Tax Working Group Public Submissions Information Release

Release Document

February 2019

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Workplace Savings NZ
Te māngai penapena ā-mahi

1 November 2018

Tax Working Group Secretariat
PO Box 3724
Wellington 6140

By email: secretariat@taxworkinggroup.govt.nz

Feedback on *Future of Tax* Interim Report

Thank you for the opportunity to provide feedback on the Tax Working Group's *Future of Tax* Interim Report.

This response is from Workplace Savings NZ Incorporated (**WSNZ**), a non-profit member organisation representing the interests of employers who offer workplace retirement savings schemes, their trustees and their members, other retirement scheme managers and supervisors, 18 KiwiSaver scheme providers, retirement savings industry service providers and professional advisers.

More information about WSNZ is set out in the Appendix to this letter.

The focus of our feedback is on the implications for retirement schemes collectively (KiwiSaver schemes, workplace savings schemes and superannuation schemes) of:

- the options being considered for extending the taxation of capital income;
- the Tax Working Group's recommendations to the Government regarding KiwiSaver schemes only, being:
    - exempting from ESCT the employer's matching contribution of 3% of salary for a member earning not more than $48,000 per year; and
    - reducing the two lower tiers of PIE tax rates by 5% each; and
- the Group's recommendation that the Government consider ways to simplify the determination of PIE tax rates (an initiative that would benefit the providers and members of all multi-rate PIEs).

Summary of our feedback

The Group's final report should:

- give appropriate recognition to non-KiwiSaver retirement schemes (i.e. workplace savings and superannuation schemes) and their contributions to the retirement savings base; and
- recommend treating those schemes equitably relative to KiwiSaver schemes.

We do not support imposing any tax on retirement schemes' capital income to the extent that it is not already imposed, as that would eat into members' retirement savings and therefore run counter to the desired policy aim of growing the retirement savings pool for all New Zealanders to reduce their dependence on New Zealand Superannuation.

The proposed targeted ESCT exemption must apply to a functionally KiwiSaver-equivalent locked-in account in a workplace savings scheme which is a complying superannuation fund. Additionally:

- the applicable income limit should be tested in the same way as combined salary and employer superannuation contribution amounts are currently tested for ESCT purposes; and
- if there is to be a maximum income limit, suitable evidence-based consideration should be given to what might in empirical terms be the appropriate maximum.

We consider it fundamentally wrong for KiwiSaver to have a uniquely 'approved' status among retirement schemes for PIE tax rate purposes, giving it an investment income tax advantage over workplace savings and superannuation schemes – all retirement schemes should be treated consistently for PIE tax purposes.

We strongly agree with taking this opportunity to simplify the rules for determining PIE tax rates, in the interests of fairness and coherence – and we also recommend that 'prescribed investor rate' be replaced with clearer terminology so as to convey the right concepts and reduce the risk of error.

No exploration of how to make the tax treatment of retirement savings fairer would be complete without acknowledging (and optimally addressing) the inflexibly high tax impost placed on defined benefit schemes and the tax treatment of lifetime annuities.

General comments

While we do acknowledge that timing constraints have limited the scope of the Interim Report, we were somewhat struck by the absence of any reference to the non-KiwiSaver workplace savings schemes and superannuation schemes which continue making a very significant contribution to the retirement savings pool and to New Zealanders' well-being in retirement.

To give some idea of the continuing size and significance of this sector, in overview terms and based on latest annual reports there were recently estimated to be:

- 90 workplace savings schemes (22 of them open to new joiners) registered under the Financial Markets Conduct Act 2013 (**FMCA**) as having restricted status – those schemes had a little under $12 billion in assets and around 97,000 members;
- 19 FMCA-registered legacy superannuation schemes, which had around $4 billion in assets and close to 90,000 members;
- 6 FMCA-registered multi-employer workplace savings schemes, with over $6.5 billion in assets and almost 90,000 members; and
- 10 FMCA-registered on-market retail superannuation schemes, with close to $1.2 billion in assets and a little under 10,000 members.

Non-KiwiSaver retirement schemes therefore had (as at the latest balance dates for which annual reports are available) over $23.5 billion in assets and over 285,000 members. Those numbers, while smaller than the $48.6 billion in assets and 2.84 million members referred to in the Financial Markets Authority's latest *KiwiSaver Annual Report*, make non-KiwiSaver retirement schemes still very important contributors to the national retirement savings pool.

Part 7 of the Interim Report, headed *Retirement Schemes,* does not acknowledge this reality. Superannuation schemes are referred to only in passing and workplace savings schemes (which almost invariably involve greater employer subsidy rates than KiwiSaver and other features such as ancillary death and disablement insurance) are not mentioned in any way. Only KiwiSaver schemes are referred to as supporting private saving to maintain an adequate standard of living in retirement.

We urge that:

- the Group's final report gives appropriate recognition to non-KiwiSaver registered retirement schemes (i.e. workplace savings schemes and superannuation schemes) and their contributions to the retirement savings base; and

- the Group's final recommendations treat those schemes equitably relative to KiwiSaver schemes (and are particularly mindful of not further disincentivising employer sponsors from supporting their employees' retirement savings through workplace savings schemes).

Expanding taxation of capital income

We note that the proposed new rules whereby capital income from Australasian shares are no longer specifically tax-exempt would not only increase the total tax impost for retirement schemes but would also necessitate significant systems changes. By resulting in:

- more complexity and therefore increased administrative cost (inevitably passed on to members); and
- an increased investment income tax burden;

those changes would eat into the retirement savings of KiwiSaver, workplace savings and superannuation scheme members and would therefore run counter to the desired policy aim of growing the retirement savings pool for all New Zealanders to reduce their dependence on New Zealand Superannuation in retirement.

The proposals would also impact not only members' savings but additionally (in defined benefit schemes) employers' balance of cost funding obligations, because by reducing after-tax investment earnings rate assumptions they would impact those schemes' actuarially assessed funding ratios.

WSNZ considers the current system of taxing retirement schemes' investment income imperfect certainly; but also relatively simple, fair and widely understood. As the Interim Report acknowledges, New Zealand already in any case stands out internationally for the relative insignificance of its retirement savings incentives.

We therefore do not support imposing any tax on capital income to the extent that it is not already imposed on retirement schemes.

Consistency in treatment of retirement schemes

The Interim Report notes that extending the taxation of capital income by taxing capital gains from holding shares in New Zealand and Australian companies would impose significant additional income tax on KiwiSaver and other savings vehicles. It then observes that the ESCT exemption and PIE tax rate reductions proposed for lower-earning KiwiSaver scheme members would considerably more than compensate that group for the increased tax on Australasian shares.

We acknowledge that the proposed targeted ESCT exemption would partially restore an earlier KiwiSaver-specific savings incentive. It would be essential though that:

- as was the case with the previous ESCT exemption; and
- as remains the case with member tax credit contributions from the Government;

that incentive extends to the first 3% of an employer's contributions to a functionally KiwiSaver-equivalent locked-in account in a workplace savings scheme which is a complying superannuation fund.

We also urge that:

- the applicable income limit is tested in the same way as combined salary and employer superannuation contribution amounts are tested for tiered ESCT rate purposes currently (i.e. on a backward-looking basis, thereby enabling certainty in year-in-question terms) – the current tests can themselves cause significant administrative difficulty in practice, but are clear in technical terms; and
- if there is to be a maximum income limit, suitable evidence-based consideration is given to what might be in empirical terms the appropriate maximum, noting that the currently recommended figure of $48,000:
    - coincides with the income threshold for the imposition of a 30% PAYE rate; and
    - is a key income threshold for PIR determination purposes;

  and is in that sense consistent with other thresholds, but:

    - it is meaningfully below the national average wage (and in an environment where the median percentage of savings for households whose highest income earner is aged between 30 and 60 is nil for seven out of the ten income brackets); and
    - alignment with an existing ESCT rate threshold (such as the maximum level of salary/wage and employer superannuation contributions to which the 17.5% rate applies, which is $57,600) would be administratively simpler as well as perhaps more appropriate on enquiry.

For completeness, we note that as the targeted ESCT exemption would apply only to certain employed members contributing from pay - though it could be expected to increase the size of that complement - it would not benefit the self-employed, retirees and other non-employees who make up a considerable portion of KiwiSaver members. The net incentive effect (factoring in the offsetting adverse effects of the capital income tax proposals) would also reduce the lower an employed member's income, and the greater his or her level of exposure to Australasian shares.

Turning to the <u>PIE tax rate recommendations</u>, WSNZ is strongly of the view that, in keeping with the core tax principles of equity, fairness and coherence which are referenced in the Interim Report, the recommended 5% lower PIE tax rate reductions should extend to <u>all</u> retirement schemes which are multi-rate PIEs (and not merely to KiwiSaver schemes).

Any retirement scheme which is registered as such under the FMCA must be established and operate for retirement savings purposes, and all retirement schemes must therefore impose (and must conform to) various lock-in requirements.

The Interim Report refers in Section 7 to there being a case for introducing additional concessions for retirement savings, adding that:

- additional saving will improve the living standards of individuals in retirement; and
- there are also likely to be broader economic benefits if there is an increase in the rate of national saving.

These are observations that in our view apply (if valid) co-extensively to all FMCA-registered retirement schemes – but the Interim Report then simply conflates retirement savings with KiwiSaver savings and makes ESCT and PIE tax rate recommendations solely with respect to KiwiSaver schemes.

In seemingly the same vein, the *Taxation of Retirement Schemes* Background Paper:

- distinguishes in several places between KiwiSaver schemes on the one hand and all *"non-locked-in PIEs"* on the other;
- observes that *"non-locked-in PIEs are a close substitute for other forms of saving so we would see little justification for providing a five percentage point discount for non-locked-in PIEs"*; and

- concludes that for this reason such a change should only be considered for PIEs that are KiwiSaver schemes.

This reasoning either overlooks non-KiwiSaver retirement schemes which are multi-rate PIEs, or ascribes to non-KiwiSaver retirement schemes a false equivalence with other managed investment schemes, despite them being required to be established and operate for retirement savings purposes. If the latter, then characterising non-KiwiSaver retirement schemes which are multi-rate PIEs as 'non-locked-in' PIEs which impliedly are not (in conceptual terms) for retirement savings is incorrect in principle.

We consider it fundamentally wrong for KiwiSaver to have a uniquely 'approved' status among retirement schemes for PIE tax rate purposes, giving it an investment income tax advantage over workplace savings and superannuation schemes, in view of those other retirement schemes' broadly KiwiSaver-consistent purposes and their major contribution to New Zealand's retirement savings pool. In our view all retirement schemes should be treated consistently for PIE tax purposes, including in the context of any concessionary relief given to lower earners or any other demographic to encourage them to save more for retirement.

Simplifying PIE rate determinations

We firmly concur with taking this opportunity to simplify the rules for determining PIE tax rates in the Income Tax Act 2007.

The current tests are described in the Interim Report (with commendable understatement) as *"somewhat complex",* hence the recommendation that the Government consider ways to simplify the determination of the PIE tax rates.

The complexity of the rules for determining the correct PIE tax rate to apply to an individual investor is such that investors in multi-rate PIEs frequently choose incorrect rates. This leads to similarly unfortunate outcomes - applying incorrectly low rates exposes investors to:

- the compliance burden of having to file an income tax return when they would not otherwise need to; and

- potential interest and penalties on tax shortfall payments;

and the choice of incorrectly high rates cannot later be remedied by way of tax refunds.

Simplifying those rules would be a highly desirable exercise in furthering the core tax principles of fairness and coherence. It would also be even more important to the extent that concessionary PIE tax rates were available to lower earners saving through retirement schemes (who would consequentially have more to lose by choosing the wrong rates). We recommend that careful consideration be given to (in particular):

- possible automation options, drawing on information that Inland Revenue already has available to it; and
- a simpler 'look-back' test based on what is on record (at Inland Revenue perhaps) with respect to the most recent tax year for which the required income information is available.

In an ideal world, a KiwiSaver scheme provider for example would send Inland Revenue a scheme participant's Tax File Number (possibly at various points – when joining, when making a withdrawal and as at each 31 March) and Inland Revenue would, using the taxable and PIE income information they have, reply by advising his or her current PIE tax rate.

A further issue with PIE tax rate determinations is the "prescribed investor rate" terminology itself. Providers report a concerning incidence of lower-earning subscribers appearing to choose the 28% rate inappropriately because they misapprehend that the term 'prescribed investor rate' denotes investment earning potential or another favourable metric, despite denoting an investment income tax rate.

We recommend that 'prescribed investor rate' be replaced with a much clearer term such as "PIE tax rate" or "investment income tax rate" (or even just "prescribed tax rate"- the key is referencing tax) so as to convey the correct concepts and reduce the incidence of errors. We know that words have power in this context - such a change would be consistent with another pending KiwiSaver initiative whereby, effective 1 April 2019, a contributions holiday will be legislatively renamed a "savings suspension".

Pension schemes and annuities

No exploration of how to make the tax treatment of retirement savings fairer would be complete without acknowledging (and optimally addressing) the inflexibly high tax impost placed on defined benefit workplace savings schemes, where there is no facility to apply anything other than the top 33% ESCT rate and (at best) the 28% widely held superannuation fund investment income tax rate even where most or indeed all members may have already retired and begun receiving a pension.

The taxation of lifetime annuities in New Zealand is similarly inflexible, contributing to their lack of popularity and consequent unavailability – the investment income relating to the funds underpinning any such annuity would be taxed at 28% and then the annuity itself may be subject to tax on distribution in some cases.

Follow-up discussion

We would be pleased to meet with members of the Tax Working Group to discuss any aspect of our feedback or any matters of detail. We would also be very happy to receive a phone call or email if any of the points raised in our response are in any way unclear or require any follow-up.

Thank you very much for considering our feedback.

Yours faithfully

[1]

David Biegel

Chairman

Workplace Savings NZ Council

[1]

Copied to:

Richard Klipin/Haydee Stroud

Chief Executive Officer/Head of Member Services

Financial Services Council

About Workplace Savings NZ

WSNZ's objective is to be the *Voice of Workplace Savings* - advancing the sustainable, effective, and efficient delivery of workplace savings outcomes for all involved, including the workplace savings scheme members who remain key to the organisation. WSNZ aims to do this through:

1. Advocacy – proposing and commenting on legislative and public policy initiatives beneficial to workplace savings and participation in the workplace savings industry, making submissions, engaging with policy-makers and officials and issuing media commentary to advance those causes.

2. Education – promoting trustee, employer and member financial and regulatory education through dedicated training programmes, newsletters and special interest seminars.

3. Networking – providing trustees, employers and service providers involved in workplace savings schemes with a regular forum for sharing ideas and information on industry matters.

4. Promotion – publicising the benefits of workplace savings, and helping to improve public confidence and participation in workplace savings.

WSNZ's membership embraces all types of retirement schemes (KiwiSaver, workplace savings and superannuation schemes) and participants who are public and corporate, union-sponsored and industry-based.