Looking at Labour's CGT proposal

Labour's Capital Gains Tax proposal throws up some basic questions. Here are a few answers.

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Our last article was written before the Labour Party's announcement of its CGT, and posed nine questions for readers to ask of the proposal. In this article we provide the answers, and a score, where 1 is very bad and 10 is very good.

So, is it a good proposal, or is it a bad one?

■ Will the Labour Party's CGT proposal adjust gains for the inflation effect? Answer: No. Inflation would be taxed. Our score: 1.

■ Will it be taxed as income, at income tax rates, or will it be a separate regime with special rates? Answer: No. A new 15 per cent tax rate is proposed for capital gains. If this were part of a new flatter tax rate regime, where capital gains were taxed like income, we'd give it a 10. But it's not, and in fact it's part of a package that introduces two new rates for income tax, and for that reason we have to downgrade it to 5.

■ Will the rates be progressive, like our income tax rates are, or will they be fixed? Answer: No. Score: 10.

■ What exemptions will there be? The most important exemption proposed is the family home. Score: 8.

■ What range of share investments will be included? For example, will KiwiSaver gains be exempt? Yes, KiwiSaver realisations will be exempt. Score: 5.

■ Will there be relief for re-invested gains, like the British model? For example, where a farmer sells one farm to move to another? Answer: No. Whilst the gain on the farm owner's residence will not be taxable, the farm sale will. This will place a serious impediment in the path of stepping stone farmers, so the score has to be 1.

■ Will CGT become a death duty in disguise? Answer: No. Unrealised gains on bequeathed assets will be rolled over until the asset is sold. Score: 8. But note that transfers to a family trust will be treated as a sale, and taxed accordingly. Anyone contemplating the formation of a family trust, needs no clearer warning: see your accountant soon.

■ Will CGT replace or simplify our very complex land sale taxation regime? Answer: Apparently not. That's a pity, as it might have been a means of simplifying the existing land sale taxation laws, which ask, Was it bought with the intention of selling it at a profit? A sensible solution would be to treat all land sales that are not on revenue account equally with those that are taxed as capital gains. Score: 3.

■ Will CGT be a step towards a broader, flatter tax base, with more people paying less? Answer: Broader, yes, but flatter? No. The stated intention is to use it to fund the removal of GST on fruit and veges, and a zero tax rate on incomes under $5,000. Score: 5.

The National Party objections to the Labour tax package are summed up by the following comments from Bill English:

'It [Labour] would also have six income tax rates, a GST that applies to some things but not others, a big gap between the company rate and the top tax rate, and a capital gains tax on productive industries with a maze of exemptions that raises virtually no revenue in the first few years. All of this would encourage tax avoidance. Instead of more taxes, New Zealand needs more taxpayers. Instead of growing the government, we need to grow the economy.'

English has also argued that National's 2011 removal of depreciation allowances on buildings, and the discontinuation of the LAQC regime, go a long way towards discouraging the New Zealand public obsession with investing in the non-productive housing sector.

In terms of the national interest, those arguments have considerable merit. But as taxpayers, we need to face the reality that it is more than probable that Labour will introduce a CGT when they are next elected, and we will have no choice but to live with it.