

Tax Working Group Public Submissions Information Release

Release Document

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2 November 2018

Tax Working Group

By email submissions@taxworkinggroup.govt.nz

To whom it may concern

**FUTURE OF TAX: INTERIM REPORT - SUBMISSION OF THE GOVERNMENT
SUPERANNUATION FUND AUTHORITY**

Background

- 1 Thank you for inviting submissions on the Future of Tax: Interim Report (**Interim Report**).
- 2 The Government Superannuation Fund Authority (**Authority**) is a crown entity, established under the Government Superannuation Fund Act 1956 (**GSF Act**) to manage and administer the Government Superannuation Fund (**GSF** or the **Fund**) and the schemes within the Fund (the Schemes) in accordance with the GSF Act. It was established, under the GSF Act in 2001, to honour an historical Crown obligation to current and former government employees and to manage the Fund.
- 3 Annuitas Management Limited (**Annuitas**) is providing this feedback on behalf of the Authority. Annuitas provides staff who act in management and secretarial roles on behalf of the Authority.
- 4 The Fund is a superannuation scheme and the focus of our feedback on the Interim Report relates to matters which directly affect the operation of the Fund as a retirement scheme.

Feedback

The Fund should not be taxed at all

- 5 It is inefficient and costly for the Fund to be taxed at all. We would therefore recommend that the Tax Working Group use this opportunity to consider a tax exemption for the Fund.
- 6 The Fund has a large actuarial deficit, with assets of around \$4.5 billion and liabilities of around \$12.7 billion. Paying income tax on returns from the investment assets of the Fund increases the amount the Crown is required to pay into the Fund.
- 7 The Crown makes payments to GSF every four weeks to fund its share of the benefits. These payments are subject to employer superannuation contribution tax (**ESCT**). This means that, in addition to making the required payments to the Fund, the Crown is also paying an additional 33% to the Inland Revenue.
- 8 These payment processes increase accounting, audit and taxation advice costs for the Fund and the Crown. We are of the view the Fund should not be subject to tax at all.

We consider the Tax Working Group's recommended changes to the taxation of KiwiSaver should be extended to all registered retirement schemes.

- 9 Retirement savings is one of the most important areas being considered by the Tax Working Group and is critical for the future success of all New Zealanders. Any recommendations in the Tax Working Group's final report in relation to retirement savings must be comprehensive and consider all forms of retirement savings.
- 10 KiwiSaver has been successful in raising individual levels of retirement savings in New Zealand. We support the Tax Working Group's recommended further tax changes to the treatment of KiwiSaver, comprising:
- 10.1 the removal of the ESCT on employer's matching contribution of 3% of salary for KiwiSaver for employees earning up to \$48,000;
 - 10.2 a 5% reduction of the lower PIE tax rates for KiwiSaver funds only;
 - 10.3 simplifying the way PIE rates are applied for KiwiSaver members; and
 - 10.4 a suggestion that the member tax credit (MTC) should be increased to 1:1 basis.
- 11 However, the Tax Working Group's interim report suggests KiwiSaver is the only way that New Zealanders are saving for retirement. Individual retirement savings in New Zealand are held in a wider range of registered retirement schemes¹. Registered retirement schemes comprise:
- 11.1 KiwiSaver;
 - 11.2 Superannuation Schemes, which lock in funds until retirement; and
 - 11.3 Workplace Savings Schemes, which typically lock in funds until retirement or on leaving service from an employer.
- 12 Superannuation Schemes and Workplace Savings Schemes (excluding KiwiSaver) make up a significant proportion of New Zealand's total retirement savings, and at June 2018, held funds of approximately NZD 29 billion (in comparison to KiwiSaver which holds funds of approximately NZD 50 billion)². These schemes offer certain advantages to individuals and employers, including enabling higher contribution rates by employers. If the Tax Working Group's objective is to make the "tax treatment of retirement savings scheme fairer"³, the current and proposed tax treatment of KiwiSaver (and complying superannuation funds) should be extended to all registered retirement schemes⁴.

¹ Registered means those Superannuation Schemes, Workplace Savings Schemes and KiwiSaver Schemes as those scheme are defined in the Financial Markets Conduct Act 2013 and that are registered on the register of managed investment schemes.

² <https://www.rbnz.govt.nz/statistics>

³ Interim Report, page 6

⁴ We note that current tax benefits include member tax credits and extend to KiwiSaver and certain Complying Superannuation Funds (refer definition of Superannuation Savings Scheme in s.YA 1 of the Income Tax Act 5301885_1

We support the Tax Working Group's approach that it has not proposed any changes to the Portfolio Investment Entity (PIE) regime and that the single level of taxation at the PIE level should be maintained.

13 The Portfolio Investment Entity (**PIE**) regime is an important part of New Zealand's investment and retirement savings framework. The majority of New Zealand investment vehicles are now PIEs and the Fund is also classified as a PIE. A key feature of the PIE regime is its simplicity - a single level of taxation at the PIE level (and no tax for foreign investment zero-rate PIEs), with no further tax at the investor level.

If the Tax Working Group recommend a capital gains tax, it should also consider a capital gains tax exemption for assets held within a PIE.

14 The Tax Working Group's interim report does not provide any real detail as to how capital gains tax would apply to investments held in a PIE.

15 It is GSF's view the current PIE regime is simple and provides certainty as to the taxation treatment of investment assets.

16 Our submission is that the current PIE regime should remain unchanged.

17 As noted in the Interim Report at present, gains on New Zealand and Australian shares are not taxed, and gains on the sale of other foreign shares are generally not taxed and instead taxed is calculated on a deemed rate of return (**Fair Dividend Rate** or **FDR**) method. The difficulty with capital gains is that (unlike income) it is not known whether an asset will generate a gain or loss until it is ultimately realised. A capital gains tax in a fund can give rise to inequitable results for investors, because it will not be known if a particular asset will ultimately give rise to a gain or a loss until it is realised.

18 If, however, the Tax Working Group recommends that capital gains tax applies to gains within a PIE, we consider there should be an option to calculate that tax on a deemed risk free rate of capital return.

19 Any such method could approximate the long term capital return on all investments. While work would need to be done to determine the appropriate rate, a long term average inflation rate return of say 1% to 2% would seem appropriate.

20 We also note that the current 5% rate of FDR rate applying to determine income on equities would now seem to be too high, in the current environment, and should be revisited. We suggest a rate of 3% or less would be appropriate.

21 Finally, if capital gains tax were to apply to assets in PIEs, it will be important that there is no further level of tax. We understand that the Tax Working Group are not proposing that sales of PIE interests will be subject to tax to the extent that they are currently exempt income.

We are available to answer any questions you may have and look forward to having an opportunity to discuss our feedback with you.

Yours sincerely

[1]

Simon Tyler

CHIEF EXECUTIVE