ABSTRACT

Campaigning in New Zealand’s 2005 general election focussed primarily on taxation policy. In the coalition negotiations, minority party United Future, with three current Members of Parliament, wrung several concessions from the Labour Government. The Confidence and Supply Agreement between Labour and United Future includes a commitment to produce a discussion document on income splitting for couples raising children which should be released in early 2008. Under New Zealand’s generic tax policy process a discussion document is prepared by the Inland Revenue Department and available for public consultation before the drafting of legislation.

The New Zealand legal and tax system has its roots in a colonial heritage from the United Kingdom. This system seeks to tax an individual’s income, although some different New Zealand legal structures enable income splitting between taxpayers. This paper reviews the current New Zealand income tax system and comments on possible change in the taxing unit from the individual to the family unit.
INTRODUCTION

The results of New Zealand’s general election in September 2005 required the Labour Party to launch into a series of negotiations with other political parties. This again resulted in Labour forming a minority government in coalition with Jim Anderton’s Progressives (holding one seat). To gain a working majority of 67 members out of a total of 121 members of Parliament, Labour also concluded Confidence and Supply Agreements with the New Zealand First Party (holding seven seats) and the United Future Party (holding three seats). Labour also reached an agreement with the Green Party of Aotearoa New Zealand (holding seven seats) to abstain on confidence and supply votes (Government Directory online, 2005). These various agreements signal a possible change in the taxing unit in New Zealand.

The Confidence and Supply Agreements with the New Zealand First and United Future parties include commitments to review the current business tax regime as well as several specific tax issues. One of these specific tax issues for the United Future Party is to produce a discussion document on income-splitting (PriceWaterhouseCoopers, 2005).

The remainder of this paper is structured as follows. Section 2 reviews the process of tax policy making in New Zealand. The third section sets out the tax unit used in different Organisation of Economic Co-operation and Development (OECD) countries. Section 4 reviews the current tax regime in New Zealand and identifies the current issues Inland Revenue have with income-splitting vehicles. The proposal included in the Confidence and Supply Agreement between Labour and United Future to review the current income tax policy and practice to permit family income-splitting is discussed in section 5, followed by a concluding section.

LITERATURE REVIEW

Adam Smith in Chapter 2 of Book V of the series entitled “An Inquiry into the Nature and Causes of the Wealth of Nations” published in 1776 suggested that one of the four maxims of taxation, now commonly referred to as the canons of taxation, stated:

“The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation.”
That a “good” tax system should require equality of sacrifice is almost universally accepted by tax policy commentators (Lymer & Hancock, 2001; Peddle, 1989; Sandford, 1993). According to Sandford (1993) who analysed tax reform in the 1980’s in the United Kingdom, New Zealand, Australia, United States of America, Canada and Ireland, these countries sought different methods to achieve horizontal and/or vertical equity. These two measures of the fairness of the tax system are defined by Lymer & Hancock (2001) as:

- “a tax system is horizontally equitable if taxpayers with equal taxable capacity bear the same tax.
- “a tax system has vertical equity if those whose need is greater suffer less tax” (p. 3/9).

The problems of defining and implementing horizontal and vertical equity have been well documented.

Over the last 15 years New Zealand’s tax system has undergone major reform and modernisation. The focus of the New Zealand Inland Revenue Department Policy Advice Division is now on “improving the efficiency of the tax system and clarifying and simplifying it” (Inland Revenue Department, 2006).

Since 1995 all tax policy in New Zealand has been developed under the Generic Tax Policy Process. This is a five step process designed to “ensure better, more effective tax policy development through early consideration of all aspects - and likely impacts - of proposals, and increased opportunities for public consultation.” (Inland Revenue Department, 1995).

The five stages of tax policy development are described by Inland Revenue as follows:

- **Strategic**, which involves the development of an economic strategy, fiscal strategy and three-year revenue strategy. Broad policy proposals may be publicised through channels such as Budget documentation.
- **Tactical**, which involves the development of a three-year work programme and an annual resource plan to implement the revenue strategy. The process allows the initial scoping and development of broad policy options, and may involve external consultation at this point, often by means of a high-level 'green' paper, or discussion document.
- **Operational**, which consists of detailed policy design, detailed consultation, and gaining Ministerial and Cabinet approval of recommendations. Again, discussion documents, or 'white' papers in this case, may be used for purposes of consultation. Proposed reforms may be revised in light of the submissions received. This phase culminates in Government approval of practical tax policy initiatives that are ready to be introduced into Parliament and implemented.
- **Legislative**, in which the detailed policy recommendation is translated into legislation. This occurs in parallel with the operational phases described above, which speeds up the process by ensuring legislation
is ready for introduction into Parliament once all policy issues have been resolved. It also ensures the proposed reforms can be expressed clearly in legislation. External consultation takes place through public submissions to the select committee considering the bill.

- Implementation and review, which include the post-implementation review of new legislation, after it has had time to 'bed in', and identification of remedial issues that need correcting for the new legislation to have its intended effect. Opportunities for external consultation are also built into this stage.”

As a result of the 2005 General Election and the Confidence and Supply Agreement reached between the Labour and United Future Parties the Honourable Peter Dunne, Leader of the United Future Party became Minister of Revenue with responsibility for management of tax policy issues and overview of the administration of the Inland Revenue Department, including maintaining the integrity of the tax system, as defined in s 6 (2) of the Tax Administration Act (TAA) 1994. One of the tax principles of the United Future Party is that the “tax system should work in the interests of those raising families” (United Future Policy Statement, 2005) to be achieved by income splitting between family members. On the 28 November 2006 Peter Dunne, stated:

“taxing households on the basis of the members within them, rather than just the individual income earner, which is really what income splitting is about, has the potential to be fairer, but also to recognise more effectively the contribution both partners are making to the running of that household.

“It is not a costly policy to implement.

“Treasury estimates in 2005 were that our policy of allowing couples with dependent children earning up to $120,000 between them to split incomes would cost about the same as dropping each of our current 21 cent, 33 cent, 39 cent tax rates by one cent” (Dunne, 2006)

Peter Dunne expects the Discussion Document on the issues relating to income splitting and household income to be released early in 2008.

INTERNATIONAL COMPARISON

Lahey (2000) stated that the type of taxation unit used to calculate income tax in different jurisdictions around the world varies and may be based on either the individual or some form of joint taxing unit. The taxation of the individual ranges from one with either virtually no relationship-related provisions such as in Sweden, to a large number of such provisions, for example Canada. The use of the joint taxing unit may range from being either optional or mandatory and can be based on either income splitting between spouses such as in the
United States of America, or between all members of the family, for example in France (Lahey, 2000).

History shows that “the oldest European income tax systems automatically used the married couple as the tax unit because taxation was essentially treated as an extension of family property law” (Lahey, 2000). The first comprehensive income statute was adopted by Sweden in 1710, followed by England in 1799. From the beginning the English tax system used the husband as the taxpayer and treated the wife’s income as belonging to the husband. In 1894, in response to the women’s movement, the Finance Act was amended to provide a special deduction for wage-earning women. A change in 1990 resulted in England using the individual as the tax unit, with a number of income splitting provisions continuing to be possible between spouses. The married man’s credit was repealed in April 2000 in the United Kingdom, and was replaced with a child credit in April 2001 (Lahey, 2000).

The United States which had begun with individual filing moved to a joint filing system and income splitting after World War II (Lahey, 2000). In the period 1970 to 1999, no country in the OECD moved to a joint or optional taxation system (Organisation for Economic Co-operation and Development, 2001).

The type of taxation system for most countries of the OECD since 1970 has moved from a joint taxation system to one where there is compulsory and separate taxation of couples (see Table 1). In 1970, New Zealand was one of the five OECD countries that had separate taxation, along with Canada, Japan, Greece and Australia. By 1999, the move to separate taxation has resulted in only nine countries of the OECD retaining a joint taxation system, or one where couples with average earnings were likely to opt for joint taxation. Countries that retained the joint taxation system were: the United States, Portugal, Poland, Ireland, Germany, Switzerland, France, Luxembourg and (for all but very small incomes) Turkey (Organisation for Economic Co-operation and Development, 2001).

Canada is an example of a country which has used the individual as the tax unit from the date of the inception of its income tax system in 1917, although it “has always taken account of certain aspects of spousal and familial relationships” (Young, 2000). Changes in the nature of relationships have resulted in amendments to the Income Tax Act but the Canadian income tax system has consistently treated married persons in a different manner to single persons. It is considered by Lahey (2000) that “the Canadian individual tax system remains a hybrid because it contains so many joint provisions” (p. 15) and there are now “nearly 200 provisions that depend in some way on adult relationships” (p. 15).

In November 2006, the Finance Minister of Canada Jim Flaherty announced a “Tax Fairness Plan”. One of the measures included in this plan is to allow pensioners (over the age of 65) to allocate up to one-half of certain qualifying pension plan incomes to their spouse or common law partner from 2007 onwards (Canada Retirement Information Centre Inc., 2006). It would appear
that Canada is moving more towards joint taxation, contrary to the overall trend of other OECD countries.

**Table 1  Developments in personal income tax systems, 1970 - 1999**

<table>
<thead>
<tr>
<th>Type of taxation system*</th>
<th>1970</th>
<th>1990</th>
<th>1999</th>
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<tbody>
<tr>
<td><strong>North America</strong></td>
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<td></td>
</tr>
<tr>
<td>Canada</td>
<td>Separate</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Mexico</td>
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<td>Separate</td>
</tr>
<tr>
<td>United States</td>
<td>Joint</td>
<td>Joint</td>
<td>Optional/Joint</td>
</tr>
<tr>
<td><strong>Asia</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>Separate</td>
<td>Separate</td>
<td>Separate</td>
</tr>
<tr>
<td>Korea</td>
<td>.</td>
<td>.</td>
<td>Separate</td>
</tr>
<tr>
<td><strong>Europe</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>Joint</td>
<td>Separate</td>
<td>Separate</td>
</tr>
<tr>
<td>Finland</td>
<td>Joint</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Iceland</td>
<td>Joint</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Norway</td>
<td>Optional</td>
<td>Optional</td>
<td>Optional</td>
</tr>
<tr>
<td>Sweden</td>
<td>Joint</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Greece</td>
<td>Separate</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Italy</td>
<td>Joint</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Portugal</td>
<td>Variable</td>
<td>Joint</td>
<td>Joint</td>
</tr>
<tr>
<td>Spain</td>
<td>Joint</td>
<td>Optional</td>
<td>Separate (Joint)</td>
</tr>
<tr>
<td>Czech Republic</td>
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<td>.</td>
<td>Separate</td>
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<tr>
<td>Hungary</td>
<td>.</td>
<td>.</td>
<td>Separate</td>
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<tr>
<td>Poland</td>
<td>.</td>
<td>.</td>
<td>Optional</td>
</tr>
<tr>
<td>Ireland</td>
<td>Joint</td>
<td>Joint</td>
<td>Optional/Joint</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Joint</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>Austria</td>
<td>Joint</td>
<td>Separate</td>
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<tr>
<td>Germany</td>
<td>Joint</td>
<td>Joint</td>
<td>Joint</td>
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<tr>
<td>Netherlands</td>
<td>Joint</td>
<td>Separate</td>
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<td>Switzerland</td>
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<tr>
<td>Belgium</td>
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<td>Separate</td>
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<td>France</td>
<td>Joint</td>
<td>Joint</td>
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<td>Luxembourg</td>
<td>Joint</td>
<td>Joint</td>
<td>Joint</td>
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<tr>
<td>Turkey</td>
<td>Separate/Joint</td>
<td>Separate/Joint</td>
<td>Separate/Joint</td>
</tr>
<tr>
<td><strong>Oceania</strong></td>
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<tr>
<td>Australia</td>
<td>Separate</td>
<td>Separate</td>
<td>Separate</td>
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<tr>
<td>New Zealand</td>
<td>Separate</td>
<td>Separate</td>
<td>Separate</td>
</tr>
</tbody>
</table>

(Organisation for Economic Co-operation and Development, 2001)
THE CURRENT NEW ZEALAND TAX REGIME

New Zealand has always used the individual as the tax unit. The current New Zealand tax regime is based on a combination of ‘residency’ and ‘source’. Revenue streams that are deemed by s OE 4 Income Tax Act (ITA) 2004 to have a source in New Zealand are subject to New Zealand income tax. This section covers all those types of income that are traditionally deemed income under ordinary concepts, in accounting terms, revenue expenditure.

Individuals are deemed to be tax resident in New Zealand if they have a "permanent place of abode in New Zealand, whether or not that person also has a permanent place of abode outside New Zealand" (s OE 1(1) ITA 2004). There are supplementary tests relating to personal presence in, and personal absence from, the country. The progressive tax rates applicable to individuals are 15c on income up to $9,500; 21c on income between $9,500 and $38,000; 33c on income between $38,000 and $60,000 and 39c on income above $60,000 (Schedule 1 ITA 2004).

Companies are deemed to be tax resident in New Zealand if the company is “incorporated in New Zealand; or has its head office in New Zealand; or control of the company by its directors, acting in their capacity as directors, exercise decision making in New Zealand whether or not decision making is confined to New Zealand” (s OE 2(1) ITA 2004). In addition, Subpart HG ITA 2004 creates tax vehicles known as qualifying companies (QCs), which seek to tax companies with five (5) or fewer shareholders as though they were a partnership, allowing the distribution of capital gains without needing to liquidate the company. Directors and shareholders must elect to join the regime because they relinquish their limited liability for the company’s income tax. QCs pay only fully imputed or tax free dividends. Also, a company which meets all the criteria for a qualifying company and has only one class of shares may elect to become a loss attributing qualifying company (LAQC). Such companies must attribute all losses annually to shareholders in accordance with their effective interest in the company. LAQCs have become extremely popular vehicles in New Zealand. In June 2006 there were 118,000 LAQCs registered with the Inland Revenue Department (Oxley, 2006).

Section 42 (1)(b) of the TAA 1994 requires partners to make a joint return of income though no joint assessment is issued. The partners are separately assessed for partnership income or losses. Anti-avoidance rules apply to prevent partnerships and close companies (one where 50% or more of the company is owned by five (5) or fewer shareholders) from making excessive distributions of revenue to partners, partner’s relatives, shareholders, directors or relatives (ss GD 3 and 5 ITA 2004). Section GD 4 ITA 2004 prevents spouses being paid by the taxpayer without prior approval from Inland Revenue Department.

Another very popular vehicle for asset protection, wealth generation and income splitting is the family trust. In 1999 there were in excess of 120,000 trusts in New Zealand and the estimate was made that there would be closer
to 150,000 in 2002 (TEO Training Limited, 2002). The ‘settlor’ regime dates from 1 April 1988 and provides for the tax treatment of the trust to follow the tax residency of the settler (Inland Revenue Department, 1989).

There are four types of trusts under the settlor regime with different taxation outcomes. These are qualifying trusts, non-qualifying trusts, foreign trusts and charitable trusts. In brief, non-qualifying trusts are those that have not met all the tax obligations since created or 17 December 1987 (whichever is the later) and pay tax at the penalty rate of 45c in the dollar on all distributions of accumulated funds (post 1 April 1988) and capital gains. Distributions of accumulated funds pre 1 April 1988 and corpus (as defined in s OB 1 ITA 2004) are non-taxable. All other beneficiary income is taxed at the beneficiary’s marginal tax rate. Trustee income is taxed at a flat rate of 33c in the dollar.

Foreign trusts have no New Zealand settlors but have New Zealand resident beneficiaries. The trust could derive New Zealand sourced income which would be taxed to the trustee at a flat rate of 33c in the dollar or to the beneficiary at their marginal tax rate. Foreign sourced income would obviously attract no New Zealand income tax until the foreign sourced income is distributed to the New Zealand resident beneficiary. Beneficiaries will also pay New Zealand tax at their marginal rate on taxable distributions of the trust (accumulated funds post 1 April 1988 and non-arm’s-length capital gains).

A charitable trust is any trust in which the trustee income is held in trust solely for charitable purposes (s HH 1 ITA 2004) and as such are exempt from New Zealand income tax.

The most common type of trust in New Zealand is termed the ‘qualifying trust’ for tax purposes (Subpart HH of the ITA 2004). Such trusts return their income which may then be taxed as ‘beneficiary income’ or ‘trustee income’. Under s OB 1 of the ITA 2004 beneficiary income comprises income which vests absolutely in the beneficiary during the year or which is paid to or applied for the benefit of the beneficiary during the income year and up to six (6) months thereafter.

Vesting means to become absolutely entitled in interest (but not necessarily possession) to the income. The vesting may occur either by the terms of the trust or the exercise of a discretion on the part of the trustee in favour of the beneficiary. Obviously for the income to vest under an exercise of trustee’s discretion the appropriate resolution would have to be made before the end of the tax year.

The paid or applied rule is more complex. Beneficiaries under the age of 20 years (section 4 Age of Majority Act 1970) have not attained their majority and as such cannot give the trustee a valid receipt for any distribution made. In these circumstances the trustee may apply the income distribution for the beneficiary’s benefit, eg by paying school fees. Case S43 (1995) 17 NZTC 7,293, a New Zealand Taxation Review Authority decision is of significance in establishing basic rules that must be met for the income to be treated as
beneficiary’s income under this provision. There must be a resolution by the trustees in which they exercise a conscious mind; the distribution must involve a distribution of cash or the legal severance of the funds from the trustee’s capacity as a trustee and there must be an appropriate resolution of documentation to support the distribution.

Trustee income is any income which is not vested absolutely in a beneficiary in an income year nor paid to or applied for the benefit of the beneficiary during the income year and six (6) months thereafter (s OB 1 ITA 2004). Income that would otherwise be beneficiary income is deemed to constitute trustee income where the beneficiary is under the age of 16 years at the balance date of the trust (s HH 3A(1) ITA 2004). This rule does not apply if the beneficiary’s share of the trust income is $1,000 or less in the tax year (s HH 3B ITA 2004). There are further exceptions when the income arises from a child disability allowance (s HH 3E(1) ITA 2004); from a Group Investment Fund or a Māori Authority (s HH 3E(2) ITA 2004); or if the settlement (corpus) is less than $5,000 where the settlement has been for less than market value; or $1,000 where the settlement included a loan at less than market rates of interest (s HH 3D ITA 2004). The minor beneficiary rules applied from the 2000/2001 tax year when New Zealand’s top income tax rate became 39c in the dollar.

In 1999 the income returned by the 120,000 New Zealand tax resident trusts was allocated $NZ1,500 million to beneficiaries and $3,000 million to trustees (TEO Training Limited, 2002). It would certainly be interesting to view more up to date figures if they could be obtained from Inland Revenue Department. Our guess is that there would be even more trusts registered with large sums of assets under administration.

Limited liability companies and family trusts can be used as vehicles for income splitting among shareholders and family members. It goes without saying that this will not be the only reason for either establishing a business as a limited liability company or setting up a family trust. All New Zealand tax resident companies and trustees’ income, as described above, pay income tax at a flat rate of 33c in the dollar. At an income of $44,460 the company and trustee flat tax rate would attract an equivalent amount of tax as an individual would pay on income up to $60,000 using the individual progressive tax scale. The earnings of an individual in excess of $60,000 would attract 6c in the dollar more than if that income was earned by a company or taxed as trustees’ income making it possibly more attractive to establish income splitting vehicles.

Many changes were required to the legislation in the year 2000 to bolster the top rate and ensure that taxpayers did not succeed in avoiding the extra 6c in the dollar. When introduced the 39c in the dollar tax rate was meant to apply to only 5% of taxpayers. It now applies to 12% of taxpayers who pay 51% of all income tax (Dunne, 2006). The Hon Peter Dunne said “just to retain relativity with the 2000 position, we would probably be looking at adjusting the top threshold to somewhere over $90,000, with consequential adjustments to other thresholds”.
Current issues identified by the Inland Revenue Department

The briefing paper to the incoming Minister of Revenue following the 2005 General Election identified the following three key policy challenges:

- “New Zealand's substantial company tax base is at risk because of our relatively high reliance on corporate tax as a revenue source and the relatively high foreign ownership of companies. Many other countries have lowered their company tax rates over recent years and, as they do so, it becomes harder for New Zealand to retain its corporate tax base.

- “Of particular concern are Australia's lower, 30% company tax rate and its full imputation system, both of which can act as incentives to stream profits abroad, thus eroding our company tax base. We also need to establish a response to Australia's reduction of non-resident withholding rates on interest, dividends and royalties. This means that the future of the trans-Tasman tax relationship needs to be considered as a matter of priority.

- “Problems with our personal income tax structure are also emerging, particularly in relation to the 33% and 39% personal income tax rates. There is growing evidence of tax sheltering and income splitting, raising questions of how robust our tax system is.” (Inland Revenue Department, 2005)

The issues facing the Minister of Revenue and Inland Revenue Department are reproduced in Appendix A. Among the issues identified are the differences in marginal tax rates, the lack of consistency of taxing different vehicles including trusts and companies and providing scope for income splitting within a family which leads to perceptions of unfairness.
POSSIBLE FUTURE POLICY CHANGES IN NEW ZEALAND

The results of New Zealand’s general election in September 2005 required the Labour Party to launch into a series of negotiations with other political parties. To gain a working majority of 67 members out of a total of 121 members of Parliament, Labour also concluded Confidence and Supply Agreements with the New Zealand First Party (holding seven seats) and the United Future New Zealand Party (holding three seats). These various agreements signal a possible change in the taxing unit in New Zealand.

The Confidence and Supply Agreements with the New Zealand First and United Future parties include commitments to review the current business tax regime as well as several specific tax issues. One of these specific tax issues for the United Future Party is to produce a discussion document on income-splitting (PriceWaterhouseCoopers, 2005).

The United Future Party was formed from the merger of the United New Zealand Party and Future New Zealand Party. Future New Zealand originated from the old Christian Democrat Party founded in 1995. Future New Zealand was a secularised evolution of the Christian Democrats but followed the same basic policies, mainly the focus on the family. The United Future Party

“is a centrist political party that seeks innovative solutions to issues based on common sense, not ideology. United Future is based on the premise that every political issue is ultimately a family issue. When the family is working well, the community and the country is working well.

“No one political party or political philosophy has the market on good ideas - United Future works constructively with parties from across the political spectrum for the benefit of New Zealand families.

“United Future puts the family at the centre of its policymaking, empowers communities, and puts interests of the country ahead of petty politics (United Future Party, 2006).

On the 28 November 2006 the Hon Peter Dunne, Leader of the United Future Party in a speech to the Employers and Manufacturers Association said:

“Research by both the OECD and the Families Commission supports United Future’s long held contention that we do not do enough to recognise the plight of second income earners in a household, invariably a mother at home caring for the kids.

“Targeted tax relief through policies like Working for Families has been the preferred way of addressing these matters to date, but there will come a time when more of the same is viewed as just middle class welfare payments.”
In the same speech, the Hon Peter Dunne stated that income-splitting has the potential to be fairer and to recognize the contribution members of a household make to a family. The new Discussion Document is due for release in 2008.

United Future’s tax policy reflects their philosophy that “every political issue is ultimately a family issue” (United Future Party, 2006). For example the first $3,000 of income will be treated as tax free “as part of the Working for Families package” and “ensure that the taxation system takes into account the costs of raising a family by introducing income split for couples raising children.” One can speculate that this family focus may reflect their Christian Democrat heritage as evidenced by their opposition to the Civil Union Act 2004. This Act extended to same sex couples and mixed sex couples who choose not to marry the same rights as marriage. Further to this the Property (Relationships) Amendment Act 2001 provides that de facto relationships after of period of three years have the same rights as married and civil union couples to a fifty per cent share of relationship property on dissolution of the relationship and in a ongoing relationship where the parties agree to the 50:50 division of relationship property. It is possible that this party may find it philosophically difficult to extend income splitting beyond married couples to all couples raising children.

Lahey (2000) states that support for joint taxation was essentially “a matter of horizontal equity between couples with equal incomes” (p. 21), the proposition being that couples with the same income should bear the same tax liability. It is also seen as an effective anti-avoidance device as it deters couples from transferring income to the lower-earning income partner. Joint taxation is seen as reflecting the contribution of both parties to the relationship. Joint taxation has also been described as a method of simplification by reducing compliance and administration costs as only one tax return needs to be filed.

Arguments against joint taxation are that it would be potentially inconsistent and result in a tax policy that must give rise to anomalies. For example couples earning in excess of $60,000 each would derive no benefit from income splitting. Income splitting must increase complexity because the legislation will need to define such items as the parties involved, the duration of the relationship, and what constitutes a dependent child. A decision would need to be made as to whether the income splitting was mandatory or voluntary.

According to Statistics New Zealand (2006) in their final census data from March 2006 41.95% of New Zealand families comprise couples living with a child or children. We could speculate the extent to which United Future’s income splitting policy might be of benefit to these couples or whether it is just a “vote-catcher”. Michael D’Ascenzo, the Federal Commissioner of Taxes in Australia, stated that “politicians had responded to voter preferences for equity rather than simplicity. They’re [politicians] making choices informed by what the population is likely to vote for and that complexity was “in a way” the fault of taxpaying voters” (Garnaut, 2006). Dr Michael Dirkis, tax counsel with Taxpayers Australia said that “politicians had exacerbated tax complexity by
inserting family benefit rules into the Tax Act – merely so they could describe the handouts as tax rebates rather than welfare” (Garnaut, 2006).

**CONCLUSION**

The result of the Confidence and Supply Agreement between the Labour-Progressive Coalition and the United Future Party has raised issues of tax policy which could be viewed as social-engineering. Although the Hon Peter Dunne admits that “it is difficult and costly to introduce a structural change to the relationship between the tax and benefit systems that does not leave at least some people worse off” he still believes that such a policy will be adopted in time (Sawyer & Tan, 2006).

The United Future Party appears to be advocating a move towards joint taxation rather than using the individual as the tax unit. This move appears to be consistent with Canadian tax policy and against the trend in other OECD countries.

Public consultation will be invited when the Discussion Document is issued in early 2008 as part of New Zealand’s generic tax policy process.
REFERENCES


Inland Revenue Department. (2005). Briefing for the incoming Minister of Revenue.


Appendix A

Briefing for the Incoming Minister of Revenue - 2005 - Part 2

*Taxes, distortions and the New Zealand tax system*

Taxes are needed to finance government spending. At the same time, taxes distort economic behaviour, which can inhibit growth. When the tax system causes people to invest in particular assets or to structure their affairs in ways which are sensible only because of taxes, the tax system is said to be inefficient. A goal of good tax reform is to raise sufficient revenue to meet government requirements as efficiently as possible, consistent with a government's equity objectives.

Although most taxes can distort economic behaviour, it appears to be income taxes where most pressures are emerging. Income taxes can distort behaviour, harm economic growth and produce other undesirable effects in three different ways. The possible distortions can be grouped as follows:

- those attributable to all marginal tax rates
- those attributable to differences in marginal tax rates and
- those primarily attributable to the top marginal tax rate.

It should be noted at the outset that in listing these potential distortions we are not suggesting New Zealand's tax system is poor relative to tax systems in other countries. On the contrary, we will see that in many ways New Zealand's tax system is relatively well designed. Being aware of the three different possible sets of distortions, however, is helpful in examining how efficient New Zealand's tax system is likely to be.

First, high marginal tax rates can hinder individuals from working as long, as hard or in as difficult and demanding jobs as they would if marginal tax rates were lower. High marginal tax rates can also discourage individuals from saving when it would be desirable to do so if not for these tax rates, and encourage avoidance or evasion of taxes. The degree of distortion will depend on an individual's marginal tax rate on any additional income, and different individuals will face different marginal tax rates on additional income. Thus these inefficiencies will depend on the levels of marginal tax rates facing all individuals.

Second, differences in marginal tax rates can produce another set of distortions. If marginal tax rates rise with income, the high rates faced if a risky investment pays off and the low rates faced if the investment fails may discourage risk-taking behaviour.[1] Similarly, increasing marginal tax rates can discourage individuals from "investing in human capital" and acquiring new knowledge and skills. It is also differences in marginal tax rates that give rise to problems in taxing different forms of savings vehicles, including trusts and companies, on a consistent basis and lead to biases in the ways that
individuals save. Moreover, differences in marginal rates provide scope for income splitting within a family. This leads to perceptions of unfairness.

Third, some distortions may predominantly be affected by the highest marginal tax rates. If certain forms of investment are tax advantaged relative to others, those who have the biggest incentives to invest are those on the highest tax rates. Provided these individuals have or can borrow sufficient capital, it may well be the tax rate of these individuals that determines the efficiency cost of the distortion.

By international standards, New Zealand has broad bases for both its income tax and GST, and about 90 percent of total government tax revenue comes from these taxes. Both tax bases have relatively few concessions by international standards. This allows lower tax rates and a more efficient tax system than would otherwise be possible.

The basic structure of our tax system was endorsed by the Tax Review 2001, which concluded that "... radical restructuring is not required. The broad architecture of the tax system is sound." The Tax Review commissioned Professor Alan Auerbach, a leading international expert on the economics of taxation, to comment on its June 2001 Issues Paper. He prefaced his report by stating "New Zealand's current tax system already conforms more closely to the standard objectives of taxation than do the tax systems of many other developed countries. Thus New Zealand's tax system is not obviously in need of major overhaul" (p.2). (Inland Revenue Department, 2005).