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CONTENTS

CONTENTS CONTINUED

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Developing a sustainable tax base through a financial transaction tax: An analysis of suitability for the New Zealand environment

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Abstract

The purpose of this research is to address whether a Financial Transaction Tax (FTT) should be implemented in New Zealand in order to address the effect of an ageing population on the New Zealand tax revenue base. This paper considers the wider theoretical literature on the implementation of a FTT. In considering the literature it draws out the main arguments for and against the imposition of a FTT. This paper identifies that New Zealand has an imminent issue with needing to adapt the tax revenue base because of the impact of its ageing population. The advantages and disadvantages of a FTT are considered in the New Zealand context. The key advantages are that a FTT can generate increased revenue and reduce speculative behaviour in financial markets. The disadvantages identified in the literature are that there are limited means to accurately predict the actual revenue generated by a FTT, or the potential negative effects on market trading within a country. There is also concern that a FTT needs to be applied on a regional or wider global basis for a FTT to be effective. In the New Zealand context further research could include considering the amount of potential revenue that can be generated by a FTT, assessing the potential effect of a FTT on the government-funded superannuation saving scheme, KiwiSaver, and whether the imposition of a FTT would be more effective on a regional scale across Australia and New Zealand. This paper provides an initial explorative study of the potential for a FTT to be implemented in New Zealand and areas for future research.

Key words: Financial Transaction Tax, Tax base, Tax policy, Tobin tax, KiwiSaver, New Zealand

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The next section will consider the specific impact of retirees on the collection of taxes in New Zealand by examining the New Zealand tax base model.

3.3 Effect of an ageing population on tax base

The New Zealand tax base is reliant upon the collection of taxes from three major sources: personal income, company income and GST.[15]

One notable change in recent years is that the proportion of revenue from individual income tax has decreased while the proportion of revenue from GST and company income tax has increased. Between the years ended June 2010 and June 2013, individual income tax reduced from 48 percent to 39 percent of total revenue, while company income tax increased from 13 percent to 16 percent of total revenue, and GST from 24 percent to 32 percent. This switch in tax revenue is partially attributable to the increase in the GST rate from 12.5 per cent to 15 per cent and reductions to individual income tax rates from 1 October 2010.

New Zealand has the sixth lowest GST rate at 15 per cent amoung OECD countries, however, proportionally the collection of GST as a consumption tax is the highest in the OECD.[16] The high amount of GST collected reflects New Zealand's GST broad base, which has been extended in 2016 to include supply of digital services.[17] On the other hand the contribution of individual income tax remains the main source of revenue in the New Zealand tax base. The change in New Zealand demographics means that in the future it is plausible to foresee changes in the tax base for income taxes.[18]

3.4 Private retirement savings and other funding solutions

Funding solutions to the problems of an increasing number of retirees has typically focused on superannuation funding. New Zealand has a universal tax-funded state pension scheme called the New Zealand Superannuation (NZS) available by right to all residents over 65 years of age.[19] NZS payments do not depend on prior earnings of an individual and are paid at a flat rate to all who are entitled to receive it.[20] In 2007 the New Zealand government introduced an opt-out workplace-based superannuation savings scheme called KiwiSaver.[21] The purpose of the scheme is to encourage saving for retirement.[22] KiwiSaver is funded by contributions from the government, employers and employees. As a result of KiwiSaver many New Zealand retirees will have access to the accumulated private retirement funds. However due to the

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[15] New Zealand Inland Revenue Department, Briefing for the Incoming Minister of Revenue—2014: The New Zealand Tax System and How it Compares Internationally (Inland Revenue Department, 2014) 11 <http://www.ird.govt.nz/resources/8/d/8d8ea55f-9fe9-4934-87c5-9094338af754/bim-2014.pdf>.

[16] OECD, above n 6.

[17] *Goods and Services Tax A11 ealanG4934e Tw 3.92 0 Td (v)11 (i)5 (/2v)i1u (g)6.7 (D)-2 (,)-7*

relatively recent introduction of the scheme only modest returns will be available for several decades. This means that retirees will still have to rely principally on government support.

3.5 FTT as a solution to an aging population

For the purposes of this literature review, a FTT will be considered as a tax levied on the wholesale capital market secondary transactions.[23] The concept of FTT was developed by John Maynard Keynes in 1936 and James Tobin in 1972, and was considered a tax that would have both the benefit of raising taxation revenue, as well as reducing the negative externalities of the transactions they were imposed upon.[24] Tobin specifically considered a tax on international foreign exchange transactions and stated that it would be a 'soft' control on a system which as a result would deliver great benefit. Tobin continued to advocate for 'a uniform worldwide tax on spot transactions across currencies' which he observed was rediscovered by different groups from time to time.[25]

Broadly there are two factors in support of a 'Tobin' tax. The first is the concept of supporting international agencies as argued in Tobin's original concept advocated in 1972 at the Eliot Janeway Lectures. The second is recognition of the power of revenue generation as reviewed by Tobin in 1996.[26] Critics of Tobin's approach have argued that currency-based transactions will be moved offshore to avoid the tax and make it less effective.[27] However, the need for a Tobin-type tax on international currency exchange is linked to concerns about international finance. These concerns have only increased in light of the Global Financial Crisis (GFC) and continuing concerns about the need to put 'sand in the wheels of international finance'.[28] The potential revenue estimate from a global FTT of 0.05 per cent is US$500 billion per annum.[29] In theory, the imposition of FTT would also see financial institutions contribute to the societies in which they operate. The concerns about international finance relate mainly to speculative behaviour and its potentially detrimental effect on global economies.[30] A quantitative country-specific study has also confirmed the link between currency fluctuations and a lack of control over currency-related

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[23] Ross P Buckley, 'Introducing a 0.05% Financial Transactions Tax as an Instrument of Global Justice and Market Efficiency' (2014) 4(1) *Asian Journal of International Law* 153, DOI: 10.1017/S2044251313000271.

[24]

transactions.[31] Another counter currency speculation option includes maintaining a low interest rate to remove incentives for speculators.[32] The literature has responded to the Tobin tax proposal over time so that in its current context, post GFC, the anti-speculation aspects of a Tobin-type tax are the most important. It can be argued that in a similar manner a FTT would be a tax that can also reduce speculative behaviour in capital market transactions.

3.6 Factors influencing a FTT in Europe

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3.7 Capital markets

Moderating the impact of capital markets in global finance is a feature of the Tobin tax discussed above. In terms of a FTT, the financial markets have also been considered in the literature: Tobin tax on currency, securities transaction taxes and

and derivatives; the need to evaluate the current position of New Zealand's capital market is relevant. The New Zealand Stock Exchange (NZX) is a listed company that builds and operates capital, risk and commodity markets in New Zealand. In June 2016 it had a total of 177 listed instruments and a combined market capitalisation of $118 billion.[47] There are many other transactions and organisations that could be captured by a FTT including banks, investment firms and hedge funds operators. The size of the market and the potential revenue that can be raised is beyond the explorative scope of this study. However, other than its ability to raise revenues, the literature reveals various other advantages and disadvantages associated with FTT.

4.2 Advantages

A practical benefit in the implementation of a FTT is that the collection cost is generally low due to the electronic nature of the transactions. The United Kingdoms' collection of various stamp duties provides an example of the cost effectiveness of collecting FTT.[48] According to the United Kingdom's Revenue and Customs in 2008 to 2009 the average collection cost for United Kingdom stamp duties was approximately 0.21 pence per pound raised, whereas the average collection cost for all taxes in the United Kingdom was approximately 1.10 pence per pound. Further to this,

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transaction and as a result is likely to negatively impact the attractiveness of trading.[62] Furthermore the reductions in trading volume will also likely result in a reduction in market liquidity; however, the degree of impact remains unclear. Buckley notes that if trading costs and bid-ask spreads are regarded as measures of efficiency, then under that definition a FTT would reduce efficiency.[63] However, if the measure of efficiency is so narrowly defined in where it focuses on individual transactions only, and not the allocative efficiency of the market overall, then its measure becomes rather uninformative for policy purposes. For perspective, if one considers the fact that high-frequency transactions cause prices to diverge from the indicative prices based on economic fundamentals, then it would be reasonable to state that the current financial markets are actually allocating resources relatively inefficiently.[64]

It is also worth addressing the link between high-frequency transactions and speculation. High-frequency transactions that utilise speculation to allocate resources have been reported to make markets relatively more crisis-prone.[65] There is evidence that confirms that crisis damage impacts the long-term growth of financial markets far more than minor enhancements in trading costs.[66] Therefore, although a FTT will marginally increase the cost of transactions, it can also the decrease the long-term externalities caused by high-frequency transactions. From this perspective a FTT can actually be a means of long-term welfare enhancement.

As with any new tax regime, a key concern is where the burden of tax will fall. A FTT or the 'Robin Hood tax' is a tax that is supposed to take from the rich financial institutions, and used to provide social support to society. However, it has been argued that the burden of taxation is likely to fall entirely on the consumers who are investors or pensioners and not on the banks.[67] In response, the counter-argument is that a FTT which targets consumers would require the majority of these short-term trades to be initiated by pension fund managers.[68] Instead, evidence has shown that the majority of short-term trades are initiated by hedge funds and hedge-fund-like proprietary traders working for banks rather than accounts targeted at clients. In this case a FTT would more likely impact the profits of hedge funds and banks rather than investors or pensioners. It appears that the taxation burden is far more likely to impact on the intended financial institutions. It should be noted that the New Zealand KiwiSaver institutional investors are likely to be affected by this tax, and as such it will be important for future research to study how this will affect investor perceptions as well as the profitability of the KiwiSaver scheme. On the other hand, the benefit they receive from more stable and long-term orientated markets will likely provide greater benefit than the imposition of tax.

Another key challenge in introducing a FTT is that there may be a lack of global reciprocity between nations implementing a FTT at a similar time. A problem with introducing new taxes is that institutions and individuals will find it relatively more

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[62] Ibid.

[63] Buckley and North, above n 58.

[64] Menzies et al, above n 55.

[65] Buckley, above n 23.

[66] Menzies et al, above n 55.

[67]

attractive to move their funds overseas to jurisdictions that impose relatively lower taxes.[69] For example, if a FTT was instituted in only limited jurisdictions, depending on the FTT rate, then traders could view FTT as a disincentive to trade in a particular country. For a FTT to achieve the objectives of raising revenue and reducing speculation it should be applied across major trading jurisdictions to limit incentive to switch trading focus to non-FTT jurisdictions. New Zealand would benefit more from an FTT tax if these other major trading jurisdictions, such as Australia, also implemented a FTT. Nonetheless, just as with the current United Kingdom stamp duty, a FTT does not need to be applied globally. A regional approach may also work effectively.

5. CONCLUSION

Overall, this paper provides an overview of FTT and highlights its value. The paper has also identified that the application of a FTT requires further research. Future research could focus on practical requirements for implementation of the tax within New Zealand. This includes research on the potential impact of a FTT on retirement funds that are held as part of the government-funded retirement KiwiSaver ri t]TJ 0 Tctie t]TJ 0