V2 (Goldsmith, 2008)

We Won, You Lost, Eat That!

A political history of tax in New Zealand since 1840

Paul Goldsmith

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rich. With its army of bureaucrats, the Excise became known as 'the monster with 10,000 eyes.'[12] The balance shifted a little in 1842 with the introduction of Peel's modest income tax on higher incomes. Income tax was introduced as a short-term expedient to deal with a budget deficit. In some respects it was a defensive measure by ruling classes as social agitation threatened to spiral out of control in the middle decades of that century. Peel told Parliament on 18 March 1842, that 'by consenting to such a burden, instead of throwing it upon the articles of consumption, [the upper classes] diminish the embarrassments of their country, and take from those who are disposed to agitate the public mind the means of creating discontent and disunion.'[13] The temporary income tax kept being extended each year and was firmly established by the time of W. E. Gladstone's 1853 Budget in which he described it as a measure of fiscal equity and balance between classes. It was levied above an income threshold (£150 per annum) and at a flat rate that fluctuated over the years between 2d and 16d in the pound (0.83 to 6.66 per cent). By the early 1850s it generated around 12 per cent of British tax revenues.

In 1839, when officials were considering a new colony in New Zealand, it was assumed customs duties on spirits, tobacco, wine and sugar would be sufficient.[14] They were the sorts of duties that British settlers and traders were used to paying and they would be relatively simple to collect. It would be a matter of putting a few men in the busiest harbours, providing them with a dinghy and having them intercept each new boat as it sailed into port. George Cooper, New Zealand's first Collector of Customs and its first Treasurer, arrived with Hobson on the *Herald* on 29 January 1840. The symbolism was important: wherever government extended, the taxman was only one step behind. Cooper busied himself organising customs posts at Russell, Auckland and Port Nicholson (Wellington).

When Hobson proclaimed British sovereignty over the North Island on 21 May 1840 the New South Wales customs tariff came into effect. A year later Hobson declared New Zealand a Crown Colony separate from New South Wales. The Customs Regulation Ordinance was the third law passed in the new colony. This repealed the New South Wales tariff and established New Zealand's first, to take effect from 1 July 1841.

Spirits, or 'strong waters', attracted the heaviest duty at four shillings per proof gallon if it was British and five shillings if it was foreign. Wine received a 15 per cent 'ad valorem' duty, meaning 15 per cent of price charged. Unmanufactured tobacco was 9d per pound, manufactured was one shilling, while cigars and snuff were two shillings a pound. Tea, sugar, flour, meal, wheat, rice and other grains and pulses attracted a 5 per cent ad valorem loading. Any other goods not from

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CHAPTER ONE

Old Customs, New Land: 1840s-1850s

Five and twenty ponies
Trotting through the dark –
Brandy for the Parson
'Baccy for the Clerk
Laces for a lady, letters for a spy
And watch the wall, my darling, while the Gentlemen go by!

— Rudyard Kipling, 'A Smuggler's Song'

If alcohol never touched your lips nor the noxious weed of tobacco, and if you were abstemious with sugar and cups of tea, then as far as taxes were concerned you had a very easy ride in New Zealand for the first few decades after government was established in 1840. True, from 1866 the deceased estates of wealthy people were taxed, but so long as you remained alive that wasn't a concern. Administrations then were ingenious, as they are now, at setting various fees and licences that were in the nature of a tax, but again, unless you were a publican or an auctioneer, they were fairly modest. Custom duties accounted for most tax revenues in New Zealand until the 1870s, and more than 60 per cent of these came from alcohol and tobacco. Most tax was voluntary, in the sense that if a citizen chose to be a non-smoking teetotaller the taxman got little.

The arrangement reflected a very different relationship between the New Zealander and his or her government than the one that exists today. And yet, though the burden was very light by modern standards, taxation was always a source of vehement debate within the new colony. The question of how best to raise the money required for government activities lay at the core of most political discussions.

Modern states are obliged to fund most of their activities from taxation, supplemented by smaller contributions from profitable state-owned enterprises and other assets. They may also borrow money for capital projects. Raising loans to cover day-to-day expenses is frowned upon. New colonies in the nineteenth century, and before, typically had one or two other options. At least at first they hoped for grants from the mother country. The most basic instinct where tax

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that the changes to death duties were 'almost entirely of an administrative character' and on that basis he rushed the Bill through the Legislative Council.[55] Colonel George Whitmore just had time to state that he thought the Bill was the most important one of the session, aside from the abolition of the provinces, 'for it was likely to make a very great social revolution'.[56] But the Bill was passed with a debate that covered barely a page in *Hansard*. Little thought appears to have been given to the change, even though the idea that wealthier people should pay taxes at a higher rate than their poorer brethren had not previously been a feature of the tax system. The idea, so pregnant for the future of taxation in New Zealand, was ushered in the door in 1875, in its mildest form, an import from Australia.

Aside from the stamp and estate duties, which in the mid-1870s accounted for less than 10 per cent of total tax revenues, central government had scarcely raised any new taxes since the 1840s. There had been the opportunistic gold duties and the introduction of excise duties on locally produced whisky, but these can be seen as extensions of the customs-based taxation system that reigned supreme. Alcohol and tobacco were still the mainstays of the government revenues, accounting for a little under half of all taxes collected. Central government's tax revenues, meanwhile, had dipped below 5 per cent (4.7) of current estimates of the GDP in 1875.[57]

The real growth area in new taxation during the 1860s and 1870s was local government. The proliferation of units of local government was a confused process stretching over these two decades and became even more so after the abolition of the provinces in 1876. The provinces had no powers of direct taxation themselves, although most extended their tentacles with fees and licences as far as they could. The Auckland Provincial Government, for example, extracted £2,145 in 1865 from tolls on Great South Road. A trickle of laws, meanwhile, had given rating powers to units of local government such as cities and road boards. As yet, there was no consistent, nationwide approach to local government, and it was fast becoming a 'disorganised shambles.'[58]

Distillation Act 1868

The first attempt to establish forms of local government that could strike rates had predated the provincial system. FitzRoy's 1845 Public Roads and Works Ordinance provided that a majority of electors in a district could petition for the election of commissioners who could levy rates to construct roads, bridges, waterworks and markets. This apparently aroused negligible enthusiasm. No elections were held in Auckland and probably none in the country.[59] A series of false starts in Auckland and elsewhere followed during the 1850s. The town of Wellington subsisted until 1862 on an ad hoc arrangement whereby small committees of civic spirited citizens put the hat around for donations to improve

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Things had changed by 1865 however, when a return of local taxation in the various provinces of New Zealand that year showed local rates were generating something in the region of £50,000 (around 7 per cent of the central government figure).[61] The geographic distribution was lumpy. Hawke's Bay superintendent, Donald MacLean, proudly declared that there was no local taxation in his province, unless a sheep assessment for scab was considered such. Southland too was free of local taxation. The largest sums were being collected in the city of Auckland (£10,364 from a rate of 1s 2d in the pound for the annual value of property) and the city of Dunedin (£12,085 from a rate of 1s 4d in the pound). Road boards were multiplying like the rabbit population in rural districts: Otago had five boards in 1856 but 95 by 1866.[62] An annual tax of 10s on each dog, raised under the Dog Nuisance Act, brought in a couple of hundred pounds in most areas, although in some regions the provincial government collected this. Some of the southern provinces included a tax raised under the Education Act of £1 for each householder and 5s each for children between the ages of five and fourteen not attending private schools. Local government in Nelson gained £1,700 by this device; the city of Dunedin gathered £3,015. Auckland made do without any.

Edward Stafford's administration tried to bring some order to the area in 1867 by passing the Municipal Corporations Act 1867 which consolidated the arrangements for the twenty incorporated towns throughout the country. They had some rights to operate gasworks, libraries, gyms and other amenities. Sometimes with help from the provinces they worked on streets, drains, sewers, water, fire fighting and other worthy activities. The Local Government Bill 1867 was introduced to achieve the same level of consistency for rural areas by setting up road boards and local government units outside the towns in areas where they hadn't already been established.

Some were keen on smaller, more localised units, especially those in outlying districts who felt that the provincial governments that were based in the major towns neglected them. Against them were those who saw the extension of local government as an assault on the system of provincial government. Meanwhile, many wealthy landowners thought the rating principle, which taxed according to the size of a man's landholding, was a threat to their pockets.[63] Francis Dillon Bell, MP for Mataura, worried in 1867 about the absence of controls over roads boards or clear guidance on how land might be valued, and therefore rated. Abuse, he felt, was inevitable: 'where the taxation of property is concerned, it is preposterous to propose, as a just measure, one which places large proprietors at the mercy of their neighbours.'[64] The more a man spent on improvements, the greater the inducement given to his neighbours to tax him more heavily through rates, thus relieving themselves from some of their burden.

Stafford responded that Nelson had had roads boards for 10 or 12 years and there the comparatively poor ratepayers had not tried to oppress their richer neighbours. 'When we are told that we are not to legislate for the general advantage of the people of New Zealand,' he thundered, 'because from the rich men – the plums of the pudding – we would claim a contribution proportionate to their income, it would be a black day for the country.'[65] Later on in the debate Stafford asked: 'What is the principle of [the Local Government Bill] but to give value received? What other principle does it possess except that?' Value received was a slippery concept: did a landowner who paid ten times the rates of another owner of a less valuable piece of land, necessarily receive ten times the value? That was an idea later set aside by the courts which laid out a clear constitutional principle that tax was 'a compulsory exaction of money by [Parliament] for public purpose, enforceable by law, and … not a payment for services rendered.'[66]

It seemed few were convinced by Stafford's principle then, because the Local Government Bill failed. Notwithstanding the parliamentary rebuff in 1867, roads boards continued to spread under various provincial statutes. Statistics were patchy on this new arm of government before 1874 when the Registrar-General, R. E. Brown, obtained a comprehensive summary of their rates only, he wrote peevishly, 'after much trouble.'[67] For that year road board rates totalled £54,063.[68] Most boards charged somewhere between a halfpenny and 2d in the pound on the total value of the property (given there were 240 pence in the pound, a rate of 1d in the pound represented 0.42 per cent). Some local authorities charged rates by the acre, say 3d per acre, while others based them on the annual rentable value of the land. Meanwhile, by 1874 municipal councils – in towns and cities – gathered £38,453 between them. The cheapest township was Alexandra at 9d in the pound on the annual value; down the road in Invercargill landowners laboured under the extraordinarily heavy impost of 2s in the pound (10 per cent).

The abolition of the provinces in 1876 propelled local government to greater status. The new acts gave councils and boards more tasks, beyond the standard fare of roads, sewage, water and public amenities. The provision of education, health care and welfare now rested on their shoulders, although modest grants from central government were provided to help in all these areas, especially after the passage of the Education Act 1877. The Municipal Corporations Act and the Counties Act, both of 1876, set the context for urban and rural local government. The Town Districts Act 1881 added an intermediate layer. Together with harbour boards, river boards, education boards and numerous

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1927

Motor Spirits Taxation Act

(Goldsmith, 2008)

on tramway networks that were being made redundant by cars, bore the brunt of the demand to build more roads, and this was a major cause of ballooning rate bills.[69] This particular problem led to the most significant new tax of the decade: the petrol tax. The Motor-Spirits Taxation Act 1927 imposed a duty of 4d per gallon from the end of that year, equating to an increase of between 20 and 25 per cent in the cost of petrol.[70] Finance ministers quickly recognised they were on to a gusher and rarely retreated. Licence fees for vehicles were also increased substantially, so that within five years motor vehicle taxation generally provided £1.8 million annually, or just over 10 per cent of central government's tax revenues.[71]

That petrol taxes were dangerous and could easily be misused became obvious quickly after their introduction in November 1927. In May 1928 F. W. Furkert, Under-Secretary of the Public Works Department and Chairman of the Main Highways Board, concluded that due to competition from roads, railways might no longer be worth the money invested in them. As Bassett observed: 'Instead of questioning the indisputable fact that Railways had become an employment agency as much as a transport service, Furkert suggested that road users, who were regarded as responsible for the problems of rail, ought to bear the cost. In effect he was arguing for a [further] tax on motor fuel to support a mode of transport that the public was deserting.'[72] It was a classic example of the potentially warped logic of state activity. The money of generations of New Zealanders had been committed by politicians since the 1870s, in some cases recklessly, when they borrowed heavily to build railways, based on hopelessly optimistic projections of the population they would serve. Politicians in the 1870s had talked boldly of an ideal population of 40-50 million residents in the 1900s. That shrank to 10-15 million by the early 1920s, and withered further to 5 million by the mid-1920s.[73] Rail investment was a dud – the government wrote off £8.1 million of the rail debt in 1929 and more followed; it was further muddled, as Bassett noted, by the increased tendency in the later 1920s of using rail to mop up unemployment, confusing its purpose and making rail less profitable still. For most of the next 60 years it would be a drain on the nation's tax revenues.

The petrol tax debates centred attention on one of the key taxation issues of the 1920s: the runaway growth of local government taxation. Wilford lamented, 'Every member of this House knows that some of the local bodies of this country in the last few years have run mad so far as public expenditure is concerned'.[74] Rates revenue had doubled in the ten years following 1919, while central government tax had increased barely 10 per cent. Much of the increased local tax was gathered to pay for debts incurred in big spending programmes, partly on roads but also on the usual fare of local government, grand town halls budget for 1931 on 6 October in an atmosphere of crisis. The government's finances were in deficit and Stewart could offer only 'further cuts, further taxation and further recourse to any reserve funds available.'[29] Against that, he recognised that he needed to provide some assistance to farmers 'to avoid a national disaster in a general breakdown of the farming industry.'

Just as it generally takes a crisis to justify a new tax, it sometimes takes a crisis to get rid of an old tax. With some farmers walking away from their land, Stewart felt emboldened to jettison the graduated land tax. The tax, he said, 'is not based on any principle of ability to pay, and it has been condemned for many years.' It took no account of bad times and farmers received no relief, even if their farms were losing thousands of pounds in a given tax year. When introducing the legislation a fortnight later Stewart thought it 'a matter of equity and justice that the basis of taxation should be the capacity of the individual to pay according to his or her income.'[30] He retained only a flat rate land tax at 1d in pound, while making up for some of the lost revenue by bringing a few more farmers into the range of income tax.[31] It was a boon for the middling farmer – his land tax was slashed, but if his land was valued at less than £3,000 he still paid no income tax. Reform was once more on top in the arm wrestle between the two parties over farm taxation.

Stewart's revenue remained well shy of what was needed. His budget was unusual for this period in New Zealand history for recognising that the country had a problem with its rate of company tax. Individuals, he said, paid the least personal income tax in the British Empire because of the low rates on moderate incomes and the 'liberal exemption'. Even at the comparatively high income of £1,000 the average income tax rate was only 8.5 per cent (compared with 16.25 per cent in Britain).[32] But the New Zealand income tax system put much more of the burden on companies. Stewart candidly admitted that it was well known that company tax in New Zealand was the heaviest in the British Empire, 'if not in the world,' with any reasonable-sized business paying most of its tax at the 29.25 per cent top rate. As a result Stewart didn't want to add any further pressure on companies, especially as most of them were engaged in 'financing or assisting the primary producer'. Similarly, he felt tariff rates were already so high that the law of diminishing returns was operating.

In desperation Stewart created a precedent that was to warm the cockles of finance ministers' hearts for decades to come. He imposed an additional impost of 2d per gallon on petrol and indicated that the new money would go to the Consolidated Fund for general purposes rather than to the Main Highways Fund for spending on roads. The petrol tax was highly productive, convenient to collect, and hard to evade. It would be a perennial favourite now that it was

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lower rates. Only those holding less than one per cent of the debt had dissented and were forced to pay the special interest tax.[52] Purists fretted over this naked use of the power of the state to break contracts; the majority applauded the 'volunteers'' patriotism and preparedness to carry their share of the sacrifice.

Coates seemed set on mislabelling things. In March 1933 he introduced what was in effect a 'bachelor tax', although he refused to give it such a name. The idea was to lower further the general exemption on income tax from £260 to £210. Coates went on at some length that New Zealand's exemption level was still uniquely high, while other countries had reduced theirs to £110 or £100 and even lower.[53] All that made sense, but at the same time Coates introduced a new exemption of £50 for a taxpayers' wife. So a married man would now have a £210 exemption for himself and £50 for his wife, leaving the family's overall exemption as it had been. Harry Holland grumbled, 'If this is not a bachelor tax, what is it?'[54]

Still deficits loomed, obliging Coates to make what proved to be the final extension of the taxation net during the Great Depression. There was another tax in wide use internationally that the Economics Committee had recommended but which ministers had so far resisted – the Sales Tax. On 8 February 1933 Coates pounced, saying that the country faced a budget shortage of £9.5 million, and despite all the savings already made more tax was required. He proposed to gather another £2.5 million from taxation, around £1 million of it from increased customs duties and petrol tax. The rest would come from a sales tax of 5 per cent of the value of goods sold, in addition to any customs or excise duties already payable. It would be imposed from that night.[55] The tax was modelled on one imposed in Australia in 1930 and would be paid at the point when the goods were passed to the retailer, so customers wouldn't notice it directly. To ward off claims that it was yet more regressive taxation that would fall most heavily on the poor, he exempted most everyday food items; to keep the farmers on side a lot of items used by farmers were also exempted. From birth the new sales tax had holes in its net, increasing the cost of collection and encouraging other groups to lobby for exceptions.

Coates confessed that 'no government likes to adopt a new system of taxation', but in his view it was the 'best remaining method' available to them.[56] Forbes later said that it was something they'd resisted until the nation was 'right up against it' and could no longer avoid it. The Labour Opposition disagreed violently and hurled themselves into a 23-hour debate on the Bill that subsequently ratified the new tax. James McCombs strayed into hyperbole when he said: 'a more vicious piece of class legislation, I believe, has never been attempted in the Parliament of New Zealand.'[57] The line of McCombs' argument was that the new money

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reform of the New Zealand tariff. It won't be attempted here. Since the tariff protected many jobs in manufacturing, it was one of the more difficult areas of the tax system to reform and subsequently one of the slowest. As Moore found, it was hard to argue the merits of Joseph Schumpeter's principles of Creative Destruction to unemployed 50-year-old factory workers.[66] The media latched on to examples of hundreds of workers being laid off by manufacturing companies unable to cope with international competition. Replacement industries were slow to arrive and when they did, the many scattered decisions to hire a handful of workers were seldom newsworthy. As Muldoon had known, the political arithmetic was always difficult. But workers were also consumers. They wanted cheaper televisions in their living rooms, cheaper shoes to walk in and cheaper cars to drive. The transformation in everyday life resulting from lowered protection for industry, not just through tariff reduction but also from the axing of import controls, was substantial. Its effect on employment proved short-term.

The final act of tax reform from what had been an iconoclastic Labour Government passed with relatively little fanfare. Caygill announced in the 1990 budget that the land tax would be abolished from May 1991. This small wealth tax had survived several attempts on its life. Since 1970 it had applied only to commercial and forest land holdings. In the context of a dramatic property slump, its removal was a small gesture in favour of desperate property investors and developers.[67] Walter Nash and John Ballance might have turned in their graves, but few others aside from commercial and property men cared much.

The incoming National Government that took office on 2 November 1990 led by Jim Bolger, with Ruth Richardson as Minister of Finance, largely accepted the Labour Government's tax reforms. Its efforts focused primarily on administration of the tax department, sophisticated aspects of company tax law (more of which in the next chapter) and on less high-profile aspects of the tax system not reached by Labour. One, the extension of the fringe benefit tax to business entertaining, raised shouts of protest from National's business constituency. Richardson later lamented that the 'Entertainment Tax', as it was unwisely labelled, was reduced to Swiss cheese by her Cabinet colleagues before it reached the statute book in 1993. Successful lobbying by business resulted in exemptions that led, in that case, to absurdities: conferences held offshore were exempt from FBT, while domestic ones attracted FBT on 50 per cent of the cost. It served only to encourage companies to hold conferences overseas.[68] Fiji and Queensland cheered; Taupo and Queenstown groaned.

Richardson finally eliminated estate duties with a minimum of fuss, just before Christmas 1992. By now estate taxes gathered only a tiny fraction of tax revenue, but still hurt those caught. Richardson had hated death duties

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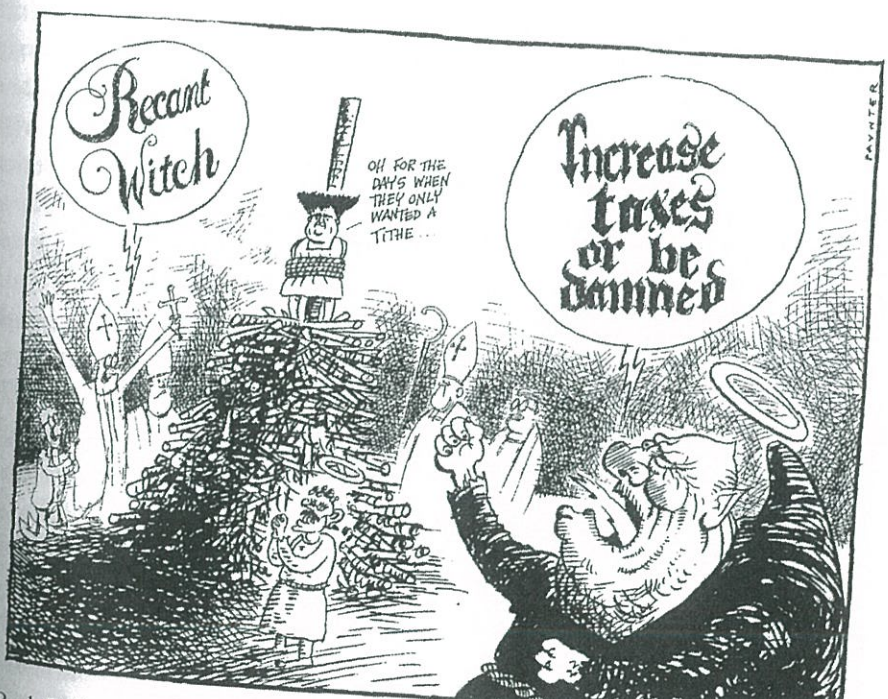
since seeing as a young woman the added suffering they caused a neighbouring farming family when the young farmer was killed in a flying accident. Estate duties have enjoyed a long history in tax systems around the world; Richardson jettisoned New Zealand's version, dismissing it as a piece of 'economic envy' that owed its existence to a 'misguided notion that people should not be permitted to accumulate too much wealth.'[69] Richardson was proud of the fact she eliminated the duties 'sotto voce' with little parliamentary debate.

In many ways the most significant tax decision of National's first term in government was to sit tight. For the third time in a row, a defeated New Zealand government had left a financial mess behind it. In 1990 the budgetary problems were compounded by the need for a substantial bail-out of the troubled Bank of New Zealand. The trouble bequeathed in 1990 was not of the same order as that in 1975 and 1984, but the worse-than-expected economic situation left government with dwindling revenue and burgeoning welfare costs. Post-election briefings indicated Bolger's government faced a budget deficit of $3.7 billion in 1991/2 if it didn't make cuts.[70] National's response was not to increase taxes, but rather to redouble efforts to reduce government spending and to accept continued



Ruth Richardson gets the treatment from church groups, Muldoon and Michael Laws.
Bill Paynter, *National Business Review*, ca. 1991