Editorial

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Editors

ARTICLES IN THE CURRENT ISSUE

In this second issue of the *New Zealand Journal of Taxation Law and Policy* (the *Journal*) for 2024 we feature four articles. The articles focus on a diverse range of subjects, including: a review of the submissions made on the 2017-19 Tax Working Group's background paper and interim report; New Zealand's approach in negotiating the 2019 China-New Zealand double tax agreement (DTA); how New Zealand's source rules can be improved so as to operate more effectively; and a critical examination of Australia's Backpackers' Tax (ABT).

In the first of the four articles, Andrew Maples observes that the Tax Working Group (TWG) was appointed in 2017 by the Aotearoa New Zealand Government to consider the future of tax and to provide recommendations to 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 significant issues.[1] The TWG released an interim report in September 2018 outlining its views as informed by submissions from individuals and organisations, including Māori stakeholders.[2] The TWG released its final report in February 2019.[3] In part due to concerns over increasing income and wealth inequality, the TWG Background Paper specifically directed submitters to consider the taxation of capital income. Maples' research analyses the submissions by key Māori stakeholders on this issue.

The author observes that the comprehensive taxation of capital income raises unique challenges affecting Māori and has significant long-term implications for, but not limited to, the holding and treatment of Māori collectively-owned assets (including Māori freehold land/whenua and settlement assets). Submissions considered a variety of implementation issues including realisation or accrual-based taxation, exemptions and roll-over relief, and the taxation of housing. Maples highlights that the significant impact of such issues on Māori-Crown relations and Māori tino rangatiratanga was also reflected in the submissions. In considering the design of a future CGT, Maples argues that the need to understand Te Ao Māori – the Māori worldview – is also underscored.

Christina Posner, in the second article, observes that in 2019 New Zealand signed a new DTA with China, with the purpose of alleviating the burden of double tax on cross-border transactions, as well as preventing international tax evasion and avoidance. The 2019 DTA replaces the 1986 version, which was one of China's first tax treaties signed after its entrance into the global market. At that time, China had a "Great Wall" protecting its tax base from other jurisdictions, which was evident in its DTAs. Between 1986 and 2019, China became one of the world's largest and most influential economies. Posner reveals that a close examination of the 2019 DTA sheds light on the evolving relationship between New Zealand and its largest trading partner.

In 2019, it was New Zealand who negotiated as if it had a "Great Wall" to protect and retain an adequate tax base. New Zealand can be seen to diverge further than expected from the OECD's Model Convention[4] for developed countries in respect to its negotiations with China. At the same time, China's treaty practice has increasingly converged with the OECD approach. Furthermore, the 2019 China-New Zealand DTA indicates the growing maturity of China's tax system and China's willingness to combat base erosion and profit shifting. New Zealand's indiscriminatory policy to foreign direct investment and free trading of goods means New Zealand is becoming increasingly reliant on China for capital and economic growth. How has a developing nation changed New Zealand's tax treaty policy? This is the question that Posner seeks to answer in her article.

In the third article, Victoria Plekhanova argues that a good tax rule is one that has a clear purpose and is fit to accomplish that purpose. Using this simple baseline for an assessment of source rules contained in the Income

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1 TWG *Future of Tax – Submissions Background Paper* (14 March 2018).

2 TWG *Future of Tax – Interim Report* (20 September 2018).

3 *TWG Future of Tax: Final Report – Volume I: Recommendations* (February 2019); Tax Working Group, New Zealand Government, *Future of Tax: Final Report – Volume II: Design Details of the Proposed Extension of Capital Gains Taxation* (February 2019).

4 OECD *Model Tax Convention on Income and on Capital: Condensed Version* (OECD, Paris, November 2017).

Tax Act 2007 (NZ), Plekhanova identifies the main inconsistencies of these rules, and outlines changes that could make these rules more functional and easier to apply, or at least be "better".

Swapna Verma, in the fourth and final article, critically appraises the contentious impact of Australia's ABT, arguing that the ABT undermines the function of Australia's residence-based taxation, by compromising the tax policy objectives of equity, efficiency and simplicity in Australia's personal income tax system. The controversy remains, the author suggests, as the ABT taxes Australian working holiday makers, irrespective of their tax residence status. This legislative change, Swapna argues, has had a problematic impact on Australian working holiday makers, as unforeseen legal complexities and a chain of inequitable results have developed in Australia's residence-based taxation system. This has been highlighted in recent tax developments such as the Australian High Court decision in *Addy v Commissioner of Taxation*[5] and Australia's 'post-*Addy*' position which limits the implications of the High Court's decision.

Verma further argues that if the proposed rewrite of Australia's individual tax residence rules is enacted, the inequities, inefficiencies and complexities created by the ABT will likely be exacerbated as most, if not all, working holiday makers will qualify as Australian tax residents. By critically examining these recent tax developments, a significant contribution of Verma's article is to inform on the extensive tax challenges of the ABT and advocates for a substantial reform or repeal of the tax. More broadly, the author promotes further discussion of more equitable alternative reforms of Australia's individual tax residence rules, which serves as another option to address the challenges of the ABT.

2.0 POLICY, LEGISLATIVE AND CASE LAW DEVELOPMENTS

2.1 Legislative and Policy Developments

Since our last Editorial in the March 2024 issue of the *Journal*, legislative and policy developments have remained relatively quiet as the new coalition government has settled in, the exception being Budget 2024. The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act received its assent on 28 March 2024.[6] As noted in our last Editorial, the future of the Digital Services Tax (DST) Bill still remains unclear as it continues in its lapsed state with the rising of Parliament last year. On 30 May 2024 the coalition government tabled its first full Budget..

Inland Revenue has recently launched a campaign to focus on those who are self-employed or run a business in the construction sector.[7] This warning reflects a return to the 'old' pre-COVID Inland Revenue, as it moves away from a 'softly, softly' approach to one where it is sharpening its focus on sectors that it perceives have significant compliance issues.

The reminder of our Editorial focuses on two reports/statements issued by external organisations with respect to New Zealand, namely from the IMF and OECD.

2.2 IMF Mission Concluding Statement on New Zealand

On 19 March 2024, the IMF released its concluding statement following its Mission to New Zealand. On its website, the IMF states with respect to its Mission:[8]

> "A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments."

Amongst the IMF's recommendations are several pertinent statements with respect to fiscal policy, with the following of particular interest:[9]

> "Policy settings should remain restrictive. *Budget 2024 should adopt a tight fiscal stance to help disinflation and address structural issues.* Monetary policy is appropriately tight."

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[5] *Addy v Commissioner of Taxation* [2021] HCA 34.

[6] A number of special reports have been issued by Inland Revenue on key provisions within this Act; see further: <www.taxpolicy.ird.govt.nz/>.

[7] Inland Revenue has set up a dedicated web link for those in the sector; see <www.ird.govt.nz/the-tax-toolbox>.

[8] See further <www.imf.org/en/>.

[9] Above n 8 (our emphasis).

In this regard New Zealand is being encouraged to take a much tighter fiscal stance for the financial year 2024-25 than occurred in prior years. With respect to any tax relief New Zealand is encouraged that this be fiscally neutral, which will be a challenge. A more significant recommendation is set out in the following observation by the IMF:[10]

> "**New Zealand would benefit from a more efficient, equitable, and sustainable tax system.** New Zealand already has one of the most efficient goods and services tax systems globally. However, tax policy reforms are needed to promote investment, and productivity growth, increase the progressivity of income tax, and mobilize additional revenue in response to long-term fiscal challenges. To achieve these objectives*, reforms should combine comprehensive capital gains tax, land value tax, and changes to corporate income tax*."

While the media have drawn attention to the recommendation that New Zealand needs to develop a comprehensive capital gains tax (CGT), a land value tax and review other aspects of its current tax system, the coalition government has specifically rejected any proposal for a CGT. In the IMF's view, A CGT could allow a rebalancing of the tax base, including further increases in marginal tax rate thresholds and a reduction in the corporate tax rate. The Labour Party appears to have taken a U-turn from its position before the last General Election as it is actively considering promoting once again a CGT as part of its tax policy. Tax policy thus remains a matter of political contention!

2.3 OECD Report

The OECD released its latest economic outlook for New Zealand in May 2024.[11] In a similar manner to the IMF, the OECD has recommended that the New Zealand government sets its operating allowances and tax policies in a manner that will gradually reduce the fiscal deficit to reach a budget balance, thereby maintaining a tight fiscal position.

With respect to tax policy the OECD observes:[12]

> "Beyond the immediate need to contribute to reducing imbalances in the economy, it is important that the government continues to steadily reduce the fiscal deficit as planned to limit the rise in public debt and thereby increase the fiscal buffer available for the next negative shock. *On the revenue side, any tax cuts should be fully funded by offsetting revenue or expenditure measures. Raising revenues should be first achieved through broadening the tax base and reducing distortions before raising rates of existing taxes*. There is a need to reduce distortions to household choice of asset allocation. Shares, land and owner-occupied residential property are tax-favoured. Most capital gains from shares, owner-occupied residential property and land are not taxed. *To ensure the tax system is not overly distorting saving and supporting broader growth, capital gains taxation reform should be done as part a wider review of tax settings for saving.* New Zealand's tax settings remain an outlier in some respects in international comparison and notably in offering no tax deduction for contributions and in taxing the returns pension funds earn while they are invested, and prior to withdrawal at progressive rates (OECD, 2018). This likely distorts saving away from national private pension saving. Foreign savings are not a perfect substitute for national savings. Even in a country relatively open to international capital flows like New Zealand, low national savings likely constrains investment (David and ors, 2020). This is particularly the case for New Zealand's significant infrastructure and long-lived capital investments needs, for which pension savings is well suited as a funding source given its long-term nature."

By recommending that any tax cuts (including threshold adjustments) be fully funded, this strongly suggests that the New Zealand government should not increase borrowing to fund any tax cuts. By 'tying one hand behinds its back' through its stated commitment that there be no new taxes, any tax cuts need significant expenditure cuts to fund them. As part of a move towards achieving a budget surplus (a somewhat distant goal), if the government chooses to achieve this by increasing taxes, the OECD recommends that it should broaden the tax base rather than raise the rates of existing taxes.

Like the IMF, the OECD focuses on New Zealand's relatively narrow tax base, including the absence of a formal CGT. In effect, the OECD is recommending that New Zealand revisit its overall approach to tax policy. Since the mid-1980s New Zealand 'stated' tax policy model has been to have a broad base low-rate (BBLR) system, with the reality being somewhat different (the absence of any real form of capital and wealth taxation). Similarly to the IMF, the OECD stated that New Zealand needs a CGT, because shares, land and owner-occupied property are treated favourably under the tax system.

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[10] Above n 8 (our emphasis is in italics).

[11] OECD, *OECD Economic Surveys" New Zealand* (OECD, Paris, May 2023).

[12] Above n 11, at 37 (emphasis added).

If this is not a sufficiently 'contentious' recommendation in itself, the OECD also suggested New Zealand look to raise the age of eligibility for government superannuation. Such a suggestion, we expect, will continue to 'fall on deaf ears' across the political spectrum.

Later on, with respect to facilitation of land use, the OECD recommends:[13]

"To capture some of this value the central government should mandate that councils charge and collect an event-based (ie, rezoning) incremental land-value tax on the owners of land on the city fringe that is rezoned or land that is rezoned to higher density or value activities within the urban boundary. *This could take the form of a tax charged on the value increase of rezoned land when the landowner sells for development, combined with a recurrent incremental land value tax from the time of rezoning, with a higher net present value than the lump-sum tax rate*. The primary purpose of this tax would be to raise revenue in an efficient and fair way, but this structure may also encourage landowners to sell rather than bank the land and speculate on further land price increases."

This suggestion may be cautiously examined with some interest from local authorities as they face the 'backlash' of substantial increases in property rates. This is all the more important as the government appears unwilling to return the GST it collects on property rates to local authorities to use. Again, is this recommendation a step too far?

Thus, with two major reports from global bodies with an interest in fiscal matters, New Zealand should be on notice that in such tight fiscal times, it needs to seriously review its tax base and expand it to reduce the pressure on those reliant upon non-capital forms of wealth (such as wage and salary earners). Furthermore, in the income tax space, New Zealand should also examine the recommendation to review its current corporate tax rate, although this should not be undertaken in isolation of other parts of the tax system.

2.4 Budget 2024

The new Minister of Finance, Hon Nicola Willis, delivered her first budget on 30 May 2024. Tax featured prominently, as was expected from earlier statements and promises made by the National Party prior to the 2023 General Election. The most significant change was a long awaited revisiting of the thresholds for individual income tax rates.[14] The new thresholds were accompanied by increases in the Independent Earner Credit for those earning up to $70,000, the In-work Credit for families, the Minimum Family Tax Credit and a new FamilyBoost for families earning under $180,000 with children in early childhood education (ECE).[15] The current (since 2010) and new income tax thresholds for individuals (the changes to take effect from 31 July 2024), are set out below, followed by the effective composite thresholds and rates for the 2024-25 income year. Interestingly, Inland Revenue and Treasury had recommended that the threshold changes only start from 1 October 2024 to reduce the fiscal cost and minimise administrative demands on Inland Revenue.[16] The composite rates will have flow on effects for the rates of FBT to be applied from 31 July 2024. As can be seen there is no change to the threshold at which the 39 per cent rate applies.

Figure 1: Personal income tax thresholds

Current brackets $	New brackets $	Rate %
0 - 14,000	0 – 15,600	10.5
14,001 – 48,000	15,601 – 53,500	17.5
48,001 – 70,000	53,501 – 78,100	30
70,001 – 180,000	78,101 – 180,000	33
180,001 +	180,001 +	39

Figure 2: Composite tax thresholds and rates (2024-25 year)[17]

Composite tax thresholds $	Composite tax rates %
0 – 14,000	10.5

[13] Above n 11, at 132 (emphasis added).

[14] For prior discussion on the need for adjusting the thresholds, see Lin Mei Tan, "Is it time to adjust the income tax brackets for inflation?" (2023) 29(3) NZJTLP 314.

[15] See further Taxation (Budget Measures) Bill 2024, introduced on 30 May 2024, debated under urgency, enacted on 31 May 2024 and received assent on 4 June 2024. See generally <www.taxpolicy.ird.govt.nz/>.

[16] See Inland Revenue and Treasury, *Regulatory Impact Statement: Personal income tax relief* (24 April 2024), released as part of Budget 2024; <www.taxpolicy.ird.govt.nz/>.

[17] Table information courtesy of Robyn Walker, Tax Director at Deloitte NZ.

14,001 – 15,600	12.82
15,601 – 48,000	17.5
48,001 – 53,500	21.64
53,501 – 70,000	30
70,001 – 78,100	30.99
78,101 – 180,000	33
180,000 +_	39

Several commentators have suggested (which is a view with which we concur) that a mechanism is needed to enable regular indexing of tax thresholds to avoid the current sizeable adjustment undertaken to recognise (in part at least) the 14-year period since the last revisions in thresholds. Fiscally speaking, the longer between indexation changes, the greater the cumulative cost and impact. Previous efforts to make changes to the thresholds have been thwarted by political manoeuvring. For example, in 2008 indexation was legislated for by the then Labour-led government but was then repealed by the National-led government after the next election due it its differing priorities. In 2017 the National-led government enacted significant band movements but this was repealed by the incoming Labour-led government. Thus, what will happen after the 2026 General Election is unclear.

Also with the Budget 2024 material, there is a brief mention of the proposed DST, such that while no decisions have been made about whether it should be enacted, there is anticipated revenue from 1 January 2025 within the government's fiscal projections. This appears rather odd as it is unlikely the DST could be enacted and in place by that date or the OECD's Pillar 1 proposal finalised and adopted by the end of 2024.

2.5 Special issue – March 2025

A further special issue is being planned for the Journal for March 2025. A conference was hosted by Qatar University in February 2024 under the theme 'Global Minimum Tax and its Impact on Tax systems in GCC countries'. The conference included papers on the Two Pillar approach in BEPS 2.0, focussing on Pillar 2 and its implications for Gulf countries. This special issue is intended to include a number of revised papers that were presented at this conference. Dr Mahmoud Abdellatif (m.abdellatif@qu.edu.qa) is the special issue Guest Editor who will be coordinating the submissions.

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