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The Future for Local Government – Study into the Principles of a High Quality Tax and Revenue System – Key Issues

This paper builds on our February 2022 paper on the principles of a high quality tax and revenue system exploring key issues in developing more equitable funding for local government. This has been stated as moving from beneficiary-based funding principles to a funding system that equitably supports communities to thrive. That would require:

“A stable revenue system that provides certainty of funding sources and enables central and local government to be effective partners and co-investors in community outcomes and priorities, with local government’s funding policies supporting equity-based progressive taxation principles”.

Such a revenue system would then enable:

- Local government to collect revenue with less restrictions given the current legislative framework and therefore provide more flexibility in how local government raises revenue
- The establishment of a genuine partnership between central government and local government; and
- Strengthen local democracy.

Greater flexibility in local government revenue raising would mean that local authorities would have revenue options of what to date has been the sole preserve of central government in New Zealand, but are commonly used for local government internationally. That seems likely to require processes to address and resolve overlaps in responsibilities and decision making by central and local government. In general local government reform of any sort (not just revenue) raises issue of processes for the better management of the central/local government partnership. It would seem desirable for the processes on managing the partnership from a revenue raising perspective to be consistent with processes for managing the wider central/local government partnership.

Thinking to date is that this overall partnership would best be managed by a multi-level governance entity that has the ability to provide for central and local government to agree on issues that intersect between national and local.

We discuss below specific issues in managing the partnership from a revenue perspective and spectrum of options from central government veto of local revenue options to having statutory guides as to what is within the local government revenue domain.

Tax Design Principles

As per the February paper the suggested principles in the design of such a revenue system are that it:

- Is easily workable
- Fair and sustainable
- Does not provide incentives for people to act in a way contrary to community welfare.

Appendix A reproduces comments on these design principles.

Potential Tax Revenue Options

Potentially a number of possible taxes and levies could meet these design principles. As set out in the February paper there are only a limited number of tax bases (economic things to tax) available to any government:

- **Income** – this includes wealth which is a measure of income. New Zealand's national income tax is a tax on income. Rates on improved property value is in part an income tax being a tax on land improvements which is in part a measure of wealth. As a measure of wealth or income land value may be viewed as a blunt measure since it does not take into account debt levels of income levels of the ratepayer.

- **Consumption.** New Zealand's GST is a broadly based tax on consumption. Our GST is often cited as a high quality tax because it is broadly based. This means it does not provide incentives for people to consume one good or service over another to the detriment of overall welfare. However, more narrowly based taxes on particular items of consumption can be efficient and fair if they disincentivise forms of consumption that have adverse welfare impacts – taxes on smoking, alcohol, gambling, and activities that degrade the environment are often justified on this basis. Congestion charges, petrol tax, and bed or tourism taxes are in effect taxes on specific forms of consumption (driving cars or enjoying tourism).
- **Transaction taxes.** Taxes on a particular transaction independent of consumption. An example is stamp duty of the sale of residential property.
- **Land tax** – tax on the unimproved value of land. Rates on land value are land taxes.
- **Poll tax** – levied on each individual or household.

These tax bases provide considerable flexibility to governments in terms of revenue raising options. Local governments overseas use a variety of them including local sales taxes and income taxes.

New Zealand Local Government Constrained in its Tax Options

Under current law, New Zealand local government is, however, heavily constrained in the tax options open to it.

Local government has no inherent taxing power and is constrained in its revenue options by what Parliament authorises. Generally local government is limited to:

- **Rates** under the Local Government (Rating) Act 2002 and as also constrained by the Local Government Act 2002. This is a land tax (but rates can also tax improvements to land). Appendix C sets out the general constraints on the rating power.
- **Fees and charges** for goods and services provided. While there can be specific legislation allowing local authorities to charge fees, the general authority is section 150 of the Local Government Act 2002 stating the general principle that, for fees prescribed by bylaw, fees should be on a cost recovery basis and cost recovery is limited to no more than the reasonable costs incurred by the local authority in providing the good or service. Fees and charges are also subject to the Auditor-General's Good Practice Guide for setting and administering fees and levies for cost recovery (2021).

Moving to a funding system that equitably supports communities to thrive seems to require local government to have greater flexibility in its revenue options than the above allows. There is a strong case for local authorities to have more funding options to fund growing demands being made on them and for local authorities to have greater autonomy so that tax options can reflect the needs and constraints of their particular local community. For example, Auckland may see a local need for road congestion charges whereas in less populated areas the need may be for taxes to ensure that the high demands placed by tourists on a small population base can be funded by those who create the need for local investment in tourist infrastructure. Auckland also has the scale and resources to administer more complex tax systems that other areas could not justify.

Maintaining Consistency with National Welfare and Overall Central Government Policy

A key central government concern with providing local government with greater flexibility and autonomy in funding options is likely to be maintaining consistency with national welfare and overall government policy.

If local government had much greater autonomy in the levying of taxes this could impact on central government in a number of ways.

- A local tax may undermine a key central government policy objective. For example, a local authority may decide to introduce a stamp duty on the sale of residential homes in its area but central government may see this as undermining housing affordability.
- A local tax may exploit a geographic advantage the area has to the detriment of the national interest. That may be because the area is the gateway for international travel to and from New Zealand or the local area may have key national resources (such as clean electricity production). Taxing these may result in the local authority raising revenue for itself with the cost of that being borne by the country as a whole.
- A local tax may undermine one of the key revenue bases of the central government. For example a local income tax may create pressure for this local income tax to be creditable against central government income tax. A local tax to be viable may also require operational support from central government.

Reaching a mechanism whereby consistency with national welfare and legitimate central government concerns can be met seems to be necessary to allow greater local government autonomy and flexibility in revenue raising. Options range from

- a central government veto over local government proposals
- a required consultation process (if the central government felt a need to be able to intervene on revenue decisions in the national interest it should be required to set out what specific aspect contravened the national interest and how, what are the options to mitigate the impact on local government (e.g. revenue sharing) and then consult before exercising any veto); to
- the legislation of principles the contravention of which could be litigated.

The options could be supported by formal structures or processes for regular central and local government revenue discussions and agreements.

Taxes Based on Good Tax Principles Would Remain Important

Any local government tax should still meet the general principles of good tax policy being it:

- Is easily workable
- Fair and sustainable
- Does not provide incentives for people to act in a way contrary to community welfare.

Considering whether any particular proposal meets the workability requirement is likely to be a key issue. This will vary according to the operational requirements of the tax and the context in which it is to be implemented which will often vary from area to area.

We illustrate this by considering:

- Rates
- A local GST or sales tax
- A local income tax
- Congestion charges
- A bed or tourism tax
- Revenue sharing with central government.

For completeness we also include our previous comments regarding a value capture taxation.

Overall this demonstrates why local government revenue options have tended to focus on rates and charges. Rate assessments based on gross (improved or unimproved) land values are easily workable, and they provide behavioural incentives consistent with the objectives of local government.

On the other hand, they cannot match well with “ability to pay” (especially if based on unimproved value) and may not meet fairness principles. To change the criteria to include income levels, debt levels or some other measures of ability to pay would increase complexity and thus reduce workability.

A local income tax would more clearly meet this concept of fairness but a local income tax would be resource intensive and would seem to require considerable support from central government (IR). A local sales tax could arguably better match fairness concerns but would be resource intensive especially in terms of system development. That would suggest such a tax would need to be levied at scale to justify the largely fixed operational costs.

More targeted levies, congestion charges and tourism/visitor levies would seem to have lower operational costs. Technology is increasing the ability to efficiently implement congestion charges but these are likely to be more justified in large urban areas with high levels of congestion than elsewhere. A major concern with tourism/visitor levies is the ability to enforce and audit them. The costs of doing so are likely to be lower in remoter areas where those subject to the levy are more easily identifiable.

Rates

What is the revenue base?

- Land if on unimproved value; land and improvements if on improved value.

Would this revenue option raise the necessary funds in a workable way that society would consider fair and reasonable?

- Workable but issues over fairness.
 - Unimproved/improved value of land - On unimproved value in theory is an expropriation of a proportion of the land.
 - Also issue over asset rich and cash poor ratepayers. Do asset rich but cash poor taxpayers have the same ability to pay compared with say debt funded ratepayers with high cash incomes? How do you overlay a simple rate calculation based on improved/unimproved value with debt levels and income levels of the ratepayer? How do you take into account debt levels and income levels of associated parties of the ratepayer?

What behavioral incentives could arise from this and are they desirable or not? If on unimproved value theory is no behavior change.

- Rates on improved value discourages improvements.

Is raising revenue in this way consistent with overall New Zealand welfare?

- Yes, already land as a tax base is the prerogative of local government. That is unless arguably taking advantage of captive industry.

Is there any difference regarding rural land and Māori land?

Considering the operational requirements set out in Appendix B, the systems and processes are already in place and are relatively simple.

- Registration of those liable. This is by the rate roll or register of land ownership
- Education, information and answering public queries. Managed by councils
- Return preparation and provision. Based on valuation notice and invoices
- Receiving and processing returns – adjusting and recording return data. Data collection. Relatively simple system requirements
- Receiving payments. Processed without heavy cost

- Auditing. Minimal
- Applying penalties. Relatively automatic
- Interpreting the law and dispute. Considerable case law
- Litigation. Managed by councils
- Collecting unpaid tax. Part of normal processes
- Policy development. As part of normal planning processes.

However, we note there has been increasing challenges with the determination and valuation of mixed use property.

GST and Local Sales Tax

What is the revenue base?

- Consumption.

Would this revenue option raise the necessary funds in a workable way that society would consider fair and reasonable?

- Works overseas but can have high administrative and compliance costs.
- A local retail sales tax seems the more workable option.
- GST is based on the national supply chain. In effect at each point in the supply chain GST is levied on the total supply but past GST is all refunded until the final supply to a non-registered person when GST is levied on the total supply. There are special rules for imports and exports. Exports are zero rated (no GST impost and refunding all past GST on the goods and service through the supply chain) and GST levied on imports. To replicate this at the local level all goods and services coming into a local area would need to be fully subject to GST with GST refunded on goods and services supplied outside the local area. The focus is always on the entire supply chain. So a local GST or supplement to GST does not seem easily workable.
- A local retail sales tax seems theoretically more easily workable. The tax applies only to one aspect of the supply chain – the point of retail sale. Those making retail sales (as opposed to say wholesale sales) need to be identified.

Behavioral incentives.

- Creates incentives to sell/buy outside taxing area.

Is raising revenue in this way consistent with overall New Zealand welfare?

- Could be seen as encroaching on a tax base that has been the preserve of central government (GST) but GST does not have national policy goal of wider income redistribution.

Considering the operational requirements set out in Appendix B:

- Registration of those liable. Councils would need to identify and register all retail sales outlets in their area. It is noted that IR data (persons registered for GST) would

not be useful since GST registration covers activities at a national not local level and does not distinguish retail from non-retail activities.

- Education, information and answering public queries. This would need to be managed by councils.
- Return preparation and provision. Those registered would need to return their level of retail sales and be taxed on that. Unlike rates it would not be based on Council produced invoices.
- Receiving and processing returns – adjusting and recording return data. Data collection. An IT system would need to be established to match those registered with returns and payments. This would need to be developed (IR's systems would not meet the needs of such a tax) although if a number of Councils introduced a retail sales tax it should be possible to share the development costs. IT systems should be available largely "off the shelf" and New Zealand has existing expertise in this area such as DataTorque (<https://datatorque.com/>).
- Receiving payments. These need to be matched with assessments under the IT system
- Auditing. Given the potential for retail sales to be disguised as wholesale and for the level of retail sales to be suppressed, Councils would need to be resourced for this.
- Applying penalties.
- If a number of Councils introduced a retail sales tax it should be possible to share resources of interpreting the law, dispute management, litigation and policy development. Considerable case law
- Collecting unpaid tax. Should be able to be built into the IT system and then normal processes.

Local Income Tax

What is the revenue base?

- Income.

Would this revenue option raise the necessary funds in a workable way that society would consider fair and reasonable?

- Other countries have local income taxes. There would be a need to integrate with the national income tax. However, the national income tax measures and is based on income sourced in New Zealand and global income of residents. This requires complex rules to measure and tax income on a global basis. It would not seem viable to have rules measuring and taxing income at a local level. For practical reasons it would seem necessary to limit any such tax to individuals (not companies or trusts) the income of which can be sourced throughout the country and attributed to "owners" in other parts of the country. Limiting the tax in this way would seem to create significant tax avoidance opportunities.
- With a restriction to individuals, it would seem only viable at the local level if income were measured on the same basis and under the same rules as the national income tax. That means IR would seem to need to support a local income tax.

Behavioral incentives.

- Especially since it is likely to be limited to all income allocated to residents, this creates great incentives to change residence.

Is raising revenue in this way consistent with overall New Zealand welfare?

- Encroaches on a tax base that has been the preserve of central government (income) and one that implements wider income redistribution (a national policy objective.)

Considering the operational requirements set out in Appendix B:

- Registration of those liable. Councils would need to identify and register all individuals living (main home?) in their area. IR data is not likely to have this.
- Given the likely need to integrate the rules for measuring income in accordance with national income tax rules, it is likely that IR would have to provide most of the operational requirements with the local income tax a supplement on the national income tax assessment. However, Councils would need to manage all issues relating to whether an individual was resident in their area and liable for the local tax.
- If the rates of local tax varied by Council, as seems likely to be desirable, then Councils would need to manage assessment and payment of tax (and have IT systems to do so).
- Education, information and answering public queries related to liability (residence) would need to be managed by councils as would auditing, as would law interpretation, dispute management . litigation and policy development.

Congestion/Road User Charges

What is the revenue base?

- Depends on design – can be seen as consumption (use of the road) or transaction (using a specified road at specific times).

Would this revenue option raise the necessary funds in a workable way that society would consider fair and reasonable?

- Main issue workability but technology making this more feasible. Precedent with toll roads such as the Northern Gateway, Route K and Tauranga Eastern Link.

Behavioral incentives.

- Should be positive – less congestion.

Is raising revenue in this way consistent with overall New Zealand welfare?

- Should be.

Considering the operational requirements set out in Appendix B:

- Registration of those liable. Basically who is using the specified road at specified times. With Northern Gateway number plate of cars.
- Education, information and answering public queries. This would need to be managed by councils but should be relatively easy.
- Return preparation and provision. Minimal requirements.
- Receiving and processing returns – adjusting and recording return data. Minimal requirements.
- Receiving payments. Mostly automatic.
- Auditing. Minimal requirements.
- Also seems minimal requirements in interpreting the law, dispute management, litigation, and policy development. Considerable case law
- Collecting unpaid tax. Should be able to be managed by normal processes.

Bed or Tourism Tax

What is the revenue base?

- Consumption by visitors.

Would this revenue option raise the necessary funds in a workable way that society would consider fair and reasonable?

- Auckland doubtful, Stewart Island seems yes.

Behavioral incentives:

- depends on circumstances

Is raising revenue in this way consistent with overall New Zealand welfare?

- Dependent on what funds are used for.

Considering the operational requirements set out in Appendix B:

- Registration of those liable. If a bed type tax, Councils would need to identify and register all those providing short term accommodation in their area. Hotel/motel accommodation providers should be identifiable and platforms (Airbnb) have shown a willingness to co-operate in registering other providers. .
- Education, information and answering public queries. This would need to be managed by councils.
- Return preparation and provision. Those registered would need to assess and return the tax (whether levied on bed numbers, or accommodation charges etc.).
- Receiving and processing returns – adjusting and recording return data. Data collection. An IT system would need to be established to match those registered with returns and payments. This would need to be developed (IR's systems would not meet the needs of such a tax). If a number of Councils introduced a levy it should be possible to share the development costs. IT systems should be available largely "off the shelf" and New Zealand has existing expertise in this area such as DataTorque (<https://datatorque.com/>).

- Receiving payments. These need to be matched with assessments under the IT system
- Auditing. This would need to be managed by Councils and could be a significant task. It is likely to be more manageable in smaller areas (Stewart Island visitor levy) than in larger areas such as Auckland where opportunity to operate unregistered or suppress taxable amounts higher.
- Applying penalties. Under normal processes.
- If a number of Councils introduced similar levies it should be possible to share resources of interpreting the law, dispute management, litigation, and policy development.
- Collecting unpaid tax. Should be able to be built into the IT system and then normal processes.

Revenue sharing with central government

Given the issues noted with a local income tax or GST, an option would be for these tax bases to remain the preserve of central government but some of this revenue is shared with local authorities under revenue sharing (often referred to internationally as fiscal federalism). The central government assists the funding of local government by sharing central government revenues.

Revenue sharing is already an important source of local government funding. This is by way of central government grants mainly for roading and transport. Grants are likely (along with taxes and fees) Congestion charges/bed taxes to remain the main sources of local government funding.

International evidence (OECD – Reforming Fiscal Federalism and Local Government – Beyond the Zero sum Game, 2012) suggests that revenue sharing has advantages and disadvantages:

Advantages

- Draws on central government revenue (mainly income tax and GST) that are generally seen as aligning with the principles of a high quality tax and revenue system.
- Can provide significant revenue to assist local government funding.
- Allows central government functions to be delegated to the local level with the revenue to fund the undertaking of these functions.

Disadvantages

- Can lead to loss of accountability with central government accountable for revenue raising and separate local government accountable for the undertaking of the functions.
- Often accountability issues managed by overly prescriptive rules set by central government as to what and how funding is to be spent. In the words of the Australian Industry Commission (1994), revenue sharing was seen as resulting in “restricted state budget flexibility and administrative complexity”.
- Revenue sharing can become subject to political driven decision making especially if it is being used to attempt to redistribute income from high wealth to poorer communities.
- In times of central government fiscal constraint, economies can be seen as most easily made by reducing local government funding.

The case for revenue sharing seems strongest where central government is using local government as an agent to deliver projects generally viewed as national in scope (or where the national benefits from activity in a location exceed the costs (externalities) borne by the location).

In the New Zealand context the case for revenue sharing for redistribution of income and wealth on a regional basis does not seem strong.

Revenue sharing seems to work best where:

- There are transparent rules that are determined after widespread consultation.
- Local government budget flexibility is retained.

Australia has a long history of revenue sharing. It has constitutional and historical context for revenue sharing different from New Zealand but seems to offer lessons in the development of efficient revenue sharing rules.

A revenue sharing formula might be based on:

- Statistical data as to the level of economic activity in the area that generates the revenue – estimates of area income or expenditure.
- On a population basis – this would have the effect of reallocating revenue to areas with relatively lower standards of living.
- On the basis of judgements over where the investment needs are highest.

It is to be noted that income tax and GST are national taxes and current systems do not provide records of how much revenue is collected by area.

An issue related to revenue sharing is whether GST should continue to be levied on rates (or a percentage of the rates). Levying GST-type taxes on local government taxes stands out as unusual in the world. Removing (or partially removing) GST on rates would reduce the cost of any particular rate level on non-business (non GST registered) ratepayers. Presumably this would allow more room for rates to be increased thus in a sense enabling part of GST revenue to be passed to local government. There are a number of options that could be explored regarding how this could be effected.

The main argument advanced for levying GST on rates seems to be that rates are substitutable for fees charged by local government and fees are subject to GST. By not levying GST on rates the argument is that councils would have an incentive to increase rates and reduce fees. The validity of this argument could be questioned.

Value capture taxation

Under value capture funding, infrastructure investment is funded by capturing some of the value created by the investment that would otherwise accrue to individual ratepayers. As explained in a paper released by Infrastructure Victoria, *Value Capture – Options, Challenges and Opportunities for Victoria, October 2016*, value capture funding involves “seeking a funding contribution from individuals or business that benefit privately from government investment or planning decisions, rather than relying solely on funding by general taxpayers. These contributions ‘capture’, ‘recover’ or ‘share’ a portion of the extra value created for individuals or business from government decisions.” (At page 14). An example is the construction of a new road or rail link that results in an increase in the market value of nearby properties because of the improved transport link. The project may be seen as “paying for itself” in economic terms since the increase in land values offsets the costs of the infrastructure investment. However, the infrastructure costs are social costs borne by the entire community whereas the benefits in terms of increased land values is captured by a small group of local land owners. Even if a proportion of the private benefits to land owners could be taxed so as to pay for the investment that generates the land value gains, then a project that might not otherwise be financially viable from a community point of view can become viable.

Value capture taxes of this nature (often termed betterment taxes) seem to meet the principles of fairness and good incentives – those that benefit from the investment help pay for it. The issue is workability. The problem is designing a workable mechanism to identify and value the private benefits of infrastructure investment. There can be significant practical difficulties with measuring who benefits from particular infrastructure spending and in implementing mechanisms that apply a user charge or value capture funding approach. Even if a person’s land increases in value as a direct result of infrastructure investment, they may not personally value that (the family home near a new transport link

the value of which increases but the owners do not wish to sell and do not themselves benefit from the transport link).

Tax options can be developed (such as taxing over time a portion of any increase in land values in an area benefiting from infrastructure investment) but these are likely to be complex. Other options are for local authorities to partner in the development to capture development benefits. An example of this is the Milldale development in Wainui north of Auckland. This is expected to support 4,000 dwellings in the Milldale area and an additional 5,000 dwellings in the surrounding area. The project and its associated infrastructure requirements are being undertaken and funded by a joint venture of Crown Infrastructure Partners (CIP), Fulton Hogan Land Development, Auckland Council, Auckland Transport, Watercare and ACC. CIP has established a Special Purpose Vehicle that is equity funded by CIP. It has raised 35-year long-term debt from ACC. CIP equity and the ACC debt are secured over the individual land titles in the development and will be repaid by annual "infrastructure payments" over a period of the loan to be made initially by the developer and, in time, by the final section owners. In this way the new dwelling owners will make payments that will be used by the Special Purpose Vehicle to repay the money borrowed to fund the bulk housing infrastructure plus interest over time.

Appendix A – Design Principles.

Easily workable

The first criteria is whether any proposed revenue measure is **easily workable**. This means it will raise revenue at reasonable compliance and administrative costs. This is fiscal adequacy, compliance, and administrative costs.

It should be assumed that workability requires local government to administer taxes/fees using their own systems. In particular, it is unlikely that central government revenue agencies (mainly Inland Revenue) can efficiently administer or provide systems to administer revenue collection designed to meet local government needs.

That is because central government systems (such as those of Inland Revenue) are designed to operate at the national level. Inland Revenue, for example, is not able to identify income tax or GST liabilities at a local level. There are also secrecy issues for Inland Revenue in providing taxpayer specific data and considerable lags between a particular year and when income is assessed. Added to that are technical issues identifying a person's annual income (such as past losses that may be accrued forward) and income a person derives through other entities such as companies and trusts. This means Inland Revenue would be unable to match a person's overall income to the income of a particular ratepayer (or landowner).

Local bodies may in some cases be able to leverage off central government systems in revenue system design but only to a limited extent. Thus, when considering the workability of local government revenue options, the need to administer these locally should be taken into account.

Alternatively, another source of information is the ratepayer themselves. That is, rather than seeking information from government agencies such as the IRD to supplement using gross improved/unimproved land values to raise rate assessments is to seek details from ratepayers in relation to income levels, debt levels or other measures. Ignoring the nature of the additional information, seeking such additional information raises the following issues:

- The processes required to request, receive, and use that information
- The secrecy requirements to provide comfort to ratepayers that the information will not be inappropriately used
- The time delays to obtain such information compared with the need to receive regular rate income (for example income levels may only be known months after income years, income years may not align with rating assessment periods etc.)
- The ability to audit or check that information and the resource to undertake such work

- The ability for ratepayers to structure their affairs to minimise their rate costs by ensuring the landowner has minimal income, maximum debt or whatever the relevant measure proposed. That is, if other measures are taken into account other than land values, taxpayers could structure their affairs to minimize their annual rate assessments.

Tax administration literature sets out some generally recognised operational requirements for administering a tax or levy. These are set out in Appendix B.

Fair and sustainable

Fair and sustainable is a judgement call as to how the population (or segments of it) will view the proposal. This is fairness and revenue integrity. Because fairness is a judgment call, what is fair should be determined by the local community. While fairness will often involve considerations of ability to pay, going further an attempting to use local taxes in an attempt to redistribute income or wealth may be seen by central government as contrary to the national interest given that income and wealth distribution is generally seen as properly viewed from a national perspective.

Incentives

Most taxes produce **incentives for people** to act in one way or another. These may incentivise behaviors that are good (encourage activities that are of wider benefit to society such reducing the level of environmental pollution) or bad (discouraging work and savings for example). This is efficiency and coherence.

These are often not separate questions

If a revenue proposal is not easily workable it is likely not to be fair and sustainable and likely to produce perverse incentives.

Incentive revenue options generate usually mean that legal incidence of tax differs from economic incidence. If the incentives mean that people change their behaviour so that they do not have to pay a tax or fee (or reduce the amount they pay) this reduces revenue. However, often those subject to a tax or fee can shift the burden onto others. Thus, an employer may be taxed on the wages paid but international evidence indicates that most of the burden of such payroll taxes are passed on to employees by way of lower post-tax wages. In this way while the legal incidence of a payroll tax may fall on employers the actual or economic incidence falls on employees.

Judgements about fairness need to be based on economic not legal incidence.

- GST is not paid by consumer but by registered business but incidence falls largely on consumer.
- Rates on property owner but some of the incidence can be on house occupier
- Issues with Auckland's the Accommodation Provider Targeted Rate where the court held the targeted rate unlawful because the Council did not undertake a "meaningful assessment" of who benefited and who met the cost of the rate.

Incidence shifts to those least able to change behaviour.

So develop from this some decision questions

The above can be summarised down to some key questions

- Would this revenue option raise the necessary funds in a workable way that society would consider fair and reasonable?
- If so what behavioral incentives could arise from this and are they desirable or not?
- Does the revenue that would be raised justify any adverse behavioral response?

Appendix B – Operational Requirements of a tax.

The following are the administrative requirements internationally recognised (OECD and IMF papers) as necessary in administering a levy or tax.

- Registration of those liable
- Education, information and answering public queries
- Return preparation and provision
- Receiving and processing returns – adjusting and recording return data. Data collection
- Receiving payments
- Auditing
- Applying penalties
- Interpreting the law and disputes
- Litigation
- Collecting unpaid tax
- Policy development

In considering the workability of a potential tax mechanism, consideration needs to be given as to:

- What these requirements are for the tax in question?
- Who is to undertake each of these functions?

Registration of those liable

Registration involves establishing a unique identifier for each taxpayer so that returns, payments disputes and data can be matched to that taxpayer. Ideally there are 3 independent identification points for each taxpayer – number, date of birth and address. This is to allow for identification and correction of errors.

Education, information and answering public queries.

This involves educating the affected public what is involved and required. Running a call centre if required etc. Ideally this involves local presence and knowledge.

Return preparation and provision

Designing the return should be the responsibility of the agency with prime responsibility for processing to ensure it meets the agency's processing requirements. It is expected the return will mainly be on-line.

Receiving and processing returns

This is a key responsibility. It involves receiving self-assessed returns, adjusting, or rejecting them for obvious faults, recording data so that who has filed is known, how much liability

each person has is recorded, and this is matched with payments received. It also involves data collection – name, date of birth of taxpayer and address.

This requires an appropriate IT system.

A relevant issue here is whether the levy return is designed as an add on to the GST return. This has been proposed (see Annex) but remains to be decided.

Receiving payments

This involves managing incoming payments. Any entity with a payments system should be able to manage it. However, payments need to be matched with liabilities in return data so there needs to be an interface with return processing.

Auditing

This involves checking returns in accordance with normal tax administration practice, identifying evasion and avoidance.

Applying penalties, Interpreting the law and disputes

This involves applying and managing the rules as to who is liable and how much that liability is. Responsibility for this would seem to follow who set these rules. If rules are set by council as per rates, then it seems to follow that council would be responsible for this function.

Litigation

Again, this seems determined by who sets the rules. If the council sets the rules, then they would engage their own litigators as per other council litigation.

Collecting unpaid tax

This is just debt collection. In theory collecting unpaid tax can be separated from processing and other functions. The debt collector is simply told there is a debt. If the debt is disputed the issue reverts to the processor or disputes manager.

Policy development

This involves updating the rules etc.

Appendix C – Constraints on Rating Power

Rating powers have been considered by a number of Court decisions. The principles underlying Court of Appeal decisions in *McKenzie District Council v Electricorp* [1992] 3 NZLR 41 and *WCC v Woolworths NZ Ltd (No 2)* [1996] 2 NZLR 537 seem to be:

- A council has a fiduciary duty to ratepayers to have regard to their interests (*Mackenzie*) but that "does not open up a route by which the court can investigate and if thought appropriate interfere with every exercise by local authorities of their discretionary powers." (*Woolworths*).
- The local authority must have regard to the levels of services provided to ratepayers and categories of ratepayers but is not obliged to adopt a narrow user pays approach (*Mackenzie*). This approach does not require a close correlation between benefits provided to a particular sector and rates levied on that sector (*Woolworths*).
- Councils can set a range of rates from general rates, through separate rates and uniform charges to user pay charges. Subject to statutory maximums and percentage limits "the choice is unrestrained." (*Woolworths*)
- The legislation imposes significant process obligations on councils but the substantive judgments on rating are made by "popularly elected representatives exercising a broad political assessment" (*Woolworths*).

These seem to be sound principles recognising that councils as elected community bodies making political assessments as to what activities they should fund and how this should be paid for in terms of overall community welfare. The Court of Appeal referred to these cases in the *Auckland City Council* case and seemed to endorse their principles despite legislative change over time but came to the view that Auckland's Accommodation Provider Targeted Rate did not meet the requirements of section 101(3).