IMPLICATIONS OF A NZ PROPOSAL FOR A FINANCIAL TRANSACTIONS TAX

By Adrian J Sawyer *

Should there be a significant change in political ideology, New Zealand may introduce a comprehensive financial transactions tax (FTT) levied on withdrawals from bank accounts both as an attempt to address the perceived dominating influence of the financial markets on taxation policy and an alternative to GST. The FTT will shift the burden of GST from consumers to financial institutions and businesses, who will be required to contribute over ninety percent of the required $NZ7.7 billion to offset the lost GST revenue. The FTT proposal contains significant opportunities for avoidance, as well as substantially increasing the complexity of New Zealand's tax system. After reviewing the FTT proposal and contrasting it with GST, the article concludes with the observation that if the necessary change in political ideology to introduce a FTT eventuates, it will introduce unprecedented alterations to financial and economic activity.

1. INTRODUCTION

New Zealand taxpayers face the prospect that the Goods and Services Tax ("GST") will be replaced by a comprehensive financial transactions tax ("FTT") levied on withdrawals from bank accounts. To give effect to such a development, the Alliance Party must emerge with a dominant influence upon central government following the next general election in 1999, since the FTT is an important component of the Alliance Party's economic and fiscal policy. Adding to the interest in the election is that it will be the second under a Mixed Member Proportional ("MMP") system, providing a further opportunity for the Alliance Party to have a significant influence of political decision making.

In the Alliance Party's Alternative Budget,1 details of the proposed FTT are provided. Specifically the tax is to be collected monthly from banks, although the word "bank" is not defined. The government will fund the reprogramming costs incurred by banks, and the Stamp and Cheque Duties Act 1971 will be abolished. The Alliance Party purports that its FTT "is the purest form of a turnover tax possible to devise."2 There are no reasoned arguments or research findings in the Alternative Budget to substantiate this assertion. The Alliance Party claims its FTT is really a money transactions tax and it will therefore tax all spending, except for barter and non-monetary gifts (and impliedly overseas transactions of New Zealand residents). It is the emerging political trend of support for parties offering a "left of centre" perspective in New Zealand and the opportunity to evaluate a radical new tax proposal, with international ramifications, that purport to be the purest form of a turnover tax, that underlies the motivation for this article. The FTT proposal and its comparison with GST offers a valuable opportunity for Australian tax policy makers to consider the impact of such taxes.

This article is set out as follows. Firstly, the criteria for a "good tax" is established. Secondly, a

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2 Ibid 1.
brief review of the history of taxes on financial transactions is presented. Thirdly, a summary of the underlying economic policy issues of a FTT from a New Zealand perspective and the implications for Australasia is provided. Fourthly, the performance of a FTT developed in accordance with the Alliance Party's economic policy issues under the established criteria of a good tax is then presented. Finally, the article discusses the likely impact of a FTT on businesses and individuals.

2. THE CRITERIA FOR A "GOOD TAX"

One basis for ascertaining whether a tax is a good tax has its foundations in the work of Adam Smith.\(^3\) Smith, a renowned economist, states that a good tax comprises four essential characteristics (although the concepts do not readily rest comfortably with one another):

- **Equity (Horizontal and Vertical):** Horizontal equity is measured by all persons with the same ability to pay tax, paying the same amount of tax. Vertical equity occurs when those with a greater ability to pay tax, pay proportionally more tax, preferably on a progressive scale.

- **Certainty:** Taxpayers should be able to ascertain their liability to a tax clearly and unambiguously, (including the rate, base, manner and time of payment), and administrators and policy advisers should be able to predict revenues with a high degree of accuracy.

- **Convenience:** Taxes should be assessed, levied and paid in the most simple manner.

- **Economy in Operation (or Administrative Efficiency):** Taxes should be cheap to collect and should not impose a heavy compliance obligation on taxpayers, with administrative costs kept to a minimum.

Other criteria have been offered beyond those advocated by Smith. Taxes should also be evaluated on their economic effect such as their ability to satisfy revenue needs and whether they achieve their objectives when introduced, with regular ongoing monitoring and analysis. A further criterion for a good tax is that of neutrality; taxes should not affect a taxpayers' choices as to their decision-making regarding purchases, allocation or resources and where they should invest. It has also been suggested that taxes must be visible, that is, the payment of the taxes and the public goods for which they finance are readily identifiable.\(^4\)

3. A BRIEF HISTORY OF TAXES ON FINANCIAL TRANSACTIONS

A tax on financial transactions, by definition, must involve to a greater or lesser extent, a contribution to the State which is legally levied on persons, businesses or property, as a result of the use of monetary resources. This use of monetary resources is represented by a change in amount and form (or disposition) of the economic resources available to those persons, businesses or property. Applying this definition would enable a wide variety of taxes on financial transactions to satisfy the requirements of a financial transactions tax. All forms of taxes on financial and securities transactions have suffered from criticism and have failed to satisfy one or more of the good tax criteria; this section of the paper will identify a number of these criticisms.

History reveals that several forms of taxes on financial transactions have existed or currently prevail. For example, selected financial transactions are taxed under income tax systems which recognise the periodic levying on a change in value of a person's or a business' resources, as measured by the difference between revenues (gross income) and expenses (deductions), but not changes of a capital nature. As part of a review of the tax system in


almost every country, one would not be surprised to
discover a form of income tax that displays the
attributes of a financial transactions tax utilising this
definition. Nevertheless, there is no income tax
system which could be categorised as containing a
comprehensive financial transactions tax which has
been in existence for a significant period to enable
an in depth analysis of the system. To introduce
the context in which financial transactions may be
subject to taxation, several forms of past or cur-
cently operative financial transactions taxes are
briefly reviewed.

3.1 Securities Transactions Taxes

One form of financial transactions tax is a secu-
rities transactions tax, which is a tax levied on the
trading of securities, including shares and other
forms of listed trading commodities. Securities
transaction taxes have existed in various forms in
many countries over the last decade or so, including
France, Germany, Italy, Japan, the Netherlands,
Sweden, Switzerland, the United Kingdom, and the
United States. Summers and Summers examine
whether securities transaction taxes can be sup-
ported on economic efficiency grounds. More
recently, several commentators have considered
how a securities transactions tax could be imple-
mented in the United States and discuss the
implications of such a tax on asset prices, trading
volume, market liquidity and the competitiveness of
financial markets. Murphy contends that the dom-
inant support for a securities transactions tax in the
US was political, with the tax to be a revenue
earner to reduce federal deficits.

Umlauf, using the Swedish transactions tax as
a case study, supports the contention that securities
transactions taxes do not bring about a decline in
volatility, but will underlie a decline in prices and
turnover. Schwert and Seguin examined the
costs, benefits and unresolved questions concerning
securities transactions taxes. While there is diverse
international experience with securities transactions
taxes, their impact upon financial markets, and the
motivations for proposing and implementing the
tax, a degree of manipulation of the financial mar-
kets and the gathering of tax revenues have been
central notions. The attention of this paper is now
focussed on two instances of taxes on financial
transactions displaying a closer resemblance to
New Zealand’s proposed FTT, operative in Aus-
tralia in the last decade.

3.2 Financial Institutions Duty –
Australia

A financial duty levied on the receipts of financial
institutions, known as a financial institutions
duty ("FID"), has been used in most Australian
states since 1982. Legislative definitions are pro-
vided for key terms such as financial institutions (a
very wide definition is given with a list of exclu-
sions), although receipt is not defined, which has
resulted in extensive reference to previous case law
for guidance.
Field\textsuperscript{12} undertakes a comprehensive analysis of the Victorian and NSW systems, and identifies that there are a number of differences in procedure and legislation between the systems, indicating the lack of uniformity of the States' FIDs. Hambly and Hamer,\textsuperscript{13} in an accompanying article, outline several legal and constitutional issues that the legislation creates. They accurately foreshadow the need for future litigation and amendments to the legislation in order to remedy defects, or at least clarify the interpretation and scope of certain provisions. Sabapathy\textsuperscript{14} observes that in most instances, the FID is passed on to depositors, and where this occurs, the FID is permitted as a deductible expense in calculating a depositor's taxable income. FID is not an income tax but a transactions tax levied on money flows which may not generate any income whatsoever. Sabapathy concludes by stating:

As a tax, FID has generated distortions. Taxpayers have reduced the number of bank accounts they maintain and corporate groups have resorted to central banking arrangements whereby a parent company acts as a treasurer for the entire group. Lumping of deposits has become prevalent to take advantage of the maximum tax on a deposit.

Since there is a double levying of FID when money flows across state borders, it has been rumoured that large qualities of money have been sent through couriers. Since Queensland does not levy a FID, it has also been said that most corporations are opening their central accounts in that state.\textsuperscript{15}

The financial institutions duty is a financial transactions tax representing one form of revenue generation from larger financial institutions, accompanied by complex legislation. The FID has not been neutral in its impact on business decision making, it is easily avoidable and is deficient on the certainty criteria. The FID has not been the only experience of financial transaction taxes in Australia; the Bank Account Debits Tax has also occupied a place in Australian financial transaction tax history.

3.3 Bank Account Debits Tax (Debits Tax) - Australia

In 1983, a Bank Account Debits Tax ("BAD" tax) was introduced by the Australian Federal Labor Government. From 1 April 1983, taxable debits made to cheque accounts kept with banks in Australia became subject to a BAD tax at the initial rates set out in Figure 1.

The banks would be primarily liable for the tax imposed but would be afforded a statutory right to

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\textbf{Amount of Debit ($A)} & \textbf{Amount of Tax} \\
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Less than $100 & 10 cents \\
Not less than $100 but less than $500 & 25 cents \\
Not less than $500 but less than $5,000 & 50 cents \\
$5,000 or more & $1 \\
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\caption{Rates of the Bank Account Debits Tax in 1982/83\textsuperscript{16}}
\end{table}

\textsuperscript{14} A Sabapathy, "State Duties on Financial Institutions in Australia" (1993) 8 Tax Notes International 1213.
\textsuperscript{15} Ibid 1219.
\textsuperscript{16} Schedule to Bank Account Debits Tax Act 1982.
recover the tax from their customers. In practice banks recover the amount from account holders either progressively during the month of the debits or at the end of the month, prior to payment of the tax to the Australian Taxation Office. Exemption certificates were made available for eligible accounts.  

The legislation was intended to operate as a code, but has been subject to considerable litigation over the scope of definitions of key terms, and has experienced frequent amendment.

Following the relinquishing of the BAD tax by the Federal Government, the New South Wales, Northern Territories, Queensland, South Australia, Tasmania, Victoria and Western Australia State Governments individually introduced their particular version of a Debits Tax in 1990. Nevertheless, the Debits Tax has continued to display high levels of inequity on its narrow base.

Consider the following example, which captures the inequity of the tax. Five individuals each make withdrawals (debits) from their bank accounts totalling $A15,000 a year. The first column of Figure 2 sets out the method in which each individual makes the withdrawals of funds from their bank accounts. The subsequent columns set out the BAD tax payable on the withdrawals (depending on year and state), highlighting the regressive nature of the rate structure at its inception and reinforcement of the regressivity with subsequent changes in rates.

If one ever sought to create a tax with the appearance of a progressive rate structure but with a regressive impact, then the BAD tax is an excellent example. It indicates that the larger and less frequent the withdrawals (over $A100.00), the lower the tax payable. It has a particularly regressive impact on low income earners, such as beneficiaries, who may only be able to withdraw small amounts (say $A50.00 - $A100.00) at a time. For large businesses, the tax is an insignificant minor fee and immaterial to business decision making. For example, the tax would be $A4.00 for a $A20,000, $A200,000 or $A2,000,000 debit from a bank account in Victoria in 1993.

### Figure 2: Indications of the Growing Regressive Nature of the Bank Accounts Debit Tax

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3.4 Financial Transaction Tax
Improvements and Innovations

Financial transaction taxes regained some prominence following the review of financial taxes undertaken by O'Bryen.19 The taxes considered by O'Bryen occupied one of three categories: taxes on usage of the financial system (including the FID, BAD tax and stamp duties); taxes on borrowings (such as the loan security duty); and taxes on instruments.

O'Bryen posits that existing taxes on financial transactions should be abolished and replaced by a new tax on the provision of credit. A Financial Accommodation Tax ("FAT") is suggested as a suitable candidate. The FAT would be levied on all forms of financial accommodation, including loans, bill facilities, and chattel leases, with a low ad valorem rate levied monthly on the average monthly level of each item of financial accommodation proposed. Issues such as the rate (suggested to be 0.08 percent per annum),20 incidence (levied on secured and unsecured financial accommodation calculated on the actual level of credit utilised for the period of its utilisation), administration, cost to lender, and introduction at the federal level were also considered. O'Bryen concluded by stating that a standardised FID and his FAT were the most appropriate taxes on financial transactions, emphasising that:

FAT would meet the theoretical requirements of a tax and would be cheap to administer. It would be politically acceptable to the majority of borrowers and even those large corporations that presently may not pay loan security duty would have seen the writing on the wall and therefore not object.

It is not yet clear whether the practicalities are such to enable FAT to proceed, but it appears workable.21

Hawtrey22 provides a comprehensive economic and legal analysis of financial taxes in Australia, and concludes that the FID is flawed by its lack of both simplicity and neutrality, avoidance opportunities and the disharmony between the States in levying the tax. The Debits Tax base is considered to be too narrow and inequitable. Hawtrey proposes to replace the current financial taxes with a single uniform State Financial Turnover Duty ("SFTD") of 0.08% to all non-internal debits and credits of financial institutions.

Dwyer23 presents the case for abolishing both the FID and BAD taxes in Australia, with the growing use of electronic transactions facilitating their abolition through providing further avoidance opportunities. Dwyer also reviews the constitutional problems associated with the FID, including the territorial constraints. The evidence continues to mount against retaining the FID and BAD taxes.

3.5 Financial Transactions Tax - Brazil

Australia has not been the only country to experiment with financial transaction taxes; Brazil has utilised a financial transaction tax with features bearing a close resemblance to the Alliance Party's proposed FTT for New Zealand.

Brazil introduced a financial transactions tax, known as the Impuesto Provisorio sobre Movimentacao Financiera ("IPMF"), effective from 27 August 1993, but which terminated on 31 December 1994. The Brazilian FTT was an attempt to raise revenue, calm down the activity of financial markets and tax an area of the economy which traditionally has not been subject to political scrutiny as a base for revenue.

20 Ibid 368.
21 Ibid 370.
The initial proposal was accompanied by protests from many sectors of the economy, and according to de Mello, protests were especially vigorous from entrepreneurs arguing that the tax would increase inflation and the rate of tax evasion. The Brazilian FTT was levied on all transactions, which means transactions concluded (legally completed) or launched (promoted) by financial institutions from which the circulation of monies results, de Almeida outlines the Brazilian FTT, which would be levied at a maximum rate of 0.25 percent. According to de Almeida, the tax would be assessed on:

1. debits to deposit, loan, and/or savings accounts maintained with financial institutions;
2. payments of any credits, rights, or amounts of a financial nature to the beneficiary of the accounts mentioned in (1);
3. transfers of credits, rights, or amounts of a financial nature carried out by banking institutions;
4. liquidation of transactions entered into on futures trading markets;
5. other transfers of credits, rights, or amounts of a financial nature, the effects of which are the same as mentioned above, regardless of denomination, subject, format, or structure of the transfer.

A number of transactions would be exempted, including transactions between government and its agencies, errors in withdrawals of deposits and payment of the IPMF. Further complexity is added when the tax is levied at zero percent. The zero percent rates applies to: transfers between state governments and municipalities, debits and transfers between bank accounts of the same taxpayer (if the taxpayer undertakes the transfer), transfers between the accounts of securities exchange companies, and certain banking institution transfers where these transfers are in connection with their normal business operations. Transfers by virtue of daily adjustments of transactions on futures trading markets will also be zero-rated. The extensive number of exceptions and exemptions not only reduces the size of the tax base significantly, but also adds to the compliance costs of bank account holders caught by the regime and ultimately those institutions/businesses who cannot pass on the tax to their customers. The tax must be paid or withheld at least once a week, with penalties and/or fines for default and late payment.

Kepp provides government estimates that the IPMF was expected to raise approximately US$3,000 million in revenue, with 20 percent earmarked for government housing (US$600 million), 18 percent for education (US$540 million) and the balance applied to the reduction of debt. Bourne suggests a variety of planning techniques for dealing with the IPMF.

Measuring the Brazilian FTT against the good tax criteria, the tax is not unduly regressive (for example, exemptions for welfare beneficiaries are provided for). While it has elements of horizontal equity (although government agencies are exempt), it does not rate highly on vertical equity in that the rate indicates proportionality but not progressivity. To buttress this observation, certain banking institutions have the privilege of zero rating. Compliance obligations can be expected to be regressive, with the greatest impact upon individuals and corporations with lower levels of withdrawals and those that do not have their own sophisticated computer systems to "track" their liability on a weekly basis. Convenience is seriously undermined through the regular (weekly) assessments and payments of the tax required under the regime. The rigid rules relating to late payment and associated penalties is certainly not a convenient feature for taxpayers.

26 Ibid.
Whether certainty prevails through the operation of the tax depends on several factors. These are whether a bank account is exempt or has a differentiated rate applying to it, and determining the appropriate base. Administrative efficiency comes under serious attack with the lack of flexibility for the revenue authorities to collect outstanding tax. Compliance and administrative costs are likely to be extremely high. The tax is unlikely to generate revenue according to reported comments by de Mello\textsuperscript{29} since it was claimed that the monitoring costs would offset any increase in revenue expected by the government, although government forecasts suggest otherwise. It should be noted that the comments do not indicate whether monitoring costs refer only to costs incurred by the revenue authorities or include the additional costs incurred by bank account holders in ascertaining their FTT liability.

Neutrality is clearly under threat since business decisions concerning the maintenance of bank accounts and the location of those accounts will be influenced by the breadth of the FTT. With respect to visibility, Kepp's provision of revenue estimates and the earmarking of the revenue to designated government expenditures suggests that the tax was visible from the public benefits viewpoint, although visibility of the tax itself was not necessarily obvious to those that incur it.

4. THE ECONOMIC POLICY ISSUES UNDERLYING AN FTT

4.1 The Underlying Philosophy

The underlying political philosophy that led to the emergence of the FTT proposal in New Zealand has been a growing concern over the wide divergence in wealth and the absence of an effective process by which the rich save and invest their wealth, thereby creating jobs and sources of income for the less wealthy, and facilitating all round prosperity.

A number of politicians and analysts are concerned that the existing tax system and political emphasis is undeniably entrenching the pre-eminence of the financial system, with most financial transactions remaining "outside" the existing tax base. With the growth in transaction size and frequency, the potential revenue base is substantial. For example, Hixson\textsuperscript{30} claims that if a tax at the rate of 0.1 percent was levied on the $US200 trillion value of transactions concluded in the US each year, $US200 billion would be raised. Even with a reduction in transactions, the revenue would be substantial. Hixson purports that the tax will positively soothe the "seething and exceedingly frothy markets".\textsuperscript{31} This philosophy of taxing the rich to improve the level of vertical equity in the tax system has several hurdles, not the least being the problem of the ability of the wealthy to avoid taxes, especially where a variety of financial markets may be utilised.

The relationship between politicians and the financial markets in the United States requires immediate redressing through a "bloodless political revolution".\textsuperscript{32} Phillips\textsuperscript{33} contends that a move towards a direct democracy can only be achieved by dispersing the power from Washington, installing direct democracy via representative government, reducing the role of lobby groups, regulating speculative financial and political influence of the financial markets (including the introduction of a comprehensive federal financial transactions tax), and reversing the trend towards greater concentration of wealth. The ideas raised by Phillips and Hixson underlie the rationale and thinking behind the Alliance Party's proposal which now becomes the focus of this article.

\textsuperscript{29} TCN de Mello, above n 24.
\textsuperscript{30} WF Hixson, "Hixson's Corner: Some Thoughts on Taxation" (1994) Economic Reform 8.
\textsuperscript{31} Ibid.
\textsuperscript{32} K Phillips, "Fat City" (1994) 144 Time 45.
\textsuperscript{33} Ibid.
4.2 The Alliance Party's Financial Transactions Tax Package

The above discussion from the United States underlies the economic policies of the Alliance Party in New Zealand and provides the impetus for the Alliance Party's FTT proposal. The financial economy is seen as dominating the politicians and their actions, with speculation displacing investment in real capital items that generate employment and real wealth.\(^{34}\) According to the Alliance Party, their FTT is promoted as a mechanism to address current money market manipulation and the control that financial markets have over politicians.

The release of the Alliance Party's Alternative Budget has been the catalyst for intense debate on the FTT. Commentators are almost unanimously opposed to the concept of the FTT,\(^{35}\) with the leader of the Alliance Party frequently drawn into a defensive response on the credibility of the FTT and the Alliance Party's economic policy.\(^{36}\) Behind the proposals is the Alliance Party's contention that the existing tax system requires significant reform to redress the perception of growing divisions between the rich and poor in New Zealand. Furthermore, there is a belief held within the Alliance Party that a sizeable area of economic activity remains untaxed - namely, a significant number of transactions involving funds withdrawn from bank accounts.

The Alliance Party initially proposed that their FTT would be phased in to provide an opportunity for refinement of the tax and then it would completely replace GST, a tax which currently provides over $NZ7.7 billion of revenue annually. A common phenomenon with the introduction of any tax, FTT being no exception, is the substantial learning curve imposed upon those directly and indirectly affected by the tax; in the case of the FTT, users and providers of bank accounts. New Zealand tax advisers, taxpayers and revenue authorities are familiar with the education process which accompanied the introduction of GST. The addition of another tax will substantially add to the complexity of the New Zealand tax system. While no country in the OECD has experienced a tax similar to that proposed for New Zealand, as was observed earlier in the article, Brazilian bank account holders have experienced a FTT. The Alliance Party's FTT package originally comprised the following:

- It was initially proposed that the FTT be levied on financial transactions at the rate of 12 cents per $NZ100, although in the Alternative Budget, the rate has been lowered to 10 cents per $NZ100, on amounts withdrawn from bank accounts. The FTT would operate concurrently with GST. FTT at this rate is expected to raise $NZ1 billion, and will be used to provide capital for social services. To achieve the target revenue, approximately $NZ833 billion will need to be drawn out from taxpayers' bank accounts in the first year of operation of the tax.

- After the first year of operation, the rate was originally proposed to rise to 80 cents per $NZ100, withdrawn from bank accounts, thereby gradually replacing GST. If the amount withdrawn from bank accounts does not decline significantly, then the tax should raise over $NZ6.5 billion (sufficient to replace GST in 1994/95 but over $NZ1.2 billion short of 1996/97 GST revenue, requiring an increase in bank withdrawals (over $NZ963 billion) or a lift in the rate to 0.92 percent).

\(^{34}\) See B Edlin, "Can the Money Industry & Reserve Bank Stifle Popular Sentiment?" (1994) 3 The Independent 34, for discussion on this issue.


Later estimates contained in the Alliance Party's Alternative Budget state that the New Zealand Reserve Bank has confirmed $NZ23 billion is transacted per day or $NZ6,000 billion per annum, which would raise $NZ6 billion FTT at a rate of 10 cents per $NZ100, without any need for a gradual phasing out of GST. However, while this level of transactions would be sufficient to offset lost GST revenue in 1994/95, it falls well short of $NZ7.7 billion GST revenue in 1996/97.

Also, following the latest estimates in the Alliance Party's Alternative Budget, FTT at 80 cents per $NZ100 would raise $NZ48 billion per annum, which is far in excess of the total New Zealand tax take which is in the vicinity of $NZ33 billion per annum (1996/97). Taken to an extreme, FTT at this rate on this tax base would enable all other taxes to be abolished in New Zealand, directing the focus of tax avoidance attention to the FTT.

To date, there has been no formal discussion or blueprint of the likely legislation, that is, the fine details of the FTT. Integral components of the proposal require research, such as an analysis of the economic impact of the FTT, especially with respect to interest rates since the FTT is regressive with respect to small time intervals. For example, with FTT charged at 1 percent, this would be the equivalent of imposing a rate of interest of 365 percent for an overnight loan, 52 percent for a seven day loan, 12 percent for a thirty day loan, or 4 percent for a ninety day loan. Clearly, without any changes in financial market behaviour (an extremely unlikely scenario), the FTT can be expected to have a significant economic impact.

However, while interest rates in excess of standard short term interest rates apply on urgently required short term money, the financial markets continue to operate in New Zealand. Nevertheless, a reduction in short-term money market transaction activity can be expected with FTT (since the FTT raises the cost of transacting), which may reduce the volatility and pressure within the financial markets, the levels of which the Alliance Party currently considers unacceptable. Resistance to implementation of the FTT from this sector is inevitable. The FTT would also increase the price of capital items and indirectly flow through to consumers, although it is acknowledged that the removal of capital items and indirectly flow through to consumers, although it is acknowledged that the removal of capital items will assist by reducing substantially the price of most goods and services (creating a deflationary effect).

Furthermore, determination of the scope of the tax will be dependent upon several factors, primarily the definitions and treatment of:
- a bank;
- a bank account;
- a withdrawal;
- a transfer between accounts; and
- an exempt account (if any will exist).

Indications of the frequency of incidence and collection, and the extra-territorial scope for imposing FTT on the overseas accounts of NZ resident taxpayers are notable by their absence, except for the recent statement that banks will be levied monthly for the FTT deducted from customers' accounts.38

In a somewhat surprising move, the Alliance Party is prepared to consult by entertaining "considerable discussion" prior to the introduction of the tax and is prepared to allow discussion to extend to the full range of issues and concerns arising from this new tax proposal.39 Nevertheless, the Alliance Party remains resolute in introducing a FTT in New Zealand.40

The Alliance Party claims that its FTT will result in a lower tax on the poor compared to GST. An attempt to substantiate this claim may be made in the following manner. Consider a household

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37 That is, all forms of direct and indirect taxes from individuals and businesses.
38 Alliance Party, above n 1.
39 Ibid. The scope of the proposed consultation has been identified in Alliance Party statements.
40 Ibid. This remains Alliance Party policy as at the time of writing, although its tax policy is under review.
which receives $NZ400.00 a week after income tax. Currently if the household spends $NZ350.00 and deposits $NZ50.00 with a bank, it will pay GST (12.5 percent) of $NZ38.89 on the $NZ350.00 and Resident Withholding Tax (RWT) of 21.5 percent on interest. With a 6 percent per annum interest rate, total gross interest for the year would be $NZ77.99, with $NZ16.77 RWT deducted. With the FTT at 0.80 percent (and with GST removed after the first year of the FTT being levied at 0.12 percent), the household would pay FTT of approximately $NZ2.49 (presuming all of the $NZ400.00 is deposited into a bank account and purchases of $NZ350.00 less $NZ38.89 GST previously paid, are made; that is no increase in household spending). Therefore $NZ311.11 is spent and $NZ86.40 ($NZ88.89 GST less $NZ2.49 FTT) can be saved per week. Consequently interest of $NZ134.77 for the year is earned and RWT of $NZ28.98 is deducted. This information is summarised in Figure 3.

On this analysis, it appears that the ‘poor’ will be better off through the opportunity to make higher savings or increased spending. However, to compensate for the loss of revenue from the removal of GST, wealthy taxpayers and those who make substantial withdrawals from bank accounts will need to pay well over 90 percent of the FTT.

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**Figure 3: The Low Income Household Before and After the Introduction of FTT**

<table>
<thead>
<tr>
<th>Gross Income $NZ</th>
<th>Required Spending $NZ</th>
<th>Savings $NZ</th>
<th>Interest $NZ</th>
<th>PAYE $NZ</th>
<th>GST $NZ</th>
<th>RWT $NZ</th>
<th>FTT $NZ</th>
<th>Total Taxes $NZ</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Before FTT</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>500</td>
<td>350</td>
<td>50</td>
<td>1.50</td>
<td>100</td>
<td>38.89</td>
<td>0.32</td>
<td>0.00</td>
<td>139.21</td>
</tr>
<tr>
<td><strong>Yearly Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7,239.05</td>
</tr>
<tr>
<td>26,000</td>
<td>18,200</td>
<td>2,600</td>
<td>77.99</td>
<td>5,200</td>
<td>2,022.28</td>
<td>16.77</td>
<td>0.00</td>
<td>5,358.46</td>
</tr>
<tr>
<td><strong>After FTT</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>500</td>
<td>311.11</td>
<td>86.40</td>
<td>2.59</td>
<td>100</td>
<td>0.00</td>
<td>0.57</td>
<td>2.49</td>
<td>103.06</td>
</tr>
<tr>
<td><strong>Yearly Total</strong></td>
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<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>26,000</td>
<td>16,177.72</td>
<td>4,492</td>
<td>134.77</td>
<td>5,200</td>
<td>0.00</td>
<td>28.98</td>
<td>129.48</td>
<td>5,358.46</td>
</tr>
</tbody>
</table>

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41 This is calculated using the formula for the compound value of an annuity. The amount of interest is: \([(\text{Annuity} \times (1 + k)^n - 1) / k) - n \times \text{annuity}])\), where \(k\) is the annual rate and \(n\) the number of periods. In this instance, \(k\) is 0.06/52 (to annualise), and \(n\) is 52 (52 periods of one week). The weekly annuity amount is $NZ50.00.

42 In both examples, bank fees are ignored. If bank fees were taken into account at a minimum rate of $NZ2.00 - 3.00 per month ($NZ24.00 - 36.00 p.a.), then there would still be some “effective” interest. The fees would nevertheless act as a strong disincentive to operating savings accounts. Note however, that not all banks charge fees on depositors’ accounts.
Here lies the incentive for avoidance, which has been discounted by proponents of the FTT as not worthwhile for businesses to investigate.44 Furthermore, if the FTT cannot be avoided, then it will be added to the price of goods and services, including those purchased by low income earners intended to be the prime benefactors of the FTT.

Other opponents of the FTT allege that the result will be a penalty on exporters which cannot be refunded (GST on inputs is refunded and GST is charged at a zero rate on export sales so that GST has no direct impact on export prices). Business margins and profits, in particular, would fall with a legislatively enforced FTT, although whether this fall in margins and profits is undesirable depends largely upon the economic philosophy of the commentator or analyst. Shome and Stotsky45 identify similar difficulties in designing an effective FTT that does not impair the efficiency of financial markets and which has minimal avoidance.

The New Zealand Business Roundtable prepared a report criticising the Alliance's FTT proposal with a view to answering the question: "Would a Financial Transactions Tax be more efficient and equitable than the Goods and Services Tax?"46 The report states that there is no recognised economic literature recommending a FTT-type tax over a consumption or income tax. This finding is not surprising, given the "bias" of economists to, and the familiarity with, traditional income and consumption based taxes. The report arrives at similar findings to this paper on a theoretical level, but takes an (unfair) advantage of the relatively weak evidence and scant research supporting the use of FTTs. Overall the report is inconclusive as to the efficiency and equity of the FTT versus the GST, although the New Zealand Business Roundtable would prefer retaining GST.

The FTT proposal has been promulgated by the Alliance Party and has attracted widespread criticism. The debate has largely focused on emotive statements rather than academic analysis (except for the New Zealand Business Roundtable, 1996), although the Alliance Party has not offered a comprehensive explanation of how its proposal will operate.

5. HOW MAY A FINANCIAL TRANSACTIONS TAX BE A GOOD TAX?

5.1 Preliminary Analysis of the Financial Transactions Tax Proposal

The FTT is proposed as a replacement to GST, and since both are examples of indirect taxes, comparison between the FTT and GST is a valid reference point to commence analysis. The initial conclusion from preliminary studies47 was that in comparing FTT to its alternative (and proposed predecessor, GST), FTT had the theoretical potential to outperform GST on most of the criteria of a good tax. FTT was considered to be less regressive than GST (and hence more equitable) with FTT's proportionate rate, and with all sectors of the community liable to the tax when they withdraw funds from a bank account. Certainty under a FTT would initially appear to be superior to that under GST, although precise details of the operative and definitional nature of the FTT remain unclear.

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43 This figure is ascertained by removing GST of $NZ38.89 per week (annualised as $NZ2,022.28) from the tax revenue (which includes RWT), prior to the introduction of the FTT. The total GST and RWT for this household will be $NZ2,039.05 per annum, and removing GST and adding the FTT, the total tax revenue will be $NZ158.46 from this household, representing a decline of 92 percent (excluding PAYE deductions). PAYE on the gross income of the household would amount to approximately $NZ95.00-100.00 per week ($NZ100.00 used in this example) and remain constant under FTT (other things being equal).

44 J Anderton, "Anderton Weeds Out his Sinister Worms" (1994) 7, 8. Anderton answers critics of Alliance Party economic policy, a policy which includes the FTT as part of the fiscal strategy.

45 P Shome and JG Stotsky, "Financial Transactions Taxes" (1996) 47. Shome and Stotsky45 identify similar difficulties in designing an effective FTT that does not impair the efficiency of financial markets and which has minimal avoidance.


Closer analysis indicates legislative drafting considerations and interpretation issues will dominate the courts, a situation familiar to the environment in which GST operates. A FTT may prove to exhibit a higher level of administrative efficiency (economy in operation) than GST, although this can only be assessed following implementation of the tax. However, it is likely to be less neutral than GST since movement towards greater use of cash transactions and overseas bank accounts is inevitable.

If an FTT is to be effective in generating revenue equivalent to GST and redistributing the tax burden, then the levels of both avoidance and evasion opportunities must be minimal. Essentially, businesses and individuals undertaking the largest transactions will incur the greatest amount of tax and consequently will be the primary source of revenue. In contrast to the final consumer directly incurring the tax with GST (although compliance costs are incurred by suppliers), banks, large businesses and financial market operators will be the providers of well over ninety percent of the tax base and revenue. Nevertheless, these financial institutions and businesses will pass on the tax to the final consumer through higher prices and charges when they are unable to utilise other methods to reduce their exposure to the tax, negating the theoretical incidence of FTT.

5.2 The Financial Transactions Tax Proposal's Performance under the Criteria for a Good Tax – Expanding Earlier Studies

The following analysis contemplates the extent to which each of the criteria of a good tax are reflected in the Alliance Party’s financial transactions tax proposal.

5.2.1. Equity

With respect to equity, FTT’s application to all individuals, corporations, institutions and firms would point to a tax with high horizontal equity. This comes with a proviso that FTT is not indirectly passed on to the final consumer or bank account holder (such as by higher bank fees where the bank pays the tax, and higher prices charged by firms). With a proportional rate, vertical equity receives minimal support, but one may argue that depending on the length of the transactions, taxpayers with short term transactions (for example, larger corporations and banks) bear a larger burden in comparison to those with a longer period before withdrawal (such as home mortgage owners).

The issue of deductibility of the FTT raises an important point; if FTT is incurred in gaining and producing gross income it should be deductible (as is fringe benefits tax for all taxpayers and GST for non-registered GST business taxpayers). However, final consumers will not be afforded this opportunity, and if their withdrawals are substantial, deductibility creates inequity. Notwithstanding this apparent inequity, FTT should be deductible for income tax purposes since it is a business expense in this instance. While one single rate improves simplicity and certainty, it reduces the opportunity for vertical equity to exist. GST however, is subject to similar criticism on this issue.

5.2.2. Certainty

The performance of FTT with respect to this attribute is unclear at present, since details of payment, responsibility for collection (other than the role of banks as the collectors of the tax), enforcement mechanisms and detailed legislation have not been provided. Nevertheless, a rate has been proposed and the potential tax base may be ascertained (subject to the avoidance issues). A forbidding obstacle to ascertaining the appropriate rate necessary to raise the revenue has emerged following the enormous disparity in Reserve Bank estimates. The problem is which of the estimates is more accurate. Calculations of withdrawals from an account could easily be determined monthly from the change in bank account balances and accounting for credits to the account. Bank account holders could receive a monthly statement indicating their FTT situation, with an annual reconciliation to cover situations where FTT had been deducted incorrectly. Alter-
natively, to tax both bank account debits and credits would create a wider base and therefore the rate of FTT may be reduced for each transaction.

5.2.3. Conveniences

Collection should be virtually costless once initial comprehension of the system is complete and the processes to calculate, deduct and pay the FTT to the Inland Revenue Department are incorporated into computer systems. With computerised systems, the amount could be withheld by banks and paid to the IRD in a similar manner to the deduction and payment of resident withholding tax (RWT) by the banks. This process has been proposed by the Alliance Party, but it is unlikely to receive a favourable response from the banks following their attitude to RWT when it was introduced.

5.2.4. Administrative Efficiency (or Economy in Operation)

Compliance costs will fall largely on the banks in this instance. The IRD will need to utilise an audit approach for detecting avoidance, with the scope of the investigation depending principally upon whether overseas bank accounts of New Zealand resident taxpayers are liable to FTT. FTT is claimed to eliminate the compliance difficulties of GST concerning the requirements to separate exempt activities from non-exempt activities, ascertain appropriate instances for zero-rating supplies and complying with return filing obligations. To an extent these difficulties may be eliminated, but until draft legislation is prepared for public analysis and the proposed treatment of avoidance opportunities promulgated (which are discussed shortly), this claim remains unable to be substantiated in any meaningful form or manner.

5.2.5. Neutrality

This aspect of the FTT is open to criticism. FTT is intended to be non-neutral in reducing financial market speculation, and by its very nature, it encourages the financing of transactions that do not require bank account withdrawals (within New Zealand). Evasion can be relatively easily monitored if banks are required to deduct the FTT and are open to audit of their computerised systems. Institutions will find pursuing avoidance opportunities worth devoting considerable resources to in many instances.

The Alliance Party claims that the FTT is neutral between exports and imports, spending and saving, financial and non-financial transactions, and spending on new goods and services and on secondhand goods and services. None of this is contended to be true of GST. However, the Alliance Party’s statement comes devoid of any analysis to substantiate the claims. The FTT is not a neutral tax; it encourages the use of forms of conducting business and spending activities without the use of New Zealand bank accounts, which itself will have a significant impact on the financial sector and the use of monetary resources.

5.2.6. Visibility

The FTT is unlikely to rate any higher than GST on visibility from the public goods perspective, although the Alliance Party intends to increase income taxes on the wealthy to fund the proposed increases in spending on lower income earners. FTT is anticipated to be readily visible on bank monthly statements received by taxpayers in a similar manner to RWT.

5.2.7. Revenue Needs and Economic Objectives

The FTT is the Alliance Party’s alternative to GST in terms of revenue generation, as well as a redistribution of the tax burden from lower income earners to big businesses and the wealthy. It represents a change in political philosophy, dominated by a more interventionist style. However, it is appropriate to consider whether the FTT can satis-

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48 Alliance Party, above n 1.
49 Ibid.
fy the revenue needs of a fiscal programme that proposes increases in government expenditure.

Detailed analysis of the New Zealand financial system by Tripe indicates there were 705 million transactions for the year to 31 December 1993, or an average of nearly two million transactions daily. Of these transactions, between 300 and 500 a day go through a Reserve Bank clearing system with an average daily total of over $NZ3 billion. With 250 working days a year this would amount to $NZ750 billion, forming the tax base. At a rate of 0.80 percent, this would yield $NZ6 billion per annum, close to the required revenue to offset the loss of GST revenue in 1994/95, but some $NZ1.7 billion short of 1996/97 GST revenue. This presupposes no significant reduction in the number and average value of financial transactions.

It is of interest to note the disparity between Tripe's figures purportedly obtained from the Reserve Bank as an applicable measure of the potential tax base, and those promoted by the Alliance Party in its Alternative Budget and supposedly confirmed by the Reserve Bank as a measure of the FTT's potential tax base. This disparity vividly illustrates the crucial role that the tax base will have on setting an appropriate rate to raise the necessary revenue.

Despite the concerns over the soundness of the FTT proposal just expressed, a larger and more damaging potential defect accompanies the proposal; the scope for avoidance.

5.3 FTT's Achilles Heal - The Scope for Avoidance

Tripe cites the example that for a transaction in the financial markets valued at $NZ1 million, FTT at 0.8 percent would amount to $NZ8,000. This would justify making some effort employing resources for setting up avoidance mechanisms, such as overseas bank accounts (if these are not caught by the regime), or to use inter-company ledger records to avoid the actual use of bank accounts. With successful avoidance mechanisms in place (or even examples of tax mitigation), then the substantial providers of FTT revenue will not be paying FTT at a sufficient level to enable the lost GST revenues to be recouped. In this instance, further tax increases will be required (most likely directed at high income earners), or perhaps the reintroduction of GST. To protect exporters, any FTT incurred could be refunded so as not to increase the price of goods and services, but this would serve to reduce the revenue collected and cause interpretational difficulties. For example, is finance provided to an overseas resident an export?

Fundamental to minimising evasion is the residency issue and whether overseas bank accounts of New Zealand residents will be caught, and if so, how will the tax be collected. If overseas bank accounts are excluded, the Australian banking system may experience growth in the number of bank accounts and transactions "sourced" to New Zealand businesses and individuals. Non-residents, with New Zealand bank accounts, are expected to be caught, and for high value, short-term capital transactions, they may choose to leave New Zealand or invest elsewhere. FTT on a transaction of $NZ10 million would be $NZ10,000, and with a short term finance arrangement, this could be prohibitive in terms of consuming any profit made on the margin.

The addition of FTT on a financial transaction requires a commensurate increase in the required rate of return on investments in New Zealand. Increasing the required rate of return requires a cut in margins or higher costs to be passed on to the final consumer, or an appropriate combination. Without this increase in the rate of return, there is significant potential for financial capital to be with-

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51 It was stated earlier that the Alliance Party has Reserve Bank figures which estimate that in a full year $NZ6,000 billion (or $NZ23 billion per day) is transacted in New Zealand.
52 If the 0.1 percent rate is used, then the same issues would arise for a transaction in the vicinity of $NZ8 million.
53 Applying the 0.1 percent rate promoted in the Alliance Party's Alternative Budget.
drawn from New Zealand. New Zealand must remain tax competitive on the international scene to retain capital investment.

5.4 FTT under the Good Tax Criteria - a Summary

The overriding issue, apart from clearly defining the tax by way of draft legislation, is avoidance. If avoidance can be minimised by a broad based tax which can be enforced, then the tax should satisfy revenue needs as far as replacing GST is concerned and go to considerable lengths in implementing the Alliance Party's economic objectives. However, the tax is not neutral (intentionally so by its proponents), but it is more equitable than GST (subject to the time period argument implicit in interest rate determination).

FTT has the potential to be both convenient and certain (although this cannot be assured, even on the event of the Alliance Party providing draft legislation). The FTT proposal can be administratively efficient, provided the problems with the FID and BAD tax in Australia can be avoided and the lessons understood. If exceptions and exemptions are granted, then while this may improve equity, administrative efficiency and certainty (and possibly convenience) will decrease. Visibility is expected to be at a similar level to that of resident withholding tax, although with a more severe impact on people carrying out large financial transactions.

Trade-offs are inevitable, but FTT has the potential to rate more highly than GST on the good tax scale. It is likely to create more business disquiet than the introduction of GST, and must overcome the hurdle of powerful lobby groups acting on behalf of businesses and financial institutions. Further economic analysis is imperative, and to this extent, the New Zealand Treasury and economic forecasting organisations will be key players.

If an FTT is introduced, what may be said of its impact on business and financial activities, and what issues and implications may it raise for future investigation and research? The article now briefly offers some tentative suggestions on the reality of residing or doing business in a country with a FTT.

6. THE IMPACT OF FTT AND ISSUES FOR FURTHER RESEARCH

FTT will have a significant influence on the manner in which business is conducted and how individuals utilise their bank accounts. Clearly FTT will provide a fresh challenge for the declining tax mitigation (and avoidance) industry. Advisers will need to develop expertise with another tax, should the proposal become a reality. Legislators will determine the scope and degree of effort required to minimise the liability to FTT, particularly through the breadth of the tax base, and the scope of terms such as a bank, an account, and a withdrawal.

FTT will encourage the development of alternatives to utilising bank accounts such as the development of an underground financial system, or methods to circumvent liability for the FTT through avoiding the New Zealand financial system. These activities will require policy-makers and drafters of the legislation to continue to close loopholes.

Crucial to the success of a FTT is protection of the tax base and widespread support for its introduction and operation. As with GST, a significant lead-in time for education purposes, development and modification to existing computer software to calculate and pay the tax, and refinement of the administration procedures, is vital. Businesses and individuals alike, in fact every entity that has a bank account, including non-profit organisations, will need to be educated on the scope of FTT. Initially when both FTT and GST are proposed to be in operation concurrently (although the Alliance

54 Umlauf, above n 9 (where following the Swedish securities transactions tax, trading, representing financial capital in this instance, moved to London).
55 Shome et al, above n 45, also identify avoidance as a pivotal issue with any FTT.
Party's Alternative Budget raises doubt that this will be the process of introducing the FTT), the tax burden will add further pressure to the economy.

The economic impact of the FTT will depend primarily upon whether it can be readily avoided. The FTT's most significant impact will be on short-term financial transactions, where the effective interest rate created by the FTT will be substantial. With all new taxes, there will be initial commencement compliance costs and ongoing costs, imposing an economic burden on holders of bank accounts.56

Further analysis of the FTT should be conducted when a detailed blueprint of the scope of the tax, and key definitional issues are resolved. This information, coupled with extensive data concerning the size of the financial markets with respect to bank account withdrawals, and prior research concerning the propensity to avoid taxes, enables economic models to be developed to predict the size of the revenue base.

Consequently, the level of research is insufficient to justify resolute commitment to introducing a FTT in New Zealand. In turn, development of models should enable further critical analysis of the expected performance of the FTT on the good tax criteria to be undertaken. Should the Brazilian FTT model be adopted with necessary modifications, New Zealand's FTT will fall short on several criteria, especially the certainty, administrative efficiency, and neutrality canons. Australian financial transaction taxes also provide a valuable learning experience for New Zealand.

As a replacement for GST, FTT has the potential to improve the existing tax system. It should not be expected to raise more revenue than GST on the rates proposed in the original estimate of the tax base. Therefore, it can at most, be a replacement for GST and not a catalyst for reducing direct taxation further. It may benefit poorer taxpayers and consumers at the expense of wealthier taxpayers through a shift in the burden of GST, which currently falls on consumers (particularly low income earners), to financial institutions and businesses. Nevertheless, the incidence of FTT is likely to be reflected in higher costs and prices to consumers. More recent estimates of the potential tax base suggest scope for increasing FTT revenue beyond that which would be feasible under GST; this disparity in potential revenue estimates is unsettling as it indicates diverse and conflicting estimates of the potential tax base for a FTT.

The FTT proposal indicates a substantial change in political ideology - a movement away from the domination of the financial markets in determining fiscal policy (through the effective lobbying of those representing the free-market and market-based philosophy), towards a revisiting of greater political intervention. FTT will only be a reality if a substantial change in government occurs in New Zealand; however this prospect cannot be readily eliminated. Despite the choice of voters in the first MMP election to prefer a left of centre government (incorporating the Alliance Party), the opposite eventuated.

By way of a comparison, GST was introduced outside of any political election manifesto and has become part of business activities, and an inevitable cost for consumers. At least with the FTT proposal, the concept behind the proposal has been raised as part of a political manifesto. Further research, political developments and the passing of time will be the ultimate arbiters.

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