

EXPLORATIONS OF STRUCTURE AND CHOICE IN TAXING CAPITAL GAINS IN NEW ZEALAND: A QUANTITATIVE AND QUALITATIVE INQUIRY

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The focus of this paper is to explore tax experts' professional opinions about taxation of capital gains in New Zealand. It attempts to explain the current phenomenon, i.e. the lack of a capital gains tax (CGT) in New Zealand by investigating theory and actual practice. It utilized an alternative approach to analyse the relationship between tax experts' perception of a CGT and their choices in tax measure. This involved a triangulation of research methods such as questionnaire survey and interview. This pilot study was conducted in order to test the appropriateness of research instruments and the validity of the research framework. This was done by polling and interviewing a sample of tax experts who were /or had been teaching taxation in New Zealand tertiary institutions in 2004.

It was found that the respondents generally agreed on the concepts of costs and benefits of operating a CGT. Adjustment for inflation was recommended. However, there was no majority agreement on the definition of "capital gain" and on the application of the general tax principle such as equity, efficiency and simplicity to the conceptual CGT model. The results reveal the importance of a consistent and understandable conceptual framework of a CGT, and the significant role of other non-taxation factors such as historical, political and cultural settings in New Zealand throughout the whole process of tax policy setting.

Introduction

In June 2005, the New Zealand Government issued a discussion document on the Taxation of Investment Income. It was proposed that a comparative value approach to the income calculation, which was similar to an accrual based capital gains tax (“CGT”), would apply to all foreign portfolio investments. However, the public response was negative and the proposal was regarded by some as “the first steps of an unrealised capital gains tax on property” (Bridgeman, 2006). The proposed CGT was later replaced by a fair dividend rate method. The withdrawal of the proposal highlights the importance of the capital gains exemption for New Zealand tax politicians and officials.

This paper presents the initial finding surrounding taxation of capital gains. The study triangulates the findings of the quantitative and qualitative investigations. It addresses the CGT adoption decision by developing variables/factors to study the propensity to adopt CGT by tax experts in New Zealand. These measures were developed after review of literature on the CGT adoption decision, a review of other studies and further refinement of variables to make them applicable in the New Zealand context. The research questions are shown below:

Objective 1 – is to investigate certain tax issues and measures (e.g. tax planning, private home) that are vital in the tax experts’ CGT adoption decision process.

Objective 2 – is to explore the relationship between variables for CGT adoption decision and tax experts’ attitudes towards particular measure of a CGT model. The factors include:

- Tax environment variables (such as tax principle, compliance and international taxation)
- Demographic and external variables (such as belief, qualification, employment status and work experience)

It is assumed that these variables exist and are readily available through exploration of current practice in the New Zealand hybrid tax system. This study identifies the factors that are more significant than the others in the CGT adoption decision. This enables further in-depth investigations on certain variables in order to refine the CGT model.

Background

In recent years there has been a wide discussion in the literature about taxation of capital gains in New Zealand. Most of the arguments put forward by researchers are either based on their professional opinions (such as legal analysis and/or critical analysis), or relying on finding of overseas empirical studies. It is not uncommon for an author who favours a CGT to be opposed by others based on the same tax principles (for example, see Hide (2001) and Morgan (2001b)). The lack of empirical positivist research on taxation of capital gains in New Zealand reflects the fact that there is no CGT in New Zealand. But to the greater extent, this creates uncertainty on the generalisation (or transferability) of inferences drawn by overseas studies in the New Zealand

context, and undermines the actual economic impact of a CGT to New Zealand as a whole. It stimulates fierce debates and raises public awareness on the tax issues of capital gains taxation. These controversial tax issues can be coded into three major categories i.e. the basic questions of Why, What, How capital gains be taxed. Previous literature is discussed more fully in later section as part of the finding of the content analysis of the qualitative research.

Methodology

This paper utilized the mixed method research strategy with a pragmatic research paradigm. Tashakkori and Teddlie (1998) believe that “Pragmatists consider the research question to be more important than either the method they use or the worldview that is supposed to underlie the method. Most good researchers prefer addressing their research questions with any methodological tool available, using the pragmatist credo of “what works”” (p.21). It is argued that emphasis should be placed on the research problem and method is “secondary to the research question” as the assumptions of ontology and epistemology hardly represent a true reality.

A research cycle always consist of three vital processes: data collection from grounded results (facts, observations); creation of theory (abstract generalizations, or theory), and predictions of particular events/outcomes (hypotheses, transferability of a case) (Tashakkori & Teddlie, 1998). Pragmatists argue that a researcher may start at any point in the research cycle. Some researchers may begin from theories or abstract generalizations, then travel to prediction of outcome through a deductive logic. Others may start from observations, and move to the creation of theory through an inductive logic. Pragmatists accept that “they will have a choice of inductive and deductive logic in the course of conducting research” (Tashakkori & Teddlie, 1998, p.27).

From a pragmatist’s perspective, the precision of quantitative method and the contextual richness of the qualitative method are equally important for achieving the research’s purpose: to investigate certain tax issues and measures that are vital in the tax experts’ CGT adoption decision process. Three phases of research process were adopted in this study. This is shown below:

[1st phase] This research started with a questionnaire survey which was used to explore the tax experts’ attitudes towards CGT. Focus was placed on tax experts at the tertiary education sector. In the survey, the questions were closed-ended (QUAN) with a space for written feedback (QUAL). The closed ended responses were analyzed statistically and all written responses were content analyzed. Descriptive statistics for the appropriate variables were calculated. The tax experts’ choice of tax model was identified. Statistical comparison was used to reveal if there was any difference within and between the respondents.

All written feedbacks and the remarks put by the respondents on the questionnaire were coded in order to generate concepts. This also included the written feedback received from the respondents who were not willing to participate in the survey but yet they would like to express an opinion on the research topic.

The objective was to identify the components of a construct (subconstructs) through analysis of QUAN data and then to compare the result with the QUAL data to validate the categories or to expand upon the information that was available regarding these subconstructs. This involved an initial classification of dimensions of tax experts' perceptions of CGT through analysis of survey data. Interview data was used to confirm the existence of such dimensions and to expand on these dimensions with the inclusion of demographic and external variables.

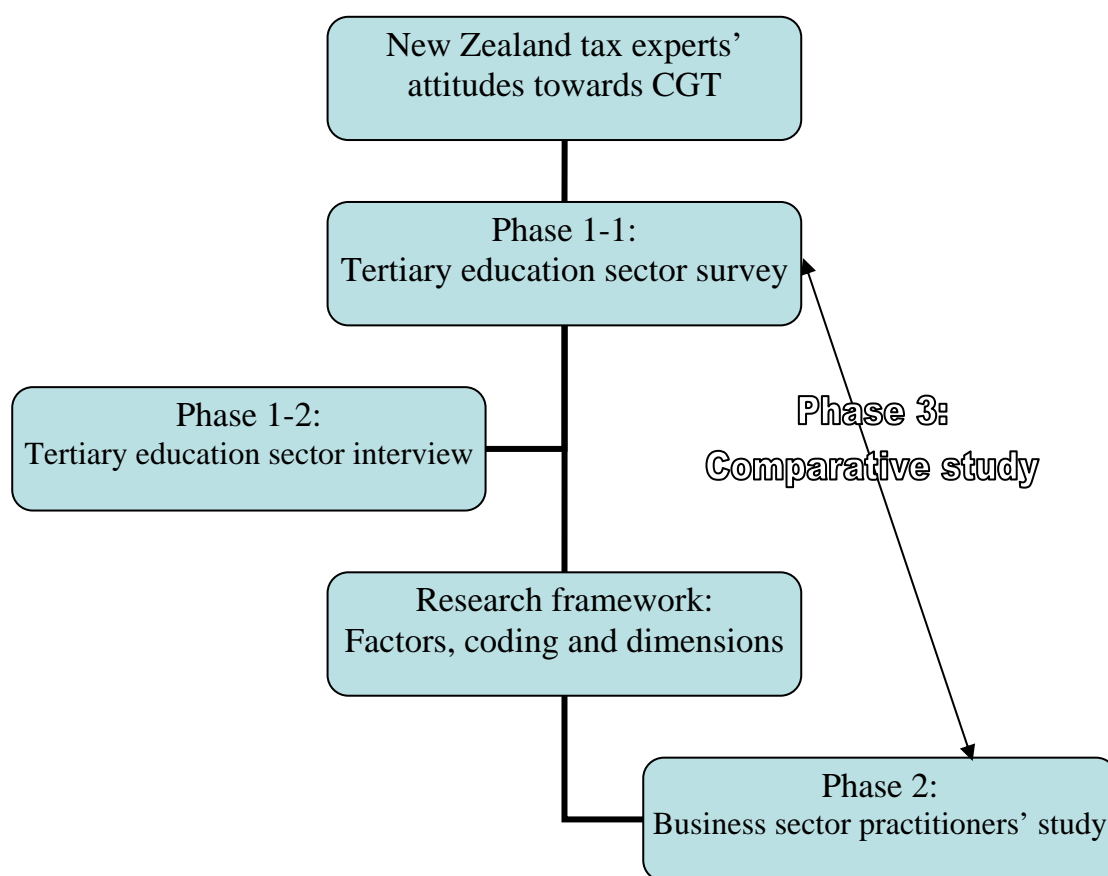
The primary aim of this mixed method study is not to test or prove a theory, but rather to generate a theory through inductive logic. The follow up interview plays an important role in data collection as it can capture the tax experts' experience as described from first person account. The interview data provide an in-depth investigation of a tax expert's experience which enables the research to undertake a comprehensive review of the tax system. This approach will enable the research to gain understanding through the viewpoint of the subjects or actual participants.

[Phase 2 and 3: Business sector practitioners' survey/interviews and comparative study] Similar to the phase one study, investigation was undertaken to examine the tax practitioners' attitudes towards CGT at the business sector [phase 2]. After the analysis, a framework was developed for the qualitative/categorical analysis that followed as the next step. This was used as a starting point for the phase 3 constant comparative analysis. The categories of events/observations that were obtained through the initial analysis [phase 1 and 2] was then be used for coding the qualitative data in the subsequent constant comparative analysis.

This research adopts purposive sampling: Selection of individuals based on specific questions/purposes of the research in lieu of random sampling and on the basis of information available about these individuals. This phase 1 study as shown in this paper involved investigations on the tax experts at the tertiary education sector only. However, it is important to note that the responses of corporate and individual tax practitioners at the business sector are equally important for research validity. This kind of evidence must be taken into account in developing tax policy. The analysis of this group of respondents was revealed at the second phase of the research.

Note that the sampling of individuals or settings ("selection bias") might have consequences for the internal validity of research findings. An example of this is when a conclusion is made on the basis of a mail survey of tax experts who are unhappy with the current tax system. On the basis of such data, a research might conclude that there is no difference in tax experts' attitude towards CGT. Lack of observed differences might be a direct result of the fact that in the sample of tax experts who responded, they were generally unhappy, regardless of their attitude towards CGT. A comparison between tertiary education sector data with the business sector practitioners' data can improve the internal validity.

The phases of the research study are shown in the diagram below:



The tertiary education sector survey and interview [phase 1]

Background information

This research study was begun with an interest in designing a CGT that could be applicable in the New Zealand environment. However it was gradually realized by the author from the survey results and the coding of the interview transcripts that this was not feasible because many of the tax experts felt they had not been given enough choice for the selection of the tax measure. Most importantly, many of them favoured the status quo and preferred amendments of the current legislation instead of a revolution of the current system. These amendments and the reasons behind them became the core category. Further interviews were conducted in order to expand on this new notion and existing transcripts were re-analyzed in the light of it.

A self administered questionnaire survey was used to explore the tax experts' attitudes towards CGT. A list of 51 tax experts who were working or had been working at the tertiary education sector was drawn from the Wiley Directory of Accounting, the Internet, personal contacts and word of mouth from colleagues and friends. Approval was sought and obtained from the ethics committee, prior to administering the survey. The survey instrument contained 31 questions (Appendix 1) which were designed to answer the unsolved questions in previous

literature. Also the survey questions were a reflection of the research objectives. The table below provides an overview of the structure of the survey instrument.

	Tax issues and measures	Related survey questions
1	General CGT issues	Part 1
2	CGT asset (realisation basis)	Part 2 Question 1-1
3	CGT event (realisation basis)	Part 2 Question 1-2
4	Indexation and tax relief	Part 2 Question 1-3 (1,3,4,5 and 6) Part 3 Question 8 and 9
5	Accrual CGT	Part 2 Section 2
6	Calculating a capital gain or loss	Part 3 Question 4
7	Tax rates	Part 3 Question 3
8	Capital losses	Part 3 Question 6 and 7
9	Other practical issues	Part 3 Question 10 to 13

The tax issues and the design of the tax measures were mostly borrowed from the Australian CGT system. The harmonization process between New Zealand and Australia had been seriously advocated by both Governments and CGT was often the main item for the difference of the two tax systems between the two countries. However, it was also acknowledged that there were also fundamental differences between the two tax systems (Cheng, Hooper & Davey, 2000) and therefore additional tax issues from other countries such as UK and Canada were also included in the questions. A pilot study was first undertaken within the Accounting Department to test the validity and the correctness of the questions. A limitation to the questionnaire method is that it does not provide in-depth information for measuring attitudes as face-to-face interviews would provide (Johnson & Turner, 2003).

To this end, the use of a qualitative research method as a form of triangulation to support a quantitative analysis was used to understand the issues surrounding tax experts' attitudes towards CGT. Respondents to the main surveys were invited to participate in the follow up interview at the final part of the surveys. A covering letter was sent by post to the volunteers with the outline of the purpose of the interviews and to arrange for date and location for interview. A review panel was conducted to help determine the nature and form of actual interview questions. Five open-ended questions were developed concerning exploration of major anomalies in the tax system and suggestions for improvement for these anomalies (Appendix 2). Each interview lasted ninety minutes in average.

Results and discussion

Including following up letters and reminders, the tertiary education sector surveys were sent in the period between 25/8/2004 and 17/11/2004. Of the 51 distributed, 30 were received and 2 out of the 30 were unusable in the analysis. The response rate was 51% (28 out of 51). Of the 28 respondents, 18 were based in the North Island, 6 in the South Island and 4 were part-time lecturers practising in tax at that time).

The interview phase resulted in 46.4% (13 out of 28 respondents, or 25.4% of the total population of 51 tax experts) based on their indication on the questionnaire of their willingness to be interviewed. 12 of the interviewees were full-time lecturers/professors and one was a part-time lecturer practising as a tax partner in a major law firm. The interviews were conducted in the period between 7/12/2004 and 13/07/2005. The interviews were conducted face to face at the respondent's premises. Interviews were taped with the permission of the interviewees. In non taped interviews, notes were taken to document responses from respondents. The demographics profile of respondents is contained in the table below.

	Survey	Interviews
Lecturers/Professors (North Island)	18	10
Lecturers/Professors (South Island)	6	2
Part-time Lecturers/Practitioners	4	1
Total	28	13

For the questionnaire, most responses were given on a Likert scale. Since the arithmetic mean cannot be validated with this form of ordinal data, comparison of medians is most technically appropriate, and non-parametric statistical tests need to be used (Collis & Hussey, 2003, p.161). Also a summary of the descriptive statistics such as mean, median and mode scores are provided in order to give a better picture of the distribution of the population with an emphasis placed on the analysis of the median scores.

General CGT issues

This section reveals the research findings on the general CGT issues concerning the "why" question. The results of the quantitative survey regarding general CGT issues are illustrated in the table below.

Questions	Mean*	Median*	Mode*
1. As most of our trading countries have a CGT, implementation of a CGT is inevitable	2.46	2.51	1 & 3
2. Taxing capital gains will clarify (and possibly	3	3.5	4

Questions	Mean*	Median*	Mode*
remove) the distinction between capital gains and income, therefore it reduces the uncertainty in the application of the tax law			
3. The absence of any CGT in New Zealand provides significant opportunities for tax planning	4.11	4	5
4. CGT will raise revenue for the government if only by protecting the income tax base	3.5	4	4
5. CGT is double taxing investors as the money they invest in a business has already been taxed	2.54	3	1
6. Capital gains and income should be taxed on the same basis	2.79	3	3

*ranging from 1 = strongly disagree to 5 = strongly agree

1. Major trading countries and the OECD reports

Respondents from the questionnaire phase had mixed feelings about whether New Zealand would eventually follow the approach of the most OECD countries, indicating multiple modes of 1 strongly disagree and 3 neutral. Two respondents put a different comment on the tax issue. They stated that “no consideration from the political side in New Zealand” and “no obvious political will [to introduce CGT]” respectively. This reveals the political sensitivity on CGT issues. The political barrier to CGT will be discussed later in this article.

Of the thirteen tax experts interviewed, eleven acknowledged the influence from the OECD countries to the New Zealand government, but only minority of them believed New Zealand would follow the Australian CGT approach. One interviewee was cautious about the statistics given by the OECD report since “everyone twists the statistics to their own end”.

One related tax issue is the idea of “competitive advantage” gained by New Zealand due to the absence of CGT as purported by Shewan (2001a). When asked for the opinion about international tax competition, eleven interviewees believed that there was tax competition. One interviewee commented that:

I believe it’s a fact of life, and therefore I think that we need to keep an eye over our shoulder to see [what] our neighbours like Australia and others are doing.

The majority saw the absence of CGT served as an incentive for foreign investors, which might become an influencing factor, provided that other factors such as business environment being equal between the two countries under investigation.

2. Capital/income distinction and tax planning

The respondents from the questionnaire phase were uncertain (mean 3, median 3.5 and mode 4) about the statement “taxing capital gains will clarify (and possibly remove) the distinction between capital gains and income, therefore it reduces the uncertainty in the application of the tax law”. On the other hand, they strongly agreed that the absence of any CGT in New Zealand provides significant opportunities for tax planning (mean 4.11, median 4 and mode 5). These results showed that while there was a general awareness of the tax planning issues, most of the respondents were uncertain whether CGT was the best solution.

In addition, while strongly supporting the idea of increasing tax planning opportunities due to the absence of CGT, most respondents agreed that “CGT will raise revenue for the government if only by protecting the income tax base” (mean 3.5, median 4 and mode 4). These results showed that CGT was understood to have offered some protections on the income tax base against revenue loss due to tax planning such as conversion of taxable income to non-taxable capital gains. However, one respondent pointed out that “CGT could also provide tax planning opportunities depending on how it is implemented”. Also, the tax expert considered that “direct revenues from CGT would be low as a percentage of tax base” despite its protective function on the tax base. The low revenue yield problem was well discussed by some interviewees.

In fact, the capital/income distinction problem was regarded as one of the most significant tax issues given in the interviews. For the interviewees, capital gains were understood to be “something that’s not income”. In principle, they perceived income as the fruit and capital as the tree. This is the definition used in tax law which is borrowed from trust law concepts. However, they also recognized there were inconsistencies of income concept used within the tax law paradigm. They often referred the income derived from the accrual rule and the foreign investment fund regimes as “unrealized gains” or “accrual income” which were “specific type of income”, this approach being different to the general income concept. On the other hand, they also were aware of other definitions of income, such as the accounting definition or the economic definition of income. The most frequently cited was the Haig-Simons definition of income. It is the concept of comprehensive income which is the sum of the change in the value of an individual’s (or an entity’s) net wealth (or assets) between the beginning and end of the period and its net cash flow (McLeod Commission, 2001, p. 23). Under this concept, there is no difference between capital gains and income. As such, this approach is mutually exclusive to the approach of fruit tree definition of income.

One respondent from the questionnaire phase commented on the traditional definition of income and capital, and the Haig-Simons comprehensive income. It was given that:

A capital gain is a simple manifestation of income (following the Schanz-Haig-Simons formulation). Capital gains, to the extent practicable, should be treated as any other manifestation of income.

Despite the S-H-S basis, gains (income or capital as traditionally distinguished) should only be triggered when there is new accretion to wealth. This is in line with the underlying tax governing property- rather than economic concepts of accretions in wealth. Ultimately tax laws must be consistent with the general law. However, in certain circumstances deemed accruals are a practical necessity e.g. deep discount bonds and a taxpayer quitting the Commonwealth.

It was observed that there were internal inconsistency and contradictions in the interviews. These problems arise from the application of the contradicting income concepts of tax law and economic comprehensive income. At the beginning of the interview, the interviewees were asked to define the terms “income” and “capital”. They would answer the question by referring to the fruit tree analogy without hesitation. Their thinking paradigm changed from a legal perspective to an economic logic after some discussion about controversy tax issues such as taxation of residential property. To justify their statements, they often used the economic concepts like efficiency and neutrality, seeing capital gains as comprehensive income. But when the definition question was asked a second time, they seemed to halt and think again about the definition of income.

This confusion between the two concepts can be illustrated in the following conversation in an interview session.

Interviewer: Go back to the revenue and capital definitions, so you are more keen to agree with the comprehensive income definition or just the apple & tree definition of income. Which one do you prefer?

Tax expert: Well I probably...

Interviewer: I am thinking you are more on the balance sheet approach because...

Tax expert: Yes, I think so. Yes.

Interviewer: But then you mentioned about that income would be like apples?

Tax expert: It comes from the original, from the tree, the tree from the assets.

Interviewer: So you like more apple trees definition?

Tax expert: Um

Interviewer: Because in the questionnaire, you agreed capital gains and income should be treated equally?

Tax expert: [sigh] Yes I do. I don't think....[sigh]

[Pause for 5 seconds and interviewer changed topic]

It is submitted that tax law is “incomprehensible”, which parallels with the concepts discussed in Prebble’s work (Prebble, 1993). Tax law is a human construct and also a social good. It involves applying laws to human actions. Attempt is drawn by the Government to apply its tax laws to reflect the substance of economic activities within its jurisdiction, in order to make the laws effective and efficient. However, the objective of tax law remains “to raise money, not to facilitate the economy” (p.18). It is these conflicting objectives make tax law incomprehensible.

As in Prebble’s words, “the problems of tax law arise from the attempt to fit rules of law around natural facts of economic life. The problems are insoluble, but tax law purports to solve them” (p.17).

In response to the definition question, one interviewee commented that:

[Depending on the] Accounting arguments or whatever you want to look at, but we don’t actually know what the topic is and yet we’re trying to look at it. We’re trying to justify things assuming we actually know what it is. If you go and talk to an economist, they’ll tell you something quite different about what income is.

This definition problem is complicated by internal and external inconsistencies and contradictions from overseas CGT experiences. As suggested by Evans and Sandford (1999), “different political cultures, both between and within countries, led to different emphases on each of these objectives and different CGT regime” (p.401). As such, there is no international guidance on capital gains. One interviewee commented that:

There is no international guidance on capital gains where as there is in income tax because we know the standard, we know there’s model treaties and negotiations, but you don’t see capital gains deal with very much in international agreement.

Since the definition of income is incomprehensible in tax law, it is extremely difficult to draw a distinction between capital items and income items. Interviewees often suggested “it is quite easy to change income to capital or vice versa”. Most literature suggest that the absence of capital gains taxation provides an incentive for taxpayers to convert otherwise taxable income into non-taxable capital gains (CCH Tax Editors, 1988; Sandford, 1967 and Ross, 1967). One interviewee agreed with the income conversion problem and commented that:

We don’t have a capital gains tax but we do tax capital gains as ordinary income and that’s where there is a confusion. But I still think that there needs to be some types of capital gains tax because there’s going to reduce the incentive for people to structure transactions get around it, and I mean if you look at a lot of our tax cases at the moment, If they are not GST cases in their income tax, it’s usually something over the revenue capital boundary type

issue, and it may or may not have tax avoidance in it. So I see that as a major problem in the current tax system.

Although the majority of the interviewees recognized the absence of capital gains taxation as a factor, their responses to taxing capital gains varied. Four interviewees, who indicated a strong preference for CGT adoption, understood that income tax inherited the capital revenue problem when it first came into existence. They knew the problem had no solution, but they believed that the problems could be reduced by taxing capital gains. On the simplicity ground, one “CGT believer” commented that:

That’s the old cat and mouse game, so by not taxing capital gains tax really your income tax suffers. It gets more complex, less exceptions, more ways to try and capture things that would otherwise have fallen out of it because the differential is huge. If there was a capital gains tax, then there might not be such concern. If more things are capital gains, at least they are going to get taxed somewhere, whereas at the moment nothing.

In contrast, for the four interviewees who strongly against CGT, they considered the conversion of income to capital was legitimate tax planning not tax avoidance. They were comfortable with existing legislation which already covered “most capital gains” such as gains from land subdivision and accrual income under the accrual regime. Most importantly, they strongly opposed CGT due to its complexity problem and considered the tax would generate more problems than solving one. One interviewee disagreed with the capital income dichotomy problem. The response of that interviewee was

I think the revenue capital distinction works reasonably well in practice even though you get a lot of commentators say it doesn’t.

The remaining five interviewees were unsure of the effects of CGT in practice. They accepted the arguments surrounding CGT such as the capital/income boundary problem, its protection on the income tax base and the complexity of the tax, but were concerned about the low revenue yield of CGT. In particular, they were uncertain the extent of the gains generated from the tax could compensate for the increased compliance cost of administering the tax, as one tax expert commented:

While from a conceptual point of view (equity etc), CGT should be executed. Personally I am against such a tax as (a) I believe individuals are overtaxed; (b) such taxes generally are very complex with increased compliance costs for taxpayers, and (c) generally do not seem to generate large sum of revenue (in percentage term) for governments.

3. Double taxation

Another controversial issue related to CGT is whether the tax will double tax on income. Hide (2001) argues that CGT will double tax entrepreneurship because

capital gains represent the capitalisation of future stream of taxed income flows. The respondents from the questionnaire phase were neutral about the double taxation issue (mean 2.54, median 3 and mode 1). Most interviewees considered double taxation was not the case. This view was also shared by the McLeod committee (2001, p.25).

4. Equal treatment between capital gain and income

The respondents were neutral about the statement “capital gains and income should be taxed on the same basis” (mean 2.79, median 3 and mode 3). In theory, capital gains and income should be taxed on the same basis (Morgan, 2001). However, timing and the lock-in effect of capital gains often hinder such equal treatment (Oliver, 2001 and McCaw, 1982). Also the taxation of housing investment has long been regarded as a "hugely controversial" issue (Rachel, 2001) which involves social equity and economic efficiency issues, not to mention its substantial influence on politics. The statistics could be explained by the desire for exemption of private residence, adjustment for inflation and the provision of average relief, which will be discussed in the later section. The interviewees also shared the same concerns about the issue.

What capital gains be taxed

This section reveals the research findings on the CGT asset coverage concerning the “what” question. The table below summarises the statistics.

<u>Question</u>	Frequencies (%)	
	Yes	No
Do you think the following assets should be included for CGT purposes?		
• Any chose in action (whether legal or equitable)	48	52
• Business goodwill	48.1	51.9
• Collectables e.g. jewellery, stamps	55.6	44.4
• Copyrights and patents	59.3	40.7
• Debt owed to a taxpayer	40	60
• Farms	69.2	30.8
• Land improvements	65.4	34.6

	Frequencies (%)	
	Yes	No
• Listed bonds and capital notes	61.5	38.5
• Personal-use property e.g. home appliance, private car	14.8	85.2
• Private home (main residence)	22.2	77.8
• Rental home	66.7	33.3
• Second home e.g. beach house	63	37
• Shares in a listed company	66.7	33.3
• Shares in a small company (non-listed)	56	44
• Share rights and options	55.6	44.4

The majority of the respondents from the questionnaire phase opposed the inclusion of personal-use property (85.2%) and main residence (77.8%). On the other hand, about 65% of them agreed on the inclusion of farms, land improvements, listed bonds, rental home, second home and shares in a listed company, and disagreed on the inclusion of debt asset owed to a taxpayer for CGT purposes. No majority agreement was reached on the inclusion of certain types of asset such as chose in action, goodwill, collectables, copyrights, shares in a small company and share rights and options.

1. Personal-use property

As shown on the table, eighty-five percent of the respondents from the questionnaire phase supported the exemption of personal-use property. Interviews with tax experts confirmed that the findings regarding the exemptions for personal use property. Ten interviewees agreed that the personal use property should be exempt for administrative simplicity of the tax. One interviewee stated that “taxpayers seldom made a capital gain by disposing of personal use property”.

2. Inconsistent approaches: taxation on property versus main residence exemption

The majority of the tax experts opposed the taxation on main residence (77.8%), but agreed on the inclusion of rental home (67%) as a CGT asset in the questionnaire phase. In the interview phase, taxation on property and main residence were one of the major issues discussed by the tax experts. All of them considered that the residential property market is a vital part in New Zealand

economy. In particular, eleven of them considered there was distortion on the flow of capital with a strong bias towards the property sector instead of going into other forms of investment such as company shares. The excess investment on the property market was confirmed by the OECD report (OECD, 2000, p.128). Although the interviewees agreed that ‘capital gain’ on disposal of property should be taxed to a certain extent, they interpreted the findings differently and approached the problem in a variety of ways.

The interviewees frequently used tax principles like equity and case law to justify their assertions. It was observed that there were either contradictions within their own arguments, and/or inconsistencies between their own and others’ approach. In particular, most inconsistencies occurred regarding the application of tax principle of equity or fairness of the tax system. When questioned about how well the current tax system covering capital gains in terms of equity, efficiency and simplicity, six interviewees felt the existing regime CD1 (or section CB5 to 9 of the Income Tax Act 2004) had covered most “capital gains”. However, two of them saw “inequity” for younger generation or first home buyers who could not afford to buy a house because of the speculative behaviour on the property market. They considered a land tax or wealth tax, but not CGT, as a possible solution.

On the other hand, there were seven interviewees who thought the current system had not covered capital gains adequately in terms of the three tax principles. Four of them preferred broadening existing tax base to include comprehensive taxation of capital gain on land transactions. They argued that there were loopholes in the tax system such as practice of negative gearing. This involved the minimization of taxable income by maximizing deductible interest expense via gearing up the property, so that only capital profit would be realized until the disposal of the property. It was also argued that CGT might reduce the distortions on the investment behaviour in New Zealand. Some of them also felt that there was inequity in the tax system if capital gains were exempt. However when asked if the tax should apply to main residence, most of them objected to the idea because they considered it was “unfair” to the property owner and “politically unacceptable”. This view corroborated the strong contradicting results between main residence (i.e. 77.8% of the respondents said “no”) and rental property (i.e. 67% of the respondents said “yes”) in the question of CGT assets coverage in the quantitative analysis.

2.1 Reasons for inconsistency

The inconsistencies between main residence and non-owner occupied property could be explained by the elusiveness of the definition of “equity” and the unique social and political environment in New Zealand.

It was submitted that the decision for the main residence exemption was based on the social equity and political grounds instead of analyses drawn from a tax or economic perspective. One interviewee supported this by stating:

Technically, under a proper definition of income those (*main residence*) should be included. So it is probably just on the ground of equity, isn’t it? Fairness to people, you can’t tax their house etc,

so probably it is fairness, equity and makes it acceptable, political acceptance.

Most literature refer “equity” or “perceptions of fairness” as horizontal equity and vertical equity (Burman & White, 2003; Dixon, 2003; Krever & Brooks, 1990; McLeod Committee, 2001; Singleton, 2003). However, “fairness” or “equity” is an inherently subjective concept (McLeod Committee, 2001). It is elusive and unavoidably involves value judgements (Dixon, 2003). Fairness is of immense importance because it will promote voluntary compliance, which is vital for the New Zealand self-assessment tax system. However, considering its subjective nature, it is a challenge to fit this concept into the evaluation of the tax system.

Political unacceptability was found to be another important factor that caused the tax experts’ contradiction. It is generally agreed that the New Zealand Government is not interested in following the conventions of the most OECD first world nations and extending the tax base to include capital gains and taxation of residential property (Louisson, 2001). All tax experts agreed that CGT was a “vote killer” for the political parties. They considered that there is a conventional wisdom at Parliament to see capital gains, in particular, a CGT on main residence, as a “guaranteed way to lose the next election”.

One interviewee looked at the historical context and argued that the “hyper-criticality” of the Parliament and the public resistance to taxation on property was due to the negative perceptions of repealed, “draconian” land speculation tax and the estate duty. At the preamble of the Property Speculation Tax Act 1973, it was stated that

an Act to make provision for the imposition, assessment, and collection of a tax on profits or gains derived from property speculation whereas the buying and selling of land for speculative purposes is undesirable and in the public interest such speculative activities should be discouraged and provision be made for the imposition of a tax on profits derived from such activities.

The Act applied wherever there had been a disposition of any land, situated in New Zealand, within two years of its acquisition (Molloy, 1973, p.1). This included any estate or interest in land but excluded domestic residence. To calculate the “gain”, one had to add the disposal value less the acquisition values plus “the sum of any amount the disposer had derived as income tax-exempt revenue since the acquisition of the property”. The tax was ninety percent for disposal within six months of acquisition, and it diminished by five percent per three months. There is no tax for disposal taking place after twenty four months. For example, where a disposal occurred after holding the property for twenty one months, the taxpayer would be charged at sixty percent on the gain for the property speculation tax (Molloy, 1973). Inflation was a serious problem at that time and the tax had caused serious social inequity as it taxed on nominal gain instead of real capital gain. Also since the tax was targeted on “property speculators”, tax avoidance was common and relatively few

transactions were actually caught (Hagman & Misczynski, 1975). The tax was abolished in 1979.

Similarly, two interviewees saw the problems in estate duty in relation to property, in the historical perspectives, the tax generating trivial tax revenue. It was argued that the tax was unfair because tax avoidance was common as people could structure their estate by gifting away their property. For those who could not afford a tax accountant, they had to pay the tax at seven to forty percent. Again one interviewee described the tax as “draconian” because the IRD would have to freeze all the estate assets in order to give a valuation on everything including shares in private company and chattels at the time of death. This created liquidity problem and emotional distress for the family members. After twenty years of the demise of the property speculation tax, the estate duty followed the trend and was repealed in 1999.

2.4 Politics – taxation on farms

The political debate for taxation on residential property was further complicated by the taxation on farms. About seventy percent of the respondents from the questionnaire phase supported the inclusion of farm as a CGT asset. One interviewee supported the taxation on farms and pointed out that:

The property speculation at the rural area is so obvious. Given the low return rate of capital on farming activities, no rational businessman will buy a farm on the basis of income returned on the amount invested. Farm prices are artificially pushed up by the government’s concessions and subsidiaries provided to the farmers.

On the other hand, two interviewees argued that family farms were different from other assets because they were used to engage in family farming business for several generations. Since the yields on most family farms were low, farmers and their family tend to have their main residence on the farm. It was considered taxation on property as “harsh” and “uneconomical”. It was harsh because farmers would be forced to sell part of their land to pay for the tax, and it was uneconomical as it was difficult to allot the farm into several smaller lots for farming purposes.

2.5 Investment culture in New Zealand- taxation on company shares

Another interesting point raised by an interviewee is the savings behaviour in the New Zealand environment. New Zealanders have a strong preference for investing in houses rather than shares. The household savings survey 2001 revealed that seventy percent of households owned no shares directly (Fallow, 2006).

About sixty seven percent of the respondents from the questionnaire phase supported the inclusion of company shares as CGT assets. Most interviewees thought capital gain derived from disposal of company shares for intention for resale should be taxable. However, one interviewee argued that the test for intention was irrelevant because making capital gain or intention for resale was always the dominant intention for those who invested into the share market. It was argued that investing in the share market was like “gambling”. An example

would be the “quick”, “huge” capital gain realized from the disposal of a new listed company “Pumpkin Patch” within a very short period of time. In contrast, property was seen as a low risk investment option that would protect their savings in long term. This reflected the New Zealanders’ unique investment culture. One interviewee acknowledged the investment culture on property by stating:

Certainly in theory at least, there is a skewing... so probably because we don’t have a capital gains tax, but also Kiwis place a high value on homes... we’re fortunate enough to own our home, and there is a certain security, cultural I guess. It’s distinct from renting... You saw when that (McLeod Committee’s) interim report came out within two days and all the parties said we would never do it.... I think it is partly capital gains tax but I think it is a cultural thing.

This is supported by another interviewee who argued that there was another external factor coming from the banking industry. It was stated that:

When you are thinking about why do New Zealanders put all their money into property? The answer is very simple. First of all, you get access to borrow money very easily, and they will give you borrowed money to buy property but they are not so keen to let you borrow money for shares, so you’ve got the banking industries. The banking industry likes property as well. The tax system is perhaps over geared up to help property, but you can also, and of course you can leverage your investment in property because you’ve got easy access of finance and that's the other reason why people are into property rather than shares.

How to tax capital gains

This section reveals the research findings on the specific CGT issues concerning the “how” question. These include discussion of the practicality of CGT such as general CGT structure, the taxation of realised and accrued gains, definition and timing of acquisition and disposal, indexation and other tax relief and international taxation.

1. Overview of CGT system

The results of the quantitative survey regarding general CGT structure issues are illustrated in the table below.

CGT system		%		%		%
1. Method	Realised CGT	84.6	Accrual CGT	15.4		
2. Structure	Part of income tax	70.4	A separate tax	29.6		
3. Tax rates	Lower than income tax rates	29.6	Ordinary income tax rates	70.4	Higher than income tax rates	0

	Mean*	Median*	Mode*
4. Do you think capital loss should be regarded as a deductible expense which can be set against gross income?	3.89	4	5
5. Do you think CGT paid at the company level should be transferred to the shareholders as CGT credits?	3.73	4	5
6. Do you think section CD1 should be repealed if CGT is introduced?	3.96	5	5
7. Do you think section CD4 should be repealed if CGT is introduced?	4.04	5	5

*ranging from 1 = strongly disagree to 5 = strongly agree

When questioned about the general structure of CGT, eighty five percent of the respondents favoured a realisation based CGT over an accrual based CGT. Seventy Four percent of them wanted the CGT to be part of the income tax and taxed at the same level of income tax rates. The respondents indicated a general agreement on the deductibility of capital losses against gross income (mean 3.89, median 4 and mode 5). Most of them thought that the loss should be carried forward for individuals and for the corporate taxpayers (74.1% and 74.1% respectively) instead of a cash refund. They also wanted CGT paid at the company level should be transferred to the shareholders as CGT credits (mean 3.73, median 4 and mode 5). In addition, they strongly agreed that section CD1 land transactions and section CD4 personal property should be repealed if CGT were introduced (both median and mode had a score of 5).

For the calculation of the cost base, the respondents generally agreed on the cost items (with a median and mode scores of more than four in average). In particular, they showed a strong level of support for inclusion of the agent fee (mean 4.33, median 5 and mode 5). Other costs such as the cost on land improvements (mean 4.33, median 4 and mode 4) and legal fees (mean 4.22, median 4 and mode 4), together with the value of the gift (mean 4.12, median 4 and mode 4) and the purchase price (mean 4.26, median 4 and mode 5) were generally agreed to be included into the cost base for CGT purposes.

These results showed that the tax experts preferred a neutral, realization based CGT system. It was provided that the tax should be integrated as part of income tax with ordinary income tax rate and general deduction for capital costs. It was surprising that the majority considered capital losses should be deductible against gross income. However, capital gains and income might not be taxed on the same basis (as revealed in the statistics previously). This was supported by the interviewees. They recognized capital items had a long term nature while income items had a short term nature. Since New Zealand had an annual filing system, it was argued that it would be difficult to allocate long term capital gains and expenditure to their correct years. Also adjustments for inflation and

averaging were required in order to minimize the unfair effects that strict year-by-year tax accounting had on people. More discussions on the tax issues for inflation and average are provided in the last part of this section.

It was found that the majority favoured a realization based CGT. A chi-square test was conducted in an attempt to see if there was any difference in all the responses in the questionnaire between the group who preferred a realization-based CGT and those who preferred an accrual based CGT. With the exception for the variable A1collect (measurement on collectible in accrual system), no significant difference was found in the analysis. This might be due to the relative small sample size and very few respondents actually favoured an accrual based CGT in the research. Further discussions on the practical issues of accrual CGT and a summary of the statistics are provided below:

2. Accrual CGT – practical issues

Do you think an objective market price is obtainable for the following assets?	Mean*	Median*	Mode*
• Commercial property	4.42	4	4
• Collectibles e.g. jewellery, stamps	3.04	3	2
• Farms	4.35	4.5	5
• Financial instruments (listed) e.g. bonds and capital notes	4.35	4.5	5
• Intangible assets e.g. patents and copyright	2.96	3	2
• Personal-use property e.g. home appliance and private car	3.08	3	3
• Residential property	4.19	4	4
• Shares in a listed company	4.58	5	5
• Shares in a small company (non-listed)	2.85	3	2
Do you think taxpayers will suffer liquidity problems under an accrual-basis tax because they have not yet converted the gain to cash?	4.46	5	5

*ranging from 1 = strongly disagree to 5 = strongly agree

These questions set out to examine the feasibility of an accrual based CGT by exploring measurement issues and the liquidity problem. The respondents generally agreed that an objective market price is obtainable for commercial property (mean 4.42, median 4 and mode 4) and residential property (mean 4.19, median 4 and mode 4). They had strong level of support on obtaining an objective valuation for farms (mean 4.35, median 4.5 and mode 5), listed financial instruments-bonds and capital notes (mean 4.35, median 4.5 and mode 5) and shares in listed companies (mean 4.58, median 5 and mode 5). Other types of asset including collectible and shares in private company received a

neutral comment (mean/median of 3). These results showed that the tasks for obtaining market valuation for assets were feasible ones.

In contrast, the responses from the tax experts at the interview gave different opinions regarding valuation problem on accrual CGT. Twelve interviewees thought it was very difficult, but not impossible, to get objective valuation for small businesses and individuals. They were concerned about the huge compliance costs involve for those entities to get their assets fairly valued on an annual basis.

A high non-response rate was found for the second question regarding charging imputed interest on asset where market valuation is not provided. The result could be explained by the wording of the question and the complexity of the issue.

When questioned about the liquidity problem of the Accrual based CGT, the respondents strongly agreed that “taxpayers will suffer liquidity problems under an accrual-basis tax because they have not yet converted the gain to cash” (mean 4.46, median 5 and mode 5). This was supported by the interviewees. Twelve interviewees considered taxing unrealized gains was unfair as it required taxpayers to pay tax on income they had not received. One interviewee stated that:

You can have zero income but with an asset tax (accrual base CGT) the government will still take the money off you, and so your government is actually impoverishing you.

Despite majority opposition to accrual based CGT, a part-time lecturer/practitioner supported such CGT system. It was agreed that an accrual based CGT could bring neutrality into the tax system by reducing the capital income boundary problem. The tax expert considered that accountants should be able to value assets objectively as it was part of the process for them to account for any impairment on all the assets for financial reporting purposes. With the high technology available, compliance costs due to record keeping were considered low. It also was argued that remission of tax could be provided and the tax could be paid by instalments if the taxpayer experiencing financial difficulties.

3. CGT realization event and rollover

Question
Do you think the following situation/event should be regarded as a “disposal” of property by a taxpayer?

CGT Events	Mean*	Median*	Mode*
Assets-for-shares acquisition	2.74	2	2

CGT Events	Mean*	Median*	Mode*
Business relocation	2.67	3	1
Giftng away the asset	3.56	4	4
Incorporation of a company	2.11	2	1
Insurance payment for destroyed property	3.04	3	2 & 5
Involuntary disposition e.g. compulsory acquisition by the government	2.77	3	3
Like-kind property exchange	2.81	3	1 & 4
Liquidations including the situation where a wholly owned subsidiary is wound-up into its parent	3.19	3	3
Reinvestment in replacement property	3	3	4
Renewal of a lease agreement	2.73	3	3
Share-for-share exchanges	2.67	3	1 & 3
Termination of a contract	3.32	3	3 & 4
Transfers of assets between related parties including spousal transfer	2.58	3	1
When a taxpayer ceases to be a tax resident in New Zealand	3.65	4	5

*rating from 1 = strongly disagree to 5 = strongly agree

This question sought respondents' opinions on the fourteen CGT events. The results are summarised in the table above. On the table, the low value of the median score would suggest the stronger level of disagreement (or stronger level of support for a non-realization i.e. rollovers), while a high median score would suggest agreement on a realization event. For example, a median value of 1 can be interpreted as either a strong disagreement on a CGT realization event, or a strong agreement on a rollover (non-realization).

Based on the table, the respondents preferred rollover for assets-for-shares acquisition (mean 2.74, median 2 and mode 2) and incorporation of a company (mean 2.11, median 2 and mode 1). In contrast, they supported the CGT events where taxpayers gifted away the asset (mean 3.56, median 4 and mode 4), or they ceased to be a tax resident (mean 3.65, median 4 and mode 5). They had neutral opinions about other realisation events.

In the interview phase, only three tax experts mentioned briefly the rollover relief. No further elaboration was given on the choice of rollover and the reason behind the support of the rollover relief. The finding reflected the difficulty for the respondents to make decision in an imaginary environment of CGT. Rollover and realization events are specific, technical tax administration issues which require specialized expertise within the discipline of CGT. The heavy focus on why CGT and what CGT assets questions diverts attention from other important administration issues such as rollover. It is submitted that more in-depth investigation is required as overseas experience suggests that rollover is one of the main problems for CGT. The lack of discussion of rollover will undermine the analytic integrity and evaluation framework of CGT.

4. Indexation and other relief

Questions	Mean*	Median*	Mode*
1. Do you think the cost base should be adjusted for inflation e.g. indexation for capital gains?	3.96	5	5
2. Do you think a tapering discount should be provided in order to reduce the lock-in effect?	3.42	4	4
3. Do you think an averaging relief should be provided in order to reduce the bunching effect?	3.62	4	5
4. Do you think a tax relief should be provided for disposal of a small business (e.g. turnover of less than \$1 million)?	3.12	3	5
5. Do you think a tax relief should be provided for new/innovative business venture?	2.62	2.5	1
6. Do you think a general exemption should be provided for small gains (e.g. the total of capital gains of a taxpayer is less than \$1,000) because of administrative simplicity?	4.59	5	5
7. Do you think a partial exemption should be provided for the disposal of active assets of a small business (whose annual turnover is less than \$1 million)?	3.59	4	5

*ranging from 1 = strongly disagree to 5 = strongly agree

The statistical results of the tax experts' opinions on indexation and other relief are illustrated in the table above. The respondents from the questionnaire phase strongly agreed that the cost base should be adjusted for inflation e.g. indexation for capital gains (mean 3.96, median 5 and mode 5) and the provision of general exemption for small gains (mean 4.59, median 5 and mode 5). They generally agreed on the provision of taper discounts (mean 3.42, median 4 and mode 4),

averaging relief (mean 3.62, median 4 and mode 5) and partial exemption for disposal of active assets for small businesses (mean 3.59, median 4 and mode 5). In contrast, they were neutral about the tax relief for disposal of a small business, and disagreed on the provision of tax relief for new/innovative business venture (mean 2.62, median 2.5 and mode 1).

1. Adjustment for inflation

The tax experts in the interview phase supported the statistics findings that there was strong demand for adjustment of inflation. Inflation was a central issue of the interviews, similar to the tax issues of capital income boundary and taxation on property. Eleven respondents considered only real capital gains should be taxed. Three interviewees explained the problem of taxing nominal gain in a historical context. They considered that New Zealand households had experienced considerable strong house price growth during high inflation period in the early 70s. It was argued that a large proportion of capital gains were illusory increases in wealth of the home owners. The problem lay in the use of the historical cost accounting system in New Zealand tax system. The tax experts argued that a tax on nominal capital gains without adjustment for inflation would amount to the confiscation of real capital holdings. They considered the situation as unfair and economic inefficient.

The interviewees approached the problem in a variety of ways. Seven interviewees considered the indexation approach as a possible solution. It was argued that indexing reflected the underlying economic fact that the purchasing power of money declined with inflation so that it was taxing true gains. Tapering was described as a “hit and miss” measure and would distort the neutrality of the tax system. On the other hand, three interviewees saw the merits of simplicity for a taper system. It was argued that an indexation would be complicated, and overseas experience like United States, United Kingdom, Canada and Australia had adopted tapering instead of indexing capital gains.

It is submitted that both system will distort neutrality to a certain extent as ordinary income is not adjusted for inflation. It is uncertain how the interaction between the incentives of indexation or tapering discount and the lock in effects of CGT impacts the taxpayers’ behaviour in long term. No matter which method is implemented, it is observed from the interview data that ordinary income and capital gains cannot be treated on the same basis. This is also supported by the statistics as discussed earlier.

2. General exemption for small gains

Similar to the statistical findings, ten respondents from the interview phase favoured the provision of the tax free threshold or ‘de minimis’ limit for administrative purposes. Four interviewees preferred indexing the small tax free threshold for capital gains every year with three of them arguing that the concept of indexed tax free threshold should be extended to ordinary income.

Foreign investments funds and international taxation

	Mean*	Median*	Mode*
Do you think New Zealand tax residents' overseas assets should be included for CGT purposes?	3.81	4	5
Do you think non-residents should pay CGT if they earn capital gains from disposing of New Zealand assets?	4.27	5	5
Do you think the CFC and FIF regimes should be repealed if CGT is introduced?	3.56	4	5

*ranging from 1 = strongly disagree to 5 = strongly agree

When questioned about international taxation, the respondents agreed that, 1) "New Zealand tax residents' overseas assets should be included for CGT purposes" (mean 3.81, median 4 and mode 5), 2) that non-residents should pay CGT if they earn capital gains from disposing of New Zealand assets (mean 4.27, median 5 and mode 5) and 3) that "the CFC and FIF regimes should be repealed if CGT were introduced (mean 3.56, median 4 and mode 5).

Eleven interviewees found the controlled foreign companies (CFC) and foreign investment funds (FIF) regimes were problematic and they were concerned about the anomalies created by the existing approach. It was argued that the distortion of investments occurred when there was an incentive for taxpayers to invest into grey list countries so that there would be no capital gains tax. They considered that the regimes affected "people coming into or leaving New Zealand" and they had "horrific implications" to the tax system. Four interviewees had considered the approach suggested by the Stobo Committee (Stobo, 2004). They considered it was a form of wealth tax on a specific type of assets. They were cautious about the approach as they considered the process for setting a required tax rate as arbitrary, and there was no similar overseas precedent to follow. They were also concerned about the asymmetry between capital gains and capital loss because of the non-deductibility of capital loss.

It is interesting to note that, instead of following the Stobo's recommendation, the Government later proposed a modified accrual based CGT on foreign investments. However, this proposal was strongly opposed by the public, having the Government to change its proposal to include incentives such as five-year exemption for certain large companies and concession for no tax in loss years. A fair dividend rate approach with similar mechanisms of the McLeod's risk free return rate model was also proposed. The amended report was sent to the Parliament on 6th December 2006, and the bill was passed on the 13th of the same month.

CGT: an academic exercise?

In the interview phase, it was observed that tax experts often perceived CGT as an “academic” exercise. The phenomenon was evident when they frequently promulgated their arguments by first stating the terms “in theory”, “from a theoretical point” of the concepts, and then gave a contradicting fact found in practice or from empirical evidence. It was submitted that there was a gap between the tax principles and the tax practice in the case of CGT. In particular, the consideration of tax practice and economic facts had significant influences on the CGT adoption decision. It was observed that two interviewees, who had undertaken a relative small number of literature review, supported CGT at the beginning of the interview. However, after being informed of the point of the low revenue yield of the tax, they became cautiously optimistic about the tax and changed to either opposing to, or giving neutral comment about CGT. It was argued that New Zealand, a small country whose commercial activities were comprised largely of small businesses, could not afford the complexity and compliance costs of CGT.

The findings from the interviewees reveal an important factor in tax policy setting in the New Zealand context. New Zealand has a small economy which comprised largely of small businesses and is heavily reliant on international trade. Since the concept of equity/fairness is so ambiguous, it is argued that New Zealanders place a relative strong emphasis on compliance and simplicity of the tax. Equity is still a consideration factor but the view of “fairness” is likely drawn from subjective data and interpretation to support the tax policy.

It was interesting to note that all tax experts frequently described goods and services tax (GST) as a model of “good tax” in terms of the tax principles. In their view, the tax was “the best of its kind in the world”. It was neutral as it did not create a number of exceptions, and it was simple as the tax was straightforward. Also it raised a substantial amount of tax revenue. There was no mention of the regressive nature of the tax, and the administrative costs involve dealing with a large number of case laws. It was argued that the perceived benefits of simplicity and revenue yield of the tax had outweighed its costs of inequity and voluntary compliance.

Five interviewees argued that any government proposing a CGT would face similar political pressure with the introduction of GST. Opposition was strong when GST was introduced in 1986. But political theoretical debates stopped when the Roger Douglas government operated the tax in practice. They believed that CGT was possible in New Zealand as long as (1) owner-occupied homes were exempt; (2) indexation was provided, and (3) the income tax rate was reduced.

Conclusion

The complexity of CGT was mirrored in the complexity of the research approach employed to explore it. Given the exploratory nature of this research study, there was amazing wealth of quantitative and qualitative data generated from a study with such a small sample size. The essence of the mixed method

methodology is that new ideas are being captured and triangulation analysis of the data has become a continuing and evolving process within the research cycle.

This study utilized both a quantitative and qualitative research approach to determine the extent of the tax experts' perceptions towards CGT in the New Zealand context. It was an attempt to capture a more complete understanding of certain tax issues and measures (e.g. tax planning, main residence exemption, adjustment for inflations, etc) that were vital in the tax experts' CGT adoption decision process. It was found that the tax experts agreed on the concepts of costs and benefits of operating CGT to a certain extent. However, it was observed that there were inconsistencies and contradictions on the incomprehensible capital/income concepts and the application of the general tax principle such as equity. The results revealed the importance of a consistent and understandable conceptual framework of a CGT, and the significant role of other non-taxation factors such as historical, political and cultural settings in the CGT adoption decision process.

Appendix 1: Survey instrument Capital Gains Tax

I am interested to know your views on how a capital gains tax (CGT) could be handled in New Zealand if one were to be implemented.

Part 1. Capital Gains Tax (CGT) – General Issues

	Strongly disagree	2	Neutral	4	Strongly agree
1. As most of our trading countries have a CGT, implementation of a CGT is inevitable	1	2	3	4	5
2. Taxing capital gains will clarify (and possibly remove) the distinction between capital gains and income, therefore it reduces the uncertainty in the application of the tax law	1	2	3	4	5
3. The absence of any CGT in New Zealand provides significant opportunities for tax planning	1	2	3	4	5
4. CGT will raise revenue for the government if only by protecting the income tax base	1	2	3	4	5
5. CGT is double taxing investors as the money they invest in a business has already been taxed	1	2	3	4	5
6. Capital gains and income should be taxed on the same basis	1	2	3	4	5

Part 2. How to tax capital gains

The first section covers questions about a realisation based CGT¹ while the second section due with accrual based CGT².

Section 1: Realisation basis

In this section, consider a CGT system where capital gains are taxed when they are realised i.e. the tax is triggered after the disposal of a property.

¹ A realisation based CGT is a tax system where capital gains are taxed when they are realised i.e. the tax is triggered when a taxpayer sells or disposes a property.

² An accrual based CGT is a tax system where the **unrealised** capital gain of a taxpayer's CGT assets, which is computed as the difference between the fair market value and its cost, is taxed annually. It does not matter if the taxpayer actually has not sold/disposed of the CGT asset.

1-1. Asset Coverage

Do you think the following assets should be included for CGT purposes and what should the exempt amount be?

	No	Yes, this item should be included for CGT purposes but only greater than the amount of:						Or specify if you wish
		\$0	\$1-50,000	\$50,001-150,000	\$150,001-300,000	\$300,001-500,000	Above \$500,001	_____
• Any chose in action (whether legal or equitable)	No	\$0	\$1-50,000	\$50,001-150,000	\$150,001-300,000	\$300,001-500,000	Above \$500,001	_____
• Business goodwill	No	\$0	\$1-50,000	\$50,001-150,000	\$150,001-300,000	\$300,001-500,000	Above \$500,001	_____
• Collectables e.g. jewellery, stamps	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____
• Copyrights and patents	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____
• Debt owed to a taxpayer	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____
• Farms	No	\$0	Below \$500,000	\$500,000-\$1million	\$1m-5million	\$5m-10million	Above \$10million	_____
• Land improvements	No	\$0	\$1-50,000	\$50,001-150,000	\$150,001-300,000	\$300,001-500,000	Above \$500,001	_____
• Listed bonds and capital notes	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____
• Personal-use property e.g. home appliance, private car	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____
• Private home (main residence)	No	\$0	\$1-100,000	\$100,001-250,000	\$250,001-500,000	\$500,001-1,000,000	Above \$1,000,001	_____
• Rental home	No	\$0	\$1-100,000	\$100,001-250,000	\$250,001-500,000	\$500,001-1,000,000	Above \$1,000,001	_____
• Second home e.g. beach house	No	\$0	\$1-100,000	\$100,001-250,000	\$250,001-500,000	\$500,001-1,000,000	Above \$1,000,001	_____
• Shares in a listed company	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____
• Shares in a small company (non-	No	\$0	\$1-1,000	\$1,001-5,000	\$5,001-10,000	\$10,001-50,000	Above \$50,001	_____

listed)

- Share rights and options

No \$0 \$1-1,000 \$1,001-5,000 \$5,001-10,000 \$10,001-50,000 Above \$50,001

1-2. Defining a realising event

Do you think the following situation/event should be regarded as a “disposal” of property by a taxpayer?

	Strongly disagree		Neutral		Strongly agree
• Assets-for-shares acquisition ³	1	2	3	4	5
• Business relocation ⁴	1	2	3	4	5
• Gifting away the asset	1	2	3	4	5
• Incorporation of a company ⁵	1	2	3	4	5
• Insurance payment for destroyed property	1	2	3	4	5
• Involuntary disposition e.g. compulsory acquisition by the government	1	2	3	4	5
• Like-kind property exchange	1	2	3	4	5
• Liquidations including the situation where a wholly owned subsidiary is wound-up into its parent	1	2	3	4	5
• Reinvestment in replacement property	1	2	3	4	5
• Renewal of a lease agreement	1	2	3	4	5
• Share-for-share exchanges ⁶	1	2	3	4	5
• Termination of a contract	1	2	3	4	5
• Transfers of assets between related parties including spousal transfer	1	2	3	4	5
• When a taxpayer ceases to be a tax resident in New Zealand	1	2	3	4	5

³ A situation where a company takes over another by exchanging its shares for assets of the target company

⁴ A situation where pursuant to company law a company ceases to be incorporated in one jurisdiction and becomes reincorporated in another jurisdiction

⁵ A situation where a sole trader or partnership transfers business assets into a company and takes back shares

⁶ A situation where one company acquires another by offering shares in itself to the shareholders of the target company

1-3 Computation of CGT and Tax Relief

	Strongly disagree		Neutral		Strongly agree
• Do you think the cost base should be adjusted for inflation e.g. indexation for capital gains?	1	2	3	4	5
• Do you think a deemed “market value” should be applied on the disposal price when there is lack or no consideration? (e.g. non-arm-length transaction and gifts)	1	2	3	4	5
• Do you think a tapering discount (i.e. the longer the taxpayer holds an asset, the lesser the tax liability) should be provided in order to reduce the lock-in effect?	1	2	3	4	5
• Do you think an averaging relief (i.e. the liability of CGT is spread over several years to avoid the accumulation of a big capital gain in one year) should be provided in order to reduce the bunching effect?	1	2	3	4	5
• Do you think a tax relief should be provided for disposal of a small business (e.g. turnover of less than \$1 million)?	1	2	3	4	5
• Do you think a tax relief should be provided for new/innovative business venture?	1	2	3	4	5

Section 2: Accrual basis

In this section, consider a CGT system where **unrealized** capital gains are taxed annually.

Accrual basis	Strongly disagree		Neutral		Strongly agree
2-1. Do you think an objective market price is obtainable for the following assets?	1	2	3	4	5
• Commercial property	1	2	3	4	5
• Collectibles e.g. jewellery, stamps	1	2	3	4	5
• Farms	1	2	3	4	5
• Financial instruments (listed) e.g. bonds and capital notes	1	2	3	4	5
• Intangible assets e.g. patents and copyright	1	2	3	4	5

Accrual basis

	Strongly disagree			Neutral			Strongly agree
	1	2	3	4	5		
• Personal-use property e.g. home appliance and private car	1	2	3	4	5		
• Residential property	1	2	3	4	5		
• Shares in a listed company	1	2	3	4	5		
• Shares in a small company (non-listed)	1	2	3	4	5		
2-2. Where an objective market price of an asset is not available, the capital gain of the disposal of such asset should be adjusted for its opportunity cost i.e. Use of Money Interest.	1	2	3	4	5		
2-3. If you disagree (scale of 1) with question 2-2, please skip this question and go to question 2-4. Otherwise, what type of interest rate should be applied? (Please tick appropriate box)							
Inflation rate							
Internal rate of return of the investment							
Risk free rate i.e. interest rate from government bond							
2-4. Do you think taxpayers will suffer liquidity problems under an accrual-basis tax because they have not yet converted the gain to cash?	1	2	3	4	5		

Part 3: Building a CGT system

(Please tick appropriate box)

1. Do you prefer the realisation based CGT or the accrual based (unrealised gains) CGT?	Realised CGT	<input type="checkbox"/>	Accrual CGT	<input type="checkbox"/>
2. Should CGT be integrated into the income tax system or should it be a separate tax?	Part of income tax	<input type="checkbox"/>	A separate tax	<input type="checkbox"/>
3. What tax rates should be applied for capital gains?	Higher than income tax rates	<input type="checkbox"/>	Ordinary income tax rates	<input type="checkbox"/>
	Lower than income tax rates	<input type="checkbox"/>		

International Taxation

	Strongly disagree		Neutral		Strongly agree
10. Do you think New Zealand tax residents' overseas assets should be included for CGT purposes?	1	2	3	4	5
11. Do you think non-residents should pay CGT if they earn capital gains from disposing of New Zealand assets?	1	2	3	4	5

Integration with other legislation

12. Do you think CGT paid at the company level should be transferred to the shareholders as CGT credits?	1	2	3	4	5
13. Do you think the following section of the legislation should be repealed if CGT is introduced?					
• Accruals rules	1	2	3	4	5
• CD1 land transaction	1	2	3	4	5
• CD 4 personal property	1	2	3	4	5
• Controlled foreign companies (CFC) and foreign investment funds regime (FIF)	1	2	3	4	5
• Gift duty	1	2	3	4	5

Part 4. Please indicate your background.

1. What is/are you specializing area(s)?

Auditing

Business consultancy

Costing

Financial accounting

Legal advice

Management

Taxation

Others

2. Are you willing to participate in further interview?

YES

NO

Please feel free to add other comment or observation

Thank you very much for your help!

Appendix 2

Questions for interview

1	What do you see as the major problem(s) in the current tax system? (i.e. anomalies /inconsistencies)?
2	Given your answer in Q1, what changes can be made to the tax system so that it can be more unbiased in its application? Considering whether the income tax base should be broadened with the introduction of capital gains tax.
3	How well does the current tax system cover capital gains in terms of the 3 tax principles (namely, equity, efficiency and simplicity)?
4	Which of these tax principles (namely, equity, efficiency or simplicity) is the most important in setting tax policy? Justify your answer.
5	If CGT was in NZ, what would you like to see as its core elements? What aspects should be avoided? <ul style="list-style-type: none">• Draw a picture• Worst possible outcomes of CGT
6	Is there any other issue that I should consider but not covered in the interview?

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