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# Editorial

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ADRIAN SAWYER AND LIN MEI TAN

Editors

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## 1.0 ARTICLES IN THE CURRENT ISSUE

In this third issue of the *New Zealand Journal of Taxation Law and Policy* (the *Journal*) for 2022 we feature four articles. These four articles encompass: a proposed new framework for tax policy setting; a review of the Tax Working Group's recommendations for the future of the New Zealand tax system; and two articles exploring recent changes to the Brightline test for residential rental properties and associated reductions in permitted interest deductions.

In the first of the four articles, Alison Pavlovich (the second of two articles with the first appearing in the prior issue of the *Journal*), proposes a new framework for tax policy setting. The prior article argued that there should be two main tax policy setting objectives: fairness and prosperity. This second article discusses the conceptions of fairness and prosperity for these purposes. Four sub-aims are introduced to support the dual objectives. Progressivity, neutrality, participation and productivity, support both objectives. The major risks in current tax settings highlighted are regressivity and the increasing levels of inequality.

Andrew Maples, in the second article, comments that in 2017, the New Zealand Government created the Tax Working Group (TWG) to consider the future of tax, and to provide recommendations to the Government that would improve the fairness, balance, and structure of the tax system. In March 2018, the TWG published "Future of Tax – Submissions Background Paper", which called for public submissions on a range of issues considered important by the TWG for improving the tax system. Some 6,700 submissions were received by the 30 April 2018 close-off. Five polls included on the TWG website sought views on respective questions. In addition to these polls, the TWG website sought more specific feedback on two questions, the first being "Are we taxing the right things?"

The purpose of Maples' article is to gain some insight into the views of individual submitters to that question, on the topics of capital gains taxation, wealth/asset tax, inheritance tax/death duties, and property taxes. Twenty per cent of submissions were reviewed and ranged in length, detail and opinions expressed. Themes among those supporting change to the taxation of property included issues of fairness, inequality, and the tax burden. Addressing these issues saw support for a range of tax measures. Opposition to tax changes focused on the negative impact on saving and investment, fairness, avoidance, and resistance behaviour.

Maples observes that in September 2018, the TWG released an interim report outlining its views as informed by submissions from individuals and organisations. The TWG released its final report in February 2019, with the majority of the TWG recommending a broad extension of capital gains taxation. Despite the recommendation of the majority, due to a lack of support from coalition partner New Zealand First, the author laments that the Government decided not to pursue a CGT any further.

In the third article, David Sutton and Alison Pavlovich comment that the Labour-led Government announced steps in March 2021 to address heavily mediated concerns about New Zealand's housing crisis, this being a result of the combined effects of a lack of housing availability and housing unaffordability. The authors observe that recent years have seen rapidly rising housing prices, increasing homelessness, rapid rental increases, and a growing reliance on the government for emergency housing. The 2021 Budget was accompanied by a series of proposed tax policy responses aimed at reducing these problems. The key legislative changes include removal of interest deductibility on residential property investment made on or after 27 March 2021, the phased reduction and eventual removal of interest rate deductibility by 1 April 2025 on such investments made prior to 27 March 2021, and the extension of the Brightline Test (BLT) to 10 years, from five years, with maintenance of the five-year BLT for new builds. Collectively, the authors suggest, these policies aim to subdue house price rises, thereby improving residential property affordability and availability to owner occupiers, without reducing new supply.

Sutton and Pavlovich's discussion adopts the style of a debate, seeking an answer to the question of whether the legislative responses are 'fit for purpose' or whether they are 'barking up the wrong tree'. The policies are assessed against their aims, as articulated by the government, the ways in which they meet those aims, and the ways in which they fall short. The conclusion of this debate between the authors is that if the reader accepts the causal indeterminacy of the housing crisis, the case for the tax policy changes prevails. However, if the narrowing down

of key causes in the case in opposition to the tax policy changes is accepted, then it is the case arguing for the ineffectiveness of the proposed policies which prevails.

In the final article, David Sutton comments that in 2019 the Government introduced loss ring-fencing provisions in relation to residential property investments. These provisions quarantined tax losses related to residential property investment within the individual property investment or residential property investment portfolio. The provisions, extended to widely held entities holding more than 50 per cent of their assets in (disallowed) residential investment property, were designed to prevent deductibility of residential investment property losses against the individual shareholding taxpayer's global income (more than 10 per cent in the case of investors in closely held entities or trustee investors).

In 2021, the author observes that proposals were made to extend this treatment to tax avoidance using interposed entities which the taxpayer has borrowed to buy shares in, making the borrowed funds available for residential property investment by the entity. This issue arises from the Government proposal to eliminate deductibility of interest expenses for borrowing to fund residential property investment. In both instances, the 'residential investment land-rich' classification has been employed to define a threshold for interest limitation. This is an anti-avoidance measure, but it is constrained in its effectiveness by the view that apportionment involves excessive compliance complexity.

Sutton makes the case that the 'compliance complexity' argument is unwarranted, that historical legislative precedent indicates that the complexity issue is overstated, and that apportionment eliminates the need for the 'residential investment property rich' designation, as well as eliminating the separate treatment of close companies, compared to widely held companies. A further argument raised by the author is that the 'residential investment land-rich entity' classification runs counter to government policy intent, inferred to place owner occupiers in a position of competitive advantage over residential property investors in the market for housing purchase.

## **2.0 POLICY, LEGISLATIVE AND CASE LAW DEVELOPMENTS**

### **2.1 Legislative and Policy Developments**

Since our last *Editorial* in the June 2022 issue of the *Journal*, legislative and policy developments have been steady, although the rate of technical information released by Inland Revenue has gathered momentum, with regular releases of items for consultation or publication in various for a including the Tax Information Bulletin. In this issue of the *Journal*, we comment on Budget 2022 and the recently enacted Cost of Living Payments Act. There have been no significant tax judgments delivered by the courts in the last few months.

### **2.2 Budget 2022**

On 19 May 2022, the Minister of Finance, Grant Robertson, delivered Budget 2022.<sup>1</sup> While this is the government's fourth wellbeing budget, it was light on tax policy announcements, including tax-related wellbeing initiatives. Included in the budget speech and associated documentation were:

- A proposed cost-of-living payment to New Zealanders earning up to \$70,000 in the 2021/22 year. This payment totalling \$350 per eligible person would be spread over three months and be paid to eligible people from 1 August 2022. No application process would be required as Inland Revenue would assess eligibility and pay the money direct into bank accounts;
- That from 1 July 2023 child support collected by Inland Revenue will be passed on to sole parent beneficiaries;
- Permanent baseline funding would be provided for Inland Revenue's on-going administration of the research and development tax incentive (since current funding was due to expire on 30 June 2022); and
- Funding for Inland Revenue to maintain capability to support ongoing integrity work and manage cost pressures.

### **2.3 Cost of Living Payments Legislation – A Policy Disaster?**

The Minister of Revenue, David Parker, introduced the Cost of Living Payments Bill (the Bill) on 19 May 2022 to enable Inland Revenue to make a cost of living payment to eligible individuals (this was announced earlier in Budget 2022).<sup>2</sup> The payment is a temporary measure to provide short-term support for certain individuals earning up to \$70,000 in the 2021/22 year. The Bill was enacted the same day and assented to on 29 May 2022, all without any external public consultation.

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<sup>1</sup> See further NZ Government, *Wellbeing Budget 2022: A Secure Future* (May 2019) at <[www.budget.govt.nz/](http://www.budget.govt.nz/)>.

<sup>2</sup> See <[www.legislation.govt.nz/bill/government/2022/0128/4.0/whole.html](http://www.legislation.govt.nz/bill/government/2022/0128/4.0/whole.html)>.

The proposed amendments would allow the Commissioner of Inland Revenue (the Commissioner) and his staff to use their existing powers for the purposes of administering the scheme. The amendments also provide how the payments under the scheme would be treated for income tax and social policy purposes. The main eligibility criteria for an individual receiving the payments are:

- net income of \$70,000 or less for the 2021–22 tax year;
- not eligible to receive a qualifying benefit for the winter energy payment (WEP), sole parent support, supported living payment, jobseeker support, jobseeker support student hardship, emergency benefit, emergency maintenance allowance, youth payment, young parent payment, New Zealand superannuation, or veteran’s pension, during the payment period;
- aged 18 or over;
- **both New Zealand tax resident and present in New Zealand;** and
- not incarcerated.

Interestingly both the Treasury and Inland Revenue recommended against the approach proposed by the New Zealand Government but nevertheless the government went ahead with the proposal.<sup>3</sup> The Treasury warned at the time that the original announcement was made with Budget 2022 that the payment would be inflationary. From an Inland Revenue perspective, it would have a critical impact on its operations and would severely impact its already stretched workforce. The cost of the payments was estimated to be around \$800 million with a cost to administer of around \$16 million (including hiring an additional 400 temporary staff and seconding others from within Inland Revenue).

With the first payment being made on 1 August 2022, flaws in the underlying policy have been exposed. Hundreds of people have reported receiving the payment, yet they are not eligible due to them not being resident in New Zealand. Some have stated that they have sought to cancel any further payments. The Minister of Revenue estimates that one per cent of those paid are not eligible (out of an estimated 2.1 million eligible people). In contrast, many eligible people cannot receive this payment as their 2022 tax year return/position has not been finalised (that said, eligible people have up to March 2024 to receive any outstanding payments), or Inland Revenue does not have their bank account details. Indeed, many hundreds of thousands of people who are ‘eligible’ have not received their first payment. At least, at the time of writing this Editorial, there have been no stories in the media to our knowledge of people incarcerated receiving the payment.

Furthermore, the Minister of Revenue stated that Inland Revenue will not be requested to chase up ineligible people to get the money back that had been paid to them (unless the money was obtained by fraud or similar means). Any repayments would be up to the voluntary actions of (ineligible) recipients.

The approach has been criticised on many fronts, including that many people suffering from the current fiscal crisis are ineligible, that many receiving it do not need it (for example, the individual earns less than \$70,000 but their partner has a high income), and that many receiving it are ineligible. Furthermore, it fails to recognise the importance or prior public consultation that would have been possible had the Generic Tax Policy Process (GTPP) been followed.

We accept the proposition that all potential approaches have problems, so despite its flaws, the “rough and ready” approach taken by the New Zealand Government has an immediate impact. Other approaches could have been to have an opt-in scheme, although this would have taken a longer time to give full effect to and may not have reached those who needed it the most. Another approach is that the lowest tax rate threshold could be adjusted to deliver tax relief (while benefiting all taxpayers those on lower incomes would benefit proportionally more), or to increase welfare benefits for those that would not benefit from this tax rate change. However, the amount of \$350 may be too small in itself to warrant an adjustment to the tax rate threshold, and therefore a change must also be premised on the need to make adjustments for bracket creep. A tax-free threshold could be introduced, like that applying in many other developed countries.

The suggested alternatives would take more time, but investigating how to implement them efficiently and with less flaws is important as taxpayers’ money is involved. The most poignant point is that all of this should have started months ago. This is due to the Government’s delay in responding (exacerbated by refusing for many months

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3 See Inland Revenue and Treasury, *Supplementary Analysis Report: Cost of Living Payments* (4 May 2022) at <[www.treasury.govt.nz/publications/risa/supplementary-analysis-report-cost-living-payments](http://www.treasury.govt.nz/publications/risa/supplementary-analysis-report-cost-living-payments)>.

to accept New Zealand was experiencing a fiscal crisis), and then perceiving that it had to act quickly through implementing a compromised approach.<sup>4</sup>

We anticipate that this will continue to be an evolving story which underlines the risks inherent in a government setting aside the GTPP in the interests of expediency.<sup>5</sup>

## 2.4 The Supreme Court decision in *Frucor*<sup>6</sup>

As we noted in the last two issues of the *Journal*, back in early June 2021 the Supreme Court heard the appeal in *Frucor*,<sup>7</sup> a significant tax avoidance case. As we have previously observed, in line with s 170(3) of the Senior Courts Act 2016, around 80 per cent of (Supreme Court) judgments are expected to be delivered within six months of the hearing, with particularly complex cases potentially taking longer. As at the time of writing in August 2022, this six-month timeframe has well and truly passed; indeed, it will be around 15 months after the hearing by the time that this issue of the *Journal* is published. We eagerly anticipate reading the Supreme Court's judgment in *Frucor*, hopefully in the not-too-distant future.

## 2.5 The end of an era

We would like to pay our respect to the passing of Her Majesty Queen Elizabeth II on 8 September 2022. As the world works through this time of significant change and sadness, reflecting on 70 years of unwavering service, we look forward to a new era under King Charles III. Over the coming months there will be many changes to reflect the new Monarch, although in most respects the impact from a tax perspective will be on formalities rather than changes of substance.

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4 One of the editors provided his opinion via Radio New Zealand on this debacle; see <[www.rnz.co.nz/national/programmes/middayreport/audio/2018851642/govt-s-cost-of-living-payments-start-today](http://www.rnz.co.nz/national/programmes/middayreport/audio/2018851642/govt-s-cost-of-living-payments-start-today)>.

5 See comments in our March 2022 Editorial.

6 *Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited* (SC 92/2020, 8-10 June 2021, Winkelmann CJ, William Young, Glazebrook, O'Regan and Ellen France JJ). The prior Court of Appeal decision was released in September 2020 and leave to appeal to the Supreme Court granted in December 2020.

7 For prior comment on the Court of Appeal decision in this case in the *Journal*, see Craig Elliffe "Discerning Commercial and Economic Reality: Applying the GAAR to *Frucor*" (2021) 27(3) *New Zealand Journal of Taxation Law and Policy* 223.