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'The tax system is broken'

Cuts to help spread the load

By VERNON SMALL and TRACY WATKINS - The Dominion Post Last updated 08:03 21/01/2010

The top 38 per cent personal tax rate could be wiped out as early as the May Budget as the Government looks to dump business tax breaks and sock landlords to help pay for the change.

It is also looking at further tax cuts for lower-income workers, paid for by increasing GST to 15 per cent.

Finance Minister Bill English signalled yesterday that a quick cut to the company tax rate was also on the agenda to pre-empt a similar move by Australia. That makes a big reduction in the top tax rate - introduced by Labour in 1999 - almost certain to avoid a bigger gap between personal and business taxes.

The hints come after a 70-page report from a Government-mandated tax working group out yesterday, said that the curr tax system was broken and needed reform to make it efficient and curb tax rorts.

Among its recommendations was aligning the top personal rate, now 38 per cent on income over $70,000, with the 33 pe cent rate paid by trusts, while leaving room to lower the company rate from 30 per cent to 27 per cent.

That would put about $20 a week in the pockets of workers on $90,000 a year but give those earning less than $70,000 nothing.

However, a rise in GST from 12.5 per cent to 15 per cent could be used to cover lower income taxes across the board. Beneficiaries and superannuitants could get help to compensate for the higher GST.

The Government has said any future cuts would need to be balanced by extra tax elsewhere. "It's not a lolly scramble. Y just can't give stuff away," Mr English said.

The group is eyeing an extra $1.3 billion from dumping depreciation tax breaks on buildings. A highly placed Government source said a move on depreciation would be "easier and more acceptable" to implement in this year's Budget than othe options.

The group also recommended a new tax on residential investment properties that could raise up to $850m from landlords broad land tax was also recommended but that is seen as too risky politically.

Mr English said any changes would need to improve the economy, be fair and provide incentive for people to get ahead. "The threshold is still fairly high for getting a package that works."

The working group had raised concerns about the impact of Working for Families.

But Mr English said well-off individuals rorting the system was the fault of the tax system, not Working for Families.

The Government was monitoring possible cuts in Australia's company tax rate, which could encourage business to cross Tasman. But he expected the Rudd government to move cautiously in an election year.

The working group, led by Victoria University professor Bob Buckle, said change was needed because workers and companies paid a disproportionate amount of tax while the wealthiest earners were avoiding tax by shifting income into trusts, rental properties and other savings vehicles.

"Put simply, the tax system is broken and needs to be fixed," Professor Buckle said.

Federation of Family Budgeting Services chief executive Raewyn Fox said some middle-income families were struggling with financial commitments every week. "If they just compensate the low-income earners then the middle-income bracket become the new poor, because they are suffering more."

The recession had left many families surviving on a single pay packet, Ms Fox said."It should be targeted at the people tl need it, but in that middle-income bracket it is incredibly hard to do."

Labour finance spokesman David Cunliffe said the report seemed to focus more on aligning tax rates and cutting the top personal rate than on equity. Only two countries - Mexico and the Slovak Republic - had fully aligned top rates and there was a spread of up to 15 points between Australia's top personal and business tax rates.

Recommended changes to tax rules for business and on rental property could raise $2.5 billion a year for redistribution. "How about some for superannuation? And if there is tax relief, why not spread it around?"

WEALTHY KIWIS DODGE HIGHER TAX RATES

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The Tax Working Group set up to investigate the tax system said an Inland Revenue sample of 100 of the richest New Zealanders showed that only about half were paying the highest marginal tax rate on their income.

It has also been revealed that 35 families with a household income of more than $150,000 are pocketing Working for Families taxes. Property investors are claiming $13 million in welfare subsidies by claiming losses on their rental properti

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The Tax Working Group said wealthy individuals were able to restructure their affairs to minimise tax, leaving wage and salary earners to carry a disproportionate share of the tax burden.

By putting their money and assets into a company, a trust or a special savings vehicle, they could shave 8 cents in the dollar off the top 38c tax rate.

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Tax Working Group member Mark Weldon said it was a rort and demonstrated why the tax system needed reform.

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TAX OPTIONS CRITICISED

Federated Farmers spokesman Philip York said a land tax could cost farmers $525 million.

"I know tax reform supporters will argue reform will encourage enterprise, but can anyone tell me how taking $525m off farm businesses will grow exports? That's the effect of a 0.5 percent land tax on an agricultural taxable land base of $10 billion."

Farmers were asset rich but income poor and farming profits were shared across the economy, he said, and argued tha local council rates were having a big enough impact.

Business NZ chief executive Phil O'Reilly said a land tax would be an anti-competitive cost on land-based businesses.

Labour Party finance spokesman David Cunliffe said the party would consider the report and urged caution that any changes did not disadvantage workers.

Green Party co-leader Russel Norman said the recommendation to align the top personal tax rate with the corporate rat should be rejected because those earning less would end up having to pay more.

He said tax loopholes should be shut down. The Greens supported a capital gains tax and would also like to see environmental taxes introduced.

The Council of Trade Unions hoped for tax cuts but said there did not need to be a reduction in the top rate. It opposed increasing GST as did the Tourism Industry Association, which said the move could hurt its industry.

What is wrong with the current system?

* The group says it relies too heavily on taxes harmful to growth, particularly business and personal income tax, and PAY bears a disproportionate burden.

* There is a major hole in the tax base concerning tax on capital.

* Working for Families creates very high effective marginal tax rates.

* The system lacks coherence and fairness.

How would a risk-free rate of return on rental property work?

If you own an investment property valued at **$300,000** with a mortgage of **$200,000**, you have equity of **$100,000**. If you top tax rate is **38 per cent** and the annual risk-free return is **6 per cent**, then the taxable income is **$6000** and the tax liability on the property for this person is **$2280**.

How much would I get if the top personal rate was dropped to 33 per cent?

If you earn up to **$70,000** you would get nothing. At **$80,000** you would get an extra **$500** a year or about **$10** a week. A **$90,000** it would be worth **$20** a week and at Prime Minister John Key's salary of **$393,000** it would be worth **$15,150** a year or **$291** a week.

What would the tax changes raise?

* Increasing GST to 15 per cent would give the Government an extra $1.9 billion a year.

* A land tax at 0.5 per cent would raise up to $2.3b.

* Removing depreciation on buildings and new assets would raise $1.6b.

* A tax based on a risk-free rate of return of 6 per cent on residential investment properties would raise up to $850 millio

* The cost of dropping the top rate of personal income tax from 38c to 33c and cutting the rate on trust profits from 33c t 30c would be $1.6b.

How would a land tax work?

A land tax would be levied on the unimproved value of your section (that is, the value of the land, not the buldings on it). S if your section was worth **$100,000** and the tax was **0.5 per cent**, then you would be liable for **$500** a year. It would probably be added to your rates and for those unable to pay, be accumulated, plus interest, paid when a property was s owner died.

What would a rise in GST cost me?

In 2007 the average household spent **$950** a week on living expenses, including groceries, fuel, clothing and healthcare. About **$106** of that was GST, so lifting that tax to **15 per cent** would add an extra **$21.25** to the weekly bill.

HOW MUCH TAX IS COLLECTED

* Workers pay the lion's share of tax collected by the Government - $28.5 billion or 53 per cent of the total tax take come from personal income tax.

* GST on goods and services is second on the list - we pay $11.6b a year in GST, or 21 per cent of the total tax take.

* Company taxes come down the list at $9.3b - comprising 17 per cent of the tax take.

* A further $4.8b, or 9 per cent of all tax paid, is collected from excise on petrol, tobacco, alcoholic products, road user charges, stamp duty and some import tariffs.

* Forty-two per cent of all income tax is paid by 308,000 taxpayers who earn more than $70,000 a year and pay the top rate of tax. The rest is spread among three million taxpayers.

WHAT THE TAXPAYERS THINK ABOUT RAISING GST

The Dominion Post asked taxpayers what they thought of the proposal to raise GST to 15 per cent. We asked: How will increase affect your household budget? How would it affect your spending habits? Would you rather pay more GST, or more income tax?

Michael Tuffery, 43, Khandallah, artist.

An increase will "definitely" affect his family and business budgets. "We're struggling enough as it is ... We'd probably just eat less." He did not have a preference between paying more income tax or higher GST. "It's just shifting the game."

Joe Roberts, 42, Silverstream, construction worker.

An increase would not affect his budget and he was unlikely to cut back on anything. Would prefer to pay more GST because his biggest expense was his mortgage. "If I was on a low income, I'd definitely say more income [tax] though."

Bill Gregory, 59, Napier, policeman.

An increase would not affect his budget or spending habits much now "but if you turned the clock back 20 years to when we had kids it would definitely make a difference". Would rather pay more GST. "I'd have a choice then."

Emily Burmo, 18, Miramar, nanny.

An increase would mean her spending money would not go as far and she would stick more closely to a budget. "Groceries I'd cut down on or get cheaper stuff." Would prefer to pay more income tax.

Fiona Keedwell, 33, Newtown, sales rep.

Has a fixed household budget so an increase "would make everything go up. We'd have to forgo some things." Would cut back on entertainment, clothing and "nice-to-haves". Would rather pay more GST because she could control it through spending.

- with NZPA