Submission to “The National Commission of Audit”

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Dr Patrick Caragata (former New Zealand IRD Chief policy advisor) working with a team of economists, while in the employ of the I.R.D. came to an interesting conclusion with regard to taxation. They theorized that there is an optimum tax rate (common sense really). If taxes are below the optimum, increasing taxes increases Government revenue. However, if the tax rate is above that optimum, increasing taxes reduces Government revenue. The Caragata study concluded that (for N.Z.) cutting tax by 1% would result in more than 1% economic growth. Also the study concluded that the growth maximizing rate would be between 16 and 25 %. The reasons are simply as listed below.

New businesses will prefer the lower tax environment overseas.

Investors will follow their money overseas.

Entrepreneurs have less to re-invest into their businesses.

High taxes result in less consumption expenditure.

The Caragata study assessed New Zealand's tax rate as being well above the optimum.

The Caragata study also concluded that reducing taxes by 1%

would increase our growth rate by more then 1%.

The report was ignored. Incredibly Australia has never done a similar study. It is just common sense that increasing taxes above a certain level will suppress the private sector and reduce the tax base.

People have voted for high taxes in order to get more health and education funding. The reality is that higher taxes can, and have, reduced the tax base leaving even less for these services.

The post WW2 period through till now will be remembered as the era of big Government. The following statistics apply to New Zealand although Australia will be similar. In the 1920's Government took 12 % of GDP in taxes. In the 1930's the % had increased to 16%. In the 1940's through till the 1960's the tax take was 25%. It was 27% in the 1970's. In the 1980's it increased to 31%. In the 1990's it rose to 35%. This has been the trend throughout the Western World, is there any surprise that our economies are stagnant?

Income tax has become excessively complex requiring an army of accountants to book keep for individuals and business. We have various exemptions and a graduated tax scale because Governments have confused the roles of revenue gathering and social security. There is an army of tax and estate planners arranging individuals and business affairs in order to minimize their tax burden. The compliance costs of tax accounting (including paye ) is high for small business (for N.Z. 2.4% of GDP – p40, Closing the Gaps, ACT N.Z. Parliamentary Office, 2001). Income tax is not a level playing field. An example, why should an employee not be able to claim travel getting to work and other expenses associated with his work when a person doing exactly the same job, but as a contractor, is able to? Under the tax rules different industries are treated differently as a result of political interference. Prime agricultural land, for example, may not be used for highest and best use due to tax concessions for forestry. Our tax legislation has evolved in a hotch potch manner over a long period of time to satisfy the whims of various politicians. Incredible as it sounds the whole lot needs to be dumped for a simple broad based system that creates a level playing field.

Sir Roger Douglas, a former finance minister of New Zealand, proposed completely replacing income tax in his book "Unfinished Business" (Sir Roger has received the prestigious Swedish Hayek medal for services to economics). By introducing compulsory health insurance (subsidized for low income people), education accounts for education (reduced as income levels rise) and efficient small Government, then a small GST increase, plus making GST exemption free would enable for the complete removal of income tax and other distorting taxes such as stamp duties, gift and death duties, land tax and tariffs. Income reporting would still need to be a requirement to allow for social security assistance. GST should have been an exemption free broad based replacement tax, not an additional tax. GST is a tax on consumption rather than production, it changes the emphasis. Income tax has passed it's use by date, it can be leapfrogged by GST. Income reporting would still be needed, subsidizing education and health for low income people helps compensate for the fact that GST is not a graduated tax. However things need to be as transparent and simple as possible, we do not want another estate planning industry developing in order to maximize subsidies.

Finally with regard to tax, I believe that the Government should not be placing itself above individual citizens as if it has some exalted status. Government is there to serve us, by the people, of the people, for the people. For this reason when tax liability is in dispute, the burden of proof should be with the tax department. If a private sector service provider has a dispute with a debtor, they need to take that debtor to court and prove liability. The Government is a glorified service provider with more resources than individuals. In liability cases involving the tax office the same rules should apply. Also in cases of bankruptcy, small sub-contractors, often good viable businesses, can be put at risk as a result of moneys owed by a firm going into bankruptcy. The tax office places itself ahead of unsecured creditors when the residue is being dished out. I believe the tax office should, in the case of bankruptcies, pay out GST owed on outstanding expenses, but line up on an equal footing with unsecured creditors, for GST receipts on current sales. These changes would be a first step in recognizing that the state exists for its citizens, citizens are not here for the state.

Regards

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