

Proposed Tax Working Group recommendations positive for share market investors; not so good for property investors

The recent proposals by the [Tax Working Group](#) (TWG) could have significant impacts for all of New Zealand but particularly for property owners. Happily, we expect the proposals to be positive for our investors

In summary, the TWG key recommendations are

1. Align the top personal, trust and corporate rates at 27% (currently the top personal rate is 38%, the trust rate is 33% and the company rate is 30%).
2. Increase GST to 15% to help pay for the drop in the tax rates.
3. Increase tax on property and particularly rental properties as this is significantly under taxed investment currently.

Their intentions of simplicity, fairness and international competitiveness are sound.

Aligning tax rates so people focus less on minimising the tax they pay by setting up complex trust and corporate structures makes sense. Lowering tax rates so people are encouraged to work, don't feel over-taxed and skilled people from offshore are attracted here is also a good thing.

Of course, no one will grumble at lower tax rates across the board. The two controversial aspects will be where they have suggested an increase in tax to pay for those tax cuts.

The first is an increase in GST to 15%. This should encourage more saving and less spending. And the government knows that with an ageing population we each need to be saving for our retirement as the cost of paying national superannuation at a level to provide a comfortable retirement is likely to be out of reach. The challenge is to ensure that those people on low incomes who simply don't have choice to save or spend do not get forced into poverty by a higher GST rate.

The TWG also talks about broadening the tax base by removing the current incentives to invest in property over other asset classes. We like the concept of people's investment decisions being made on the basis of the best place to invest their money without the influence of tax. It doesn't make sense for example, to have \$200 billion of investment assets in rental properties but collect no tax from those investments. In fact, it costs other tax payers \$150-\$200m a year to fund the paper losses of those landlords.

There are a number of suggestions for taxing property. The TWG preferences include:

1. Not allowing depreciation on buildings, which affects residential rental and commercial property

2. A land tax of 0.5% p.a. on property (not just rentals)
3. A risk free rate of return (say 4-5%) on the equity in rental properties
4. They did consider a full capital gains tax but it's not feasible or politically palatable.

If the TWG recommendations are implemented the short term impact will be negative for property owners, especially landlords. In the medium term the changes will be positive for share markets and the economy as rental property becomes relatively less attractive and more money flows into productive sectors.

The focus on New Zealand's tax system being internationally competitive, dovetail nicely with the recent recommendations from the Capital Markets Development Taskforce to encourage offshore investment in New Zealand and to ensure great New Zealand businesses don't have an incentive to relocate offshore.

In our view the changes are positive for share market investors and building a productive economy over the longer term. How far the government goes toward implementation is yet to be seen but expect to see at least some of the recommendations in the May budget.