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REPLY SUBMISSION OF THE NEW ZEALAND TAXPAYERS' UNION TO THE TAX WORKING GROUP'S INTERIM REPORT

Introduction

1. This is a reply submission of the *New Zealand Taxpayers' Union* to the *Tax Working Group* to the Tax Working Group's *Future of Tax: Interim Report* (the "Report") and is made further to our earlier submission of April 30 2018 available at www.taxpayers.org.nz/twg_sub

2. The focus of this submission is on areas where the Working Group has not made a final recommendation. Nevertheless, it addresses the Group's recommendations as to the purported complexity of inflation-indexing tax thresholds as we believe the Group has erred in its reasoning to rule out the measure.

Request to meet for oral submissions

3. We understand members of the Working Group have met with a range of submitters, and in particular corporate taxpayers. Given the volume of submissions made in support of our April submission (we understand this to be more than 1,000 people) we ask to be afforded equal opportunity to meet with members of the Group.

Table of Contents

Section one: Indexing income tax thresholds to inflation or average wage growth

4. We submit that the Working Group should recommend that the Government implement inflation indexation of tax thresholds. Failing to adjust these thresholds for inflation causes an effect called 'fiscal drag' where income earners' tax burdens increase every year as they are pushed into higher tax brackets.

5. While the Working Group argues that *"[the] impact of inflation on income tax is best dealt with through periodic reviews of the thresholds"* personal income tax thresholds have not been adjusted since the 2010 Budget.

6. In our 2017 report*, Five Options for Tax Relief*,[1] we showed that the average income earner is worse off by nearly $500 per year since 2010 just as a result of failing to adjust the tax thresholds for inflation.

7. Through a combination of inflation and real wage growth, the average earner will be in the top tax bracket by 2022.

8. Fiscal drag is regressive. As middle and low income earners have their nominal incomes increase through inflation, they are pushed into higher brackets. However, those already earning above the top threshold cannot be pushed into any higher bracket. The tax system effectively 'flattens', with those on lower and middle incomes pushed into higher marginal tax brackets through time.

9. Indexing income tax thresholds to inflation would ensure households do not have their tax obligations increase year-on-year purely because of inflation. That would ensure that unless the Government chose to pass legislation to increase taxes, the average rate of income tax to households would be consistent over time.

10. While the Report argues that *"[annual] changes to rates and thresholds impose compliance costs on individuals and businesses"*, Canada's system of inflation indexation is popular. Despite an effort by the Mulroney Government in the 1980s to eliminate inflation indexation in response to fiscal pressures, indexation was returned in 2000 after a sustained campaign by the left-leaning Caledon Institute, and still exists today[2].

11. Given most businesses now use digitised payroll systems for PAYE calculations, the administrative and compliance costs of an annual change to thresholds is minimal.

12. Failing to adjust tax thresholds for inflation is equivalent to increasing the tax burden automatically every year, but without select committee hearings, coalition negotiations, public submissions, or any form of national dialogue about the merits or demerits of higher tax rates.

13. In that sense, a failure to index tax thresholds for inflation is not just an economic problem, but also represents a failure of public accountability and transparency.

14. In the Working Group's Terms of Reference, the Government outlines its objectives for the tax system. This includes an expectation that the Working Group reports whether there are "changes which would

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[1] Appended to our earlier submission.

[2] Lanigan (2015) *Fighting for taxpayers; battles fought & battles ahead*. Canadian Taxpayers' Federation La Fédération canadienne des contribuables

support the integrity of the income tax system". Allowing the tax burden to increase annually without accountability or debate is a failure of integrity for the tax system.

15. We submit that if Parliament would like to increase personal income taxes, it should pass a law to do so, rather than avoid a public discussion by building hidden tax increases into the system that are not subject to the usual legislative scrutiny.

16. The Working Group argues that the Maori Authority tax rate of 17.5 percent is a useful simplification given the tax status of most Maori Authority members. However, inflation will slowly pull Maori Authority members into higher tax brackets. Inflation-indexing our tax brackets can help to maintain the legitimacy of the Maori Authority rules.

Section two: Capital income taxation

Summary of proposed changes

18. The Tax Working Group has proposed two possible systems for changing the treatment of capital income for tax purposes.

19. The first system ("extending the net") proposes that all realised capital gains be treated as income for tax purposes.

20. This is a change from the current model which treats some realised capital gains as income for tax purposes (in cases where realising a capital gain was the intent of purchasing an asset, or where the bright line test applies).

21. The second system is a tax on equity (or "wealth tax") where a deemed percentage rate of return is applied to the value of an asset, which is then taxed at the individual's marginal tax rate.

Revenue neutrality

22. On 20 September 2018, Minister of Finance Grant Roberston wrote to Working Group Chair Sir Michael Cullen instructing the group to provide "measures that could result in a revenue-neutral package" in its final report.[3]

23. The Working Group should not only provide information related to revenue-neutral packages but should recommend a revenue neutral package, regardless of the costs and benefits of changing any individual tax.

24. Increases to any income tax rate or the rate of GST have been ruled out of scope[4]. The bulk of any increase in revenue is therefore likely to be derived from capital income taxation changes, which is equivalent to a ceteris paribus increase in capital income taxation.

25. A *ceteris paribus* increase in capital income taxation would be undesirable. New Zealand already collects a disproportionate share of revenue from capital taxation in the form of company taxation, which is the highest in the OECD as a share of GDP[5] (Chart 1).

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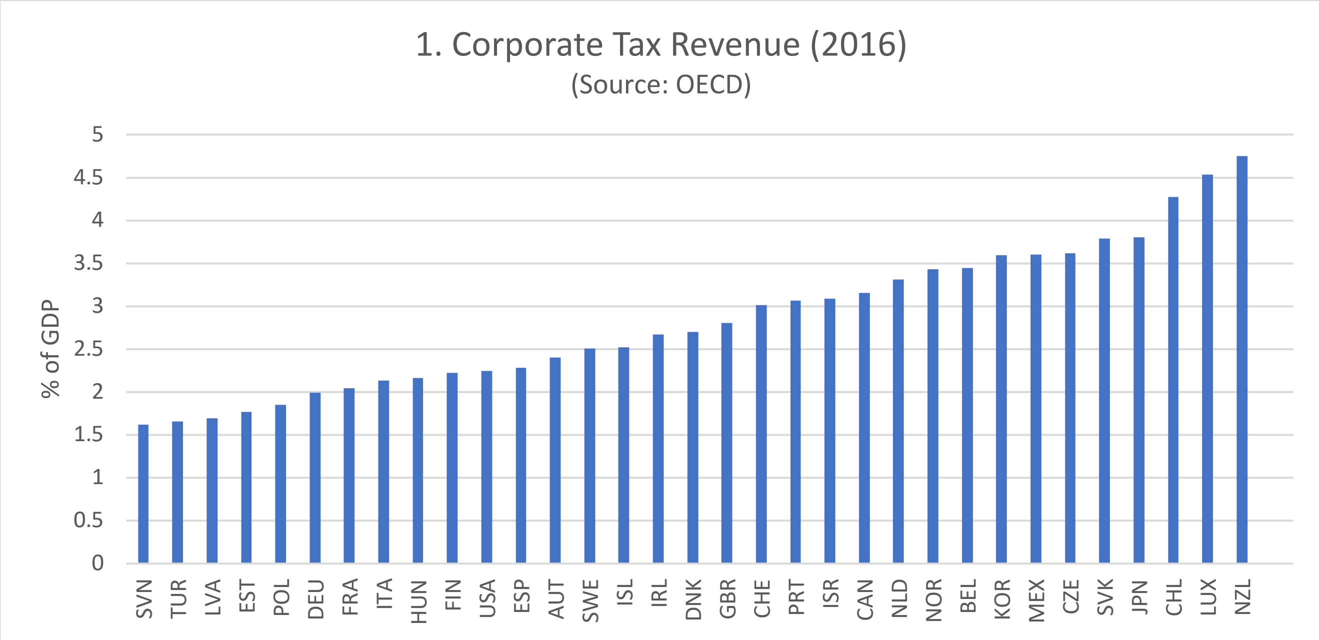
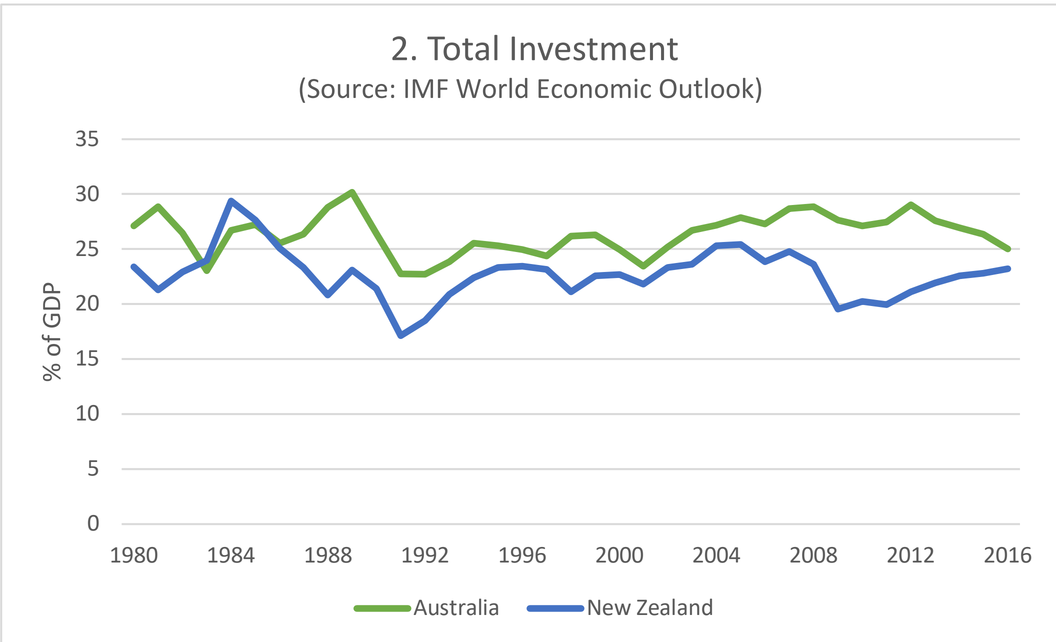
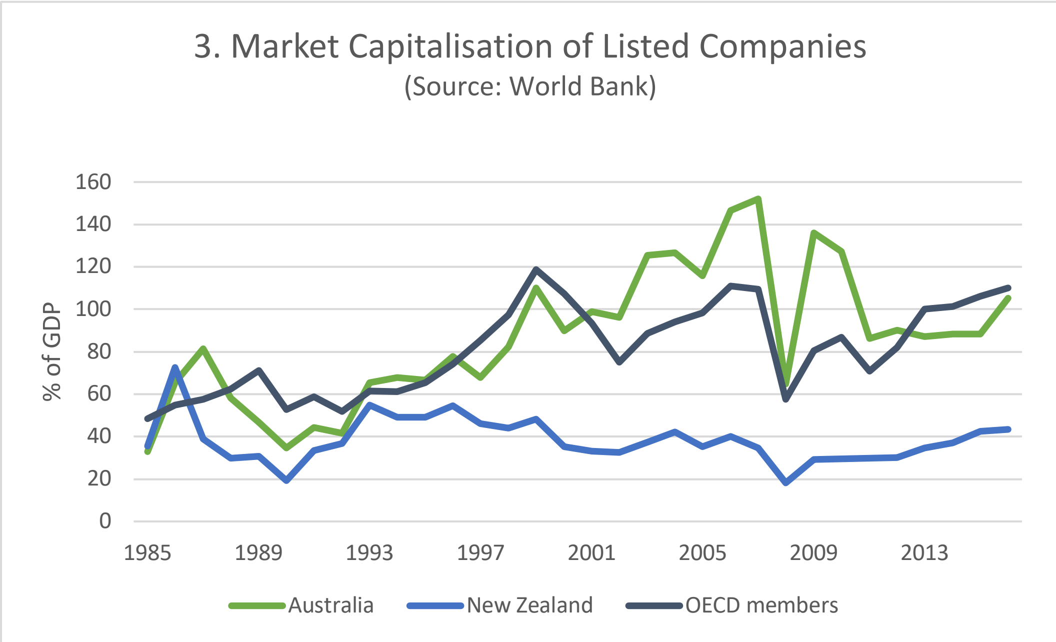
[3] Letter available at https://www.beehive.govt.nz/sites/default/files/2018-09/TWG%20letter%20final.pdf
[4] Tax Working Group Terms of Reference are available at https://taxworkinggroup.govt.nz/resources/terms-reference-tax-working-group
[5] OECD (2016) https://data.oecd.org/tax/tax-on-corporate-profits.htm

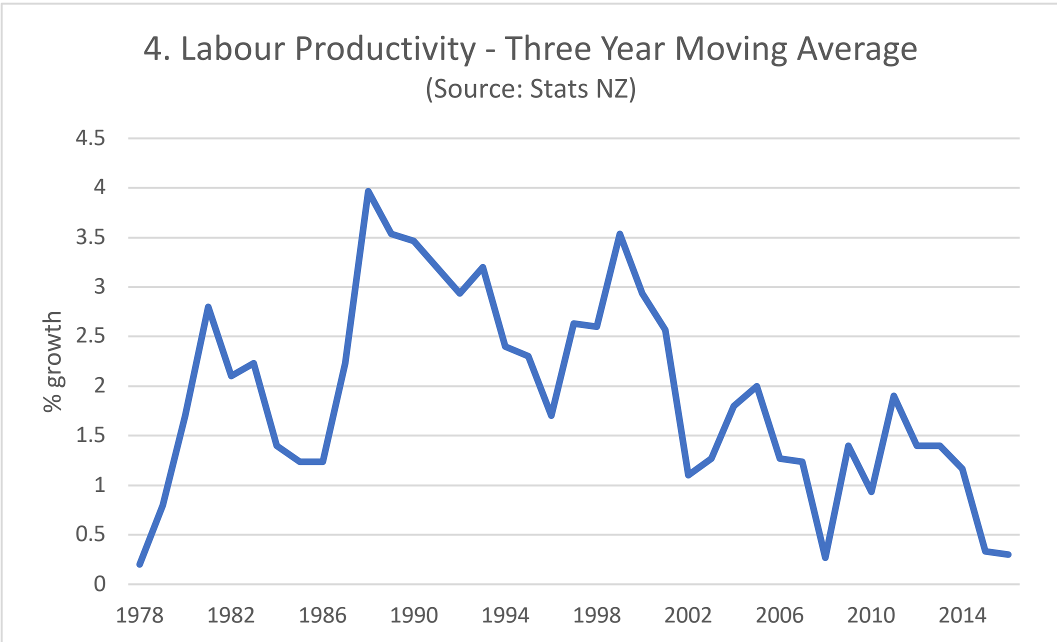


26. High capital taxation (in the form of high company taxation) may be contributing to New Zealand's low rates of capital investment (compared to Australia in Chart 2)[6], thin capital markets (compared to Australia and the OECD average in Chart 3) [7], and poor productivity performance (Chart 4 illustrated a substantial decline in the three-year moving average of labour productivity growth over the last thirty years)[8].



[6] IMF World Economic Outlook Investment Data
https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx
[7] World Bank Data https://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?view=chart
[8] Available at https://www.stats.govt.nz/information-releases/productivity-statistics-19782017





27. Capital investment is crucial to improving productivity, which in turn increases incomes.

28. To limit any increase in the burden of capital income tax on future incomes, we submit that the Working Group should ensure that its recommendation to the Government is revenue neutral, preferably by reducing taxes on savings, other forms of capital income taxation (like the headline company tax rate) personal income taxation, or by implementing full capital-expensing.

Capital investment and double taxation

29. The Working Group should acknowledge that capital gains taxes are a form of double-taxation.

30. Any capital – whether it comes from household savings or reinvested profits – has already been taxed when it was earned. Capital investment is paid for from after-tax income.

31. A capital gains tax then taxes this sum of money again as it appreciates in value through investment. A significant portion of this tax may not even represent any real increase in the value of the asset as the Working Group has chosen to not exclude inflation in its capital taxation proposals.

"Extending the net"

32. The implied rate of the proposed capital gains tax (extending the definition of taxable income to include realised capital gains) is much higher than any previous proposal.

33. Realised gains will be taxed at the individual's marginal tax rate, which for most New Zealanders with assets additional to their family home will be 33 percent. The capital gains tax rate that Labour campaigned on at the 2011[9] and 2014[10] elections was 15 percent.

34. The capital gains tax as proposed would significantly expand the definition of taxable income to include realised capital gains from a range of investments currently excluded from the bright-line rule, including shares, commercial property, private equity, and residential property held for longer than five years.

35. Residential property investment (other than the primary residence) is currently subject to a tax disadvantage (due to the bright-line test), compared to the aforementioned categories of investment.

36. The effect of extending the net of capital income taxation will be to eliminate that tax disadvantage. This will give residential property speculation its previously equal tax treatment compared to share investment and commercial property investment.

37. Investment in the primary residence (adding an extra level, renovating the kitchen and/or bathrooms, adding a double garage) will now enjoy an even greater tax advantage, as the only form of investment not subject to a capital gains tax.

38. The net effect will be that residential property investment receives a comparative improvement in its tax treatment, while commercial investment suffers.

39. This could lead to a 'mansion effect' where residential properties become larger and more opulent as a form of storing tax-free wealth, which given the Working Group's mandate to consider housing affordability, could be viewed as undesirable.

[9] https://www.interest.co.nz/property/54374/labour-run-capital-gains-tax-39-top-income-tax-rate-gst-fresh-fruit-and-vegetables
[10] https://www.radionz.co.nz/news/political/253774/q-and-a-capital-gains-tax-explained

40. Artificially increasing the size and quality of housing will be accompanied by higher prices, making it more difficult for first-home buyers to enter the market, while also increasing the share of the economy's capital stock which is tied up in owner-occupied housing.

41. Coleman has commented on this effect extensively[11], as the Working Group will be aware.

42. On net, reduced share investment and commercial property investment should be expected.

43. Capital gains taxes reduce productive capital investment in two other key ways, that were discussed at length in our initial submission (refer to paragraphs 115 to 137). In summary:

    (a) 'lock-in' effects make portfolio re-allocation more expensive by imposing transaction costs on the sale of previously successful shareholdings; and

    (b) there are a range of companies that are capital-hungry in their early stages and are not expected to pay dividends for a long time (start-ups and tech companies, for example), but attract investors on the basis of prospective capital gains. Reducing the prospective returns from high-risk, innovation-heavy companies could be undesirable for future economic growth.

Risk-free return method

44. The proposed risk-free return method ('RFRM') functions as a tax on an individual's wealth (less any wealth held in their primary residence).

45. The exact nature of the RFRM has not been determined: obtaining verifiable, accurate prices for off-market assets could be extremely difficult and costly for the Government, particularly during recessions or periods of strong asset price growth. In light of those costs, the Government may choose to only re-value off-market assets rarely, but this could cause taxpayers to pay artificially low or high amounts of tax.

46. An RFRM is theoretically desirable because it does not punish risk-taking and has none of the associated lock-in effects that come with capital gains taxes. In fact, some taxpayers may receive an effective tax cut as a result of the policy; for example, a taxpayer currently earning a taxable return greater than the risk-free rate, will receive a tax cut under the policy, such as a shareholder receiving a dividend yield of 4 percent on stocks owned will pay less tax under the RFRM system than currently.

47. However, a shareholder that receives a taxable return less than risk-free rate, will face a tax increase. This will apply most significantly to families with holiday homes or shareholders of companies that do not regularly pay dividends, and instead return value to shareholders through retained earnings and growth.

48. We submit that the administration costs associated with an RFRM capital income tax are too high to justify implementing the policy.

[11] Coleman (2017) Housing, the 'Great Income Tax 'Experiment', and the intergenerational consequences of the lease https://www.otago.ac.nz/economics/otago642975.pdf

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Full capital-expensing

49. If the Working Group chooses to intensify capital income taxation, it needs to take steps to reform other areas of the tax code in order to encourage capital investment.

50. In our earlier submission, we submitted that the Working Group should recommend a full capital-expensing regime in order to encourage firms to bring forward and intensify their expansion and investment plans (refer to paragraphs 69 to 75).

51. Full capital expensing was one of the major components of the recent United States tax reform legislation where many businesses can now fully expense some purchases of equipment and capital investment in the year of purchase.

52. The literature indicates that full expensing of capital investment encourages businesses to bring forward planned investment as a result of receiving a tax advantage with substantial evidence indicating that full expensing of capital spending encourages businesses to bring forward investment.

    (a) Ohrn[12] finds that adoption of 100 percent bonus depreciation increased investment activity by 17.5 percent, and over a five-year period, increased employment by 7.7 percent. "These results suggest that accelerated depreciation policies had and will continue to have substantial impacts on the U.S. manufacturing sector."

    (b) Maffini[13] et al. find that firms eligible for first-year depreciation allowances have an 11 percent increased rate of investment.

[12] Ohrn (2017) The Effect of Tax Incentives on U.S. Manufacturing: Evidence from State Accelerated Depreciation Policies

[13] Maffini et al. (2016) The impact of investment incentives: evidence from UK corporation tax returns

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Section three: Savings taxation

53. While savers should receive tax relief, we submit that the Working Group should broaden the scope of tax relief in its final report. The recommendations made by the working group may not have the effects that members might have envisaged.

54. The current recommendation are too narrow to induce material increases to net national savings. Approximately half of all earners have an annual income that exceeds $48,000. As of the end of June 2017, 55 percent of income earners had an annual income above $46,000[14].

55. The Taxpayers' Union agrees with the Working Group's analysis on the benefits of a higher rate of net national savings. To achieve a higher rate of net national savings, the Working Group should recommend comprehensive reform that encourages higher rates of savings for all earners, rather than fewer than one in two.

The Working Group's recommendations

56. The Working Group has recommended:

    (a) a removal of ESCT on the employer's matching contribution of three percent of salary for individuals earning up to $48,000 per year;

    (b) a reduction of the lower PIE rates for KiwiSaver funds by five percentage points each; and

    (c) that the Government consider ways to simplify PIE rates.

57. The Working Group acknowledges the benefits of higher savings rates in the Report, but offers poor advice in paragraphs 44 through 46 of the Report.

    (a) The Group claims to have "calibrated its recommendations to ensure that any changes are in areas more likely to have a net positive impact on national savings", but also acknowledges that "low- and middle- income earners face income constraints in their ability to take advantage of tax concessions for saving."

    (b) If low- and middle- income earners face income constraints, the rational behaviour from these groups in the presence of favourable tax treatment for retirement savings could be to:

        (i) reduce their rate of savings such that their future total retirement savings is equivalent to their future total prior to the introduction of favourable tax treatment, which allows for additional consumption prior to retirement; or

        (ii) to maintain existing savings rates and take advantage of the additional future total retirement savings, while maintaining their rate of consumption under the old regime.

58. For example, suppose an individual begins working at age 25 and earns $47,999 per year, until they retire at age 65 (i.e. for 40 years) and suppose they currently contribute four percent of their gross income towards their KiwiSaver, their employer contributes three percent and they earn a 6.5 percent

[14] Stats NZ Household Economic Survey Year ended June 2017 available at http://archive.stats.govt.nz/browse_for_stats/people_and_communities/Households/HouseholdEconomicSurvey_HOTPYeJun17.aspx

average annual return[15], which is taxed at their PIR rate of 17.5 percent. The employer contribution is also subject to ESCT and is taxed at 17.5 percent. They also receive the annual tax credit of $521.43.

(a) After forty years of savings, this individual will have accumulated $535,815 in retirement savings.

(b) In a world where the rules change as recommended by the Working Group (eliminating the ESCT for people earning less than $48,000, and reducing the lower PIR by five percentage points each), this individual instead accumulates savings equal to $617,920

(c) However, the individual could also choose to reduce their contribution rate from four percent to three percent, with the effect of reducing their retirement savings to $540,680 – still higher than their total future retirement savings under the old rules, but with a lower savings rate.

(d) It would not be surprising if a low income individual chose to keep an additional $479.99 per year in income if they could maintain their future level of retirement savings. An additional nearly $500 per year in income-in-the-hand could make a significant difference at Christmas, or to have available to spend on car repairs, or emergency medical costs, like a child's urgent doctor visit.

(e) Those are not bad outcomes, but they also do not meet the goals espoused by the Working Group.

59. We submit that the Working Group needs to consider more carefully whether changing the tax treatment of KiwiSaver accounts for low and middle households would achieve the higher savings rates they argue it would.

60. If, as the Working Group argues, the goal of retirement savings taxation policy is to encourage higher pools of retirement savings among low income earners and to lift the net national savings rate, this policy does not necessarily achieve either.

61. There is some evidence in the literature for these effects.

(a) Corneo et al. (2011) find substantial evidence that savings subsidies in the form of "special allowances and tax exemptions" known as the 'Riester scheme' had almost no impact on savings rates in Germany. The authors note:

(i) "Even though we apply a wide range of methods and specifications, we come to the unambiguous conclusion that in Germany household saving hardly responded to the introduction of that saving incentive program. Participation in the Riester scheme seems to largely substitute for other forms of saving."

(b) Coleman (2014)[16] argues more generally that Kiwisaver has not been effective in lifting retirement savings levels. This result is robust to age, gender, income, education, wealth, partner-status, and home ownership status.

62. More generally, if low savings rates (and small pools of savings) are linked to income levels, the tax system should be designed to encourage income growth, rather than making potentially ineffective transfer payments to low-income households in order to induce saving.

[15] Compounded monthly.
[16] Coleman (2014) KiwiSaver and the Accumulation of Net Wealth, New Zealand Treasury Working Paper 14/22

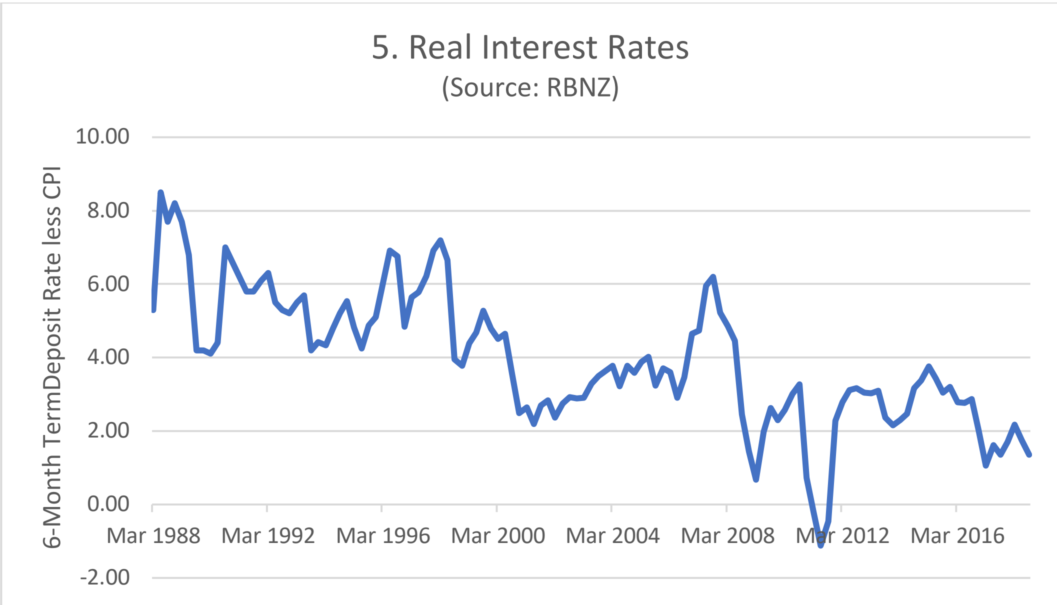
63. In paragraph 52 of the Report, the Working Group expresses concern that significantly changing the tax and transfer treatment of KiwiSaver could simply encourage high-earners to transfer savings held in other schemes and accounts into KiwiSaver in order to reduce tax liabilities on their retirement savings.

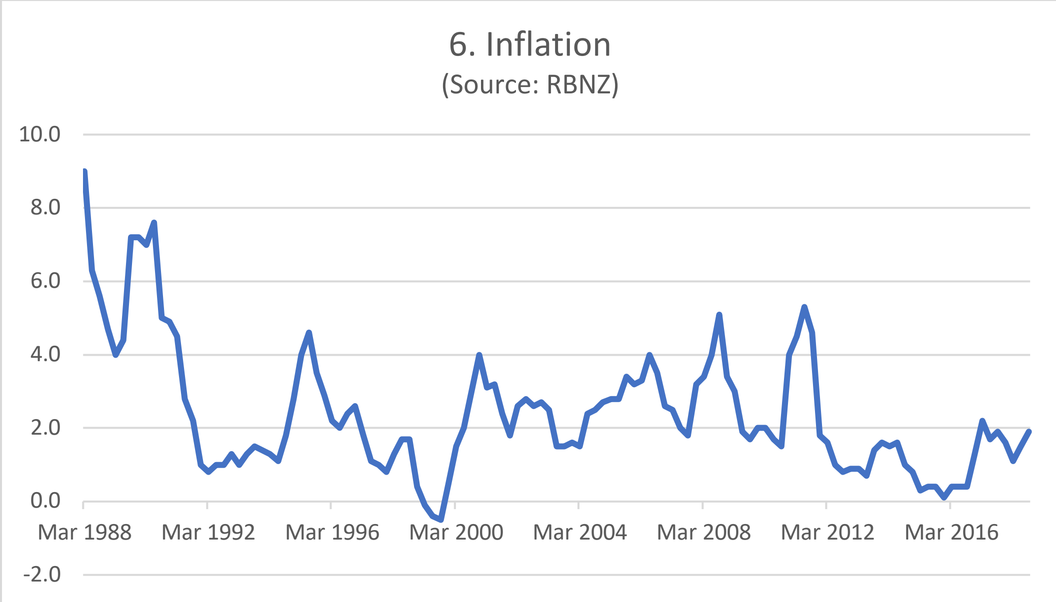
Our recommendation

64. We submit that the Working Group should recommend that the Government exempt the inflation component of interest income from income tax.

65. While the Working Group has largely argued that the low rate of inflation has only a small distortionary impact on tax effects, even when inflation is low it can have a significant distortionary effect on effective tax rates applied to interest income.

66. Real interest rates have trended downwards over the last 20 to 25 years (Chart 5), while inflation has (but for the last five years) stayed mostly between 1 and 4 percent (Chart 6).





67. If real interest rates continue to stay low, even low levels of inflation will make up a significant share of nominal interest income on savings, so taxing the inflation component of interest income will still be significantly distortionary.

68. For example, while the real interest rate on a six-month term deposit before tax is 1.35 percent in the September 2018 quarter[17], when you apply the statutory rate of 33 percent the after tax real interest rate is 0.3 percent: equivalent to a 77.8 percent marginal tax rate on interest income.

69. This functions as a punitive tax specifically for individuals who choose to put their savings in low-risk, low-return investments where inflation comprises a greater share of their nominal return, which is unfair: the tax system should be neutral with regards to the risk appetite of the investor.

70. Removing the inflation component from savings would ensure that savers only ever pay the statutory rate of tax on their real interest income.

71. Inflation-proofing the tax status of interest income would need to be matched by changing how borrowers can deduct interest payments from their taxable income. The obvious solution would be to only allow borrowers to deduct the real interest payment from their taxable income.

72. We submit that the Working Group should recommend that the Government remove income tax on the inflation component of interest income.

[17] Data obtained from https://www.rbnz.govt.nz/statistics

Section four: Environmental taxes

Summary

73. The Working Group is interested in using the tax system to achieve environmental goals. Specifically, increasing the waste disposal levy and 'strengthening' the emissions trading scheme is suggested.

74. We submit that the Working Group should not recommend an increase in the waste disposal levy and should recommend that policy makers develop an objective framework for assessing the trade-offs between economic growth and global emissions inherent to climate policy before strengthening existing regimes.

Waste disposal levy

75. The Taxpayers' Union is opposed to an increase in the waste disposal levy. Putting to one side the very poor quality of grant decision making relating to the Waste Minimisation Fund, evidence used to justify an increase in the waste levy is not sufficient.

76. The Eunomia report[18] which the Working Group references (and mentions that it has not assessed) should not be used to justify an increase in the waste disposal levy. The authors fail to take into account any opportunity costs associated with imposing a higher waste levy on households and then argue that the waste disposal levy creates employment by encouraging growth in the recycling industry.

77. This is equivalent to arguing that a carbon tax will create jobs in the economy by encouraging growth in low-carbon industries, without taking into account the effect of the tax on household budgets and other industries.

78. There might still be a possible justification for an increase in the waste disposal levy, but this will require an honest appraisal of the economic effects, rather than ignoring the costs to households.

79. In paragraph 81, the Working Group argues that even if the waste levy internalises any externalities that come from waste disposal, "higher rates might also be needed to achieve behaviour change." This is a poor argument. The reason for suboptimal market behaviour is the presence of an externality, but if this is corrected for, there no longer exists a problem that needs to be solved. The purpose of tax is to solve for specific market failures, not to discourage certain market outcomes people subjectively dislike.

80. We submit that the Working Group should remove the hypothecated status of the waste disposal levy. Hypothecating revenue from the waste disposal levy for the waste minimisation fund ('WMF') means projects funded under the WMF do not have to meet as high a standard as projects funded through general taxation.

Strengthening the emissions trading scheme

81. Climate policy requires a trade-off between economic growth and reductions in emissions, with the aim of reducing global emissions in order to prevent rapid climate change.

[18] Eunomia (2017) The New Zealand Waste Disposal Levy

82. When determining climate policy, policy makers need to be tightly focussed on this trade off. NZIER's cost estimate of adopting a net-zero policy for emissions ranges between 10 and 22 percent of GDP in 2050[19].

83. NZIER notes in its report: *"Our modelling suggests the households that are in the lowest 20 per cent bracket for income may be more than twice as affected, on a relative basis, than those households with an average income."*

84. Given the potentially devastating economic consequences to the most vulnerable New Zealanders of adopting stronger climate policy, any change in policy needs to be able to demonstrate genuine and significant reductions in global emissions.

85. This analysis needs to include estimates of 'emissions leakage'[20] in response to domestic policy changes in order to ensure that New Zealanders are not suffering from lower incomes and higher prices in exchange for only negligible improvements in climate outcomes.

86. We submit that policy makers should develop an objective framework to assess climate policies against, which includes the size of any costs to New Zealanders by failing to take a strong stance on climate change. New Zealand only contributes 0.17 percent of total global emissions so domestic action will probably be of no consequence for global outcomes.

[19] NZIER (2018) Economic impact analysis of 2050 emissions targets https://nzier.org.nz/publication/key-results-from-economic-modelling-of-2050-emissions-targets

[20] Emissions leakage refers to the phenomenon where, in response to additional taxes and production levies, industry relocates to jurisdictions with weaker climate policy regimes. This effect can significantly weaken any reduction in global emissions which waters down any effect of domestic policy on climate outcomes.

Section five: Behavioural taxes

87. As argued in our initial submission, the Working Group is correct to recommend no more increases in tobacco excise. Large hikes in tobacco excise have failed to achieve large reductions in smoking prevalence and have been accompanied by significant social and financial harm to vulnerable communities.

88. We have commented more extensively on this topic in our recent report – *Up in Smoke: the social cost of tobacco excise* – launched on 1 January 2018 to coincide with the annual increase in tobacco excise.[21]

89. While the Working Group is correct to point out that the current alcohol excise regime is a mess, simplification should be treated as an opportunity to increase excise levels across the board.

90. The Working Group should not recommend a sugar tax. Sugar taxes are regressive and their behavioural effects have often been over-stated in the literature, compared to results in real world markets where they have been tried.

Tobacco excise

91. The Working Group is correct to be concerned about increases in tobacco excise. Large increases to tobacco excise have been accompanied by increases in crime and financial damage to the budgets of low-income families. Tobacco excise increases are also becoming less effective in encouraging people to quit smoking.

92. The Working Group is also correct to note that the Government should look at other measures to help people quit smoking.

93. Consistent with the Government's intent to adopt risk-proportionate regulation for all tobacco products, including smokeless tobacco and vaping products[22], we submit that the Working Group should recommend that the Government adopt a consistent risk-proportionate approach to tobacco excise, where low risk non-combustible tobacco products receive a lower rate of tax than cigarettes.

94. In response to the global drive to reduce smoking rates, there has been significant innovation to develop alternative products that deliver nicotine to users without combustion, where most if not all of the harm of smoking could be avoided.[23]

95. Vaping products, for example, have been shown by Public Health England to cause 95 percent less harm than smoked tobacco[24], with 0.5 percent of the cancer risk associated with cigarettes. Similarly, heated tobacco or 'heat-not-burn' products have been estimated to be around 90 percent less harmful than cigarettes[25] and contributed to significant declines in smoking rates on other jurisdictions. Snus (which is a form of packaged salted tobacco stored under the lip to release nicotine) has been shown to be

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[21] *Up in Smoke* is available online at https://www.taxpayers.org.nz/up_in_smoke

[22] Refer to Ministry of Health, Vaping and smokeless tobacco (updated 12 September 2018), https://www.health.govt.nz/our-work/preventative-health-wellness/tobacco-control/vaping-smokeless-including-heated-tobacco

[23] UK Royal College of Physicians, Nicotine without smoke, 1 April 2016, https://www.rcplondon.ac.uk/file/3563/download?token=Mu0K_ZR0

[24] https://www.gov.uk/government/news/e-cigarettes-around-95-less-harmful-than-tobacco-estimates-landmark-review

[25] UK House of Commons Science and Technology Committee, E-Cigarettes, Seventh Report of Session 2017–19 [para 90] https://publications.parliament.uk/pa/cm201719/cmselect/cmsctech/505/505.pdf

effective in reducing smoking rates among men in Sweden[26]. Evidence indicates snus has reduced health risks compared to tobacco.

96. The purpose of excise is to improve health outcomes by reducing smoking rates. The Government should improve health outcomes by changing the tax treatment of reduced harm products.

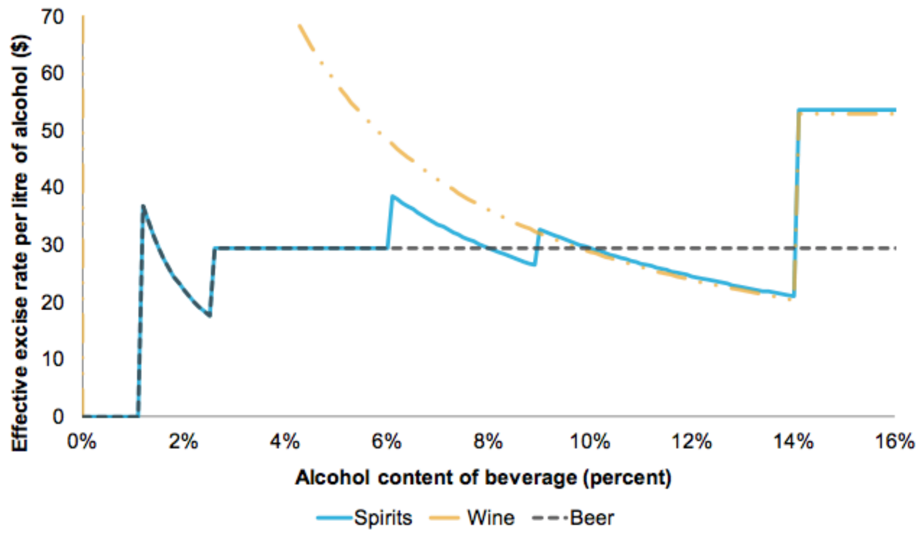
97. Lower rates of excise on low risk products will encourage smokers to transfer to less harmful nicotine delivery systems, encourage producers to innovate less harmful alternatives to cigarettes, reduce smoking rates and support public health objectives.

98. In summary, we support a modernised tobacco excise tax regime — based on the principle that excise tax is set at rates commiserate to the relative harm of the various alternate nicotine delivery technologies — to incentivise Kiwi smokers to shift to less harmful products as it is both fair and the most effective way for New Zealand to achieve its Smoke Free 2025 objective.

Alcohol excise

99. The current alcohol excise regime is a mess. Excise regimes should be linked to the harm of the product, which for alcohol, is the quantity of alcohol in beverage. Applying different rates of excise for both the percentage alcohol and type of the beverage unfairly favours some products over others.

Figure 10.1: Effective rate of excise per litre of alcohol, (2018)



Source: The Treasury

[26] Foulds et al (2003) Effect of smokeless tobacco (snus) on smoking and public health in Sweden

100. Wine, for example, faces a lower effective rate of excise than beer when the percentage alcohol of the wine exceeds 10 percent and the percentage alcohol of the beer is less than 14 percent.

101. Given that the vast majority of wine is stronger than 10 percent alcohol, and the vast majority of beer is weaker than 14 percent alcohol, this gives wine producers an unfair tax advantage.

102. Perhaps perversely, this tax advantage grows as wine gets close to, but does not exceed, 14 percent alcohol.

103. The Working Group should recommend a unified excise regime that applies to beer, wine, and spirits identically.

104. However this should not be treated as an opportunity to simply increase alcohol excise across the board.

105. The well-publicised[27] BERL paper which attempted to estimate the social cost of tobacco has been regularly criticised[28][29] for over-estimating the costs of drinking.

106. While the Working Group suggests alcohol excise could be regressive (high-income households spend more on alcohol than low-income households) this misses that because alcohol excise is volumetric, excise makes up a greater share of low-price alcohol, and therefore a greater share of a low-income household's budget.

Sugar taxation

107. The Working Group correctly highlights that a major risk with sugar taxes is the propensity for consumers to switch to cheaper or untaxed products.

108. The literature often fails to account for intra-product-category quality substitution[30][31] (consumers shifting to lower quality equivalents in the presence of a tax) which leads to substantially over-estimated price elasticities (and health benefits).

109. Wang (2016)[32] also shows that the presence of storability can lead to an over-estimation of price elasticities for sugar taxes.

110. An across the board sugar tax (as opposed to just a tax on sugar-sweetened beverages) will suffer from exactly the same concerns, even if there might be a reduced rate of inter-product group substitution.

111. Failure to achieve improved health benefits is likely to be accompanied by regressive financial effects on low-income families.[33]

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[27] https://www.stuff.co.nz/national/health/106343048/alcohol-harm-more-than-triple-the-cost-of-all-treaty-claims-so-far--economist
[28] https://nzinitiative.org.nz/reports-and-media/opinion/the-alcohol-cost-zombie-has-returned/
[29] https://lancewiggs.com/2009/07/03/fix-the-berl-report-on-alcohol-and-drugs/
[30] Gibson and Romeo (2017) *Fiscal Food Policies are Likely Misinformed by Biased Price Elasticities from Household Surveys: Evidence from Melanesia*
[31] Gibson and Kim (2017) The Price Elasticity of Quantity, and of Quality, for Tobacco Products
[32] Wang et al. (2016) Heterogenous Behaviour, Obesity, And Storability in the Demand for Soft Drinks
[33] Backholer et al. (2016) *The impact of a tax on sugar-sweetened beverages according to socio-economic position: a systematic review of the evidence*

Thank you for the opportunity to submit.

Yours sincerely
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