

Taxes tipped to be among taskforce's topics

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Ways in which the tax system distorts saving and investment decisions are likely to feature in the Capital Market Development Taskforce's report.

The Reserve Bank this week renewed its call for changes to the tax system that would lift savings rates and remove what it regards as the unduly favourable treatment of property and housing.

It referred in particular to the need for a more comprehensive and even-handed treatment of capital income (the returns on savings) and the possibility of adjusting the tax system.

In Australia, Treasury Secretary Ken Henry, who heads a tax review due to report this month, has also reflected on the dangers of relying on foreigners' savings to fund a country's investment needs and the increasing importance of capital income as the population ages.

He pointed to the wide disparity in how different forms of saving are taxed – ranging from not at all in the case of the family home to very high real effective marginal rates on bank deposits.

The same case could be made here.

Economist Andrew Coleman at the Wellington think tank Motu argues that even with low rates of inflation, the fact that it is nominal and not real interest payments that are taxable and deductible overtaxes lenders and subsidises borrowers.

"In the last decade when interest rates averaged 6 per cent and inflation averaged 2.6 per cent, the tax on real interest income was 75 per cent higher than the tax on other types of income," he said.

Meanwhile, if landlords borrow to finance their investment they are allowed to deduct the full nominal interest payment as an expense even though inflation is eroding the value of their debt. This has social effects, Coleman points out.

The tax system is especially hard on the least sophisticated savers, who are most likely to opt for the simplest option, bank deposits.

And it means that those with money to spare are better to buy a house and rent it out than to lend people the money, via the banks, to buy the place themselves. This has tended to bid up house prices and reduce home-ownership rates.

If changing the tax law, so that only real interest income is taxable and only real interest costs are deductible, is administratively too difficult, as Inland Revenue appears to believe, there are other ways of addressing the issue, Coleman says.

For example, most countries in effect tax labour income more heavily than capital income by funding much of their social spending through social security taxes rather than personal income tax.