the Taxation Committee*, para. 197. This theme of inter-generational equity, and particularly the benefits the post-war generation secured via the social welfare system, is addressed in the thesis of David Thomson, *Selfish Generations? How Welfare States Grow Old* (Cambridge: The White Horse Press, 1996).

⁵⁸ *NZPD*, vol. 257 (27 June 1940), 305.

⁵⁹ Land and Income Assessment Act 1891, s. 43.

⁶⁰ The Department was established as the Land Tax Department in 1878, and renamed the Property Tax Department in 1879. Following the enactment of the Land and Income Assessment Act 1891 it was renamed the Land and Income Tax Department. Upon amalgamation with the Stamp Duties Department in 1952 it was given its present name, the Inland Revenue Department; refer Fiona McKergow, *The “Taxwoman” One Hundred and One Years of Women Working in the Inland Revenue Department 1892-1993* (Wellington: Inland Revenue Department, 1993), 6.

years earlier.⁶¹ Given that the notional taxpayers received wages and salaries only, it would have been more difficult for them to avoid taxes; social security levies were deducted at source, and even though employees were responsible for filing their own returns at the end of the year, the authorities would be able to confirm wages paid with the employers. Of course, taxpayers themselves might also make errors; National Leader Hamilton suggested that inadvertent overpayments would likely outweigh any evasions.⁶²

Income tax progression was also affected by the distinction between earned and unearned income, and by the A+B+C system, a “simple system of assessment”⁶³ introduced in 1942. This was a step in the direction of taxing comprehensive income base for taxation, as proposed by Simons.⁶⁴ Opponents criticised it as “a simple system of securing more taxation,”⁶⁵ and also for the complexity it introduced into the income tax.⁶⁶

11.5.5 What to tax: Tax base

Although the income tax legislation continued to be regularly amended, the tax base itself was not significantly changed. Rather, increasing numbers of the population became subject to taxation, mainly due to inflation. Although a *de minimis* exemption remained by virtue of the General Exemption, the value of the General Exemption value fell over time.

Discussions of tax were, by now, largely discussions of income tax. Customs duty was rarely mentioned. As the government’s dependence on income tax as a source of revenue grew, other taxes became increasingly less significant.

11.5.6 Why tax: The role of government

The twenty years from 1930 to 1950 had witnessed significant change in the role of government. Until 1930, the functions of the government were largely those of the night watchman state, with

⁶¹ Gibbs, *Report of the Taxation Committee*, para. 456.

⁶² *NZPD*, vol. 256 (3 October 1939), 542.

⁶³ *NZPD*, vol. 261 (8 May 1942), 293: discussion on the Finance Bill, 1942.

⁶⁴ Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938).

⁶⁵ *NZPD*, vol. 263 (22 July 1943), 300.

⁶⁶ *NZPD*, vol. 277 (28 August 1947), 677. This “simple system” led Opposition leader Holland to call for “the writing of our legislation in clearer language,” *NZPD*, vol. 261 (8 May 1942), 295. The simplification of New Zealand’s tax legislation was not commenced until the 1990s: refer Adrian Sawyer, “New Zealand’s Tax Rewrite Program – In Pursuit of the (Elusive) Goal of Simplicity,” *British Tax Review* 4 (2007), 405.

the added role of infrastructural development; in 1930 the state essentially fulfilled the functions Adam Smith had described some 150 years earlier.⁶⁷ Certainly government expenditure had increased quite considerably, in part due to the legacy costs of World War One; yet even the initial response to the Great Depression reflected Smith's views.

Labour added "cradle to grave" social provision to the roles of government, and National affirmed this role. From the election of the First Labour Government in 1935 until the reform of the electoral system with the introduction of Mixed Member Proportional representation in the 1996 General Election, New Zealand effectively had a two party political system, with Labour occupying the centre-left, and National reflecting a centre-right perspective. Yet it is not clear that a change of government changed the conception of what was fair in taxation. It is difficult to detect any obvious changes in the taxation payable at various levels of income due to a change in government. The Labour Government during World War Two increased taxation as had the conservative Reform Government in World War One. Following World War Two, the level of income tax did fall for a time, but then soon exceeded the levels reached during the war, despite a change of government in 1949.

There is no clear distinction in the tax rhetoric of the parties in Parliament. Ability to pay, benefits received, and sacrifice were used promiscuously in the debates as it suited the argument. Indeed, despite the adversarial tone of the Parliamentary Debates, there was little substantive disagreement between the parties when it came to economic policy. This is evident in two areas. First, both parties were committed to providing social security. Despite National's vocal opposition in 1938, by 1948 its leader Holyoake could state that, "The only point of Social Security that National opposed was the socialisation of the medical service."⁶⁸ Just as the Reform Government in 1912 had co-opted the Liberals' estate-bursting taxation policy, so National rewrote history with regard to social welfare. With this increase in government expenditure came a concomitant increase in the income tax.

But second, a comparison of their stated tax principles reveals little difference between the parties. Prior to coming to power in 1935, Labour had promoted taxation policies that would place the tax on the shoulders best able to bear it. On both the revenue and expenditure sides –

⁶⁷ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan (London: Methuen, 1950).

⁶⁸ *NZPD*, vol. 282 (15 September 1948), 2301.

tax policy and social welfare – Labour argued for redistribution. These Labour principles are echoed in two post-war lists of National’s tax principles.

In 1947, Oram suggested that “The present was an opportunity for the members of the National Party Opposition to review the whole field of taxation.” He summarised his views as follows:

Firstly, no more should be taken than is absolutely necessary for the purposes of the Government – I think this is a cardinal principle of taxation.

Secondly, the incidence of the tax should be fair and equitable to all sections of the people.

Thirdly, the taxation should provide incentives ... In that connection I think first of the family man; taxation should be so directed as to give incentives to men to raise families and develop the family life of the Dominion, because on that depends the future of our country; it should give incentives to business men to develop their undertakings ... Then, the taxation should be such as to give incentives to workers ...

*Lastly, when we are considering incentives, we should not forget the necessity for thrift.*⁶⁹

The first and fourth principles hark back to the opposition to the Liberal’s income tax in 1891, and reflect a conservative position. The second principle is an empty slogan unless fairness and equity are defined. It is the third principle that indicates how much things had changed. Far from being radical, incentives were now accepted by both parties, and were not considered inconsistent with Oram’s first principle: that no more should be taken than is absolutely necessary for the purposes of the Government. Social security, now less than a decade old, had become conventional.

Two years earlier, having stated that a good deal of taxation is just class taxation,⁷⁰ Opposition leader Holyoake proposed seven guiding principles for “a comprehensive revision of our taxation system”:

First, you cannot bring about prosperity by discouraging thrift;

secondly, you cannot strengthen the weak by weakening the strong;

⁶⁹ NZPD, vol. 277 (28 August 1947), 673-4.

⁷⁰ NZPD, vol. 282 (15 September 1948), 2305.

thirdly, you cannot help the small man by tearing down the big man;
fourthly, you cannot help the poor by destroying the rich;
fifthly, you cannot lift the wage-earner by tearing down the wage-payer;
sixthly, you cannot build character and courage by taking away a man's initiative and independence;
*and seventhly, you cannot help men permanently by doing for them what they could and should do for themselves.*⁷¹

Both lists echo the old Victorian ethic of self-help and self-reliance; yet the social context had changed considerably. Neither list is any more specific than the more general principles of benefits, ability to pay, or sacrifice. Certainly, Holyoake's list seems to be a critique of Labour's social welfare policies – although he himself favoured social welfare. Yet at the level of the personal income tax, subsequent history would reveal little practical difference in taxation policy; the two-way progression of taxpayers in terms of income and domestic situation would continue, as would social welfare, regardless of which government was in power.

11.5.7 Report of the Taxation Committee

A quarter century after the Royal Commission on Taxation of 1924, and less than a decade after the end of World War Two, the Government called for another enquiry into taxation. The resulting Taxation Committee was given a broad mandate to inquire into the present system of land and income taxation in New Zealand and to make recommendations.⁷² Given this mandate, and a report of 134 pages, it is perhaps surprising that little attention was given to the matter of fairness or equity in taxation. Yet the Taxation Committee's Report does provide an indication of what was understood by fairness in taxation following the turbulent years of the 1930s and 1940s. Rather than being a tax on high incomes only, by this time the income tax had become a democratic tax: the cost incurred for military security and economic social security. Rather than being evaluated on an individual basis, the income tax was considered as a social event; a sharing of burdens in return for the benefits provided by society. The Report both illustrated the notion of tax fairness following World War Two, and in measure described the norm that would apply for the next two decades.

⁷¹ Ibid.

⁷² Gibbs, *Report of the Taxation Committee*, para. 1.

The Report commenced by providing a statistical survey of the growth of taxation over the previous 25 years. This very substantial increase in government expenditure “can be accounted for only by the expansion of Government activity.”⁷³ Taxation was levied for several purposes: to raise revenue for the needs of Government in administering and developing the country, the protection of industries or control of spending. “A third objective, which has been increasingly prominent in recent years, is redistribution of incomes. An extension of [this] objective is to provide revenues for promoting employment.”⁷⁴ Overshadowing all of these was the cost of government’s defence obligations.

Part 3 of this Report, headed “The Relation of Taxation to the National Economy,” opened with a section entitled “Principles of Taxation.”⁷⁵ This section commenced with the claim that, “Adherence to sound principles of taxation is all the more important at the present time when large expenditures on war and social welfare programmes have called for high levels of taxation.”⁷⁶ Despite such high levels, it suggested that, “Where taxpayers have confidence in the equity of the taxation system they will be more inclined to pay their taxes with good grace and honesty.”⁷⁷

What then are sound principles of taxation? The report provides six:

- (a) Taxes must be broadly based over the whole community... There is a limit as to what can be paid in taxes without loss of incentive, fostering of waste and extravagance, and mounting pressure to pass on the tax in higher prices.*
- (b) Taxes must be fair as between the members of the community...*
- (c) Taxes should be levied with due regard to the encouragement of primary and secondary production...*
- (d) Taxes must be capable of being collected...*
- (e) Taxes should not be levied at rates or by methods that impair or prevent adequate savings for capital requirements of the community.*

⁷³ Ibid., para. 36.

⁷⁴ Ibid., para. 60.

⁷⁵ Ibid., para. 55.

⁷⁶ Ibid.

⁷⁷ Ibid., para. 64.

*To these ... should be added the paramount necessity for ensuring the effective distinction between capital (a source of production) and income (the result of production).*⁷⁸

The first principle reflects the democratisation of income taxation which had been occurring since 1930 and was confirmed during World War Two. Originally a tax on the wealthy only, by now the tax should be paid by all, lest disincentive effects of high taxation on the effort of those on higher income earners prove deleterious to the whole community. Revenue was needed, and this enlarged revenue “could not be obtained just by ‘soaking the rich’ or by hitting companies harder.”⁷⁹

Whereas the 1922 Commission had started with Adam Smith’s familiar maxims, which address how a tax should be levied so as to be most fair to the individual,⁸⁰ the 1952 Gibb’s report assumes the status quo, and then considers how to promote the macro-economy. The individual is almost invisible, and fairness is not discussed beyond the aphoristic, “Taxes should be fair as between the members of the community.” The meaning of this phrase is not elaborated. Further, fairness is considered in subjective, rather than objective terms, as the next sentence indicates: “Taxpayers must feel they are being treated equitably....”⁸¹ Just what this might mean in practice is hardly specified, although ability to pay was assumed as the criterion for apportioning the tax burden.⁸²

In part the social, rather than individual, focus of taxation flowed from the entrenchment of social security little more than a decade after its introduction.⁸³ Since all benefited from the state, all should pay (that is, benefits theory), in terms of their ability to do so (for example by means of a graduated income tax). The Gibb’s Report set the tone for ensuing decades, where macro-economic considerations dictated taxation policy. Heavy state involvement in the economy, already evident in Vogel’s day, continued in World War One, was furthered by the Social

⁷⁸ Ibid., para. 57 (emphasis added).

⁷⁹ Ibid.

⁸⁰ W D Hunt, “Report B5: Report of the Committee Appointed to Enquire into the Taxation of the Dominion of New Zealand,” *Appendices to the Journals of the House of Representatives* (Wellington: New Zealand Government, 1922), para. 28.

⁸¹ Ibid., para. 57b.

⁸² Ibid., para. 211f.

⁸³ Ibid., para. 195.

Security Act 1938, accelerated during World War Two, and would continue in the future. Certainly, concern was expressed that “a high income tax, imposed for the purposes of redistribution, is subject to the law of diminishing returns.”⁸⁴ Yet the populace soon came to accept the higher tax in return for the benefits of Social Security.

As to how much tax should be paid, this too was addressed in macro-economic, rather than personal terms: “The well-known economist, Mr. Colin Clark, has advanced the proposition that the safe political and economic limit of taxation is about 25 percent of the national income.”⁸⁵ Yet by 1949-50 total taxation in New Zealand was 34 percent of the national income.⁸⁶ Concern was expressed that very little reserve of taxable capacity existed.⁸⁷ But again, this was expressed in terms of the economy as a whole, and not in terms of vertical equity between individual taxpayers. Certainly, too, “it is a matter of equity to the great majority of citizens who pay their full taxes that the Government shall exercise the greatest effort to trace effectively and deal properly with the evaders.”⁸⁸ However, the equity of the tax itself or of progression was not discussed; apparently there was no need.

11.6 Summary

By 1950, the income tax had thrived during two world wars and a serious economic depression. It had grown to become the main source of government revenue, and become a universal tax, affecting all earners irrespective of their level of income. But the income tax had also come to be accepted as fair or equitable in principle, if not in all respects, in practice.

The fairness of the income tax was not defined by any single criterion. Rather, appeal continued to be made to the standard elements of ability to pay, benefits received, and sacrifice, as well as to the needs of society in terms of social welfare and the prosecution of war. By 1950 the income tax reflected that most New Zealanders of ethics: the “fair go” for all. Both Labour and the National Party Members suggested that fairness of the income tax was largely determined in terms of its outcomes: did it conduce to a fair and equitable society, and did it share the costs of society in a fair way?

⁸⁴ Ibid., para. 68.

⁸⁵ Ibid., para. 120.

⁸⁶ Ibid., para. 120, cf. para. 43

⁸⁷ Ibid., para. 173.

⁸⁸ Ibid., para. 69.

As far as tax was concerned, the income tax provided the easiest means to obtain government revenue, and the easiest way to adjust the burden of taxation. It permitted graduation based on income and graduation based on domestic situation. Coupled with the social welfare system, and particularly the Family Benefit, some degree of equity could be produced in society. Despite frequent adjustments, this pattern remained in effect for the subsequent three decades. During the war, the population paid ever-increasing amounts of tax. Inured to these higher rates of tax, and accepting of a greater role for the government in the economy, the rates did not fall to pre-war levels after the crisis had passed. Crises facilitate taxation change. The 1951 Taxation Committee Report may have noted that:

*In a time of national danger there is no doubt that the majority of taxpayers will accept high rates in a spirit of patriotism, but when high taxation is continued, without a sense of national crisis, widespread and strong resistance is inevitable.*⁸⁹

Their first claim appears to be justified. However, the post-war experience calls the Taxation Committee's conclusion into question. A crisis may justify the enactment of high taxation; the passing of the crisis does not automatically lead to a reduction. The level and pattern of taxation, once implemented, is not so quickly changed.

⁸⁹ Ibid., para. 64.

Chapter 12

1950-1970: Steady Does It!

Taxation is no longer simply a device to raise the revenue needed to meet the cost of government. In this modern age taxes are now recognised as important tools for influencing the development of the economy, and for implementing economic and social policy in a variety of ways.

Report of the 1967 Taxation Review Committee¹

12.1 General Context

After World War Two, Labour's Finance Minister Walter Nash summarised the basic objectives of the Government's economic policy as, "full employment and a rising standard of living in terms of real wealth."² In measure, New Zealand society in the 1950s and 1960s approached this ideal. New Zealand ended the war in a strong economic position, benefiting from strong demand for its primary exports, and "during the baby boom, there was overall prosperity, economic expansion and labour shortages."³ Social security, introduced prior to the war, continued and was consolidated after the war.

During the two decades ending in 1970, New Zealand's population grew almost 50 percent to 2.9 million, as New Zealand experienced an increase in the Total Fertility Rate from 2.1 in 1936 to 4.2 in 1961.⁴ GDP per head more than doubled on an inflation adjusted basis. Unemployment was low, family sizes grew with the post-war "Baby Boom,"⁵ Britain still bought much of New Zealand's exports,⁶ and social security provided for times of need.

Politically, the First Labour Government was defeated at the polls in 1949. By then, the Conservative opposition had reformed as the National Party, which was established in 1936 in

¹ L. N. Ross, *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington: Government Printer, 1967), para. 5.

² *New Zealand Parliamentary Debates (NZPD)*, vol. 277 (21 August 1947), 550.

³ Ian Pool, Arunachalam Dharmalingham and Janet Sceats, *The New Zealand Family from 1840: A Demographic History* (Auckland: Auckland University Press, 2007), 199.

⁴ *Ibid.*, 215.

⁵ For a detailed discussion of the Baby Boom in New Zealand, refer Pool, *The New Zealand Family*, 166-216.

⁶ The United Kingdom had taken 80 percent of New Zealand's exports before World War Two, but this dropped to around 50 percent by the early 1960s: see Gary R. Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985), 222.

response to Labour's victory the year before. National would dominate New Zealand politics until the 1980s.⁷ Yet compared to the election of the First Labour Government in 1935 the shift to a National Government after 15 years resulted in incremental, rather than substantive, changes in economic policy and the income tax. In ensuing decades, the social framework adopted in the late 1930s and early 1940s was tweaked, but not significantly altered. Given a two-party, first-past-the-post voting system, radical change was unlikely. Instead, the policies and practices of the two main parties, National and Labour, tended to converge. Writing of the Fourth Labour Government of 1984 to 1990, Miller aptly comments:

*While it suited National electorally to depict Labour as left-wing, in the vital area of economic policy the differences between the two parties were more imagined than real. As in the 1950s, National became a rigorously effective manager of Labour's economic achievements.*⁸

National followed where Labour had led, just as earlier in the century the Reform Government had followed where the Liberals had led. In the absence of a significant external crisis the status quo largely obtained.

12.2 Taxation Context

Like the periods from 1892 to 1913, and 1925 to 1929, the income tax was relatively stable during the two decades commencing from 1950. Total tax as a percentage of GDP hovered around 25 percent, more than double the 12 percent level of 1930. Income tax comprised all but one percent of the direct taxation and between 60 and 65 percent of total taxation revenue. Significantly, the proportion of income tax to total tax, and the tax to GDP ratio, continued to rival, and then surpassed, the record levels of World War Two.

In part, this increase in taxation reflects the blossoming of the welfare state. Not only did this entail a significant increase in government expenditure; it also suggested a democratisation of taxation; since all benefited from social welfare and the managed economy, all should contribute.

⁷ For an introduction the history of the National Party, see Barry Gustafson, *The First 50 Years: A History of the New Zealand National Party* (Auckland: Reed Methuen, 1986).

⁸ Raymond Miller, "Labour," in *New Zealand Government and Politics*, ed. Raymond Miller (South Melbourne: Oxford University Press, 2003), 241.

Government policy also reflected a focus on families. Families had been a focus of industrial policy since the turn of the century, as is evident in the workings of the Industrial Arbitration system in setting awards. Child and spousal exemptions had already made the income tax more family-friendly. However, the universalisation of Family Benefit from 1946 significantly reduced the net tax impost on families, and marked a significant shift towards the government's being involved in direct redistribution, funded by the tax system.

The continuation of the welfare state only tells part of the story. The increase in taxation following World War Two also reflected a change in economic policy. The command economy of wartime translated into the managed economy of peacetime.⁹ Far from being a night watchman state with minimal functions, both Labour and National Governments actively intervened to manage the economy by means of import licensing, subsidies, incentives, price and incomes policies, and the like. If the primary role of government at the turn of the century had been to maintain law and order and to provide infrastructure, by the late 1930s this role had increased to include the provision of a social security safety net. After the war, memories of the Great Depression and the government's role in the war of managing the economy, coupled with Keynesian interventionist orthodoxy, all conduced to the government's adopting a greater role in the economy. Taxation was needed to fulfil this role; not only to provide the necessary funds, but also as an instrument to enable the government to effect its fiscal policy.

12.3 Income Tax Legislation

12.3.1 Tax rates

The Basic Rates scales remained in effect throughout this period. These scales provide prima facie evidence of governments' views on vertical equity. Figure 12.1 illustrates that the scales were clearly progressive and essentially linear, peaking at a rate of sixty percent. The Social Security Levy of 7½ percent was levied separately until 1970, giving a maximum marginal rate of 67½ percent.

⁹ Gary R. Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985), chapter 9.

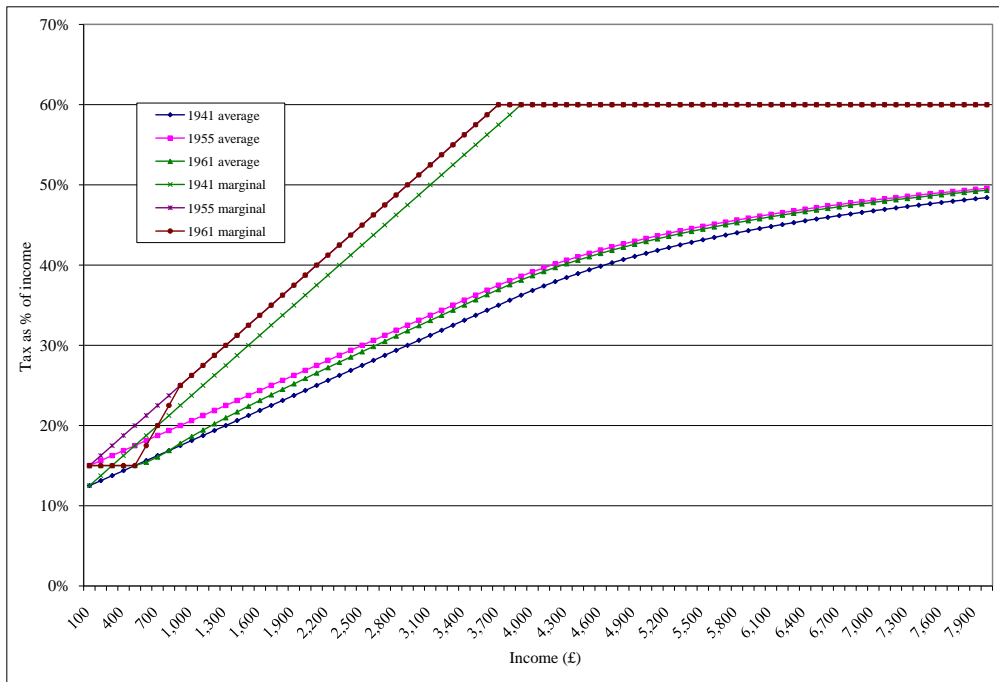


Figure 12.1 Marginal and average tax rates per the Basic Rates scales 1941, 1955, and 1961

The first basic scale, which applied from the 1941 income year, was introduced by the Labour Government and replaced in 1955. This 1955 scale, introduced by National, peaked at an income of £3,600 (previously £3,800), and still at a rate of 12 shillings (60 percent). Marginal rates increased consistently until the peak rate was reached.

Whereas the 1955 scale simply shifted the whole scale up a notch, Labour's 1961 scale reduced the basic rates on lower incomes (up to £800), but otherwise was identical to that of 1955. This change did provide relief for low to middle income earners given that a hairdresser's award rate in 1961 was £694 per annum. The scale was decimalised from 1967¹⁰ but otherwise remained unchanged until a new Basic Rates scale was introduced in 1970. The reduction at the bottom of the scale functioned similarly to the original exemption in providing an amount of untaxed income; effectively the scale displayed a degree of depression. However, the value of this exemption from 1956 was considerably less than the original substantial £300 exemption of 1891 had been.

¹⁰ Charles A. Staples, *A Guide to New Zealand Income Tax Practice 1972-73 (33rd edition)* (Wellington: Sweet and Maxwell, 1973), 647.

The Basic Rate scales alone do not tell the full story since they were adjusted year by year. Until 1954, a percentage surcharge was added; from 1956 a rebate was applied which was limited to a certain maximum (refer Table 12.1). Surcharges and rebates were thus applied asymmetrically; whereas the former had applied to the whole of the income tax for all taxpayers, the latter only applied to the whole tax of lower income earners, but to a portion of the tax for all. In this way, the benefit of any income tax reduction for a high income earner was capped.

Table 12.1 Income tax surcharges or reductions (1941-1970)

Year	Surcharge	Reduction
1941	15%	
1942-45	33 $\frac{1}{3}$ %	
1946-50	15%	
1951	10%	
1952	5%	
1953	2 $\frac{1}{2}$ %	
1955	n/a	
1956		Lower of 20% or £75
1957		Lower of £100 or tax assessed
1958		n/a
1959		Lower of 12 $\frac{1}{2}$ % or £37/10
1960		Lower of 10% or £30
1961-63	n/a	
1964		Lower of 7 $\frac{1}{2}$ % or £75
1965-69		Lower of 10% or £100
1970	n/a	

Since it is enacted by those in power, taxation is necessarily political. The 1957 rebate of the lower of £100 or the tax assessed was the result of electioneering on the part of both parties; 1957 was an election year.¹¹ National had promised a rebate of up to £75. Labour pitched a higher bid at the electorate, promising a £100 rebate, which it then enacted upon coming to

¹¹ Hirschfeld notes that, "The introduction of P.A.Y.E was obviously seen by both parties as a vehicle for taxation concessions. Originally the bids to the public were low but when National upped the bid in 1957, Labour followed suit. The net result was the biggest cash offer ever made to the public by both parties ... a policy which 'offered to every individual in the community some financial reward in return for a vote'." Michael A. Hirschfeld, *The New Zealand Labour Party in Office 1957-60*, (MA Thesis, Victoria University, 1970), 232, 243.

power. Whereas the previous year's rebate reduced a taxpayer's liability by 20 percent up to a maximum of £75, the 1957 rebate reduced the whole of the taxation payable up to a maximum of £100. The appeal to the electorate was clear; during the 1957 election campaign, Labour Party President Moohan had placed an advertisement which baldly asked, "Do you want £100 or not?"¹²

The effect of this £100 rebate was compounded for some taxpayers by the introduction of "Pay as You Earn" ("PAYE"). Rather than the income tax on employees being paid annually in arrears as before, from 1 April 1958 it would be deducted at source. Social Security Levies payable by wage and salary earners, though not by the self-employed, had always been deducted at source, but income tax was paid annually in one lump sum. The 1951 Taxation Committee had considered the advantages and disadvantages of introducing a pay as you earn system for the income tax and recommended against it. The first disadvantage it noted was that:

*It is said that taxpayers should be kept aware of present high levels of State expenditure. Deduction of taxes at the source tends to remove the full appreciation of the liability – the taxpayer does not feel the direct weight of the tax. He becomes concerned only with his net "take home" pay, and there is the tendency to press for higher net wages to offset taxation ...*¹³

One accountant suggested that PAYE converted the income tax from a direct to an indirect tax; rather than the taxpayer feeling the burden of the tax, it would be disguised and unfelt.¹⁴

A problem that arises in the year a PAYE system is introduced is that employees will be subject to two years' tax in the one year; the prior year's tax payable in a lump sum the following year, as well as the current year's tax deducted at source. To avoid this problem the government simply remitted the 1958 income tax in full.

¹² Keith Sinclair, *Walter Nash* (Auckland: Auckland University Press, 1976), 301.

¹³ T. N. Gibbs, *Report of the Taxation Committee* (Wellington: Government Printer, 1951), para. 207.

¹⁴ J. A. Cornelius, "Pay-As-You-Earn Taxation," *Accountants' Journal* 29 (1950): 154. A similar concern that the income tax remain a direct tax in form was expressed by Neil V. Casey, "The Taxation of Incomes in New Zealand" (MCom thesis, University of Auckland, 1953), 260ff.

From 1962 the first £104 of income was exempted from Social Security Levies. This effectively added a degressive element to these levies, and was a step toward making these levies progressive. From 1970 the income tax rates scale was amended to include the Social Security Levy and the latter was no longer separately levied. As a result, the social security tax, like the income tax, was assessed on a progressive scale.

12.3.2 Adjustments

A rebate of £10 per person or up to £20 per married couple was introduced in 1949 and continued in effect until the adoption of the new Basic Rates scale in 1955.¹⁵ In contrast to an exemption, which reduces the taxable income, a rebate reduces the actual tax payable. As a result its value is not affected by the taxpayer's marginal tax rate.

The other longstanding exemptions, whose value is affected by the taxpayer's marginal tax rate, remained in effect during the 1950s and 1960s. However, these were amended; the General Exemption increased to £230 in 1954¹⁶ and £375 in 1955,¹⁷ before being reduced to £338 in 1959,¹⁸ and to the original £300 in 1960.¹⁹ In 1961, following a change in government, it was increased to £468,²⁰ and remained at that level until 1970. An interesting attempt at age discrimination was the additional £45 general exemption for taxpayers over 65 years of age which applied in the tax years 1955 to 1960 inclusive.²¹

The Child Exemption increased from £50 to £65 in 1954²² and then to £75 per child in 1955.²³ It increased to \$156 with the introduction of decimal currency, and remained at this level until 1970

¹⁵ Land and Income Tax (Annual) Act 1949, schedule 1.

¹⁶ Land and Income Tax Amendment Act 1953, s. 3.

¹⁷ Land and Income Tax Amendment Act 1954, s. 9.

¹⁸ Land and Income Tax Amendment Act No. 2 1958, s. 20. The General Exemption was reduced from £375 to £300 effective 1 October; hence the annual exemption of £338.

¹⁹ *Ibid.*

²⁰ Land and Income Tax Amendment (No. 2) Act 1959, s. 5.

²¹ Land and Income Tax Amendment Act 1954, s. 9.

²² Land and Income Tax Amendment Act 1953, s. 4.

²³ *Ibid.*, s. 3.

when it was reduced to \$135,²⁴ before being abolished in 1974 with the shift from exemptions with rebates.

The Dependent Spouse Exemption was increased to £125 in 1955,²⁵ £162 in 1956,²⁶ and £200 in 1960.²⁷ With the arrival of decimal currency on 10 July 1967 it was reduced to \$312.²⁸ It was subsequently reduced further before being replaced with a rebate from 1975.

The Life Insurance Exemption was also modified, with the exemption level increasing to £175 in 1954 and to £250 in 1961, but subject to a maximum exemption (15 percent of assessable income of £175 in 1954, 20 percent of assessable income in 1959).²⁹ This exemption would likely have been of most benefit to the wealthy, as those on lower incomes would struggle to put away a high portion of their income in insurance savings.

12.4 Effect on Taxpayers

By about 1950 the post-World War Two reductions in income tax rates ended. Over the ensuing two decades the tax remained relatively stable, although inflation resulted in a slow increase in the effective average tax rate. An exception resulted from the remission of tax upon the introduction of PAYE in 1958. Prior to the introduction of PAYE, employees had faced an annual tax bill which was payable in February of the following year. With the introduction of PAYE, this was no longer the case. PAYE was deducted from wages commencing 1 April 1958, which reduced employees' take-home pay. Rather than paying tax in arrears (for example, the tax due for the year ended 31 March 1957 fell due in February 1958), the employee now paid it in advance (that is, the tax due for the year ended 31 March 1958 was deducted at source throughout the year ending 31 March 1958). In displaying the tax on an income year basis, the following graphs obscure the actual experience of taxpayers.

²⁴ Charles A. Staples, *A Guide to New Zealand Income Tax Practice 1972-73 (33rd edition)* (Wellington: Sweet and Maxwell, 1973), 649.

²⁵ Land and Income Tax Act 1954, s. 81.

²⁶ Land and Income Tax Amendment (No. 2) Act 1958, s. 21.

²⁷ *Ibid.*

²⁸ Staples, *Guide 1972-73*, 649.

²⁹ *Ibid.*

Despite the remission of tax in 1958, Social Security Levies at a rate of 7½ percent were paid for that year by employees, since these were always deducted at source from employees but not from the self-employed. The National Government initially intended to remit these unpaid Social Security levies on the self-employed, which would have discriminated against employees who had already had their levies deducted at source. The outcome of this matter is discussed below.

12.4.1 Income level

Figure 12.2 confirms that, aside from the remission of the 1958 income tax, the income tax remained relatively stable for a single person during the 1950s and 1960s. A low income single taxpayer paid on average around 13 percent of their income in tax. For medium and high income earners, the figures were 20 percent and 50 percent, respectively. These percentages fluctuated during the period, but within a relatively limited range, though taxation tended to increase toward the end of the period. By way of comparison, during World War Two the rates had peaked in 1946 at 19, 26, and 52 percent for low, medium, and high income earners, respectively.

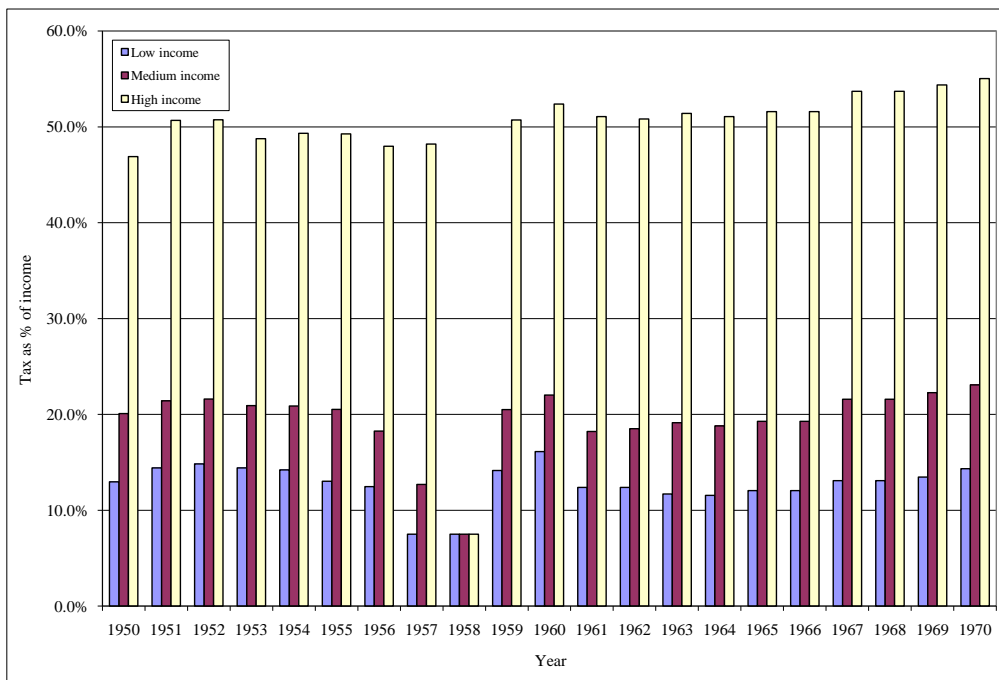


Figure 12.2 Income taxation on a single income earner at three income levels (1950 to 1970)

The pattern of taxing a low income at around two-thirds the rate of a medium income, and the high income at about two and a half times the medium, seemed entrenched. Figure 12.3 indicates that this same general pattern also applied to married taxpayers who had no children.

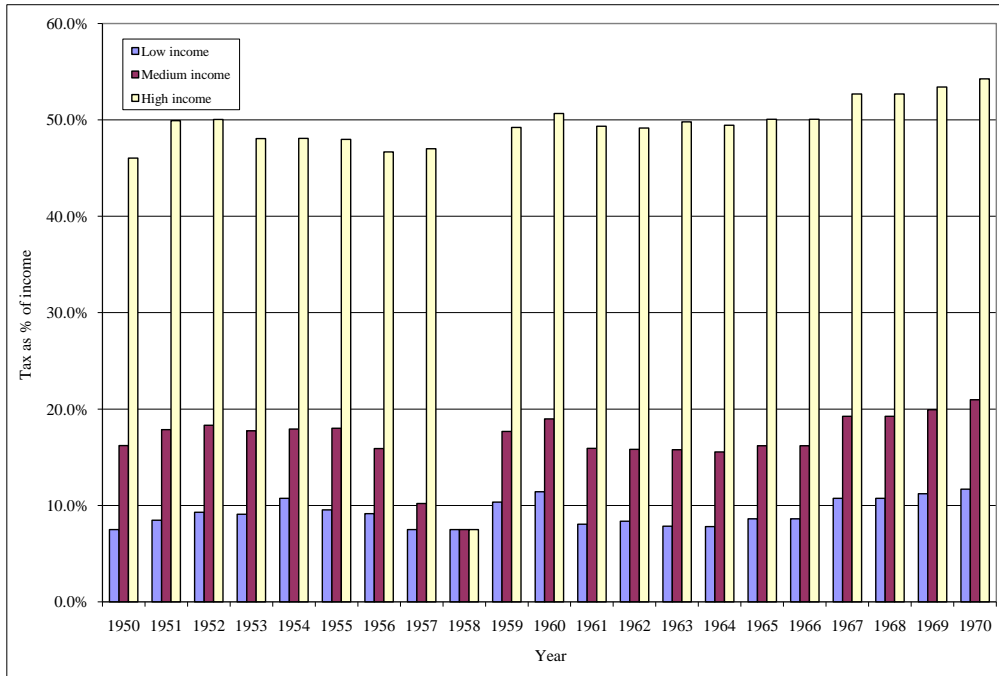


Figure 12.3 Income taxation on a married income earner with no children at three income levels (1950 to 1970)

The pattern had changed for families with children following the universalisation of Family Benefit. Family Benefit more than offset the income tax charge for low income families with children and halved the cost for medium income families. Higher income earners derived a smaller relative benefit from the Family Benefit. As with singles and married couples without children, Figure 12.4 indicates that the income tax on employment income was progressive for families with children – as incomes increased, the average tax rate also increased.

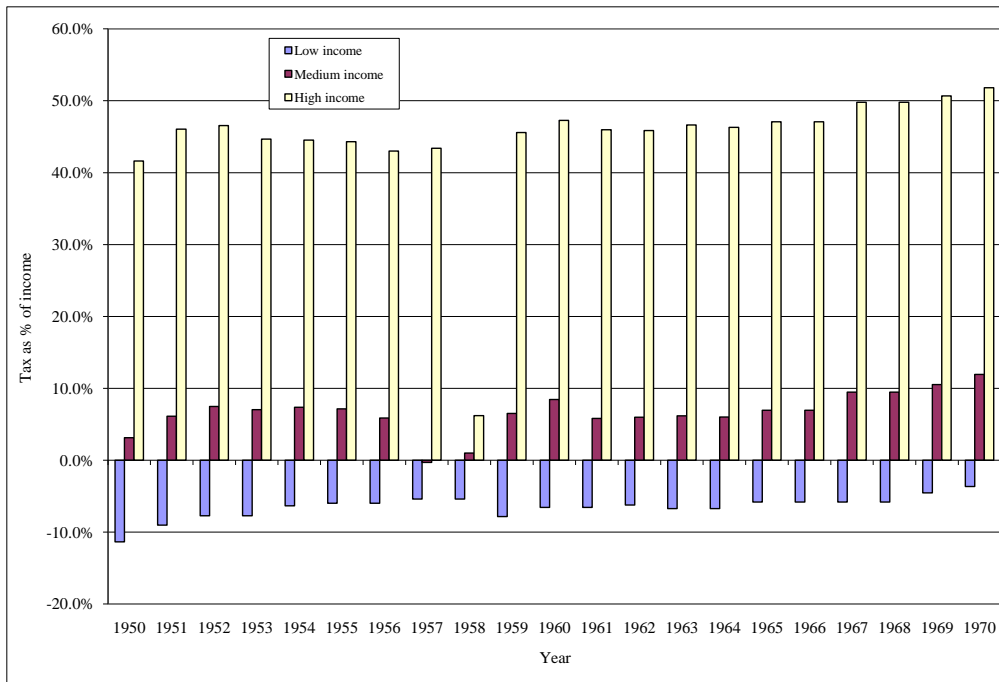


Figure 12.4 Income taxation on a married income earner with three children at three income levels (1950 to 1970)

12.4.2 Family circumstances

The pre-World War Two and wartime pattern whereby single taxpayers paid more tax than married taxpayers and the latter more than families continued after the war, and was accentuated by the Family Benefit. The effect of this Family Benefit was most notable in low income households as indicated in Figure 12.5. A low income three-child taxpayer paid no net income tax in the 1950s and 1960s. Since the amount of Family Benefit was fixed, it decreased in value over the period due to inflation, despite a fifty percent increase in the rate of Family Benefit from ten to fifteen shillings per child per week effective 1 October 1958.³⁰

³⁰ Social Security Amendment Act 1958, s. 10.

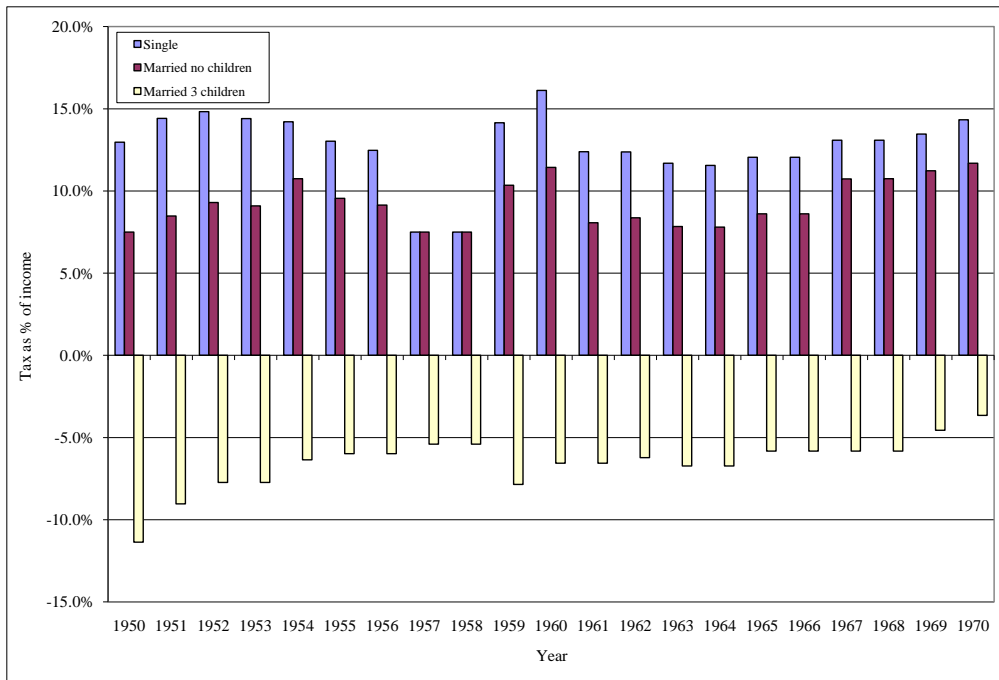


Figure 12.5 Income taxation on a low income earner in three domestic situations (1950 to 1970)

Reductions in exemptions or increases in incomes significantly affected low incomes given the narrow (£100) rates bands in the Basic Rates system. This is evident in 1959 and 1960, where the general exemption was reduced from £375 in 1958, to £338, and then £300. Tax on lower incomes was somewhat mitigated in the 1961 Basic Rates by extending the first bracket to the first £500 of income (previously £100).

By the 1930s middle incomes had become a source of income tax. Due to inflation this group provided an increasing amount of revenue by the mid-1960s.³¹ Whereas this group was virtually untaxed before 1930, and paid no more than 10 percent before World War Two, Figure 12.6 indicates that their tax was double that for most of the Fifties and Sixties, unless they had children.

³¹ Ross, *Taxation in New Zealand*, para. 220.

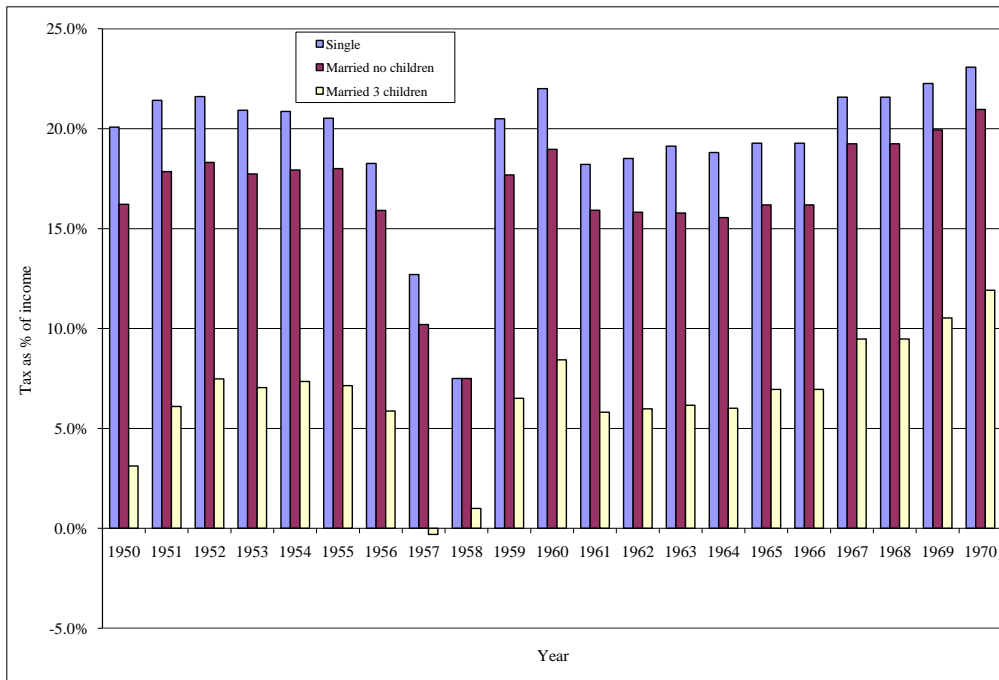


Figure 12.6 Income taxation on a medium income earner in three domestic situations (1950 to 1970)

Domestic situation had a relatively minor effect on the tax paid by high-income earners since the family-related rebates and the Family Benefit constituted only a small percentage of their income. By 1970 their average rate of tax exceeded World War Two levels. However, Figure 12.7 indicates that the same three stage pattern holds even at high levels of income. Single taxpayers paid more tax than married taxpayers, who in turn paid more than married taxpayers who had children.

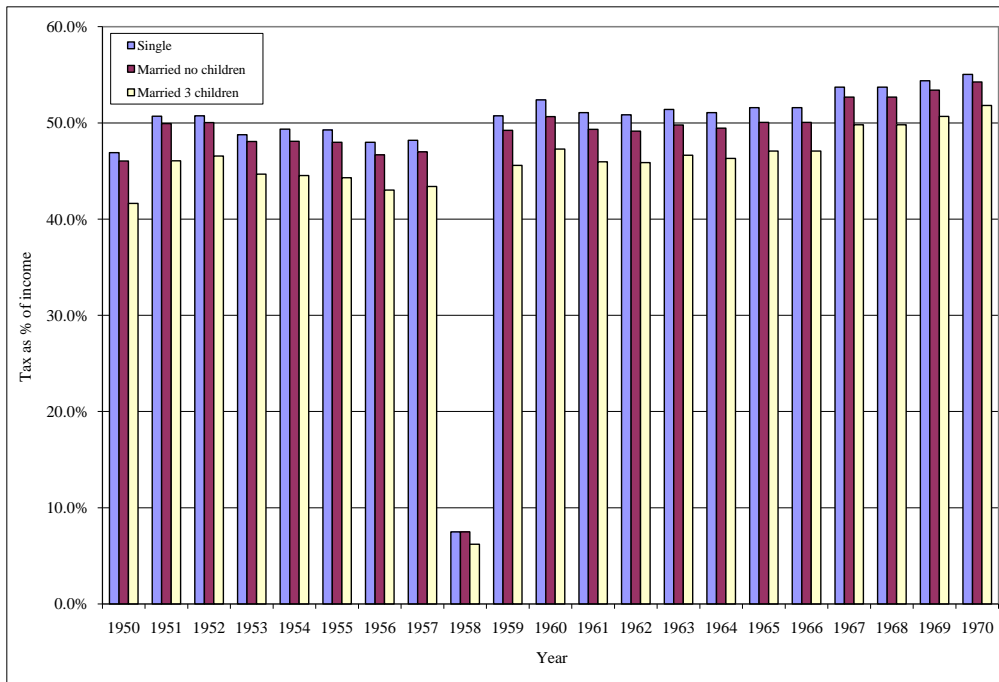


Figure 12.7 Income taxation on a high income earner in three domestic situations (1950 to 1970)

12.5 Vertical Equity

12.5.1 The “normal” post-war tax structure

The New Zealand income tax had assumed a more or less “normal” form by 1950. The 1951 Taxation Committee Report confirmed that vertical equity was understood in terms of ability to pay, and this in two dimensions: in respect of income level, “the basic tax rates provide an acceptable rate of progression to conform to the criterion of ability to pay.”³² The effect of differing domestic situations on taxpayers was addressed by special exemptions or rebates to taxpayers which “grade the income-tax liability in accordance with ability to pay and having regard to the domestic and family unit.”³³

Married taxpayers paid less tax than single taxpayers, and married taxpayers with children still less. This was due both to exemptions and rebates, and, more directly, by the “negative income tax”³⁴ of the Family Benefit. This pattern held throughout the decades of the 1950s and 1960s

³² Gibbs, *Report of the Taxation Committee*, 212.

³³ *Ibid.*, 211.

³⁴ *Ibid.*, para. 207f.

and comprised a prolonged period of relative stability in the practice of vertical equity in the income tax.

The income tax was universal, with a decreasing amount of income being exempt by reason of the General Exemption. All earners benefited from certain allowances and rebates, and all benefited from a universal social welfare system. Barely a decade after its introduction, the 1951 Committee noted that:

*The Committee is fully conscious that social security and the welfare programme have become part of the national economy, and that the country is committed to a continuation of the programme.*³⁵

Despite the cost neither party was interested in repealing the Social Security Act 1938. Indeed, National's Opposition leader Sidney Holland had previously confirmed bipartisan support for Social Security, stating that "every right thinking person in NZ believes in social welfare ... [which was] an effort on the part of people generally to assist those who are in need of assistance."³⁶ It had been introduced in the context of the Great Depression and sustained by wartime levels of taxation and the subsequent post-war boom. The Report of the 1951 Taxation Committee made note of this post-war prosperity:

*Rising prices for New Zealand's exports of primary produce have increased the national income substantially in recent years. It cannot be too strongly emphasized, however, that just as the national income rose by millions last year as a result of the abnormal advance in wool prices, so it can fall just as suddenly by as many millions.*³⁷

Compared to the 1930s and 1940s the income tax was remarkably stable during the two decades ending 1970. The crises of the Great Depression and World War Two left in place a universal income tax and social welfare. Despite numerous legislative changes, and ignoring the one-off tax remission of 1958, the percentage of tax actually paid by an individual employee fluctuated within a relatively small range. This stability in the income tax mirrored the political stability of

³⁵ Ibid., para. 195.

³⁶ NZPD, vol. 270 (10 October 1945), 533.

³⁷ Ibid., para. 117.

the post-war years; the National Party was in power for all but three of the years from 1950 to 1970. Holyoake, National's Prime Minister for most of the 1960s:

*... favoured cautious policies, not radical strategies, or, as he often remarked, a 'steady does it' approach. One of the Government's economic advisers recalled that Holyoake "regularly and forcibly reminded Harry Lake and others of Nordmeyer's political fate after his so-called 'black budget'." This attitude had an important inhibiting influence on the willingness of the Government to make radical change in the tax structure or stabilisation policy of the early 1960s.*³⁸

Two party politics led to a middle-of-the-road approach. Even though, as Miller put it, "in the vital area of economic policy the differences between the two main parties were more imagined than real,"³⁹ the parties did attempt to distinguish themselves. National's Minister of Customs, Bowden, justified his party's policy of post-war tax reductions as one that "gave consideration to those worthy people who had in their earlier days contributed to the prosperity and advancement of the Dominion."⁴⁰ Labour's Nash focused on a different group, noting that "if we are to make some reduction in taxation, we should give it to those who need it most."⁴¹ Yet as during the two previous periods of income tax stability – 1892 to 1913, and 1925 to 1929 – the pattern of taxation changed little in these two decades for the wage or salary earner, and this irrespective of whether Labour or National was in power. Despite economic fluctuations, there was no occasion to change the basic pattern; any change was incremental, demonstrating the maxim that, ordinarily, an old tax is a good tax, since "taxpayers are by nature conservative and resist tax innovations."⁴²

12.5.2 The "Black Budget"

In this context of post-war prosperity, and given taxpayers' preference for stability, Labour's "Black Budget" of 1958 provides an object lesson on how *not* to tax. Where there is a genuine

³⁸ Barry Gustafson, *Kiwi Keith: A Biography of Keith Holyoake* (Auckland: Auckland University Press, 2007), 315.

³⁹ Raymond Miller, "Labour," in *New Zealand Government and Politics*, ed. Raymond Miller (South Melbourne: Oxford University Press, 2003), 241.

⁴⁰ *NZPD*, vol. 298 (17 September 1952), 1493.

⁴¹ *Ibid.*, 1485.

⁴² Keith C. Hooper, *Taxation as a Social Phenomenon: An Historical Analysis: Discussion Paper No. 93* (Palmerston North: Massey University Department of Accounting, 1989), 19.

crisis such as World War Two that is obvious to taxpayers, taxes can be raised almost with impunity. A sudden economic downturn in 1958 appeared to provide such a crisis.

After years of post-war prosperity, New Zealand faced a severe balance of payments crisis, due to a disastrous fall in butter and other primary export prices on the London market.⁴³ Compounding this were concerns about Britain's possible entry into the European Economic Community. In response, Labour's Finance Minister Nordmeyer commenced his 1958 Budget speech:

*Since the last Budget 11 months ago, the returns from our exports have fallen unexpectedly and considerably ... The object of the Government's financial and economic proposals, some of which I shall announce tonight, is to ensure that any reduction in living standards arising from lower overseas prices for our exports is spread fairly throughout the community without hardship or unemployment.*⁴⁴

The upshot was that taxes were increased across a wide field. Although the increases in indirect taxes – on alcohol, tobacco, and motor spirits – are best known, income tax too was increased. The effect of any specific increase was compounded by the low income tax in the two previous years due to the £100 rebate in 1957 and the remission in 1958 which accompanied the introduction of PAYE. Additionally, wages increased significantly between 1958 and 1960, resulting in bracket creep. The government's response is reminiscent of that adopted by the Reform and Coalition Governments during the Great Depression. As Miller aptly puts it:

*Ironically, on the occasion of Labour's rare 1957 victory, its 72 year-old leader, Walter Nash, presided over a government that is best remembered for its parsimonious economic management and cautious leadership.*⁴⁵

Had a prolonged economic crisis akin to the Great Depression actually ensued, the electorate might have accepted these increases. Instead, a year later Nordmeyer commenced the 1959 budget, "Tonight's budget has been prepared in circumstances very different from those existing

⁴³ Bruce Brown, "Nordmeyer, Arnold Henry 1901 – 1989," *Dictionary of New Zealand Biography* (Wellington: Ministry for Culture and Heritage, 2007), <http://www.dnzb.govt.nz/> (accessed 23 March 2009).

⁴⁴ *NZPD*, vol. 316 (26 June 1958), 276.

⁴⁵ Miller, *Labour*, 240.

twelve months ago.”⁴⁶ The crisis was short-lived, but the memory of the government’s tax measures endured. By the time of the 1960 General Election, the “crisis” had been forgotten, but the tax increases had not. National trounced Labour at the polls and continued to make political capital of the 1958 Black Budget in ensuing years. Thus in 1970, National leader Holyoake berated the Opposition: “... if by some unhappy political accident Labour had become the Government at the end of last year, we would have had something akin to the “black” Budget ...”.⁴⁷ Unlike a general economic depression, and more particularly a world war, a balance of payments crisis is largely invisible to an employee. Although it was very real to the government that responded by raising taxes, it did not constitute an occasion where significant change to the tax system was accepted as justified by the population, particularly when it did not endure.

Labour’s response to the 1958 balance of payments crisis indicates the close interplay of politics and taxation. Although each political party might endeavour to distinguish itself by its tax policy, it is unlikely to receive a popular mandate to implement its policy unless the public accepts the need for change. Successful implementation requires a crisis: either a real crisis recognised as such by the electorate, or a manufactured crisis that is successfully sold to the public. Using the income tax, or indeed indirect taxes, to fix a short-lived crisis is likely to lead to revolt, or, in a democracy, defeat at the polls. It does not constitute a sufficiently serious crisis to justify tampering with the tax paradigm.

National’s Leader Holyoake made much political mileage out of the situation at the time. After Nordmeyer had finished his Budget speech, Holyoake opined, “Socialism is obviously very highly priced; I would say prohibitive. Socialist governments are just too expensive a hobby altogether, but the people can have their say about that later.”⁴⁸ Yet National’s deeds did not match its words; within a few years the tax rates payable by employees were higher than they had been under Labour, and increases in excise duties became a hallmark of National’s Finance Minister Muldoon in his budgets and mini-budgets from 1967 onwards. However, the latter changes were incremental and regular, rather than occasional and abrupt. Taxation might be

⁴⁶ *NZPD*, vol. 319 (9 July 1959), 333.

⁴⁷ *NZPD*, vol. 366 (30 June 1970), 1378.

⁴⁸ *NZPD*, vol. 316 (26 June 1958), 289.

tweaked, or inflation might be allowed to achieve the same effect, but Nordmeyer's perceived radical change contributed to Labour's defeat at the polls.⁴⁹

12.5.3 How to tax: The practice of graduation

12.5.3.1 Progression

The 1951 Taxation Committee had mentioned the fact of graduation but made no comment on the rates scale as such – it was assumed. As indicated in Figure 12.1, the basic rates scale changed little between 1940 and 1970. Discussing the post-war tax reductions, National's Finance Minister Bowden commented that, "the whole principle of assessment is the graduated system. If it is right to have a graduated system for putting the tax on, surely it is all right to have a graduated system for taking the tax off."⁵⁰

12.5.3.2 Rates scale

Each party did have a turn at amending the Basic Rates. National introduced the 1955 revised Basic Rates scale, and Labour the revision of 1961. The latter made some allowance for income inflation. More significantly, it made allowance for lower income earners by reducing the rates on incomes up to £800 at a time when the hairdresser's award rate was around £700 per annum. After losing power, Labour's Nordmeyer argued that National, in leaving the scale of taxation the same as Labour's, had recognised that it was "a fair and reasonable one."⁵¹ The language of political debate reflected an apparent consensus as to what the tax scale should look like.

12.5.3.3 Economic development

Ability to pay provided the basis for how to assess income tax, but the realisation of this ideal remained elusive, and was complicated by governments' assuming an increasing role in the economy. Historically, ability to pay might be assessed on an inter-group basis, and in measure National retained this focus, with the introduction of a number of measures to incentivise farming. Thus, Finance Minister Lake announced in his 1950 budget, "a further measure of assistance in farming operations,"⁵² and successive budgets maintained this emphasis.

⁴⁹ For contemporary reactions, refer R. M. Chapman, W. K. Jackson, and A. V. Mitchell, *New Zealand Politics in Action: The 1960 General Election* (London: Oxford University Press, 1962), 48-50; Muriel F. Lloyd Prichard and James B. Tabb, *The New Zealand General Election of 1960* (Auckland: University of Auckland, 1961), 31-5: "Why Did Labour Lose the Election?"

⁵⁰ *NZPD*, vol. 300 (30 September 1953), 1595.

⁵¹ *NZPD*, vol. 328 (13 September 1961), 2220.

⁵² *NZPD*, vol. 290 (24 August 1950), 1843.

More significantly, taxation fairness increasingly came to be seen in terms of the macro-economy, rather than at the (inter-)personal level. The 1967 Ross Report highlighted this shift:

*Taxation is no longer simply a device to raise the revenue needed to meet the cost of government. In this modern age taxes are now recognised as important tools for influencing the development of the economy, and for implementing economic and social policy in a variety of ways.*⁵³

World War Two had given the government experience of a command economy. The government now sought to influence the development of the economy using the vastly expanded taxation resources available to it. Budgets in the 1960s referred to “policy measures and taxation incentives which are designed to encourage more investment in productive industries,”⁵⁴ and the provision of “valuable incentives to encourage increased production, particularly production for export.”⁵⁵ In 1968, Finance Minister Muldoon suggested that, “This government is committed to the pursuit of sound economic growth and the improvement of the living standards of all New Zealanders.”⁵⁶ The income tax provided a key tool for effecting this fiscal policy.

Labour did not disagree with the vision – it largely shared it. Labour’s Tizard suggested that Labour’s policy was “... to alter the incidence of taxation rather than the total amount, in order to foster productivity and to give encouragement where it is due.”⁵⁷ However, the provision of incentives was not the same thing as enhancing a wage or salary earner’s take-home pay. Tizard continued:

*It is clear that the whole trend of National party policy has been to shift taxation from the shoulders of those able to pay it and put it on to wage and salary earners.*⁵⁸

⁵³ Ross, *Taxation in New Zealand*, para. 5.

⁵⁴ *NZPD*, vol. 330 (28 June 1962), 525.

⁵⁵ *NZPD*, vol. 338 (25 June 1964), 345.

⁵⁶ *NZPD*, vol. 355 (18 July 1968), 608.

⁵⁷ *NZPD*, vol. 348 (1 September 1966), 2418.

⁵⁸ *Ibid.*, 2419.

Incentives only indirectly benefit wage and salary earners, but directly benefit manufacturers, exporters, and farmers. For this reason, Tizard argued that “it is the amount of taxation that each individual pays – the proportion of his earnings that he pays in tax – that is significant.”⁵⁹ Nordmeyer had said the same thing in the more familiar phrase: “It is not what we take but what we leave you that matters.”⁶⁰ Similarly, Labour’s future Prime Minister Kirk suggested that the remainder, rather than the tax, should be considered, for even though the income tax might have been reduced, costs had risen due to government charges that the National Government had increased:

*An examination of the Bills also shows that this reduction in taxation is being purchased at the expense, economically and financially, of the families of the smaller taxpayers ... The government has reduced taxation by leaving it exactly as it was and adding more to rents, interest charges, rail fares, and power charges.*⁶¹

12.5.3.4 Families

If economic development was a focus, so too were families, as is evident in Figures 12.5 to 12.7 above. The theme stated in National’s Prime Minister and Minister of Finance Sidney Holland’s 1953 budget was continued throughout the period: “In considering the classes of taxpayers to whom the reductions will apply, the Government gave first consideration to the family unit, as the basis of our national life.”⁶² He continued this theme the following year when, in reducing taxation, he sought as much as possible to ease the burden “on the lower-income section of the people, and particularly to give the utmost concessions to the family unit.”⁶³

The social consensus concerning progression provided little room for disagreement between the parties. In fact, their policies, as realised in practice, differed little. This is clearly seen when Labour questioned the fairness of the post-war reductions made by National, since the wealthy benefited most when a flat percentage reduction was made to the rates.⁶⁴ With some justice, National retorted by asking why Labour itself had done the same thing when it had reduced rates

⁵⁹ Ibid.

⁶⁰ *NZPD*, vol. 298 (17 September 1952), 1487.

⁶¹ *NZPD*, vol. 328 (13 September 1961), 2227.

⁶² *NZPD*, vol. 299 (27 August 1953), 772.

⁶³ *NZPD*, vol. 303 (22 July 1954), 646.

⁶⁴ *NZPD*, vol. 298 (17 September 1952), 1485.

while in power immediately after the war.⁶⁵ National had simply continued where Labour had left off.

12.5.3.5 Rebates

At times, the differences between the parties came to light in the smaller details. National introduced a £45 additional rebate for taxpayers 65 years and older in order to:

*... give some special reward to people of sixty-five years of age and over who were not drawing social security benefits – in other words, people who had made such provision for their own future that they were disqualified by the size of their assets and income from drawing social-security benefits.*⁶⁶

Labour objected on the grounds that this rebate was not universal.⁶⁷ Since the rebate applied to a section of the population that either had personal means or was provided for by way of social security, the rebate could not be justified on the grounds of need.

Similarly, Labour criticised the introduction of the £25 exemption for donations and school fees in 1962 since many lower income people, which would have included parents of children at (then private) Roman Catholic schools, would not benefit from it, and suggested it would have been a fairer to have given a flat rebate rather than a deduction. Labour Member of Parliament Connelly's criticism drew on both benefit and ability to pay notions:

*... in fact about half the people who send their children to private schools will receive no benefit whatever under that provision, despite the fact that it is on such people that the burden of fees rests most heavily. It could therefore be a valid criticism of this clause that it assists the wealthy and ignores those who we would say were in the needy category.*⁶⁸

The same argument indeed applies to all exemptions, since the value of the exemption increases with increases in the taxpayer's marginal tax rate. Labour would address this matter when it regained power in 1972.

⁶⁵ Ibid., 1486.

⁶⁶ NZPD, vol. 296 (6 December 1951), 1389.

⁶⁷ NZPD, vol. 291 (27 November 1950), 4606.

⁶⁸ NZPD, vol. 333 (4 December 1962), 3057.

12.5.3.6 PAYE and the Social Security Levy

A distinction between the two parties was also evident in their respective approaches to the remission of the Social Security Levies for 1958 for non-employees. Prior to the introduction of PAYE, Social Security Levies had been deducted at source from employment earnings, but were paid annually in arrears by the self-employed. National announced in the 1957 Budget that it would extinguish the Social Security charge on income other than salary and wages for the 1958 year, just as it remitted the income tax for all taxpayers for that year.⁶⁹ In this way, all taxpayers would only pay one year's social security charge each year. Labour's Nash objected to this:

*One [group] pays no social security charge for the first year, but the other does. If the first man gets the remission for one year now, he will pay less by one year than the wage and salary earner.*⁷⁰

This episode suggests a difference between the two parties; Labour found its natural constituency among the workers, whereas National among farmers and the self-employed. Labour's Nash emphasised the intergroup unfairness of this measure, and also its regressiveness: "My criticism of the government, and I reiterate it here, is that the general benefits given under this and prior Budgets have gone to those on the higher incomes."⁷¹

However, it was also an election year. Arguably, National was seeking to garner support in its natural constituency. Certainly, no taxation measure is ever a pure application of political or ethical philosophy, least of all in the context of an election, which had already seen the two parties attempt to outbid one another as far as the £100 rebate was concerned.⁷² The remission was enacted.⁷³ However, the first Act passed when Labour assumed the Treasury benches reversed this, making the outstanding self-employed social security charge payable in three annual instalments.⁷⁴

⁶⁹ *NZPD*, vol. 312 (25 July 1957), 1187.

⁷⁰ *NZPD*, vol. 312 (30 July 1957), 1241.

⁷¹ *Ibid.*, 1249.

⁷² Sinclair, *Walter Nash*, 296-303.

⁷³ Income Tax Assessment Act 1957, part IV.

⁷⁴ Land and Income Tax Amendment Act 1958, s. 5.

12.6 Report of the Ross Taxation Committee

The Parliamentary Debates confirm the evidence provided by the tax legislation: the two decades following World War Two were decades of relative stability in income taxation, and in the practice of vertical equity in income taxation. This was confirmed by the next major taxation review, that of the Ross Committee in 1967.⁷⁵

In his 1966 budget, Finance Minister Lake announced a review of the whole field of central government taxation, since it was:

*... of vital importance that the structure of our tax system should be so designed as to place the least practicable restraint upon incentive and efficiency while at the same time maintaining equity among all groups of taxpayers and the community generally.*⁷⁶

The terms of reference of the 1967 Ross Committee were “to carry out a comprehensive review of the rates, structure, and incidence of the whole field of central Government taxation in New Zealand”. Significantly, the Ross Committee was “to have regard to the need to maintain an adequate level of total taxation revenue in relation to Government expenditure and to the requirements of economic growth and stability.”⁷⁷ The theme of economic development and stability pervades the report. Whereas “the original concept of taxation was a simple one: taxes were the means of raising revenue for subsequent expenditure by the ruling authority,”⁷⁸ in a modern society this was no longer the case:

*Taxation is no longer simply a device to raise the revenue needed to meet the cost of government. In this modern age taxes are now recognised as important tools for influencing the development of the economy, and for implementing economic and social policy in a variety of ways.*⁷⁹

Taxation was considered to have three roles. It provided the government with finance, redistributed income on a socially acceptable basis, and was an instrument to enable the

⁷⁵ Ross, *Taxation in New Zealand*.

⁷⁶ *NZPD*, vol. 346 (16 June 1966), 584.

⁷⁷ Ross, *Taxation in New Zealand*, para. 8.

⁷⁸ *Ibid.*, para. 7.

⁷⁹ *Ibid.*, para. 5.

government to meet its economic aims.⁸⁰ First, taxation has always been a means to finance Government expenditure. Although there had been a social purpose in the introduction of the land tax in 1891, namely the “bursting up” of the large estates, the raising of revenue was the main purpose for which the income tax had been levied.

A second role of taxation, redistribution, came to the fore in the later 1930s with the passage of the Social Security Act 1938. The 1967 report commented that Adam Smith’s four maxims for taxation (equity, certainty, convenience, and economy)⁸¹ needed expanding.⁸² As far as equity was concerned:

*The determination of equity in taxation must rest upon value judgments as to the overall pattern of income distribution (after tax) considered desirable. There are two major aspects of equity; first, the like treatment of persons in like circumstances; and second, the ability to pay, which is related to the economic wellbeing or standard of living to be enjoyed by the taxpayer.*⁸³

The first aspect reflects the usual understanding of horizontal equity. The second, however, again equates vertical equity with ability to pay. Equally significantly, the focus of these equity concerns is the after-tax rather than the pre-tax distribution, and on what had been Labour’s focus on not what a person has, but on what a person will enjoy as the criterion for distribution. However, the Ross Committee noted that, “Equity in the taxation system should not be confused with equality.”⁸⁴ Nor could political reality be ignored: “it is inescapable that a tax structure must reckon with public opinion.”⁸⁵ This focus on ability to pay was consistent with the 1951 Report of the Taxation Committee more than a decade earlier.

⁸⁰ Ibid., para. 6.

⁸¹ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan, (London: Methuen, 1950), 5.2.

⁸² Ibid., para. 4.

⁸³ Ibid., para. 14.

⁸⁴ Ibid.

⁸⁵ Ibid.

The effect of family situation on ability to pay was clearly spelled out: “It is generally accepted that the impact of taxes on income should vary according to income levels and family responsibilities.”⁸⁶ Indeed:

*It is probably universally accepted, and it is certainly accepted in New Zealand, that a direct income tax system should be so designed as to have regard for a taxpayer’s family status so that, generally speaking, an unmarried man on a certain level of income pays more income tax than a married man on the same income. This principle is applied further so that a taxpayer with other dependents, for example, children, pays less tax than another taxpayer on the same income who has no or fewer dependents. In most cases the dependants for whom tax recognition is given are a wife (or dependent husband) and children.*⁸⁷

Put simply:

*... as a prime requirement, a system of taxes on individual incomes likely to be acceptable to the majority of New Zealanders must be progressive in incidence and provide adequate recognition of family circumstances.*⁸⁸

Although the existing system did this, the Ross Committee expressed concern that it bore heavily on taxpayers in the middle income range, reaching the top marginal rate of 67½ percent (including social security tax) at the “unduly low” income level of \$7,200. It proposed a new scale and set of exemptions, with rates (including social security tax) ranging from 10 percent, to 75 percent on income in excess of \$40,000.⁸⁹

The Ross Committee also expressed concern at the increasing amount of tax derived by way of the income tax. It recommended a shift in the incidence of taxation from direct to indirect taxes to encourage work, enterprise, and saving, and to discourage unnecessary expenditure.⁹⁰ Acknowledging that indirect taxes are generally considered regressive in effect, it suggested that the whole system of taxes, and not merely one part of it, needs to be considered. It further

⁸⁶ Ibid., 256.

⁸⁷ Ibid., para. 244.

⁸⁸ Ibid., para. 273.

⁸⁹ Ibid., para. 110ff

⁹⁰ Ibid., para. 208.

suggested a system of cash grants, “to make up the individual’s income to the basic level,”⁹¹ thereby protecting the standard of living of a low income earner.

The third role of taxation was to enable the government to effect fiscal policy. This function was already evident in the Vogelian infrastructure investments of the 1870s. However, it came into prominence with the virtual monopoly of Keynesian thought after World War Two, and was promoted by the Ross Committee, which argued that:

*There is a strong case in favour of a greater use of fiscal measures in the economic management of the country than has been made by successive Governments in the past.*⁹²

In 1967, economic conditions in New Zealand were still buoyant, and the role of the state in steering the economy was not questioned. The Ross Committee’s report reflected certain post-war priorities, namely:

- a satisfactory rate of growth in real income;
- full employment;
- price stability;
- balance of payments stability;
- the distribution of income in conformity with the standards of equity considered accepted by society; and
- freedom of choice consistent with the attainment of other objectives and conforming with accepted views of rights and duties.⁹³

The progressive income tax paradigm was uncontested, and income as the primary source of taxation revenue was well-established. The Ross Committee’s preferred definition of income, “consumption plus additions to wealth,”⁹⁴ reflects the Simons definition published immediately prior to the war, namely, “the algebraic sum of the individual’s consumption expense and accumulation during the accounting period.”⁹⁵ Given this definition, the Ross Committee could

⁹¹ Ibid., para. 209.

⁹² Ibid., para 10.

⁹³ Ibid., para. 17.

⁹⁴ Ibid., para. 44.

⁹⁵ Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), 206.

recommend that, “The introduction of a realised capital gains tax is desirable on the grounds of equity.”⁹⁶

Social welfare was no longer treated as a means of assisting people external to the tax system, but would soon be fully integrated into the income tax, allowing the economically desirable taxation mix to be mitigated for equity concerns. Overall, taxation was a major tool in the arsenal of a government whose role was not merely to be the night watchman, or even the provider of a social safety net, but rather the driver of the economy.

To make most effective use of this tool, the Ross Committee recommended that governments be able to adjust taxes quickly to meet emerging situations.⁹⁷ Although National’s Finance Minister Muldoon appealed to the “severe short-term economic difficulties which we have recently experienced,”⁹⁸ as a reason for not adopting the more significant of the Ross Committee’s recommendations, his interventionist use of fiscal policy would become a hallmark of his administration.

12.7 Summary

The post-World War Two years were a time of “steady does it”. The personal income tax did not change substantially in form from 1950 to 1970; changes were incremental. Nor, in a two-party democracy dominated by the National Party, was there much scope for radical innovation; the policies of the two parties converged. Yet the cumulative effect of minor adjustments and of inflation-induced bracket creep meant that by 1970 most taxpayers were paying substantially more tax than they had at the end of World War Two. For families, Family Benefit mitigated the high level of income tax.

In the absence of any sustained crisis, the 1950s and 1960s demonstrate that significant change in the income tax is unlikely. In contrast, the 1970s were a period of economic turmoil which placed significant demands on tax policy as a tool to effect economic policy.

⁹⁶ *Ibid.*, para. 1008.

⁹⁷ *Ibid.*, para. 76ff.

⁹⁸ *NZPD*, vol. 355 (18 July 1968), 617.

Chapter 13

1970-1984: Economic Malaise

*This is the way the world ends
Not with a bang but a whimper.*
T. S. Eliot¹

13.1 General Context

Although the 1950s and 1960s were generally prosperous times for New Zealand, there were clouds on the horizon. One, the possible entry of Britain into the European Economic Community, was nervously anticipated.² The effect on New Zealand's exports was expected to be dire given that Britain was an almost monopsonistic purchaser of New Zealand's primary exports.³ After its attempts to join were thwarted in 1961 and 1967 Britain finally did become part of the European Economic Community in 1973.⁴

Another concurrent shock was not expected, namely the oil shock of 1973 and again in 1979. The ensuing stagflation limited the ability of the government to balance budgets or the current account. A third, less visible shock, was the breakdown of the Bretton Woods system of international monetary management in the early 1970s. By the late Sixties the "Golden Weather" was coming to an end.⁵

¹ T. S. Eliot, "The Hollow Men," in T. S. Eliot, *Collected Poems* (London: Faber and Faber, 1974), 92.

² This concern is well-expressed in the title of a contemporary collection of essays: J. R. Marshall, H. J. de Koster, and F. W. Holmes, *Fight for Life: New Zealand, Britain and the EEC* (Wellington: Price Milburn for the New Zealand Institute of International Affairs, 1971).

³ In 1930, 80 percent of New Zealand's exports went to the United Kingdom; this had fallen to 66 percent by 1950, 36 percent by 1970, and 9 percent by 1985: Keith Sinclair, *A History of New Zealand* (Auckland: Penguin, 1991), 314.

⁴ Philippa Mein Smith, *A Concise History of New Zealand* (Cambridge: Cambridge University Press, 2005), 198-202.

⁵ The phrase derives from the title of Bruce Mason's play, *The End of the Golden Weather* (Wellington: Price Milburn, 1962), and is regularly applied to the economic change occurring in the late Sixties or early Seventies: see Philippa Mein Smith, *A Concise History of New Zealand* (Cambridge: Cambridge University Press, 2005), 202; Brian Roper, "The End of the Golden Weather," in *State and Economy in New Zealand*, ed. Brian Roper and Chris Rudd (Auckland: Oxford University Press, 1993). Gary Hawke places the turning point in the late Sixties: "the date of 1967-68 is of more than symbolic significance": Gary R. Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985), 322. Hugh Templeton suggests that 1967 "marked the end of the golden weather for the New Zealand economy," Hugh Templeton, "Muldoon and Parliament," in *Muldoon Revisited*, ed. Margaret Clark (Palmerston North: Dunmore Press, 2004), 30. A less specific date suffices for present purposes, given that there is a delay between external events and local fiscal responses.

For most of the period, except for the term of the Third Labour Government (1972-1975), economic and taxation policies were almost personified by Finance Minister (from 1967) and Prime Minister (1975-1984) Robert Muldoon. The focus of economic policy was the protection of the rural sector and latterly on growth catalysed by large scale state intervention. Income taxation involved regular tweaking of the rates scale, as well as of the various allowances and rebates that were in place. No ideological purist, Muldoon “distrusted the free market, believing in the tradition of managing the economy and society so that ordinary people could benefit from capitalism ‘while being protected from its excesses.’”⁶ As he put it, “any country which today allowed its economy to run completely free would get the worst of all worlds and go downhill very rapidly.”⁷ Rather, his wages and price intervention, and “Think Big” economic development policies in the economic sphere, were mirrored by his micro-management of the income taxation.

In this context, vertical equity continued to focus on enhancing welfare. As Muldoon put it at the start of his tenure as Minister of Finance, “This government is committed to the pursuit of sound economic growth and the improvement of the living standards of all New Zealanders.”⁸ However, in view of the challenging international economic environment, the second goal might be seen as subordinate to, or even a consequence of, the first.

It is tempting to read the post-Muldoon history of the income tax as the inevitable result of the failures of the Muldoon period. However, this is overly simplistic. Certainly there were pressures to reform the income tax, particularly by reducing the reliance on direct taxation.⁹ However, the basic question of how vertical equity was practised in the income tax is best considered within its own period. The various adjustments that were made, and the debates surrounding such changes, provide evidence as to what fairness was understood to mean at the time.

⁶ Mein Smith, *Concise History of New Zealand*, 204.

⁷ Alan McRobie, “The Politics of Volatility,” in *The Oxford History of New Zealand*, ed. Geoffrey W. Rice (Auckland: Oxford University Press, 1992), 393.

⁸ *NZPD*, vol. 355 (18 July 1968), p. 608.

⁹ From the mid-1970s, a raft of policy papers were published by the New Zealand Planning Council, many of which addressed the question of taxation, for example: Paul Bevin, Avery Jack, and John Jensen, *Income Maintenance and Taxation: Some Options for Reform* (Wellington: New Zealand Planning Council, 1978); Pamela Jeffries, Suzanne Snively and Graeme Thompson, *Taxing Issues* (Wellington: New Zealand Planning Council, 1981); Pamela Jeffries, *An Agenda for Tax Reform* (Wellington: New Zealand Planning Council, 1981); Judith Davey and Peggy Koopman-Boyd, *Issues in Equity* (Wellington: New Zealand Planning Council, 1983); and Gary R. Hawke, *Government in the New Zealand Economy* (Wellington: New Zealand Planning Council, 1982).

13.2 Taxation Context

During the 1970s, the government's increasing management of the economy is evident in the increase in the tax to GDP ratio from around a quarter to nearly a third. Coupled with sustained deficits, the government marshalled a similar portion of the nation's resources as in World War Two.¹⁰

Income tax had, by now, become the tax of choice. Although indirect taxes remained significant, Labour's perhaps fatal experience with these in 1958 prevented subsequent governments from making more than marginal adjustments to indirect taxation. However, the income tax could be more easily adjusted, and was almost annually, producing three-quarters of tax revenue by the end of the period.¹¹

13.3 Income Tax Legislation

13.3.1 Tax rates

A new Basic Rates scale was introduced for the 1970 year. This was replaced in 1972, to which immediately a 3½ percent surcharge was added.¹² This surcharge was increased to 7½ percent in 1973 and ten percent in 1974. In subsequent years the practice of Basic Rates scales was abandoned; a new rates scale was introduced almost annually.

The almost strict linearity of the Basic Rates scales¹³ was also abandoned. The first and second Basic Rates Scales of 1941 and 1955 had been linear up to a maximum rate. The 1961 Basic Rates were proportional up to £500, and linear thereafter, with one rate of progression up to £1,000, and a less steep progression thereafter up to a maximum rate. This was no longer the case after 1970.

The Social Security Levy was merged with the income tax in 1970. The form of this levy now reflected what had always been the case; that the levy contributed to, but had never fully paid for, Social Security. As the Gibbs Committee had noted, "The Social Security Fund is not founded on

¹⁰ Gary Hawke, *The Making of New Zealand: An Economic History* (Cambridge: Cambridge University Press, 1985), 300.

¹¹ P. M. McCaw, *Report of the Task Force on Tax Reform* (Wellington: Government Printer, 1982), Table 2.2 (p. 11).

¹² Land and Income Tax (Annual) Act 1971.

¹³ Refer Table 12.1 (p. 318).

an actuarial basis nor is it self-supporting.”¹⁴ The Forbes Coalition Government of 1931 to 1935 was the last government that had endeavoured to fully fund welfare spending by way of a separate levy. The First Labour Government did not expect its Social Welfare scheme to be fully self-funding, and annual transfers were made from the Consolidated Fund to the Social Security Fund from its inception. In 1958 the nomenclature was changed. The Social Security Charge became Social Security Income Tax; indeed it always had been a tax, albeit at a flat rate rather than progressive rates. The metamorphosis of this charge to a tax continued with a special exemption of £104 (\$208) being allowed from the yearly assessable income of every personal taxpayer for the 1963 to 1969 income tax years,¹⁵ thereby converting the Social Security Levy to a degressive rates scale. Finally, by merging the social security income tax into the personal tax rates, the social security levy was effectively assessed on the same progressive rates as the income tax. What had been a proportional rate levy which in measure reflected benefits theory was thus converted into (a portion of) a progressive rates structure assessed on an ability to pay basis.

13.3.2 Adjustments

The Third Labour Government under Prime Minister Rowling finally eliminated the remaining exemptions and replaced them with rebates. The General Exemption had been cut to \$275 in 1971 and was replaced by a rebate of \$125 in 1975. This was altered to \$145 in 1976, \$155 in 1977 and 1978, and then down to \$77.50 in 1979, before being eliminated.¹⁶

The Dependent Spouse’s Exemption suffered a similar fate. It was reduced to \$240 per week in 1970, then increased to \$275 from 1971 to 1974. From 1975 it was replaced by a rebate of initially \$125 in 1975, then \$145 in 1976, \$156 in 1977 to October 1983, before being repealed.¹⁷

The National Government eliminated the Child Exemption, which had been reduced to \$135 per child in 1970, but was discontinued in July 1972.¹⁸ Concurrently, the Family Benefit was doubled to three dollars per week.¹⁹ It was again doubled in 1982 to \$6 per week per child.²⁰

¹⁴ T. N. Gibbs, *Report of the Taxation Committee* (Wellington: Government Printer, 1951), para. 190.

¹⁵ Charles A. Staples, *A Guide to New Zealand Income Tax Practice 1972-73* (Wellington: Sweet and Maxwell, 1973), 650.

¹⁶ Charles A. Staples, *A Guide to New Zealand Income Tax Practice 1986-87* (Wellington: Sweet and Maxwell, 1987), 742-3.

¹⁷ *Ibid.*

¹⁸ Staples, *Guide 1972-73*, para. 89.06.

Several new rebates were added that favoured families. A General Rebate of the lesser of two percent of income or \$50 was introduced in 1975.²¹ This was finally repealed from the 1992-93 income year, from which time deduction for employment-related expenses was no longer permitted. Other family-friendly rebates were added by the National Government in the late 1970s:

- Single Income Families Rebate of \$208 in 1978, rising to \$260 in 1979 and 1980 before being repealed;
- Young Families Rebate of \$156 in 1977, \$468 in 1978 to 1982, falling to \$234 in 1983 before being removed;
- Low Income Family Rebate of \$468 introduced in 1981, falling to \$234 in 1983 before being repealed;
- New Family Rebate of \$702 from 1983, increasing to \$1,404 in 1984; and
- Principal Income Earner Rebate of \$702 introduced in 1983, doubling to \$1,404 in 1984.

Micromanagement of the rebates system thus continued to focus on families. Again, as with the introduction of Social Welfare, the National Party followed Labour. Labour had replaced exemptions with rebates, which National subsequently extended.

13.4 Effect on taxpayers

13.4.1 Income level

The income tax remained progressive. However, the relativities between different income levels changed considerably, with little distinction remaining between a low and a medium income by the end of the period, except where there were children.

In contrast to the relative stability of the preceding two decades, taxation fluctuated almost annually, and at times quite markedly so. The effect of inflation over this period meant that the benefit families received from the Family Benefit almost disappeared. Similarly, the elimination of rebates almost removed the distinction between single and married individuals. However, the introduction of a number of rebates aimed at low income families maintained the focus on

¹⁹ Social Security Amendment Act 1972, fifth schedule.

²⁰ Social Security Amendment Act 1982, s. 7.

²¹ Income Tax Act 1976, s. 105.

families, and the progressive rates scale ensured that higher income earners continued to pay more in taxes than those on lower incomes.

A first glance at the following graphs suggests that the income tax was slashed by the Third Labour Government. However, the significant rates reductions were actually an election year measure by the then National Government. The top marginal rate fell from 67½ percent to 50 percent, or 51⅔ percent with the three percent surcharge added to these basic rates. Rates reductions were also made to middle income levels but not to the lowest incomes. These were reversed in the course of National's subsequent nine years in office. By the end of the period a single high income earner paid tax at no more than the rate applying at the beginning. In contrast the tax on a single medium or low income earner increased almost steadily in all but the last two years. In particular, Figure 13.1 indicates that a single low income earner who had seen 14 percent of his income go to tax in 1970, paid 25 percent by 1984, and a medium income earner went from 23 percent to 37 percent by 1982, before dropping back (Figure 13.1).

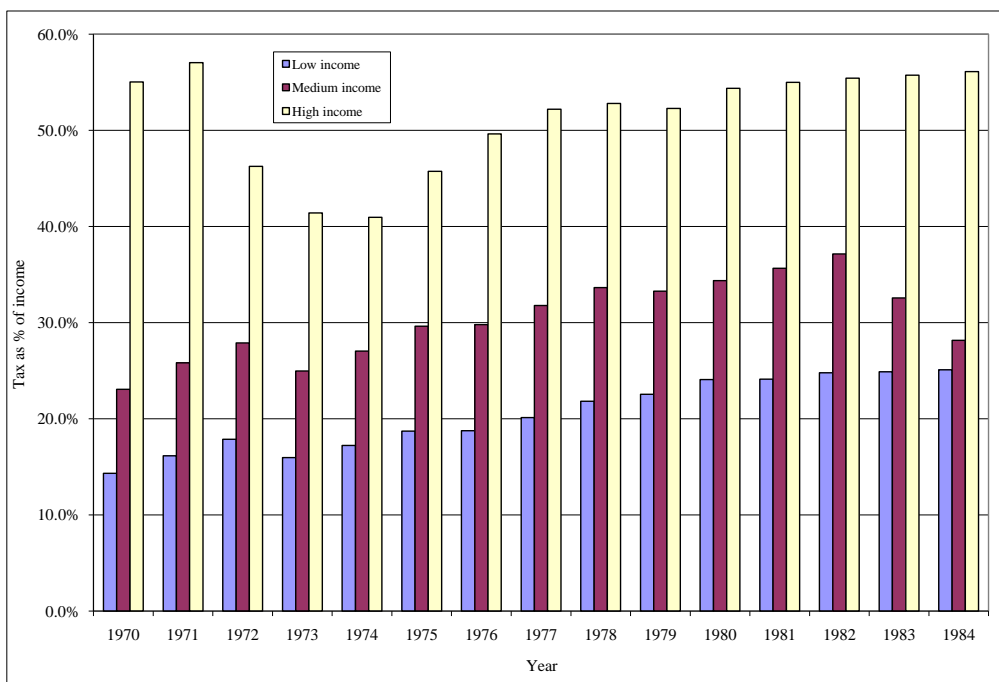


Figure 13.1 Income taxation on a single income earner at three income levels (1970- 1984)

Similar trends are evident in the case of a married taxpayer without children. Again, taxation increased rapidly on the low and medium income earner. However, Figure 13.2 indicates that

while there was significant relief granted to the medium earner in 1983 and 1984, there was none for the low income earner.

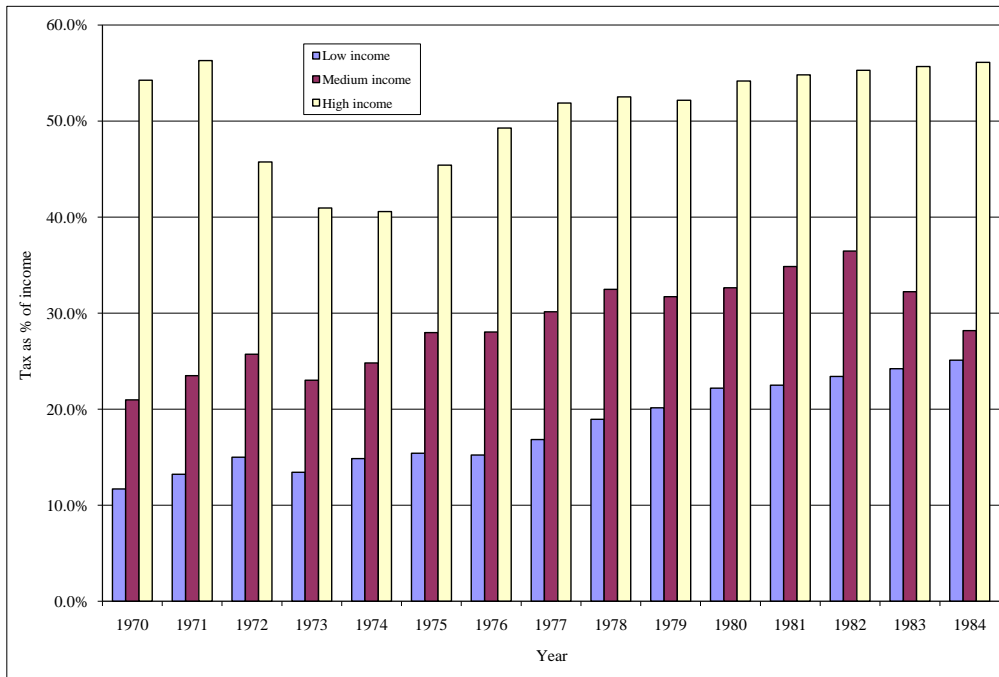


Figure 13.2 Income taxation on a married income earner with no children at three income levels (1970-1984)

A low income taxpayer with children had a roller-coaster ride. Although Family Benefit remained, and was doubled in July 1982 to \$6.00 per child per week,²² changes to exemptions and rebates were the main cause of change. Figure 13.3 shows that, unlike either Family Benefit or the earlier exemptions, most rebates were income-tested and abated once a taxpayer's income exceeded a certain level.

²² Ibid.

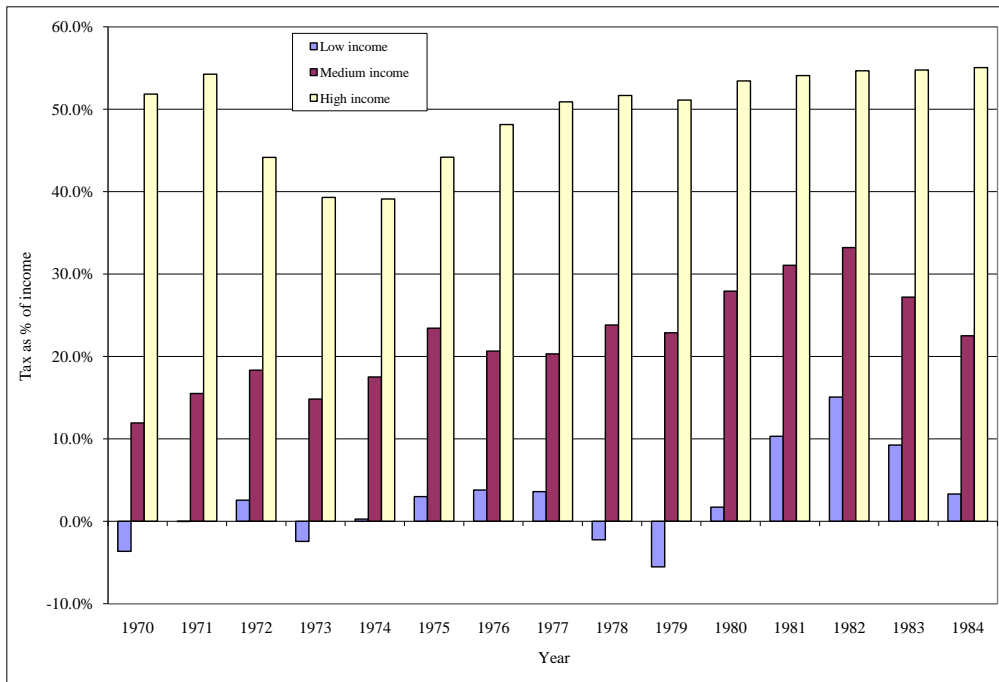


Figure 13.3 Income taxation on a married income earner with three children at three income levels (1970-1984)

13.4.2 Family circumstances

The income tax did remain family-friendly; low income families paid little if any income tax throughout the period except between 1981 and 1983; in fact, the receipt of family benefit effectively offset the tax that many employees with families paid. The convergence of the taxation payable by singles and those who were married but without children was complete by 1984. The reduction of tax brackets from 36 in 1979 to five in 1980 resulted in lower income earners losing the benefit of a more gradual progression between the brackets, resulting in a higher effective tax rate, as Figure 13.4 shows.

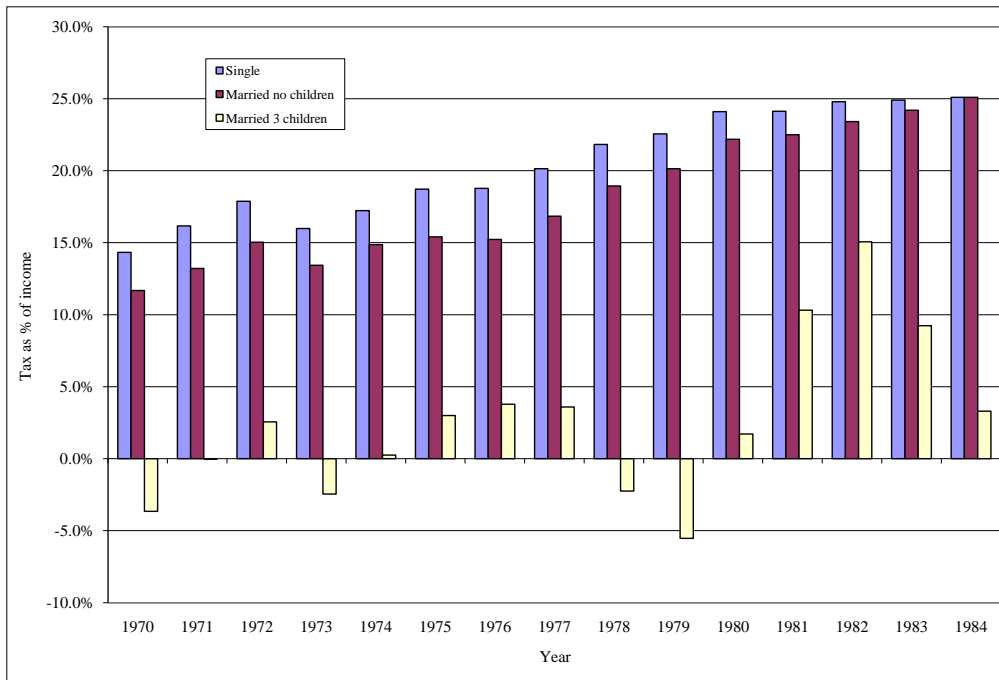


Figure 13.4 Income taxation on a low income earner in three domestic situations (1970-1984)

Medium income earners saw a similar, almost annual, increase in their effective tax rate until 1982. Thereafter, amendments to the rates scale reduced their liability by some 20 percentage points (Figure 13.5).

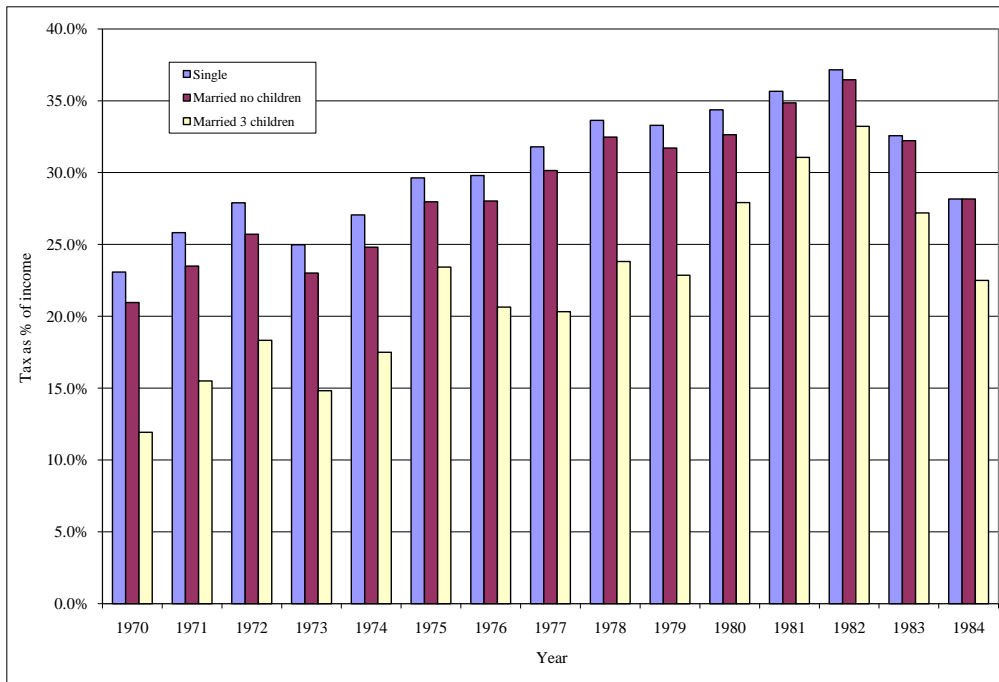


Figure 13.5 Income taxation on a medium income earner in three domestic situations (1970-1984)

At high income levels, differing domestic situations had little effect on the tax paid, either in percentage or absolute, terms. Figure 13.6 indicates that, after a large tax cut in the early 1970s, income tax on high earners crept up incrementally. By the end of the period, the amount payable was reverting to what it had been at the beginning.

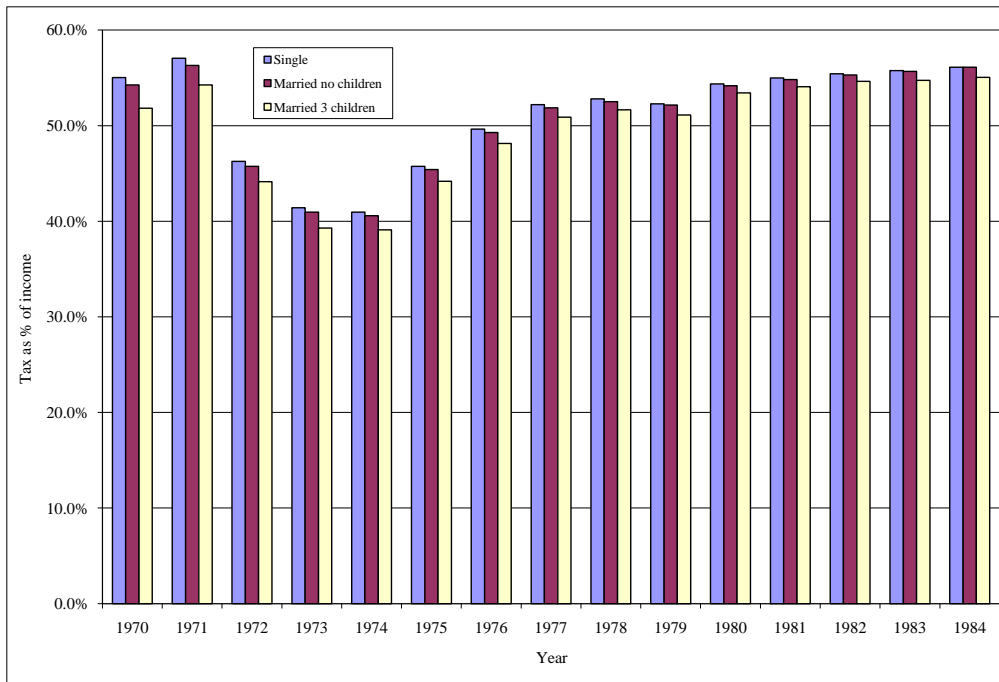


Figure 13.6 Income taxation on a high income earner in three domestic situations (1970-1984)

13.5 Vertical Equity

13.5.1 Vertical equity, politics, and the economy

The 1967 Ross Report had suggested a consensus as to how the income tax should be practised in New Zealand, and had defined vertical equity in terms of ability to pay, understood in terms of both income level and domestic situation.²³ Yet during the 1970s the practice of vertical equity changed. The end of the “Golden Weather” was followed by equinoctial turbulence, reflected not only in regular changes in the tax rates scales themselves, but in the changes to the relativities between taxpayers. Taxpayers continued to be distinguished based on income level and domestic situation, but the extent of differentiation changed, and at times significantly. Two main factors contributed to this turbulence.

First, inflation, which resulted in bracket creep, minimised the relevance of low marginal rates; as incomes increased to compensate for price rises, taxpayers on ever lower incomes were pushed into ever higher marginal, and thus average, tax rates. Low income earners, in particular, saw their tax bills escalate.

²³ L. N. Ross, *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington: Government Printer, 1967), para. 273.

Secondly, taxation became more obviously politicised. This was perhaps most clearly evident in the early 1970s. Having narrowly won the 1969 General Election and facing another election in 1972, National announced substantial tax rates reductions in its 1970 budget to take effect for the year commencing 1 April 1971. Taxpayers subject to PAYE would see a drop in tax from that date, and the self-employed would notice reduced final tax bills during 1972, in time for the November 1972 General Election. These changes would have no effect on the first \$2,500 of income, but would reduce rates on higher incomes, with a maximum rate of 50 percent on incomes over \$12,000.²⁴ In 1971 a hairdresser's award rate was \$2,475. Clearly, this reduction would benefit those on higher incomes most, since the top rate fell from 67½ percent to 50 percent, to which a 3⅓ surcharge was added.

Tax and politics have always mixed. However, the significant reduction in 1970 was presented as consistent with good economic, rather than social, policy. Both the Gibbs Report,²⁵ and the Ross Report,²⁶ had emphasised the role of government in promoting economic development, with the latter report suggesting that the government needed a measure whereby it could rapidly adjust fiscal policy to reflect economic conditions. Muldoon suggested he was doing just this:

*If these moves appear to be concentrated primarily in the field of economic management rather than in the field of the personal affairs of the ordinary citizen, then the reason for this approach is that in a country such as New Zealand, the prosperity of the whole country is inevitably shared by every citizen and equally in terms of economic adversity, no citizen can remain immune from the hardship that occurs nationally.*²⁷

Economic development was the key. Muldoon suggested that these tax changes were aimed at:

... reducing as far as possible the disincentives inherent in our progressive income tax structure. At the same time I have been very conscious of the desirability of providing a

²⁴ NZPD, vol. 366 (25 June 1970), 1311.

²⁵ Gibbs, *Report of the Taxation Committee*.

²⁶ Ross, *Taxation in New Zealand*.

²⁷ *Ibid.*, 1298.

*flexible instrument of fiscal policy which can be used to help offset variations in the level of activity in the economy.*²⁸

This micro-managing of the macro-economy, which became a hallmark of Muldoon's tenure as Finance Minister (and, from 1975, Prime Minister), was again evident in 1972, when a foreshadowed ten percent surcharge was scrapped:

*The level of economic activity is influenced by the use of fiscal policy and on a number of occasions in the past I have had to raise taxes in order to restrain demand ... At the present time, the opposite situation exists and the level of demand is insufficient to make full use of existing capacity.*²⁹

The stated aim was first to stimulate economic activity and raise productivity, and only secondly to provide substantially greater assistance to those in need.³⁰ Yet arguably, given that this was an election year, the prime motivation was more likely political: either to win votes from National's natural support base of the self-employed and farmers, or to ensure that Labour, if elected, would have to increase taxation once in power, as it effectively did.³¹ Any subsequent increase by Labour would seem to confirm that Labour governments were taxing and spending governments. Labour's leader, Norman Kirk, castigated this use of the tax system, stating that, "Such income tax relief as the Budget gives goes to the wealthy, with little regard for any of the lower income groups."³² Rather than a focus on the macro-economy:

*Surely, instead of providing tax relief at the top end of the scale, what was needed was relief from the burden of taxation on the smallest incomes who by the processes of inflation have been made into income tax payers over the years, and also relief for the middle income group.*³³

²⁸ Ibid., 1309.

²⁹ NZPD, vol. 378 (22 June 1972), 411.

³⁰ Ibid., 425.

³¹ Paul Goldsmith, *We Won, You Lost, Eat That: A Political History of Tax in New Zealand since 1840* (Birkenhead: David Ling Publishing, 2008), 257-64.

³² NZPD, vol. 366 (25 June 1970), 1367.

³³ Ibid., 1369.

To this, National's leader Holyoake retorted, "He sets out in the traditional old Socialist style to divide our people."³⁴ If Labour had come in, he suggested there would have been another "Black Budget".³⁵

The focus on the group, rather than the individual, is evident. Although distinctions were still made at the level of the individual by way of the progressive income tax, the reductions of the early 1970s reduced these distinctions. When National concurrently increased the exemptions, Holyoake noted that, "It is the same amount of exemption for all, of course."³⁶ The flattening of the rates scale and the continued provision of universal exemptions reflect a particular view of vertical equity.

After Labour came to power at the 1972 General Election, it sought to distinguish itself from National. In his first budget as Finance Minister, Bill Rowling presented "a new system of personal taxation designed to assist those in middle and lower incomes, and in particular married people in these income groups."³⁷ He also carried out Labour's long-held goal to replace any remaining exemptions with rebates.³⁸ This theme continued in his last Budget in 1975, which, he said, "was committed to twin goals: economic progress and social justice. The Labour Party, unlike the National Party, does not divorce these two aims."³⁹ However, given a worsening economic situation in the wake of Britain's entry into the EEC, and the impact of the first oil shock in 1973, the budget did have to address the pressure of wage demands and attempt to stimulate the economy.⁴⁰

After only one term in office the Third Labour Government was voted out of office. National held power for the ensuing nine years from 1975 to 1984. The National Government's focus continued to be on economic difficulties rather than on social change. Inflation was the default (and tacit) tool for raising increasing amounts of tax. Bracket creep resulted in increases in effective average tax rates for most earners, but affected low income earners the hardest. This

³⁴ *NZPD*, vol. 366 (30 June 1970), 1378.

³⁵ *Ibid.*

³⁶ *Ibid.*, 1385.

³⁷ *NZPD*, vol. 383 (15 June 1973), 1370.

³⁸ *Ibid.*, 1368.

³⁹ *NZPD*, vol. 397 (22 May 1975), 1397.

⁴⁰ *Ibid.*, 1401.

was only mitigated in the early 1980s with the introduction of certain family friendly rebates for low income families, and the doubling of the (still universal) Family Benefit in 1982.⁴¹ However, after years of focus on the economic difficulties of inflation and unemployment, calls were made for a serious review of the tax system.

13.5.2 Report of the McCaw Task Force

In 1981, the New Zealand Planning Council (NZPC) issued a report entitled *An Agenda for Tax Reform*.⁴² It commenced by stating that “our tax system is in pressing need of reform. It may have served us well in the past, but it has been distorted by the effects of high inflation.”⁴³ This reform needed to be made as quickly as possible, and not in a piecemeal manner. Inevitably such reform would involve some redistribution of the tax burden.

One key issue the NZPC report identified was the high proportion of revenue derived from the personal income tax, which constituted 64 percent of the total tax revenue in 1980.⁴⁴ Significant, too, was:

*... the fact that rates of tax paid on additional earnings become very high at relatively low levels of salary and wage income which is taxed at source. The average wage is expected to surpass \$12,600 by the end of this year, moving the average wage earner into the 48 percent bracket at the margin. Historically, people on modest incomes have not been in such high marginal tax brackets.*⁴⁵

After mentioning some of the negative consequences of such high tax rates on wage claims, inflation, and evasion, the report set out a proposed agenda for the reform process. It recommended that the system as a whole be reviewed. Any task force should, at the outset:

- *Evaluate how the acceptability of a tax system can be defined.*
- *Consider whether the present system is equitable*

⁴¹ National did introduce universal superannuation. However this would not have affected the notional employees considered in this thesis, and therefore is not addressed in this thesis.

⁴² New Zealand Planning Council, *An Agenda for Tax Reform* (Wellington: New Zealand Planning Council, 1981).

⁴³ *Ibid.*, 5.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*, 6.

- a) *What standards can be applied to assess equity? Is progressivity an acceptable standard?*
- b) *How can the tax system best be redesigned to meet these standards.*⁴⁶

Whereas the Ross Committee had embraced the ability to pay principle,⁴⁷ the NZPC called for a clean slate, and indicated considerable agnosticism as to whether New Zealand's tax system actually had an ethical basis. Even the principle of progression, in effect since 1891, was open for discussion: any review should "examine the rates structure to assess the feasibility of reducing marginal tax rates or adopting a proportional income tax," as well as reassess the place of "existing deductions, exemptions and rebates."⁴⁸

The Government responded to the NZPC's call with the appointment of the McCaw Task Force on Tax Reform, which reported in April 1982.⁴⁹ The McCaw Task Force was charged to "undertake a thorough and systematic review of all aspects of central government taxation," a task it soon recognised to be impossible within the limited time available.⁵⁰

The McCaw Task Force reiterated the rapid changes in the tax system over the past decade:

*Taxation reform is a major issue generating much public debate, and this Report is part of the search for a more acceptable and equitable taxation system which is being demanded by almost all sectors of society.*⁵¹

Inflation had pushed up the rate of income tax such that a person on the average wage was facing a marginal rate of almost 50 cents in the dollar. In the light of this the authors argued:

*... both average and marginal personal income tax rates should be reduced for the great majority of individuals and, as far as possible, the degree of progression in the scale as it affects most members of the labour force should be reduced.*⁵²

⁴⁶ Ibid., 9.

⁴⁷ Ross, *Taxation in New Zealand*, para. 14.

⁴⁸ Ibid., 10.

⁴⁹ McCaw, *Report of the Task Force*.

⁵⁰ Ibid., 1.17.

⁵¹ Ibid., 1.2.

Clearly this would involve a significant change to the extant rates scale, which had high rates and was steeply progressive. In making its recommendation, the McCaw Task Force “had close regard for the traditional principles of taxation.”⁵³ Fairness, it suggested:

*... could only be assessed in relation to the tax system as a whole. If a paramount consideration has been adopted, it is for fairness, or equity – on the ground that no system which is unfair and is perceived to be unfair will have the acceptability and relative permanence which are required of a good tax system.*⁵⁴

The McCaw Task Force’s Report continued by stating the horizontal and vertical equity norms, noting that this involved the question “what the relationship should be between measured ability-to-pay and the ensuing tax liability.”⁵⁵ It was clear that “a higher ability-to-pay should imply a higher tax liability,”⁵⁶ but not obvious just what this meant in practice. As the Task Force put it, any “objective considerations have to be blended with important value judgments about the redistributive goals of the community before a conclusion on the shape of this relationship can be reached.”⁵⁷

After 90 years, there was still no clear basis for vertical equity. Certainly, vertical equity was defined in terms of ability to pay, but how to translate this general idea into specific tax practice remained elusive. Fairness remained an aspirational goal, realised, if at all, only in part. The role of taxation had expanded along with that of government: from a provider of basic services, to the provider of a social welfare safety net, to a promoter of economic development, to a manager of fiscal policy. In the face of these increasing and competing objectives, sight was easily lost of the place of vertical equity in the apportionment of the tax burden among taxpayers – those individuals who actually pay the tax.

⁵² Ibid., 1.10.

⁵³ Ibid., 5.2.

⁵⁴ Ibid., 5.2.

⁵⁵ Ibid., 5.3.

⁵⁶ Ibid.

⁵⁷ Ibid.

The McCaw Task Force's Report recognised the problem; economic efficiency might point to a proportional tax scale, but equity considerations would seem to rule this out. Their conclusion was a compromise:

*If a proportional scale is unacceptable, then a scale with a modest degree of progressivity over either the lower – or higher – income range, or both, and with a long flat bracket for the majority of individuals, may offer a reasonable compromise between economic efficiency and equity goals. **This is the Task Force's preferred approach.***⁵⁸

13.6 Conclusion

By 1984, vertical equity in the income tax had reached a hiatus, and the limits of the extension of the income tax seemed to have been reached. Low income earners were subject to it and were paying income tax at increasing rates. Higher income earners were paying more than 50 percent of their income in income tax. In a context of economic difficulty, the effects of such high levels of taxation on New Zealand's economy were a major concern. Furthermore, a social consensus as to the equity of the structure of the tax system, with ability to pay effected in terms of both income level and domestic situation, was increasingly questioned. So, too, was the appropriateness of using taxation rather than benefits policy to achieve society's equity aims.

The McCaw Task Force's Report signaled a change in direction, one not followed by the Muldoon Government. In response to the McCaw Task Force's Report, Prime Minister Muldoon announced that the government had placed major emphasis on five objectives, namely to reduce fiscal drag in the present tax scale; to minimise the disincentive effect of high marginal tax rates; to minimise the incentive for tax evasion; to minimise the imbalance between single and two-income families; and to reduce the tax burden between those on steady as opposed to fluctuating incomes.⁵⁹ None of these objectives make any specific mention of equity, let alone vertical equity. Efficiency, measured in terms of a tax's effect on productivity, was the order of the day.

Muldoon then presaged the future direction of income tax policy when he suggested that, "Clearly the best way to achieve these objectives is to have a flatter tax scale."⁶⁰ This was the

⁵⁸ Ibid., 6.161, (emphasis in original).

⁵⁹ NZPD, vol. 445 (5 August 1982), 1765.

⁶⁰ Ibid., 1766.

way of the future. In the past, vertical equity had meant differentiation, rather than flatter tax rates. But vertical equity was now rather out of vogue and become a background consideration, a lingering whimper in the face of an over-riding concern for economic efficiency.

PART D
PATTERNS AND IMPLICATIONS

Chapter 14

Discussion and Review

Equity and fairness will guide the Government's consideration of the Tax Working Group's options for changes to the tax system.

Finance Minister Bill English, 19 October 2009¹

14.1 Introduction

Shortly before the enactment of the Land and Income Assessment Act 1891, Premier and Colonial Treasurer John Ballance noted that, “No system of taxation can be perfect – that is, no new system of taxation can be perfect – and almost any system is sure to need amendment.”² The subsequent course of the income tax has borne him out. If the shape of the income tax had reached perfection, it would not require further amendment, except to reflect changing fiscal, technological, and commercial demands. Yet of all the Acts of Parliament, the income tax probably has been, and continues to be, the most frequently amended and altered.³

Just as perfection in taxation itself is unattainable, so too is the achievement of equity in taxation. Chapters 2 and 3 discussed the idea of vertical equity deductively, and indicated that a clear understanding of the concept was lacking. Chapters 4 to 13 approached the question of vertical equity in the income tax inductively, seeking to identify how vertical equity had been practised in New Zealand's income tax over the period from 1891 to 1984. Again no clear understanding of vertical equity appeared; the income tax has been characterised by change, and no particular manifestation of the tax could be considered to be a standard for either the practice of income taxation in general, or as a touchstone for vertical equity in particular. Interpersonal fairness may have been an aspirational goal at all times, but the realisation of this goal has remained elusive.

Yet the goal of interpersonal fairness remains, with the language of fairness pervading both popular and parliamentary discussions of taxation. In 1891 Ballance, who was both Premier and Finance Minister, might argue that, “Such a thing as an absolutely fair tax has never been

¹ Bill English, “Media Statement 19 October 2009: Equity and Fairness Key to Tax Considerations” (Wellington: Policy Advice Division, Inland Revenue Department), <http://www.taxpolicy.ird.govt.nz/index.php?view=707> (accessed 10 November 2009).

² *New Zealand Parliamentary Debates (NZPD)*, vol. 73 (18 August 1891), 372.

³ This complexity is discussed in Warwick Anderson and Adrian J. Sawyer, “Legislative Complexity – The Need for Appropriate Variables and Some Likely Candidates,” *New Zealand Journal of Tax Law and Policy* 3 (1997), 3.

conceived in the mind of man.”⁴ Yet when introducing the Land and Income Tax Assessment Bill that year, Parliament was motivated by a desire to improve the fairness of taxation, as the frequent references to that ideal indicate. Successive parliaments and parliamentary enquiries have continued to try to realise fairness in taxation. In 2009, Ballance’s successor as Minister of Finance announced that “equity and fairness would guide the Government’s consideration of options for changes to the tax system.”⁵ Ballance would surely have agreed, but taxpayers might well ask just what this could mean, and whether the present government’s chances of success were any greater over a century later.

Although it may not be possible to identify what is meant by fairness in the income tax, the concept is not meaningless. A call for fairness, equity, or justice resonates with the human spirit, and the cry for a “fair go” is almost part of the New Zealand psyche.⁶ Yet although there may be a consistent call for fairness, the preceding chapters demonstrate that fairness may manifest itself in a variety of ways, since both the low rate tax levied only on high incomes in 1892, and the high rate tax on almost all incomes by 1984 were justified as “fair” in some sense of the word.

If previous chapters considered *how* vertical equity developed in the income tax, this chapter pauses to ask *why* it developed the way it did. The historical evidence illustrates what happened in the past: how individual taxpayers were affected by the income tax, and what vertical equity looked like at the level of an individual taxpayer. Having endeavoured to allow the past to speak through the sources, attention now shifts to the overall picture and the structure of what happened.⁷

14.2 General Patterns

Chapter 5 indicated that payers of the New Zealand personal income tax were primarily distinguished in two dimensions: income level and domestic situation. Since its introduction, income level has affected the amount of tax assessed; New Zealand’s income tax has always been assessed on a progressive scale. However, this scale has changed considerably as time progressed. With a progressive scale the average rate of tax increases as the income rises.

⁴ *NZPD*, vol. 73 (4 August 1891), 99.

⁵ See note 1.

⁶ Refer Chapter 1.

⁷ Michael Stanford, *The Nature of Historical Knowledge* (Oxford: Blackwell, 1986), p. 6, 27.

Throughout the period, a high income was assessed at a higher average rate than a middle income earner, who in turn paid more tax than a low income earner.

In the past, progression based on income level was also affected by a minimum tax-exemption level. The effect of income level on taxation thus involved two questions: first, whether the taxpayer was liable to tax at all, and second, if so what amount of tax was payable. Thus an employee on a high income was liable to income tax from the introduction of the income tax. A middle income earner earned less than the general exemption level until shortly after World War One, and an employee on a low income did not pay any form of income tax until the early 1930s, following the introduction of the flat rate Unemployment Levy.

A taxpayer's domestic situation provided the second main basis of differentiation. The original Land and Income Assessment Act 1891 made no allowance for domestic situation. At that time, there was little need or pressure for such an exemption given the high exemption, low rate tax that was originally enacted. The Child Exemption was introduced during World War One, though since it was an exemption rather than a rebate it only benefited those on higher incomes. Marital status was recognised from the early 1930s with the introduction of the Dependent Spouse's Exemption. This led to a three-step scale, with single employees paying more tax than those who were married, who in turn paid more tax than married taxpayers with children. This pattern largely remained in place throughout the period. In the 1970s these exemptions were replaced by rebates, and a variety of "family-friendly" rebates were introduced.

Alongside these family-friendly exemptions and rebates, the universal Family Benefit took effect from 1 April 1946, and significantly reduced the net tax payable by all taxpayers with children compared to those without children, whether married or single. Although the value of the Family Benefit was eroded by inflation, as was that of all other exemptions or rebates, it remained significant in 1984, particularly for low and medium income earners.

As the size and scope of the income tax increased, greater distinctions were made between taxpayers. If it is true that, "Where taxpayers have confidence in the equity of the taxation system they will be more inclined to pay their taxes with good grace and honesty,"⁸ increasing the tax-take must involve balancing an increase in the tax base and tax rates with measures to enhance

⁸ T. N. Gibbs, *Report of the Taxation Committee* (Wellington: Government Printer, 1951), para. 64.

the apparent fairness of that tax. Such measures would then mitigate any apparent unfairness in the tax.

A developing two-dimensional structure of differentiation based on income level and domestic situation provides a basic model of the New Zealand practice of vertical equity until 1984. This simple pattern suggests that the higher the earnings, the higher the tax, mitigated to some extent by family circumstances. This pattern, which became the norm by the early 1930s, was confirmed during World War Two, and the extension of the Family Benefit after World War Two emphasised the effect of children on relative tax liabilities.

14.3 Process of Change

Certainly the income tax changed remarkably over its first 90 years. Given such change, is the same notion of vertical equity applicable in 1892 and 1984 when the income tax had changed so significantly and frequently between those years? The income tax of 1984 was so radically different from its original that it is difficult to justify as fair on the same grounds as the 1892 tax.

First, the extent of change to the income tax over time was radical. The 1984 income tax would baffle a New Zealander living in 1891 as much as the 1891 income tax seems inconceivable to a person living in the early twenty-first century. The increasing size and complexity of the legislation, the dramatic increase in rates and decrease in exemptions, the enlargement of government and governmental functions, and the range of adjustments, would likely lead a nineteenth century compatriot to marvel, if not despair. But secondly, the data indicate that although the income tax underwent incremental change throughout the period, significant change was occasional, rapid, significant, and enduring. Periods of radical change were followed by periods of relative stability in the tax, although the tax did not revert to its previous shape.

The rapid changes evident in the income tax suggest similar changes to New Zealanders' understandings of what fairness in the income tax meant. Politicians may argue that their tax measures reflect a concern for equity, yet the reverse may actually be the case; as taxpayers become inured to a new tax or form of that tax, the tax comes to be seen to be fair. The relationship between understandings of tax fairness and taxation practice itself seems to be reciprocal rather than linear.

Previous chapters have illustrated how the income tax, and more specifically how vertical equity in the income tax, has been practised in New Zealand. Taking a longer term perspective, is it possible to describe a structure for the changes in how vertical equity in the income tax was understood? Several suggestions might be made as to *why* the practice of vertical equity changed as it did. Three possibilities will be reviewed:

- that the practice of vertical equity reflected changes in what was understood by vertical equity in the income tax;
- that it reflected changes in the accepted role of government; or
- that it was simply a matter of party politics.

A fourth alternative will then be suggested as a structure by which to understand this change.

14.3.1 Changes in philosophical understandings of vertical equity

In his first maxim for taxation, Adam Smith argued that:

*The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.*⁹

This oft-repeated statement¹⁰ neatly conflates two possible bases for vertical equity: taxing based on a taxpayer's ability to pay, and taxing based on the benefits received from the state. The two bases suggest different approaches to apportioning the tax burden among a group. Since these are the two most basic ways of discussing how a tax burden should be distributed,¹¹ could the development of the New Zealand income tax be understood as a shift in the relative emphasis given to either of these grounds? More particularly, might change be seen as the result of a shift from an emphasis on benefits received to an ability to pay basis?

The benefits basis – levying taxes in proportion to the revenue enjoyed under the protection of the state – suggests a link between government expenditure and taxation. The basis for taxing is contractual; in simple terms, taxation is seen as a charge for the use of socially provided goods.

⁹ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan (London, Methuen, 1950), 5.2.

¹⁰ Keith C. Hooper, "Tracing the Origins of Taxation," in *Tax Policy and Principles: A New Zealand Perspective*, ed. Keith C. Hooper et al. (Wellington: Brookers, 1998), 1-26.

¹¹ N Gregory Mankiw, *Principles of Economics* (Fort Worth, TX: Harcourt College Publishers, 2001), 254-6.

Assuming the inherent fairness of a market-based system, if it were possible to treat all public provision as that of private goods, no vertical equity issue would arise; each taxpayer would simply contribute as a *quid pro quo*¹² for the services received.

Politicians did appeal to the benefits principle throughout the period. At the start of the period, benefits theory seemed to suggest taxation of the wealthy, since they benefited most from the state as it protected their wealth. Indeed, while the poorer classes were ineligible to vote, and taxation revenue was primarily expended on the limited functions of a night watchman state and infrastructure, the taxation of higher incomes and exemption of lower incomes might be justified on a benefits received basis. All New Zealanders paid the Excise and Customs Duties to finance the basic functions of the state, and the rich paid for the additional benefits they received by way of income tax.

However, given a changing social and political context, the benefits principle could also be used to justify the taxation of those on lower incomes. Taxation could be seen as a price paid for the universal franchise and the ability of those on lower incomes to determine state spending priorities via the ballot box.¹³ Following the introduction of Social Security in 1938, when those on lower incomes received a very direct benefit from the state, they too might be called upon to contribute their fair share. And as the role of the state in the economy and society increased, it became increasingly difficult to argue that one group derived a greater benefit from the state than another; the contract model increasingly did not fit reality, if indeed it ever had.

In contrast, taxation on the basis of ability to pay looks to the capacity of the taxpayer to pay tax, rather than the benefits received by the taxpayer. During wartime, this principle was expressed in terms of equality of sacrifice, a “placing the burden on the shoulders best able to bear it.” Here the focus was not on how individuals benefited from the state, but rather on how much they paid compared with their peers; the level and type of government expenditure being largely irrelevant to the apportionment of taxation. Since it is necessary to assign a value to an individual and to

¹² John S. Mill, *Principles of Political Economy, with Some of Their Applications to Social Philosophy* (London: Longmans, Green and Co, 1909), Bk. 5.2.2 (p. 804).

¹³ David Thomson notes that the universal franchise from 1893 “has often been credited with making New Zealand’s politicians more sensitive to working-class demands in general and welfare issues in particular, and there seems to be little reason to doubt the broad point”: David Thomson, *A World without Welfare: New Zealand’s Colonial Experiment* (Auckland: Auckland University Press, 1998), 157.

compare relative abilities to pay, the issue of vertical equity does arise. Indeed the ability to pay basis begs the very question of vertical equity.

From its inception, ability to pay has provided the basis for the New Zealand income tax.¹⁴ However, the assessment of ability to pay is far from easy, as the significant changes in the relative tax liabilities of those on a range of income levels, and the introduction of various family-focused allowances indicate.

Benefits theory and ability to pay provide theoretical indications of how to apportion the tax burden. Throughout the period, parliamentarians appealed to either basis as it suited their argument. However, the realities of taxation, government, and society are rather too complex for any pure view to be translated into actual policy. Although individuals might hold to either of these as the basis for their own philosophy of taxation, and governments might place greater emphasis on the one or the other, a shift from or between these bases does not provide a structure for understanding change in the New Zealand income tax. Adam Smith conflated the two bases in his equity principle, and New Zealand governments have done the same.

14.3.2 Role of government

Taxation involves the transfer of resources from the private to the public purse for public purposes. Rather than focusing on the revenue side, did changes in government expenditure, which reflected changes in the accepted roles of government, affect the understanding, and then practice, of vertical equity? Did changes in the income tax and thus in the practice of vertical equity mirror changes in a society's (or its governments') understanding of the role of government?

A simple look at the increase in the size of government indicates that the role of government changed considerably from 1891 to 1984.¹⁵ In 1890, the New Zealand government was mainly involved in the functions of maintaining law and order, defence, as well as the development of

¹⁴ Ability to pay was confirmed as an appropriate basis in the earliest tax committee report, and also in that of 1982: see W D Hunt, "Report B5: Report of the Committee Appointed to Enquire into the Taxation of the Dominion of New Zealand," *Appendices to the Journals of the House of Representatives* (Wellington: Government Printer, 1922), p. 5; P. M. McCaw, *Report of the Task Force on Tax Reform* (Wellington: Government Printer, 1982), para. 5.3.

¹⁵ A summary of key government magnitudes is found in David Thorns and Charles Sedgwick, *Understanding Aotearoa/New Zealand: Historical Statistics* (Palmerston North: Dunmore Press, 1997), chapter 4.

infrastructure and education.¹⁶ With the election of the Liberals to power in 1890, the government's role expanded in the areas of industrial relations and the provision of social welfare. These limited functions of government did not change much until the election of the first Labour Government in 1935. Certainly the size of government, and particularly of taxation, increased as a result of World War One. Following the Armistice much of this increase was due to cost of servicing the war debt. The income tax also increased markedly as a result of the war in a manner consistent with the historical pattern that wars may be funded by direct taxation.¹⁷ This limited role was also evident in the conservative Reform Government's response to the Great Depression. There was no intention to institute a "dole"; instead "belts needed to be tightened," government expenditure cut, and individuals were expected to be largely self-reliant.

The election of Labour in 1935, the passage of the Social Security Act 1938, and the introduction of import licensing, saw a significant increase in the functions of government. Not only did this change require additional revenue; it also justified democratising the income tax. Since all earners were entitled to the benefits of Social Security, it was fair that all should be called on to contribute to the cost.

World War Two again saw a massive increase in taxation, and this altered the way government was viewed. The command economy created during World War Two continued after the War. During the 1960s the government moved from management to direct involvement by way of subsidies and tariffs in order to promote economic development. This continued during the 1970s and accelerated with the "Think Big" projects of the early 1980s.¹⁸ Aside from requiring taxation to fund war and economic development, the government also used taxation as a tool for short-term fiscal management.

Changes in the role of government may result in an increase in the scale of the income tax, but could it also explain changes in the practice of vertical equity in the income tax? At one level the two are related; increasing state activity must be funded. A population that accepts an increasing role for government should also accept the consequent increases in tax. Further, to the extent that

¹⁶ These functions reflect Adam Smith's thinking; refer Smith, *Wealth of Nations*, 4.2.

¹⁷ A clear example of this was the introduction of the United Kingdom Income Tax in the context of the Napoleonic Wars; see Martin Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge: Cambridge University Press, 2001).

¹⁸ For a brief discussion of the "Think Big" projects see Keith Sinclair, *A History of New Zealand*, (Auckland: Penguin, 1991), pp. 315-6.

the benefits of the government's activity result in increasing levels of income, some degree of progression might be justified.¹⁹ Certainly, the use of direct taxes to fund war has a long pedigree; it was understood that war protected property, and therefore the wealthy should pay a disproportionate share of the cost. Arguably, the same applied to the economic development activities of the government. Likewise, social welfare spending generally most benefited those on lower incomes; if so, the large increase in taxes on low and middle income earners in the 1930s and 1940s might be a reflection of the benefit they received from government activity.

However, it is difficult to see any direct link between the role of government and the practice of vertical equity, aside from the need for increased revenue. Such a link suggests a benefits view of taxation in a general sense, namely that income taxation is the price paid for benefits received from government, and that as the benefits (such as social security or economic development) increase, the cost also increases. In measure this avoids the vertical equity question altogether, for vertical equity collapses into a question of (social) contract, not equity. Although the change in the role of government may explain changes in taxation per se, it is difficult to relate these changes to vertical equity. It is even more difficult to relate the macro-economic efforts of a government to the relative amounts of taxation paid by *individual* taxpayers.

14.3.3 Politics

The 1890 General Election was the first under universal male suffrage, with women receiving the vote in 1893, and marked the start of party politics in New Zealand. Although New Zealand political parties tend toward the centre, the Liberals and later the Labour Party are generally identified to the left of that centre, with the Reform Party and then the National Party to the right. Given that control of the Treasury Benches is contested every three years, could changes in the practice of vertical equity in the income tax reflect simple party politics, manifested as an appeal to different sectors of the electorate, or even as simple tax-trading to appeal to the electorate?

Party philosophy certainly played a role in shaping the income tax, which was introduced by the Liberal Government in the face of conservative opposition. Significant changes to the tax have tended to be introduced by the Liberal Government and later the Labour Government. Thus, aside from the introduction of the income tax by the Liberals, social welfare was introduced by Labour, though the effects of this on taxation were obscured by the onset of World War Two.

¹⁹ See Graeme S. Cooper, "The Benefit Theory of Taxation," *Australian Tax Forum* 11 (1994): 397.

The universal Family Benefit was introduced by Labour, a party which also pushed for the replacement of exemptions with rebates, and did so when it came to power in 1972.

However, any distinction between these parties cannot be drawn too tightly. Although the Liberals and Labour may have initiated measures, the more conservative opposition did not repeal them, but rather co-opted these policies once in power. Despite protesting against Liberal Party measures such as the income tax, the Reform Party both retained and increased the income tax when it came to power. Similarly, social welfare was retained by National, as was the universal Family Benefit. Labour, which had adopted a policy opposing conscription during World War One, adopted a more conservative position to war financing in World War Two than the Reform Party had in World War One. Furthermore, National did not reinstate income tax exemptions upon coming back into power in 1975.

Conversely, Labour retained the flat rate levy that the Reform Party had introduced to pay for unemployment relief, first renaming it the Employment Charge, and then the Social Security Charge. It was the Reform Party, and not the Liberals, who introduced the Child and Dependent Spouse's Allowances, though as exemptions, and not as rebates. So too, the differential treatment of unearned and earned income was originally introduced by a conservative Reform Government, and later repealed by National. This does not indicate any clear split between the parties, although some patterns may be noted. In general the Liberals and Labour introduced significant change, which was opposed by the Reform Party or the National Party at the time, but co-opted by them once they came to power. Certainly, too, some taxation measures were designed to appeal to the electorate, particularly in an election year.²⁰

Leaving political rhetoric to one side, party politics do not explain changes in the practice of vertical equity. Rather than a see-saw between right and left-wing tax policies, and views on vertical equity (to the extent that such can be identified), the data highlights policy convergence between the two parties. It also suggests a ratchet; one party leads, and the other subsequently co-opts and extends or modifies the change it inherited. Vertical equity seems to have come out of the mix: as a by-product of taxation policy rather than a driver of it, political rhetoric notwithstanding.

²⁰ The rebate bidding war during the 1957 General Election, with Labour's £100 offer is an obvious example.

14.4 The New Zealand Experience

Philosophical thought, changes in the role of government, and politics affected the income tax and the practice of vertical equity in the income tax. However, none of these provide a framework for understanding tax change. Returning to the data, change in the income tax was not linear but was tied to significant non-tax events. The most significant changes coincided with the extension of the franchise from 1890, World Wars One and Two, and the Great Depression. The extension of the franchise saw the election of the Liberal Government and the introduction of the income tax. In the course of both World War One and World War Two, the income tax increased significantly, and attained new peaks and shapes. A response to the Great Depression was the extension of direct tax to low income earners and an increase of taxation for everyone else.

Major crises tend to be costly. War required the mobilisation of significant financial resources by way of taxation or debt to finance the mobilisation of substantial human resources and materiel. Similarly, the Great Depression involved the government in drastic measures initially to “balance the budget”, and later to meet social needs. Since these crises were visible, the increased taxation was more easily “sold” to the population as a matter of public necessity and a patriotic duty. By the time the crisis had passed, the populace had become somewhat inured to the higher tax. As a result, any decrease in tax was viewed positively, even though the tax cut might go nowhere near to restoring the pre-crisis level of tax.

Significantly, once a crisis had passed, taxation did not revert to pre-crisis levels. This is particularly evident in the wake of both World War One and World War Two; although tax rates did fall, they never reverted back or even came close to pre-war levels. A pattern of taxation established during a crisis remained in place until a new crisis arose. Thus changes tended to be incremental rather than radical. Rates might be tweaked, allowances introduced or revised, but the overall tax payable only changed slowly. Indeed, aside from a tweaking of tax rates or adjustments to tax allowances, the major driver that increased taxes was inflation-induced bracket creep.

In contrast, the evidence suggests that any significant change in taxation between crises lacks an evident justification, and may cost the government at the polls. One example of this is provided by the response to Labour’s 1958 “Black” Budget, where taxes were increased as a response to an actual balance of payments crisis, but the crisis did not endure. Whereas during both World

War One and World War Two the incumbent government remained in power at a subsequent General Election despite large tax increases, in 1960 Labour did not.

Despite what politicians may say, changes in the income tax may thus be seen as pragmatic responses to crises, rather than attempts to enhance fairness. The history of the income tax may be summarised as following the pattern of Figure 14.1.

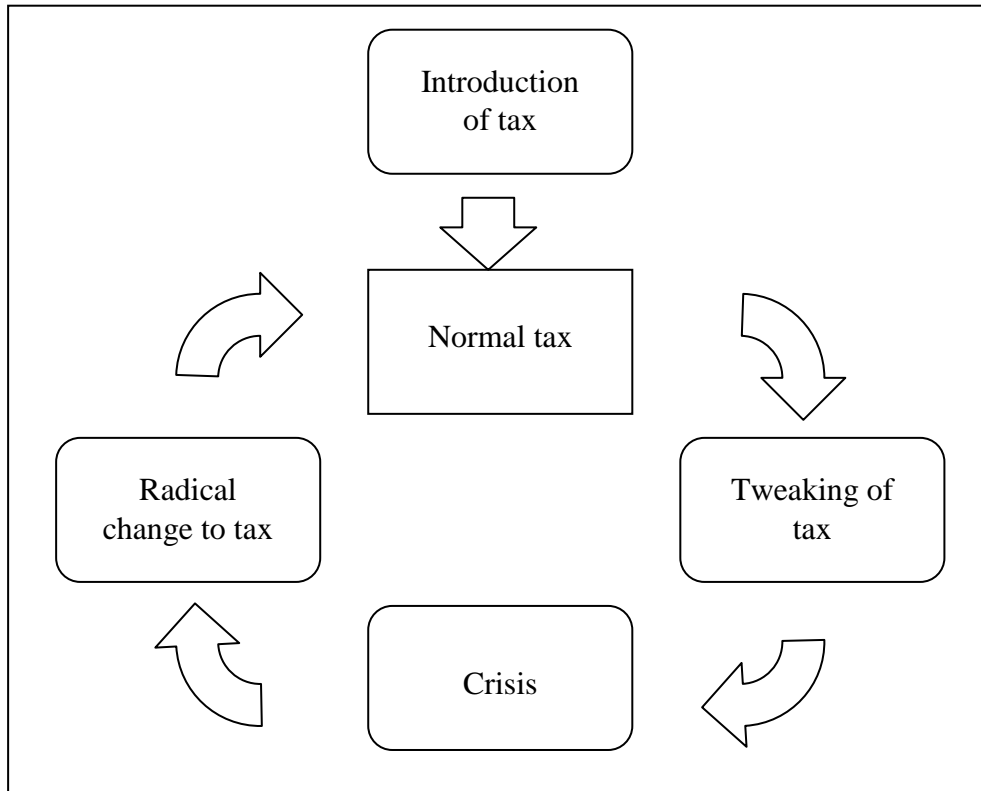


Figure 14.1 Process of taxation change

Prior to the introduction of the income tax in 1891, a variety of approaches to taxation were attempted, but no one approach endured. In part this reflected the immaturity of New Zealand's institutions. The income tax was introduced in response to the election of the Liberal Party, which itself in measure resulted from changes in the franchise. Once the income tax had been introduced, it remained largely unchanged for nearly two decades. During that period, aside from one rates increase, only incremental adjustments were made to the income tax legislation.

Substantial change occurred following the start of World War One. In the course of World War One, the income tax was radically increased, and an increasing number of New Zealanders

became liable to pay it. After a settling-down period following the war, a new “normal” income tax obtained – at a higher rate, and affecting a larger number of people. Subsequently the tax was tweaked, but the basic structure remained in place until a new crisis arose.

The Great Depression provided such a crisis. The conservative Reform Government required additional revenues not only to balance the budget but also to pay for the limited emergency relief made available to the unemployed. In the context of this crisis, the Labour Party came to power and extended the relief measures by introducing Social Security, and consequently increasing the income tax.

Before this new pattern could be confirmed, another crisis arose: World War Two. War again justified the significant increase in taxation – both in terms of the tax rate and tax base. Although the income tax had been progressive from its inception, in the course of the war the income tax became truly universal; all became liable.

Although the income tax was changed in numerous ways in the decades following World War Two, such changes tended to be incremental. Aside from changes to the rates scale and to exemptions and rebates, individual taxpayers were most affected by the extra-legislative effect of inflation-induced bracket-creep.

This structure of taxation change bears similarities to Thomas Kuhn’s thesis on scientific change.²¹ Kuhn questions an incrementalist view of change, and instead posits that science passes through various stages – from pre-science, where no one paradigm provides a common body of belief – to normal science, where a particular paradigm gains dominance. While a particular paradigm is in effect, changes tend to be incremental and consistent with that paradigm. Only when the existing paradigm is no longer able to accommodate the subject matter does paradigm change occur in the context of crisis or revolution.

The development of the income tax, and of vertical equity in that tax, may be understood along the lines of Kuhn’s thesis. The introduction of the tax in 1891 suggests a shift from a “pre-scientific” to a “normal” income tax paradigm. This paradigm, though adjusted, remained in place until a crisis required significant change. Over the ensuing nine decades to 1984, periods of

²¹ Thomas S. Kuhn, *The Structure of Scientific Revolutions* (Chicago: University of Chicago Press, 1962).

paradigmatic stability were interspersed with times of rapid and enduring change. Certainly the tax was amended during periods of stability, but radical changes were not made to the basic structure.

Although Kuhn initially cautioned against applying his thesis to the humanities,²² he subsequently recognised its wider applicability. He wrote:

*To the extent that the book portrays scientific development as a succession of tradition-bound periods punctuated by non-cumulative breaks, its theses are undoubtedly of wide applicability. But they should be, for they are borrowed from other fields. Historians of literature, of music, of the arts, of political development, and of many other human activities have long described their subjects in the same way.*²³

That this is so is evident in the variety of disciplines in which his structure has been applied, including fields as diverse as accounting education,²⁴ drug abuse research,²⁵ and theology.²⁶ Kuhn's theory also provides a useful model for framing a discussion of the development of the income tax.

14.5 Vertical Equity

So much for the pattern of change in the income tax in general; the question remains whether it is possible to identify a pattern of change *in vertical equity*. It is difficult to separate out vertical equity from the progressive income tax, since progression has been an essential feature of the New Zealand income tax since its introduction. Although vertical equity cannot be identified with progressive tax rates, there is a close link between the two. Significant changes in the

²² Kuhn distinguished between the natural and the physical sciences. He noted that, in contrast to the natural sciences, social sciences such as law (and thus also taxation) have as their principal *raison d'être* an external social need (p. 19). He also highlighted that a paradigm may insulate a community from socially important problems, from which the social sciences cannot so easily isolate themselves (p. 37). Finally he mentioned the old chestnut of whether the social sciences really are a science (p. 159), and suggests that this is not a semantic but a social issue.

²³ Thomas S. Kuhn, *The Structure of Scientific Revolutions, Second Edition, Enlarged* (Chicago: University of Chicago Press, 1970), 208.

²⁴ Jean B. Price, "Accounting Education Change: A Kuhnian Perspective," *The Journal of Theoretical Accounting Research* 1 (2006): 39.

²⁵ Sonia A Alemagno, "Drug Abuse Research; A Shifting Paradigm," *The Journal of Drug Issues* 39 (2009): 223.

²⁶ Robert F. Schedinger, "Kuhnian Paradigms and Biblical Scholarship: Is Biblical Studies a Science?" *Journal of Biblical Literature* 119 (2000): 453. Schedinger questions the applicability of the Kuhnian framework to the humanities in general.

amount of tax payable often result from changes in the rates scale, and these changes always affect the relative amounts of tax paid by different taxpayers.

The structure outlined in Figure 14.1 above helps make sense of change in the income tax itself. Given the close link between the income tax and consequent vertical equity, it also helps in understanding changes in vertical equity in that tax. Differentiation between taxpayers was mainly effected by means of progressive tax rates, and these were most significantly altered in times of crisis. This suggests that the pattern was one of crisis leading to tax changes with consequential effects on vertical equity, rather than a concern for equity driving changes to the tax – the rhetoric of politicians notwithstanding. In short, vertical equity resulted from changes to the income tax. In turn, the income tax changed as a pragmatic response to crisis and this response endured beyond the crisis.

Taxpayers were primarily differentiated in two dimensions: income level and domestic situation. Broadly, high income earners came to be assessed following the election of the Liberals in 1890. Middle income earners entered the income tax net as a result of the crisis of World War One, and low income earners in the context of the Great Depression. Differentiation based on domestic situation also arose in the context of crisis. The Child Exemption was introduced during World War One and the Dependent Spouse's Exemption during the Great Depression. Prior to World War One, the income tax rates were low and only affected high income earners. In the course of the war the rates increased, and calls were made to consider the reduced ability to pay of families, and of married couples as opposed to singles.

The introduction of universal Family Benefit seemed to occur subsequent to a crisis shortly after World War Two. However, it essentially was a delayed aspect of the Labour Party's Social Security policy, which was introduced towards the end of the Great Depression. Whether Labour would have come to power if there had been no Great Depression or been able to implement Social Security is a moot point.

Certainly, this model is a simplification, as all models are; however, it is suggestive. First it reflects and justifies the inductive approach adopted in this thesis. If tax changes - including the practice of vertical equity - reflect pragmatics rather than principle, vertical equity should be seen as a consequence rather than a driver of policy. Significant tax changes occur in response to external events, and over time the new normal tax comes to be accepted as fair. This suggests

that talk of equity in the income tax tends to be rhetorical, rather than a reflection of public policy. Therefore to understand what was meant by “fair,” one should first look at the practice of the tax, and not the rhetoric concerning it.

But secondly, given the variety of influences on tax policy, taxation research benefits from interdisciplinary perspectives. In practice, taxation is not the result of applying some pre-specified principles of taxation, but reflects political realities, a range of philosophical views, and real world contingencies. Since taxation is a human activity – a part of the human drama – taxation research is best conducted “in the round.”²⁷ In this way, the various effects of taxation on human life and society may be more clearly seen, just as a spectator’s view of a stage performance may be enhanced when the stage is in the centre of the spectators rather than out the front. Since the income tax both affects, and is affected by, the society within which it is enacted, any consideration of fairness in that tax must consider the income tax within the context of the society that levies and pays it.

Finally any rhetorical equity claims must be tested in the real world. A political party’s claim that its policy will enhance fairness can only be evaluated in terms of how it changes the amount of tax a person pays. As far as vertical equity is concerned, this amount must be considered in relation to how much another taxpayer pays. Aggregate measures may provide some indication of fairness;²⁸ yet ultimately fairness is an interpersonal matter, and must be assessed at the level of the individual. By calculating the relative amounts of tax payable by differently situated persons, it is possible to see just what vertical equity did look like.

14.6 Summary

Although the personal income tax has been the subject of constant amendment, periods of a more or less normal tax pattern were interrupted by periods of radical change. These periods of change appear not to have been the result of changes in ethical theory, but rather a pragmatic response to external events or crises. Once each crisis settled down, a new tax norm came to be accepted by the public. In general, during times of stability, changes to the income tax are usually incremental

²⁷ Margaret Lamb, “Interdisciplinary Taxation Research – An Introduction,” in *Taxation: An Interdisciplinary Approach to Research*, ed. Margaret Lamb et al. (Oxford: Oxford University Press, 2005), 7.

²⁸ An example is the Suits Index, which is a measure of the collective, rather than the individual progressivity of a tax system, refer: Daniel B. Suits, “Measurement of Tax Progressivity,” *American Economic Review* 67 (1977): 747.

rather than radical, since there is no obvious justification for significant change. Thus changes in New Zealanders' understandings of vertical equity in the personal income tax have followed changes in the practice of the income tax itself. When significant, these changes are responses to external events, rather than changes in philosophy or politics.

Fairness in taxation, then, cannot be isolated from the social and political context within which it is assessed. Rather than consult ethical theorists to determine what would constitute a fair tax, an interdisciplinary review of social and political context within which the tax was changed may be more informative. This is the approach that was adopted in this thesis.

Chapter 15

Conclusions, Limitations, and Future Research

To tax and to please, no more than to love and to be wise, is not given to men.

Edmund Burke¹

15.1 Introduction

This thesis addressed the question:

How has vertical equity (that is, the taxation of unequals) developed in the context of the New Zealand income tax on wage and salary earners from 1891 to 1984?

Although the New Zealand income tax was enacted in 1891, it did not arise in a vacuum. Taxation is almost as old as human society, and both reflects and in measure constitutes human society.

The thesis commenced by discussing the meaning of equity, and particularly vertical equity in taxation, which is the question of how unequals should be treated. It continued by considering the socio-political and philosophical background to early New Zealand taxation practice. Although this heritage informed discussions of the income tax, it did not provide a blueprint for taxation practice in general, let alone for the practice of vertical equity in the income tax in particular. Rather a variety of opinions informed the Parliamentarians who enacted New Zealand's first income tax in 1891.

A review of the direct taxes on New Zealand employment income suggested that taxpayers were distinguished in two main ways: in terms of income level, and in terms of domestic situation. The average tax rate was then calculated for a low, middle, and high income earner in three domestic situations: single, married, and married with three children, for the period from the introduction of the income tax to 1984. A review of the results identified key episodes in the income tax. The *New Zealand Parliamentary Debates* provided insight into the thinking of Parliamentarians as

¹ Edmund Burke, "Speech of Edmund Burke, Esq., on American Taxation," in *Select Works of Edmund Burke. A New Imprint of the Payne Edition (Vol. 1)*, ed. E. J. Payne (Indianapolis, IN: Liberty Fund, 1999), 149.

they enacted and then modified various direct taxes over time, and the occasional reports of taxation review committees, provided an insight of taxation thinking more generally.

It became evident that the form of the income tax and the practice of vertical equity reflected local and global events that were external to the tax itself. The initial enactment of the income tax followed significant political change following the enlargement of the franchise. That initial income tax remained relatively unchanged until the outbreak of World War One in Europe, which necessitated a considerably higher tax-take. The tax settled at a new, higher level following the cessation of hostilities, but did not revert to its pre-war form. Similarly the Great Depression of the 1930s, and World War Two in the 1940s, resulted in significant change to the income tax, and the income tax became universal. Yet when these crises had passed, the tax did not revert to its pre-war form. Conversely, in the absence of a crisis, change tended to be incremental rather than radical.

Having reviewed each episode in some detail, Chapter 14 considered whether there was a more general pattern to taxation change, and consequently to changes in the practice of vertical equity. That chapter concluded that significant changes in the practice of vertical equity in the income tax were radical and occasional, occurring as a pragmatic response to times of external crisis. Such crises resulted in significant increases in taxation, and an increasing inclusiveness of the tax. Yet once a particular crisis was over the tax did not revert to pre-crisis levels, but rather settled into a new pattern. This new norm was generally at higher rates than before. It was also more inclusive, with middle income earners becoming liable to tax during World War Two, and low income earners during the Great Depression, and especially during World War Two. Conversely, only incremental change occurred in times of general peace and stability.

Politicians repeatedly appealed to fairness, whether on the basis of benefits received, ability to pay, or sacrifice; yet the meaning and application of these bases was unclear. Rather, radical change in the progressive rates scale occurred largely independently of equity concerns. Instead, political rhetoric served to justify the reality of a need for revenue.

As the income tax increased, and in keeping with social norms, taxpayers were increasingly differentiated based on their domestic situation, with the introduction of the Child Exemption, then the Dependent Spouse's Exemption, and finally universal Family Benefit. By these means a taxpayer with a family was differentiated from one without. Just as progression based on income

came to be accepted as normative, so did differentiation based on domestic circumstances; lower taxes for married persons or families was only considered fair.

Changes in the practice of vertical equity necessarily followed the pattern of the income tax itself; tax policy drove perceptions of tax fairness rather than the other way around. For all that the language of equity or fairness was often invoked, crises drove change in the tax irrespective of the equity language used at the time.

15.2 Significance of the Study

This study makes several contributions to the literature. First, it addresses the gap that exists in studies of New Zealand taxation history in general. More specifically, it demonstrates the effect of income tax on individual taxpayers who were in employment, rather than merely noting changes in tax in either aggregate terms or by reference to tax rates or legislation in isolation from their effects on persons. In illustrating the impact of the income tax on proxies for real, living, breathing human beings, and the actual effect on taxpayers of changes in the legislation over time, the thesis also contributes to an understanding of the development of New Zealand society.

The study also endeavours to make sense of what the practice of vertical equity actually meant. The rhetoric of “ability to pay” or “benefits received” allows for a wide range of practices. By quantifying the actual tax paid, this thesis demonstrates what vertical equity looked like independently of what might have been claimed by politicians or commentators. The extended 90-year timeframe highlights longitudinal trends which suggest patterns of change. Despite the regular changes made to the level and shape of the income tax, each government claims to promote fairness in taxation. Fairness appears to be a rhetorical device, a marketing tool for changes in the practice of taxation that are necessitated by external events.

Finally, and significantly, the thesis suggests a pattern for understanding tax change. Change to the tax system is often couched in terms of a need to increase fairness or equity. Commissions of Inquiry or Tax Review Committees generally highlight these concerns, and governments promote their policies on the basis that they will result in a better or fairer tax or society. However, this thesis questions whether the rhetoric actually matches the reality. Rather, the (fiscal or political) reality is more likely to drive the rhetoric of fairness. This is hardly surprising. Philosophers disagree on how to tax, let alone how to tax fairly. Meanwhile,

governments need revenue to rule and must respond to contingencies. Taxpayers do well to take legislators' or administrators' stated commitments to fairness with the proverbial "grain of salt" and evaluate such claims against the actual effects of the legislation. Ultimately, vertical equity is evidenced inductively in practice, rather than deductively in theory or debate.

15.3 Limitations of the Study

This study makes a useful contribution to the literature. However, it is subject to certain limitations.

15.3.1 Range of cases

This thesis illustrated the practice of vertical equity in the case of taxpayers who were in receipt only of employment income by calculating the effect of the income tax in nine scenarios. These scenarios comprised taxpayers at three income levels, with the income tax liability calculated at each income level for three domestic situations. The range of cases is sufficient to illustrate general patterns, and to enable inferences to be drawn. In particular in the context of a progressive income tax, the thesis provides a diachronic data series of how vertical equity was practised given these nine scenarios which were held constant over a period of nine decades. This data is informative, though limited.

The choice of cases is a significant limitation to this study in two respects. First, it excludes a significant number of individuals who derived their incomes other than from employment, notably the self-employed (such as farmers, business owners, and professionals), and the unemployed (whether temporarily out of work or retired). It also excludes persons with a mixed income comprising, for example, both employment *and* investment income, or employment *and* trust income. Extending the discussion beyond that of an employee to include other income earners, such as the self-employed or farmer, would provide evidence for differentiation based on a factor besides employment income, though this discussion would primarily concern horizontal, rather than vertical, equity concerns. However, it does represent a significant number of taxpayers who did derive only employment income, though it is difficult to determine just how many or what percentage of taxpayers would have fallen into this category. Further, by limiting the cases to the "pure" case of employment income only, it is possible to highlight the effect of progression on the effective rate of tax paid by a taxpayer with one type of income. It also

avoided the tendency to focus on the top marginal tax rates to the exclusion of those on low and middle incomes, a significant number of whom would be low wealth employees.²

Having limited the focus to employment income only, a second limitation was the actual definition of a low, a medium, and a high level of income. It is not possible to set these with any degree of precision, given the absence of aggregate data on employment income, particularly in the early years. The low income level was determined by reference to an external benchmark, namely the industrial award rates set in terms of New Zealand's industrial legislation. The middle and high income levels were derived from and set at a constant ratio of this low income level. As further historical wages data becomes available it may be possible (and would be desirable) to refine these definitions of income levels.

These limitations in defining the employee cases are acknowledged. Further study may help to round out the picture. However, the approach adopted has the advantage of maintaining a consistent definition of income type and source, and of relativities between incomes throughout the period, one which permits a consideration of vertical equity between taxpayers who received differing levels of (employment) income, as opposed to focussing on the (horizontal equity) question of how taxpayers in receipt of the same level of income, though from differing sources, were assessed.

15.3.2 Tax types

The thesis only considered direct taxes and direct transfers. As a result, it only paints a partial picture of the effect of government revenue measures on an individual and of the practice of vertical equity. Certainly the progressive income tax and related measures (such as exemptions, rebates, and the Family Benefit) provide the most obvious evidence of vertical equity in income taxation – vertical equity, after all, has been identified with progressive taxation.³ The income tax has been a primary means to effect redistribution particularly from the time the New Zealand government assumed that role.

² The tendency to focus on high incomes continues to be evident in the Report of the Tax Working Group (2010), which made a specific recommendation that “the top personal tax rates of 33% and 38% should be reduced as part of an alignment strategy and to better position the tax system for growth (p. 10),” but the matter of high effective marginal tax rates on lower incomes was merely identified, with no clear recommendation given beyond the almost platitudinous, “There should be a comprehensive review of welfare policy and how it interacts with the tax system, with an objective being to reduce high effective marginal tax rates.” *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Wellington: Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010), pp. 9, 10.

³ Nancy C. Staudt, “The Hidden Costs of the Progressivity Debate,” *Vanderbilt Law Journal* 50 (1997); Richard A. Musgrave, “Equity and the Case for Progressive Taxation,” in *Tax Justice: The On-Going Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2002);

However, many other factors also affect vertical equity, that is, the relative distributions between persons. Flat rate indirect taxes such as Excise Duties or Goods and Services Tax may impact lower income earners more than those on higher incomes. Increases in government charges may disadvantage lower income groups if they make greater use of those services. In a managed economy, the government's incomes or industrial policy will have differential effects on persons. It would be difficult to account for each of these factors, since not only the range of possible influences on vertical equity but also the range of individual cases is almost limitless. This study therefore focused only on direct taxes and transfers as they affected employees.

15.3.3 Scope of the study

This study concludes at 1984. The Fourth Labour Government that was elected that year radically overhauled the taxation and benefits system, overturning what had developed into a de facto paradigm since 1891, namely progressive income tax rates and an increasing reliance on income as the primary source of government revenue. The changes introduced after 1984 involved considerable income tax base broadening and a flattening of the tax scale along with the introduction of means-tested social welfare measures to replace the Family Benefit and related family-friendly rebates. They also introduced a raft of taxation initiatives including Fringe Benefits Tax, Goods and Services Tax, and international taxation. This study does not consider what happened after 1984. However, given the significant changes that occurred after 1984, that year provides an appropriate end point for this thesis.

15.4 Recommendations for Further Study

The limits of this analysis discussed in the previous section suggest a number of areas for further study.

15.4.1 Extension of the study

The method adopted in this study should be applied to the period from 1984. To bring the story up to date would also provide an interesting insight into the effect of the taxation policies of the Fourth Labour Government and subsequent governments on the vertical equity of direct taxes as they affected wage and salary earners, and permit longitudinal discussions of tax practice.

15.4.2 Extension to other tax types

This thesis examined the question of vertical equity by calculating its effect on a range of taxpayers. The same approach could be applied to other tax types. This thesis provides calculations of the relative effects of direct taxes on people in different income levels. Given appropriate assumptions, it should be possible to calculate a longitudinal data series showing the changing relative cost of, for example, indirect taxes on taxpayers and to identify patterns in this data.

15.4.3 Review of specific episodes

The data provides an overview of a period of about ninety years from 1891 to 1984. Certain episodes during that period invite study in greater depth. Examples would include a comparison of the practice of direct taxation in World War One and World War Two; the role of changes in the income tax to the 1957-60 Second Labour Government's 1960 General Election defeat (such as the introduction of PAYE, election-motivated tax cuts, and the "black budget"); and the relationship between income tax practice and General Elections in the period from 1970 to 1984. Detailed discussion of the effect of income tax is lacking in the literature. Such analysis could add to an understanding of what actually happened, and why.

15.4.4 Extend interdisciplinarity

Chapter 3 of this thesis considered philosophical thought concerning the income tax and taxation in general up to the time of its introduction in 1891. Given that the data for the years from 1891 to 1984 indicate substantial changes in the practice of the income tax, this presumably reflects changes in the theory of income tax. This raises the question of what relationship there is, if any, between theorising about taxation and its practice. Although the relationship between theory and practice is, at best, ambiguous and reciprocal, a review of twentieth century theorising on vertical equity in the income tax would extend understanding of the process of tax change, and the notion of fairness in the tax.

This thesis also argues that significant change in taxation practice occurs in the context of a local or global crisis. Taxation itself is a significant social and political act. If this is so, understandings of taxation history and policy will be enhanced to the extent that the contemporary social and political context is considered, and vice versa.

15.5 Conclusion

Between its introduction in 1891 and 1984, the income tax grew from being a minor source of government revenue to providing by far the majority of its revenue. This thesis demonstrates how vertical equity developed in the New Zealand income tax during its first 90 years, and considers why it developed as it did.

By calculating the effect of the income tax on a variety of taxpayers who represented a range of income levels and family circumstances, the actual practice of vertical equity in the income tax was illustrated. Although interpersonal fairness in taxation remained the rhetorical goal throughout the period, what this looked like in reality changed dramatically. During times of major and often global upheaval, the income tax, and thus vertical equity in the tax, was radically altered, setting the basis for a new taxation paradigm once each crisis had passed. Subsequently the rhetoric of tax fairness reflected the post-crisis situation rather than the pre-crisis norm.

Notwithstanding the massive increases and significant changes in the tax during those years, New Zealand employees continued to pay their tax, and continued to vote for the governments that levied those taxes. In the meantime governments continued to appeal to the electorate using the language of equity or fairness. Perhaps this suggests that, despite Edmund Burke's opinion, it is possible, at least in measure, both to tax and to please.

APPENDIX 1

Parliamentary Careers of Members of Parliament Referred to in This Thesis

Algie, Ronald Macmillan National MP for Remuera 1943-66. Minister of Education 1949-57.

Allen, James MP for Dunedin 1887-90; Conservative MP for Bruce 1892-11; Reform MP for Bruce 1911-20. Minister of Finance, Minister of Lands, Minister of Agriculture, Minister of Labour, Minister of Industries and Commerce, Minister in Charge of Land for Settlements, Minister in Charge of Valuation, Minister in Charge of Scenery Preservation Departments, Commissioner of State Forests 1912-15; Minister of Defense 1915-19.

Anstey, John Liberal MP for Waitaki 1914-19.

Armstrong, Hubert Thomas Labour MP for Christchurch East 1922-42. Minister of Labour 1935-38; Minister in Charge of Housing and State Advances 1939-40.

Ballance, John MP for Rangitikei 1875-79; MP for Wanganui 1879-93. Liberal Premier 1891-93; Colonial Treasurer 1878-79, 1891-93; Commissioner of Customs, Minister of Education 1878-79; Native Minister, Minister of Defense, Minister of Lands and Immigration 1884-87; Minister of Native Affairs, Commissioner of Trade and Customs, Commissioner of Stamp Duties 1891-93.

Bowden, Charles Moore National MP for Wellington West 1943-46; National MP for Karori 1946-54. Minister of Customs, Minister of Industries and Commerce, Minister of Supply, Minister of Stamp Duties, Minister in Charge of the Inland Revenue Department 1949-54.

Bruce, Robert Cunningham MP for Rangitikei 1884-90, 1892-93.

Bryce, John MP for Wanganui 1866-67, 1871-81; MP for Waitotara 1881-87; MP for Waipa 1889-90; MP for Waikato 1890-91. Native Minister 1879-84, Minister of Defense 1881-84.

Buchanan, Walter Clarke Independent MP for Wairarapa South 1881-87; Independent MP for Wairarapa 1887-1905; Independent MP for Wairarapa 1908-14; Conservative MP for Wairarapa 1918-14.

Buick, Thomas Lindsay Liberal MP for Wairau 1890-96

Carr, Rev Clyde Leonard Labour MP for Timaru 1928-62.

Carrington, Frederick Alonzo, Member of the Legislative Council.

Carncross, Walter Charles Frederick Liberal MP for Taieri 1890-1902, subsequently appointed a Member of the Legislative Council.

Chapman, Charles Henry Labour MP for Wellington North 1928-46; Labour MP for Wellington Central 1946-54.

Coates, Joseph Gordon Independent MP for Kaipara 1911-14; Reform MP for Kaipara 1914-35; National MP for Kaipara 1935-43. Minister of Justice, Minister of Public Works, Railways, Native Minister, Postmaster-General, Minister in Charge of Public Trust and Government Life and Accident Insurance Departments 1919-25; Prime Minister, Minister of Public Works, Minister of Railways, Minister of Native Affairs, Minister in Charge of Electoral Department, Native Trust, Roads, and Public Buildings 1925-28; Minister of Public Works, Minister of Transport, Minister in Charge of Employment, and Roads and Public Buildings 1931-35.

Connelly, Michael Aynsley Labour MP for Riccarton 1956-69; Labour MP for Wigram 1969-78; Labour MP for Yaldhurst 1978-84. Associate Minister of Finance 1972-74; Minister of Police, Minister of Customs 1972-75

Craigie, James Liberal MP for Timaru 1908-22.

Douglas, Roger Owen Labour MP for Manukau 1969-78; Labour MP for Manurewa 1978-1990; ACT Party MP for Hunua (2008 – date). Postmaster-General, Minister of Broadcasting, Minister in Charge of the Government Life Insurance Office 1972-75; Minister of Finance, Minister in Charge of the Inland Revenue Department, Minister in Charge of Friendly Societies 1984-90.

Duthie, John MP for City of Wellington 1890-1905.

Earnshaw, William Independent Liberal MP for [Otago] Peninsula 1890-93; MP for City of Dunedin 1893-96.

Endean, William Phillips Reform MP for Parnell 1930-35; National MP for Remuera 1935-43.

Field, Thomas Andrew Hemming Reform MP for Nelson 1914-19.

Fish, Henry Smith Junior Independent MP for Dunedin South 1881-90; MP for City of Dunedin 1890-97.

Forbes, George William Liberal MP for Hurunui (1908-25); National MP for Hurunui (1925-28); United MP for Hurunui (1928-35); National MP for Hurunui 1935-43. Minister of Lands, Minister of Agriculture, Minister in Charge of Land for Settlements 1928-30; Prime Minister, Minister of Finance, Minister of External Affairs, Minister of Customs 1930-31; Attorney-General, Minister of Finance, Minister of Customs and Stamp Duties 1931-35.

Fraser, Peter Labour MP for Wellington Central 1918-46; Labour MP for Brooklyn 1946-50. Minister of Education, Minister of Health, Minister of Marine, Minister in Charge of Mental Hospitals, Minister in Charge of Police 1935-40; Prime Minister and Minister of External Affairs, Minister of Island Territories and Minister in Charge of Broadcasting 1940-49.

Freer, Warren Wilfred Labour MP for Mount Albert 1947-81. Minister of Trade and Industry, Minister of Energy Resources 1972-75.

Grey, George MP for Auckland City West 1875; MP for Thames 1876-81; MP for Auckland East 1881-87; MP for Auckland Central 1887-90; MP for Newton 1891-93; MP for City of Auckland 1893-95. Premier 1877-79; Colonial Secretary 1877; Commissioner of Customs 1877-79; Commissioner of Stamps 1878-79; Colonial Treasurer 1879.

Hall, Arthur William Reform MP for Hauraki 1928-31.

Hall, John MP for Christchurch Country 1855-60; MP for Heathcote 1866-72; MP for Selwyn 1879-83, 1887-90; MP for Ellesmere 1890-93.

Hamilton, Adam Reform MP for Wallace 1919-22; National MP for Wallace 1925-46. Minister of Internal Affairs and Employment 1931-35.

Harkness, Joseph George Independent MP for Nelson 1889-93.

Harris, Alexander Conservative MP for Waitemata 1911-14; Reform MP for Waitemata 1914-28; Independent Reform MP for Waitemata 1928-31; Reform MP for Waitemata 1931-35.

Herries, William Herbert Independent MP for Bay of Plenty 1896-1908; Independent MP for Tauranga 1908-11; Conservative MP for Tauranga 1911-14; Reform MP for Tauranga 1914-23. Minister of Railways and Native Minister 1911-19; Minister of Native Affairs, Minister of Customs and Minister of Marine, Minister in Charge of Pensions, Inspection of Machinery, National Provident Fund and Repatriation Departments 1919-23.

Hogg, Alexander Wilson Liberal MP for Masterton 1890-1911. Minister of Customs, Minister of Labour 1909.

Holland, Henry Edmond (Harry) Labour MP for Buller 1919-22. Leader of the Parliamentary Labour Party.

Holland, Sidney George National MP for Christchurch North 1935-46; National MP for Fendalton 1946-57. Prime Minister 1949-57; Minister of Finance 1949-54; Minister of Police 1954-56.

Holyoake, Keith Jacka National MP for Motueka 1932-38; National MP for Pahiatua 1943-77. Minister of Agriculture 1949-57; Deputy Prime Minister 1954-57; Prime Minister 1957, 1960-72; Minister of External Affairs 1960-72; Minister of State 1975-77.

Hudson, Richard Phineas Reform MP for Motueka 1914-28.

Kapa, Eparaima te Mutu MP for Northern Maori 1891-93.

Kirk, Norman Eric Labour MP for Lyttleton 1957-69; Labour MP for Sydenham 1969-74. Prime Minister, Minister of Foreign Affairs 1972-74.

Lake, Harry Robson National MP for Lyttleton 1951-57; National MP for Fendalton 1960-67. Minister of Finance 1960-67; Minister in Charge of the Inland Revenue Department 1960-63

Lange, David Labour MP for Mangere 1977-96. Prime Minister, Minister of Foreign Affairs, Minister in Charge of the Security Intelligence Service 1984-89.

Langstone, Frank Labour MP for Waimarino 1922-25, 1928-46; Labour MP for Roskill 1946-49; Independent Labour MP for Roskill 1949. Minister of Lands, Minister of External Affairs, Native Minister 1940-42.

Lark, Frank Edwin, Member of the Legislative Council, appointed 1931.

Lee, John Alexander Labour MP for Auckland East 1922-28; Labour MP for Grey Lynn 1931-43; Democratic Soldier Party MP for Grey Lynn 1943.

Mackenzie, Mackay John Scobie Conservative MP for Mount Ida 1884-93; MP for City of Dunedin 1896-99.

Mackenzie, Thomas MP for Clutha 1887-96; MP for Waihemo 1900-02; MP for Waikouaiti 1902-08; Liberal MP for Taieri 1908-11; Liberal MP for Egmont 1911-12. Minister of Industries and Commerce 1906-12; Minister of Agriculture 1909-12; Prime Minister, Minister of Lands, Minister of Agriculture 1912.

Massey, William Ferguson Reform MP for Waitemata 1894-96; Reform MP for Franklin 1896-25. Prime Minister 1912-25; Minister of Labour 1912-20; Minister of Industries and Commerce 1912-20; Minister of Lands 1915-18; Minister of Finance 1920-25; Minister of Stamp Duties 1920-25; Minister of Railways 1919-22; Minister of Mines 1920-21.

McCombs, James Labour MP for Lyttleton 1913-33.

McLean, George MP for Waikouaiti 1871-72, 1875-81; Member of the Legislative Council 1881-1917. Minister of Colonial Defense 1869-72; Native Minister 1872-76.

Meredith, Richard Liberal MP for Ashley 1890-1902.

Mitchelson, Edwin MP for Marsden 1881-87; MP for Eden 1887-96. Minister of Public Works 1883-84, 1887-89; Minister of Native Affairs 1887-91; Postmaster-General 1889-91.

Muldoon, Robert David National MP for Tamaki 1967-91. Minister of Finance 1967-72, 1975-84; Prime Minister 1975-84.

Nash, Walter Labour MP for Hutt 1929-68. Minister of Finance, Minister of Customs, Minister of Stamp Duties, Minister in Charge of Land and Income Tax, Minister in Charge of State Advances 1935-49; Prime Minister, Minister of External Affairs, Minister of Maori Affairs 1957-60.

Neale, Edgar Rollo National MP for Nelson 1946-57.

Newman, Dr Alfred Kingcome MP for Thorndon 1884-90; MP for Hutt 1890-93; MP for Wellington Suburbs 1893-96; MP for Wellington East 1911-22.

Nordmeyer, Arnold Henry Labour MP for Oamaru 1935-49; Labour MP for Brooklyn 1951-54; Labour MP for Island Bay 1954-69. Minister of Health 1941-46; Minister of Industries and Commerce 1946-49; Minister of Finance, Minister in Charge of the Inland Revenue Department 1957-60.

Oram, Matthew Henry National MP for Manawatu 1943-57.

Parata, Taane Liberal MP for Southern Maori 1912-18

Payne, John Labour MP for Grey Lynn 1911-19.

Rees, William Lee MP for Auckland City East 1876-79; Liberal MP for City of Auckland 1890-93. Chairman of Committees 1891-93.

Reeves, William Pember Liberal MP for St Albans 1887-90; Liberal MP for City of Christchurch 1890-96. Minister of Education, Minister of Justice 1891-93; Commissioner of Stamp Duties, Minister of Labour 1892-96.

Reynolds, William Hunter MP for Dunedin and Suburbs South 1866; MP for Dunedin 1866-75; MP for Port Chalmers 1876-78; Member of the Legislative Council 1878-99. Commissioner of Customs 1872-76; Colonial Secretary 1873.

Rhodes, Thomas William MP for Thames 1911-22.

Rolleston, Francis Joseph Reform MP for Timaru 1922-28. Minister of Justice, Defense, Minister in Charge of Police, Minister in Charge of Prisons, Minister in Charge of War Pensions, Attorney-General 1926-28.

Rowling, Wallace Edward Labour MP for Buller 1962-72; Labour MP for Tasman 1972-84. Minister of Finance 1972-74; Prime Minister, Minister of Foreign Affairs 1974-75.

Savage, Michael Joseph Labour MP for Auckland West 1919-40. Prime Minister, Minister of External Affairs, Native Minister 1935-40.

Smith, Sydney George Independent Labour MP for Taranaki 1918-25; United MP for New Plymouth 1928-35; National MP for New Plymouth 1935-38. Minister of Labour, Minister of Immigration 1930-31; Minister of Education, Minister of Employment 1934-35.

Stevens, Edward Cephas John MP for Selwyn 1866-70; MP for Christchurch City 1875-78; Member of the Legislative Council 1882-1915.

Steward, William Jukes MP for Waitaki 1871-75; MP for Waimate 1881-93; Liberal MP for Waitaki 1893-1911; Member of the Legislative Council 1912. Speaker of the House of Representatives 1891-93.

Stewart, William Downey, Junior Reform MP for Dunedin West 1914-19; Independent MP for Dunedin West 1919-33. Minister of Internal Affairs 1921-23; Minister of Customs, Minister of Industries and Commerce 1921-28; Minister of Finance, Minister of Customs, Minister of Stamp Duties, Minister in Charge of Income Tax, Attorney General 1931-33.

Talbot, Charles John Liberal MP for Temuka 1914-19.

Tanner, William Wilcox MP for Heathcote 1890-93; MP for Avon 1893-1908.

Taylor, Thomas Edward Independent MP for City of Christchurch 1896-99, 1902-05; MP for Christchurch North 1908-11.

Thorn, James Labour MP for Thames 1935-46.

Tizard, Robert James Labour MP for Tamaki 1957-60; Labour MP for Otahuhu 1963; Labour MP for Pakuranga 1963-72; Labour MP for Otahuhu 1972-84; Labour MP for Panmure 1984-90. Minister of Health, Minister of State Services, and Minister in Charge of the State Advances Corporation 1972-74; Deputy Prime Minister, Minister of Finance 1974-75; Minister of Energy 1984-87; Minister of Defense, Minister of Science and Technology 1987-90.

Vogel, Julius MP for Dunedin and Suburbs North 1863-66; MP for Goldfields Otago 1866-70; MP for Auckland City East 1871-75; MP for Wanganui 1876; MP for Christchurch North 1884-89. Premier 1876; Colonial Treasurer 1869-76, 1884-87; Commissioner of Stamps 1869-72, 1884-87; Postmaster General 1869-76, 1884-87; Commissioner of Customs 1869-72, 1884-87; Commissioner of Telegraphs 1873-76, 1884-87; Minister of Immigration 1872-74.

Ward, Joseph George Liberal MP for Awarua 1887-1919; Liberal MP for Invercargill 1925-28; United MP for Invercargill 1928-30. Postmaster General 1891-93; Colonial Treasurer, Postmaster General, Minister of Marine, Minister of Industries and Commerce 1893-96; Colonial Secretary, Postmaster General, Minister of Industries and Commerce, Minister of Railways, Minister of Public Health 1900-06; Prime Minister, Minister of Finance, Minister of Telegraphs, Minister of Industries and Commerce, Minister of Defense, Minister of Lands, Minister of Agriculture, Postmaster General 1906-12; Minister of Finance, Minister of Telegraphs, Postmaster General 1915-19; Prime Minister, Minister of Finance, Minister of External Affairs, Minister in Charge of Land and Income Tax 1928-30.

Wilford, Thomas Mason Liberal MP for Suburbs of Wellington 1899-1902; MP for Hutt (Liberal 1902-25; National 1925-28; United 1928-29). Minister of Justice, Minister of Stamps, Minister of Marine 1917-19; Minister of Justice, Minister of Defense 1928-29.

Witty, George Liberal MP for Riccarton 1902-22; Independent Liberal MP for Riccarton 1922-25.

Wright, Robert Alexander Reform MP for Wellington South 1908-11; Reform MP for Wellington Suburbs and Country Districts , 1914-19; Reform MP for Wellington Suburbs 1919-35; Independent MP for Wellington Suburbs 1935-38.

Young, James Alexander Reform MP for Waikato 1911-35. Minister of Health, Minister of Industries and Commerce 1926-28; Minister of Internal Affairs 1933-35.

Note

The above data were primarily sourced from the following:

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APPENDIX 2**Membership of Committees Convened to Investigate into New Zealand Taxation***Committee Appointed to Inquire into the Taxation of the Dominion of New Zealand (1922)*

E Anderson	Chambers of Commerce
P Barr	Chambers of Commerce
W Gow	Chambers of Commerce
W D Hunt (Chair)	Chambers of Commerce
G Shirtcliffe	Chambers of Commerce
J Bitchener	Farmers' Unions
E A Campbell	Farmers' Unions
A L Hunt	Farmers' Unions
W Barton	Sheepowners' Federation
B Tripp	Sheepowners' Federation
E W Hunt	NZ Society of Accountants
T Shailer Weston	NZ Law Society

Royal Commission Appointed to Inquire into the Subject of Land and Income Taxation in New Zealand (1924)

W A Sim (Chair)
J Begg
W D Hunt
G Shirtcliffe
T Shailer Weston

Taxation Committee (1951)

T N Gibbs (Chair)	Government appointee
A B Buxton	N Z Law Society
R A Davison	N Z Society of Accountants
W A Fox	N Z Federation of Labour
F A Harris	N Z Society of Accountants
D R Hoggard	N Z Law Society
D L M Martin	Federated Farmers
E R Norman	Associated Chambers of Commerce
A P O'Shea	Federated Farmers
S Paterson	Associated Chambers of Commerce
C U Plummer	NZ Stock and Station Agents
H W Rowden	NZ Manufacturers' Federation

Taxation Review Committee (1967)

L N Ross (Chair)
C A Blyth
N B Fippard
L M Papps
R G Stark
E Stamp

Task Force on Tax Reform (1982)

P M McCaw (Chair)

G J Schmidt

T M Hunt

J A Kean

E G Thompson

H M Titter

B H C Tyler

K M Vautier

A Wright

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