



Submission

**Submission to the Tax Working Group
on the Interim Report on the Future of Tax
November 2018**

About the McGuinness Institute

The McGuinness Institute was founded in 2004 as a non-partisan think tank working towards a sustainable future for New Zealand. The Institute's flagship project, *Project 2058*, focuses on New Zealand's long-term future. As a result of our observation that foresight drives strategy, strategy requires reporting, and reporting shapes foresight, we developed three interlinking policy projects: *ForesightNZ*, *StrategyNZ* and *ReportingNZ*. Each of these tools must align if we want New Zealand to develop durable, robust and forward-looking public policy. The policy projects frame and feed into our research projects, which address a range of significant issues facing New Zealand.

In preparing this submission, the Institute has drawn largely on our policy projects *ReportingNZ*.

About the author: Wendy McGuinness

Wendy McGuinness wrote the report *Implementation of Accrual Accounting in Government Departments* for the New Zealand Treasury in 1988. She founded McGuinness & Associates, a consultancy firm providing services to the public sector during the transition from cash to accrual accounting from 1988 to 1990. Between 1990 and 2003, she continued consulting part-time while raising children. Over that time she undertook risk management work for the public good. In 2002 she was a member of the New Zealand Institute of Chartered Accountants (NZICA) Taskforce, which published the *Report of the Taskforce on Sustainable Development Reporting*. From 2003–2004 she was Chair of the NZICA Sustainable Development Reporting Committee. In 2004 Wendy established the McGuinness Institute in order to contribute to a more integrated discussion on New Zealand's long-term future. In 2009 she became a Fellow Chartered Accountant (FCA).

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To whom it may concern,

Submission on *Future of Tax: Interim Report*

The McGuinness Institute welcomes the opportunity to respond *Future of Tax: Interim Report* by the Tax Working Group. In this submission we build on our earlier submission, focusing on the natural capital section.

Wendy McGuinness, CEO of the McGuinness Institute, attended the Tax Working Group interim report discussion at Treasury on Section 8: Environmental and ecological outcomes of the interim report. This submission is informed by both the content of *Future of Tax: Interim Report* and conversations at that discussion.

In this submission, we:

1. Agree with the thinking underlying the following statements on pp.4–5 and p. 5 respectively:

The Group is currently working with stakeholders to develop a framework to support the future evolution of the tax system that reflects principles from Te Ao Māori, alongside the four capitals of the Living Standards Framework and the principles of tax policy design. This includes exploring concepts of waiora (wellbeing), manaakitanga (care and respect), kaitiakitanga (stewardship), whanaungatanga (relationships and connectedness), and ūhangā (prosperity).

The treatment of natural capital.

New Zealand makes relatively little use of environmental taxation. There are clear opportunities to increase environmental taxation, both to broaden the revenue base, and to help address the significant environmental challenges we face as a nation.

These statements align with the concept of the four capitals that form part of the wellbeing conversation and the 2019 Wellbeing Budget.

2. Agree strongly with paragraph 45 on p. 27:

Given the non-substitutable nature of natural capital, the declining state of New Zealand's environment, and the increasing fiscal costs of mitigation and adaptation, the Group sees a case to broaden the base of the tax system and make greater use of environmental taxation.

3. Agree with the three main ways listed in ‘which the tax system supports the wellbeing of New Zealanders’ (see them excerpted below) on p. 11. However, we also consider the second point needs to be extended to include inter-, as well as intra-generational equity:

- **A fair and efficient source of revenue.** Taxes provide revenue for the Government to fund the public goods and services that underpin our living standards. The tax system thus represents a way in which citizens come together to channel resources for the collective good of society.
- **A means of redistribution.** Taxes fund the redistribution that allows all New Zealanders, regardless of their market income, to participate fully in society. While much of this redistribution occurs through the transfer system, the progressive nature of the income tax means that the tax system also plays a role in reducing inequality.

- **A policy instrument to influence behaviours.** Taxes can also be used as an instrument to achieve specific policy goals by influencing behaviour. Taxes influence behaviour by changing the price of goods, services, or activities; taxes can discourage certain activities, and favour others. In this way, taxes can complement – or even replace – traditional policy tools such as regulation and spending, depending on which approach reflects the most effective way to achieve society's goals. This may be particularly important in the environmental sphere.

4. Were therefore disappointed this language and method of analysis and systems thinking was not evidenced in the discussion in section 8. We suggest, for example, the title of *Section 8: Environmental and ecological outcomes* should read *Section 8: Natural capital taxes and credits* (or similar).
5. Would be keen for Section 8 of the report to answer the following question: Why should natural capital be taxed? This question is explored below. Clearly we support this concept, but if the answer to this question cannot be linked to the more general purpose of the tax system (in paragraph 2 above), an opportunity to design a durable, fair and cost-effective tax system may be missed.
6. Suggest the following question be answered in the final report: Why should natural capital be taxed? In our view, there are at least three reasons why:
 - a. To collect revenue (for the Crown purse). This implied in the first bullet point of paragraph 3 above.
 - b. To minimise use or contamination of our natural capital today. This implied in the second bullet point of paragraph 3 above.

Note 1: The two concepts ‘to use’ and ‘to pollute’ could become two separate purposes, as the policy solutions might prove to be very different. For example to use water is arguably not as detrimental as to pollute water.

Note 2: If New Zealand does choose to use or contaminate its natural capital, this must be done in an informed and considered manner. For example are we trading off the loss of natural capital with a gain in social, human and/or financial capital (e.g. coal mining on the West Coast) or are we trading a loss of natural capital to create a gain in natural capital (e.g. using money from fish and game licences to improve the environment)?
- c. To protect the environment for current and future generations. This is implied in the second bullet point of paragraph 3 above, but is not clearly stated – hence our recommendation that inter-generational equity should also be considered.
7. Suggest that in the final report, Section 8 should be more strongly worded, linking the purpose of taxing natural capital with the overarching purpose of New Zealand’s tax system.
8. Agree that the five draft design principles for taxing negative environmental externalities (listed on p. 63 in the *Interim Report*) is useful, but we question whether they are principles and whether they are complete. The principles are as follows:
 - Māori rights and interests;
 - Distributional impacts;
 - The price of the tax should reflect the full cost of externalities;
 - The price should vary locally where there is local variation in impacts; and

- International linkages should be considered.
9. Note that, in our view, ‘purpose’ describes a sense of resolve or determination to achieve something, this could be in the form of an overarching goal or statement of intent. ‘Principles’, in contrast, describe the guiding thoughts or beliefs that will shape decisions and ultimately the behaviour of players while on the journey towards achieving the purpose.
10. Note that the principles (reproduced in paragraph 8 above) are not what we would call principles.
11. Suggest that, in contrast to those listed in paragraph 8 above, the guiding principles could include:
- Consideration of the Treaty and the Treaty principles;
 - Fairness (e.g. in terms of geography/location, ethnicity and inter and intra-generational fairness);
 - A polluters pays principle (i.e. if you pollute, you pay e.g. phosphate leakage from agriculture);
 - Users pay (i.e. you use a public resource, you pay e.g. a water tax);
 - The precautionary principle (i.e. when uncertainty exists, an action is assumed to be damaging);
 - Durability (i.e. lasts the test of time and is responsive to changes in needs, e.g. climate change);
 - Cost effectiveness. For example scale is important. Designing a cost effective tax system would include an understanding of the cost of collecting taxes, that some taxes may not be worth collecting and that if taxes are put in place, they are regulated, penalties are charged and penalties are collected;
 - Transparency (i.e. open and transparent); and
 - Accountability (i.e. both in terms of penalties and regulation)
12. Suggest that, given the principles in paragraph 10, New Zealand should tax individuals or entities that pollute or consume natural capital and consider ways to reward those that ‘add to’ or ‘clean up’ our natural capital. This approach means New Zealand would design a tax system not just for the poorly behaved or disobedient but also for those that provide value by protecting or enhancing the country’s natural capital.
13. Agree broadly with paragraph 17 on p. 61:

Taxation is not necessarily the best tool to change behaviour. Sometimes, it may be more effective or efficient for the Government to consider regulation or spending; in other cases, taxation may be complementary. As has been stressed by public submitters, tax should not be considered in isolation when dealing with the environment; instead, the merits of tax as a policy instrument should be assessed together with the merits of other tools and approaches.

14. Suggest tax collected from natural capital could be ring-fenced so that the revenue received from this tax is funnelled back into efforts to protect and regulate natural capital. In this sense, the purpose of the tax is fulfilled, in that the revenue collected is used to protect the capital that generated it.
15. Suggest a pro rata penalty system be developed in New Zealand where points are given a dollar value, and the penalty is paid based on the points allocated for the penalty. This would stop penalties being out of alignment with each other.

16. Agree with the reference to the United Nations Sustainable Development Goals (SDG) on p. 61 of the *Interim Report* as a metric by which New Zealand's progress can be assessed:

In the environmental sphere, the goals set targets for clean water (SDG6), climate action (SDG13), life below water (SDG14), and life on land (SDG15). The Sustainable Development Goals provide one blueprint for defining and measuring a just transition over time.

However, it is important to note that any steward of the tax system should be able to measure how these goals are progressing. Our concerns with the SDG are that there are too many goals and *Goal 8: Decent work and economic growth* has a pre-existing tension and is really two goals.

17. Agree with statement on p. 62 (below), but consider the report should go further. The tax system should be designed to collect revenue to manage the additional risks of climate change (which will largely fall on government) but also to change behaviour and deliver a mix of taxes and tax credits, that together, can propel New Zealand towards a zero-carbon economy by 2050:

Greenhouse gases could be a significant source of revenue over the medium term.

18. We wonder if there are tools that can be used to measure the following: "This means abatement of emissions is likely to be achieved at a lower cost by using taxation than by mandating particular actions through regulation. There is also evidence that putting a price on greenhouse gas externalities drives innovation in abatement (Dechezlepretre, Martin & Bassi 2016).
19. Note, the Institute has a particular interest in climate change reporting in the public and private sectors. To this end, we have produced reports on climate change reporting with a view to collecting key information, which could in turn help develop a tax and credit system to help transition New Zealand to a zero carbon economy by 2050.

Key documents include:

Think Piece 30 – Package of Climate Change Reporting Recommendations (October 2018)

Working Paper 2018/03 – Analysis of Climate Change Reporting in the Public and Private Sectors (July 2018)

20. Note that the language and terms used are important considerations. For example, a plantation is not a forest and a forest is not a plantation. A forest is a complex ecosystem that meets the needs of a wide range of flora and fauna, whereas a plantation is about growing plants for the sole use of humans. Creating plantations to replace a forest to alleviate climate change does not make sense. Creating a plantation on bare land to create product that can be used as an alternative to plastic and metals does make sense. Creating a tax system to support environmental management will require a deep understanding of the goals and the processes necessary to maintain and ideally increase our natural capital.
21. Note we do not underestimate the challenges of developing a tax framework for natural capital. We agree on the 'why', but moving from 'why' to 'how' will be challenging. Table 1 overleaf illustrates how the TWG might explain the type of change they want to bring about.

22. Note that we consider more work needs to be undertaken in order to explore the best purpose, principles and processes for taxing natural capital. Above we have made a few suggestions, but we think the biggest value is in making the final report very clear in terms of what you see as driving the existing system and how that might change if New Zealand moves to a different purpose and set of principles. Table 1 below is a very initial attempt at illustrating what we envisage might be useful when preparing your final report.

23. Thank you for the opportunity to provide feedback on the *Future of Tax: Interim Report*.

Table 1: Purpose and Principles (existing and new) – to be completed by the TWG

Purpose and principles driving the existing system [TWG to expand]	How to move from the existing system to the new system (examples) [TWG to expand]	Purpose and principles driving the new system [TWG to expand]
Purpose (why): Simple, transparent easy to understand and regulate	<i>Change:</i> By giving more power to regulators to enforce taxation rules and increase penalties	Purpose (why): Simple, transparent easy to understand, regulate and enforce .
Goal 1 Collects revenue for the crown purse	<i>Change:</i> By ensuring revenue collection is equity focused and admin system costs are minimal	Goal 1 A fair and efficient source of revenue.
Goal 2 [NB: We are unsure what other goals are driving the design of the existing tax system]	<i>Change:</i> For example: [to be inserted by the TWG]	Goal 2 A means of redistribution.
Goal 3 (etc) [NB: We are unsure what other goals are driving the design of the existing tax system]	<i>Change:</i> For example: By ring-fencing tax revenue from environmental taxes to be used solely to stimulate business operations that are environmentally-positive.	Goal 3 A policy instrument to influence behaviours.
Time frame Primarily short-term focus	<i>Change:</i> Preparing 40-year budgets	Time frame Primarily long-term focus.
Design Analytical approach. How each part works. Each part is assessed and managed in isolation.	<i>Change:</i> Wellbeing focus	Design Systems approach. How each part fits within the wider ecosystem.