Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

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Tēnā koutou Tax Working Group members

Submission on *Future of Tax: Interim Report*

ANZ Bank New Zealand Limited (**ANZ**) welcomes the opportunity to submit on the Tax Working Group's (**the Group**) Future of Tax: Interim Report (**the Report**). We recognise the importance of the Group's review of New Zealand's tax system.

About ANZ

ANZ is one of New Zealand's largest companies based on profit and assets. With this scale comes responsibility and we take that responsibility seriously. From individuals and family, to the farms and small businesses that are the life blood of our economy, to our largest institutions and corporations, we play a key part in helping New Zealanders achieve their financial aspirations.

Our breadth and diversity is reflected in our people. We employ over 8,000 people throughout New Zealand. They come from a wide range of backgrounds, skills and specialisations and we value the richness that diversity brings to our business.

ANZ is the largest financial institution in New Zealand. The ANZ group comprises brands such as ANZ, UDC Finance, ANZ Investments, ANZ New Zealand Securities and Bonus Bonds. ANZ offers a full range of financial products and services including a significant range of financial advisory services, personal banking, institutional banking and wealth management services.

ANZ Investments is New Zealand's largest fund manager and manages over $28 billion for over 770,000 investors. It is also New Zealand's largest and most-awarded KiwiSaver manager, with one in four New Zealanders in KiwiSaver investing their retirement savings with us. ANZ Investments is one of the nine default KiwiSaver managers appointed by the government in 2014.

We summarise ANZ's submission points below and provide further detail in the attached Appendix.

Summary of submissions

1. As general principles for a strong and sound tax system:

    i. We support a tax system that is fair and balanced.

    ii. We consider it appropriate that any changes to New Zealand's tax system maintain tax revenue of around 30% of GDP but also promote productivity of the New Zealand economy and, consequently, growth of GDP to ensure appropriate funding for a safe, secure and financially stable New Zealand, including for future infrastructure and aging population requirements.

    iii. Tax changes should be simple to understand with high integrity to promote high levels of compliance at low administration and compliance costs.

    iv. A fair and balanced tax system should ensure investment distortions are minimised as much as possible and promote investment in productive assets.

2. These general principles are pertinent for any capital gains tax. If a capital gains tax were introduced, it would impact most New Zealanders and would be one of the most significant changes to New Zealand's tax system in more than 30 years (which has been developed largely in the absence of a capital gains tax). Globally, comprehensive capital gains tax regimes are complex with significant compliance costs. While they can lead to greater equity to invest in productive assets, they can, equally, discourage certain savings and investment by reducing post-tax returns. Any capital gains tax, if introduced, must be designed with appropriate time to ensure it is right, first time, for all New Zealanders and is a matter that we agree is for all New Zealanders to debate and decide upon.

3. More specifically, we submit on the design of any capital gains tax upon shares in multi-rate Portfolio Investment Entities (**PIEs**), if implemented. While we only submit on this design aspect of a capital gains tax (given its direct relevance to ANZ and a large number of its customers), we acknowledge, as above, the significant work ahead of the Group in respect of other design elements.

    i. A capital gains tax on New Zealand and Australian listed shares (**Australasian shares**) for PIEs will be complex. It will be critical that any such tax changes within PIEs (particularly KiwiSaver) are both well understood by members (to ensure appropriate financial awareness) and are seen as being fair by members.

    ii. Taxing accrued capital gains or extending the Fair Dividend Rate (**FDR**) to Australasian shares will be an easier solution than the partnership approach. However, it will be critical that such approaches mitigate potential inequities and distortions, as much as possible, compared to direct Australasian share investments and investment in foreign shares. For taxing accrued capital gains, this should require, as a minimum, tax equivalence of both accrued gains and accrued losses with other PIE income and losses (i.e. not ring-fencing accrued losses). It may also be necessary to have a non-inclusion rate for accrued capital gains/ losses (which, if applied, should be a single rate across all PIEs) or a reduced FDR rate. We would welcome engagement with the Group to assist in developing an appropriate level of non-inclusion/ FDR rate.

    iii. The partnership approach would be overly complex, resulting in significant difficulty for members to understand and high compliance costs.

iv. It will be critical that sufficient time is available, from when certainty arises on any changes to the PIE regime, to implement necessary changes. While we cannot determine, at this stage, the time required to implement such changes until certainty over the detail is known, we would estimate that, at least, an additional year beyond 1 April 2021 would be required if either the taxing accrued capital gains or extending the FDR regime approaches were adopted. Further time again would be required if the partnership approach were adopted.

4. ANZ supports the Group's recommendations to remove employers' superannuation contribution tax on employer contributions to KiwiSaver for members earning up to $48,000 per year. We also support the Group's recommendation to reduce the two lower KiwiSaver PIE tax rates by five percentage points and submit that this reduction should apply to investors across all PIE funds including non-KiwiSaver funds. Finally, we recommend that further incentives to promote New Zealand's private retirement savings remains on the agenda, including beyond the work stream of the Group.

Thank you again for the opportunity to provide feedback on the Report. If you wish to discuss any aspect of this submission please contact [1]
[1]

Yours sincerely

[1]

Philip Leath
General Manager, Tax – New Zealand

Appendix

1. Key requirements of a strong and sound tax system

1.1 We agree with the Group's outline of principles for tax policy design to ensure a strong and sound tax system. We consider it important that such requirements are front and centre of any changes to the tax system.

i. We support a tax system that is fair and balanced. Equivalence of income types should be consistently taxed with an appropriate level of progressivity that carefully balances living standards with productivity growth.

ii. We consider it appropriate that any changes to New Zealand's tax system maintain tax revenue of around 30% of GDP. To ensure appropriate funding for a safe, secure and financially stable New Zealand, including for future infrastructure and aging population requirements, the tax system should also promote investment (both domestically and from offshore) in productive assets to drive GDP growth. GDP growth, for which we consider tax does play a part, will be important in light of expected increasing national expenditure requirements.

iii. Any tax changes should be simple to understand with high integrity. Complexity and a lack of integrity (or cohesion) of tax policy can lead to non-compliance and high levels of both Government administration costs and taxpayer compliance costs. As the Report notes, predictability and certainty are important considerations which, generally, are derived from simplicity and integrity of tax policy.

iv. A strong and sound tax system should minimise investment distortions as much as possible to promote investment in productive assets. Distortions in post-tax outcomes across differing investments can lead to adverse or unintended economic consequences.

1.2 We acknowledge that the above principles are interconnected and all of the principles need to be carefully assessed for any tax policy change. When viewed in isolation, these principles often mean different things for different taxpayers.

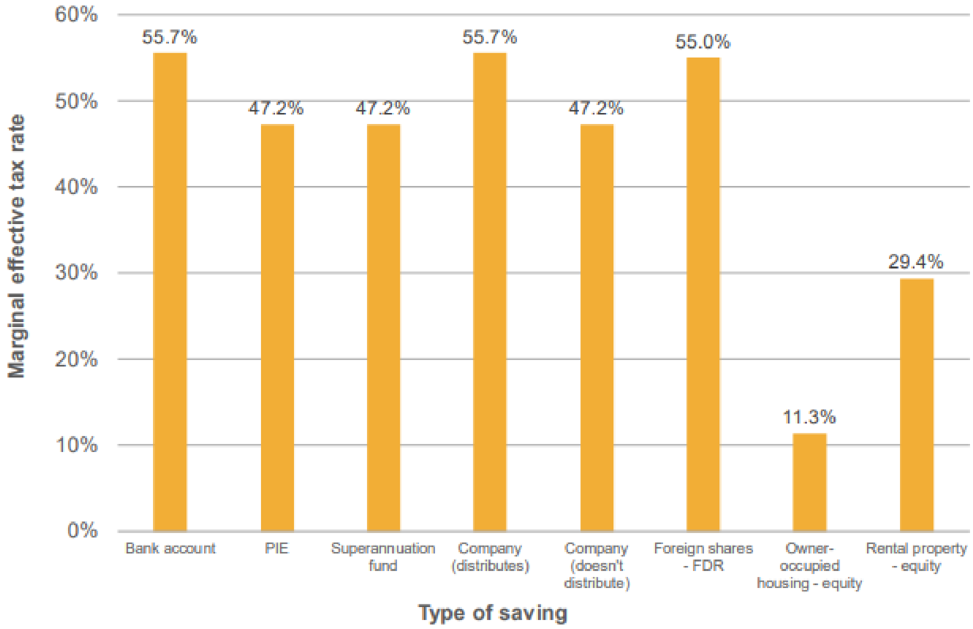
2. Capital Gains Tax – general comments

2.1 While there are a number of tax changes suggested in the Report, if a capital gains tax is introduced it will be one of the most significant changes to New Zealand's tax system in more than 30 years. It will impact the vast majority of New Zealanders in some way or another – for example, the majority of New Zealanders (more than 2.8 million) are in KiwiSaver, there are close to 500,000 small businesses in New Zealand with fewer than 20 employees (as at June 2017), and as the Report notes there is more than $250 billion of residential rental property in New Zealand.

2.2 New Zealand's tax regime has been developed largely in the absence of a capital gains tax, albeit with some exceptions. Consequently, we expect the introduction of a capital gains tax in New Zealand will be complex (particularly a relatively comprehensive capital gains tax). We note that capital gains tax regimes overseas are complex leading to significant compliance costs.

2.3 As the Group has highlighted, savings investments have differing effective tax rates which can drive investment bias and inequitable outcomes (refer to the chart below from page 40 of the Group's Future of Tax: Submissions Background Paper). A capital gains tax may, therefore, drive tax consistency across investment types. As is stated in the Report, care will be required to ensure other forms of savings are not adversely impacted from higher post-tax returns (particularly in light of New Zealand's low rate of saving) and that unintended consequences do not arise, such as the direct and indirect flow-on impact that may adversely impact New Zealand's living standard (e.g. the cost of housing rents).

Figure 21: Marginal effective tax rates on savings



2.4 Subject to the design of any capital gains tax, distortions may arise within the same investment class. This may be the case for shares given the different tax rules currently applied to share investments. A capital gains tax may be able to create a close consistency with the taxation of shares across differing investors. But doing so will require careful yet complex design to ensure differences are minimised between:

- the FDR regime (for New Zealanders investing in non-Australasian shares);
- any capital tax regime (for New Zealanders investing in Australasian shares); and
- withholding taxes on certain companies' dividends (for foreign investors in New Zealand shares).

If significant differences exist, unintended consequences could arise which may hinder New Zealand's growth. These may include:

- New Zealand companies migrating overseas (if it is perceived that New Zealand shareholders will face lower taxation under the FDR regime than a capital gains tax and dividend taxation); and
- if greater post-tax returns can be obtained through holding foreign shares (subject to the FDR regime) than New Zealand shares (subject to a capital gains tax and dividend taxation).

In this regard, we welcome the comment in the Report (at paragraph 24 of page 33) that the Group will consider the impacts a capital gains tax may have on New Zealand's equity market.

2.5 Imposing a capital gains tax on business (including goodwill) may create greater equity, particular as the wealth (or value) within a business may be perceived as being derived from personal exertion – which has similarities to labour income. However, this should be balanced with simplicity of tax rules for business, low compliance burdens, certainty and driving greater productivity for GDP growth. Such compliance burden and lack of certainty is most evident with the proposed transitional approach. Such an approach may work for assets which are distinct in nature and for which there are ascertainable market prices (such as listed shares or real property). However, as noted above, there are close to 500,000 small businesses in New Zealand with fewer than 20 employees. The transitional rules may present high complexity, uncertainty and high compliance costs for business. To expand briefly:

i. To comply with the median transitional rule, each of these businesses (as well as every larger business) will need to conduct a valuation of their business (and any necessary component parts) on the effective date as well as value the original cost. For long-standing businesses, accessing records to determine the original cost of assets and goodwill, which may have been built up over time, could be difficult. This could lead to significant deadweight compliance costs.

ii. Business valuations are inherently difficult, which leads to uncertainty – this will be heightened from such a significant number of business taxpayers all being required to obtain valuations on, or close after, the effective date. This uncertainty may lead to considerable scope for disputes between taxpayers and the Inland Revenue many years after the effective date.

iii. While the Report highlights that "acceptable rules of thumb" could be considered to mitigate compliance costs, we are unsure how available they will be to the multitude of New Zealand businesses. For example, applying fair market values for IFRS taxpayers may not be available to the many small businesses of New Zealand as they are not required to apply IFRS. Further, IFRS only requires fair market values on certain assets and liabilities and does not determine the true market value of an entire business which is more typically determined on a discounted future cash flow or earnings multiplier basis.

If a capital gains tax is introduced, particularly for business, concepts of equity, simplicity, compliance costs and certainty should be collectively considered.

2.6 We recognise the significant task ahead of the Group in this regard and would be happy to engage further on the above topics.

3. Capital gains tax for multi-rate PIEs

3.1 The Report acknowledges that a capital gains tax on Australasian shares for PIEs is complex. It is important to bear this complexity in mind from a member perspective as it will be critical that any tax changes within PIEs (particularly KiwiSaver) are both well understood (to ensure appropriate financial awareness) and are seen as being fair by members. This complexity is also pertinent for scheme providers in order to implement any changes from a systems, processes and member education perspective.

3.2 The Report highlights the options for imposing a capital gain tax, if introduced, as being: the partnership approach; tax accrued capital gains; impose capital gains tax as a fund expense; and to extend the FDR regime to Australasian shares. We agree with the Group that imposing capital gains tax as a fund expense is *"not … a promising option"* as it undermines key objectives of the PIE regime. Accordingly, we focus on the remaining three options.

3.3 We address the partnership approach first, as that is the initial option outlined in the Report. The partnership approach is the most complex option, which in summary overlays how partners in a partnership are taxed upon Australasian shares in a PIE. We do not recommend adopting the partnership approach for the following reasons:

i. <u>Partnerships are different to PIEs</u>

A partnership, generally, has significant operational differences from a PIE. Contributions and exits from a partnership are relatively rare. However, contributions into a PIE (particularly KiwiSaver) are a very common occurrence and with the volume of members in PIEs (over 2.8 million in KiwiSaver alone) exits are more common for PIEs than for a partnership.

Scale is also significantly different. It is rare for a partnership to have greater than 100 partners. ANZ's KiwiSaver schemes have around 745,000 members.

While there are some conceptual similarities in the tax treatment between PIEs and partners in a partnership there are also key differences. Each partner in a partnership is responsible for paying tax on partnership income at their marginal tax rate taking into account other income. A partnership does not fund or pay the tax; it merely calculates the taxable income of the partnership. In contrast, a PIE calculates and pays PIE tax for each investor, generally as a final tax by applying each investor's appropriate prescribed investor tax rate.

Taking into account these operational and tax differences, imposing the partnership approach for a PIE would be overly complex as outlined below.

ii. Overly complex to manage

While the partnership approach is summarised in the Report, we outline below how we consider it would need to operate. We do this to highlight its complexity as well as some current unknowns on how it will operate in practice.

The partnership approach would require tracking of a tax cost base and taxing events across each individual member and each individual Australasian share on a daily basis. This is because the partnership approach proposes to alter the cost base for each existing member (or unit) for new member contributions to the PIE as well as members exiting from the PIE. While not covered in the Report in detail, we also assume that such alterations would also be required when existing members make new contributions to the PIE to ensure equity compared with new members joining (particularly as new units are issued for every new contribution into a PIE). Contributions are not isolated events, they occur on a very regular basis, particularly in KiwiSaver PIEs.

Where the PIE sells an Australasian share (either to reinvest in other Australasian shares or an alternative investment) this would trigger a taxing point to each individual member. Exits from a PIE by an individual member would trigger a taxing point to the exiting member on the basis they have "realised" their investment. Further, all contributions (either by new members or existing members) could also trigger a taxing point for all existing members as existing members would be effectively selling a portion of their investment to the contributing member (while this tax may be deferred, the requirement to track remains).

Such an approach is broadly consistent with how partners in a partnership are taxed when new partners join or existing partners leave a partnership. However, as noted above, this is a rare event in a partnership compared to a PIE. As an example, KiwiSaver PIEs have regular contributions from existing members which differ in quantum member by member, day by day. KiwiSaver PIEs also have regular exits. Further, it is common that PIEs (e.g. retail PIEs) are structured to invest into other PIEs (e.g. wholesale PIEs) which layers further complexity that partnerships do not have.

Tracking regular contributions, new members joining, existing members exiting and actual realisations of Australasian shares against, at least daily movements in share prices across many Australasian shares, creates enormous complexity to implement and manage.

iii. Member confusion

Given the high complexity of the partnership approach, it would be extremely difficult for members of PIEs to understand their tax position.

A realisation-based tax could create a significant difference when an investor exits (or when underlying equities are sold by the PIE) between the pre-tax and post-tax values, with this gap increasing with longer investment horizons. For exiting members, we expect this would cause confusion as it may appear to members that they have been taxed on withdrawal being at odds to a Tax-Tax-Exempt system resulting in a lower withdrawal amount than expected by the member.

A question exists as to whether a realisation-based tax upon withdrawal may arise where a member transfers their funds from one KiwiSaver fund to another KiwiSaver fund or between different scheme providers or whether a roll-over relief may be available. This may impact both the transferring member and existing members. A realisation based tax upon transfer between funds or schemes is highly likely to cause confusion for all members (particularly if it alters their KiwiSaver balance).

iv. Significant compliance cost and time to implement

As the partnership approach is the most complex option, implementation would require significant resource, time and cost for necessary system changes as well as managing member communications. Certainty on the exact detail of the rules would be critical in advance of commencing such system change. As certainty is unlikely to occur until, at the earliest, enactment of amending legislation, a significant risk exists that implementing the necessary system and member communication changes could not be completed until well after the proposed 1 April 2021 effective date.

3.4 We now consider the remaining two options (tax accrued capital gains or extend the FDR regime to Australasian shares) together. We consider these options appear to be simpler than the partnership approach. However, necessary adjustments may be required to ensure potential inequities and distortions do not arise when compared to direct investments in Australasian shares.

i. Tax accrued capital gains

An accrual approach would bring forward the tax liability on Australasian share gains in PIEs that are not sold during a particular tax year compared to direct investors of Australasian shares, who would be taxed on a realisation basis. Taxing accrued gains would increase the effective tax rate for PIEs, which the Group highlights as being 47.2% (refer to the table from the Submissions Background Paper as shown above).

This presents a disadvantage for PIE members compared to direct investors, especially for Australasian shares held long term, creating the potential for inequity and distortion. If investors perceive they would achieve better cash flow timing outcomes from investing directly than through PIEs, this may lead to an undermining of PIEs (including KiwiSaver) - particularly for possible new members. It may also result in a disincentive to use the expertise of investment advisors (resulting in greater risk).

To reduce the disadvantage of accrual taxation to PIE members, the Report identifies that the lower PIE tax rates and no ring-fencing of losses (i.e. equivalence of both accrued gains and accrued losses with other PIE income and losses) may be sufficient. ANZ considers this must be a minimum to ensure some form of equivalence with direct investors (assuming direct investors' realised losses would not be ring-fenced). Further, the Report highlights that if the above was not sufficient, a reduced rate of inclusion may be required.

What this reduced rate of inclusion should be, if necessary, is a difficult question for which we recommend additional research across the industry is undertaken. Given KiwiSaver dominates the funds market, but is relatively immature compared to other funds, it will be critical that research covers many different PIE funds as well the interaction between retail PIEs and wholesale PIEs (which may hold share investments for a considerable period of time). In addition, any non-inclusion rate would need to carefully balance simplicity with economic purity – particularly as the more than 2.8 million New Zealanders who invest into KiwiSaver schemes would need to understand, with ease, how they are taxed and that they are taxed fairly. As such, it may be preferable to apply a single rate of non-inclusion across all PIEs. In this regard, and while only one of many factors that should be considered, ANZ's PIE funds hold Australasian shares, on average, for around 7 years. We would welcome engagement with the Group to develop an appropriate level of non-inclusion.

ii. Extending the FDR regime

All other things being equal, extending the FDR regime to Australasian shares in PIEs may accelerate the tax impost for PIE members compared to direct investors in Australasian shares. We also note that adopting a FDR approach for PIEs and a realised capital gains tax for direct investors heightens the lack of coherence in the tax treatment of Australasian shares and, therefore, has the greater potential for distortions in investment.

Some form of adjustment to the FDR regime (or reduction to the FDR rate) may, therefore, be required to ensure comparable investments are treated equitably across different investment vehicles and distortions do not arise. This would be most evident if Australasian shares decline in value, which would not trigger a capital gains tax to a direct investor but would trigger a tax liability for a PIE member if FDR were applied.

3.5 While we consider that the taxing accrued gains or FDR approaches are simpler than the partnership approach, such approaches will still require significant system, process and member communication changes, for which it will be critical that sufficient time is available from when certainty arises on such treatment to implement the necessary changes. While we cannot determine, at this stage, the time required to implement such changes until certainty over the detail is known, we would estimate that, at least, an additional year beyond 1 April 2021 would be required.

4. Retirement savings

4.1 ANZ supports the Group's recommendations to remove employers' superannuation contribution tax on employer contributions of 3% to KiwiSaver for members earning up to $48,000 per year, as well as simplifying the determination of the PIE tax rates.

4.2 ANZ also supports the proposed reduction in the two lower KiwiSaver PIE tax rates by five percentage points (from 10.5% and 17.5% to, respectively, 5.5% and 12.5%), but submits that this reduction should apply to investors across all PIE funds including non-KiwiSaver funds. In our view, applying the same PIE tax rates across both KiwiSaver and non-KiwiSaver PIEs would:

i. Increase horizontal equity across different PIE investments and reduce the potential for bias between different investment choices (e.g. where investors may exit their investments in non-KiwiSaver funds and reinvest in KiwiSaver in order to gain the benefit of lower PIE tax rates), which could cause significantly harm to the non-KiwiSaver managed fund industry.

ii. Be easier for PIE customers to understand. Based on the number of customer queries ANZ receives, there seems to be considerable confusion among the public about PIE tax and we expect that implementing different PIE tax rates for only KiwiSaver would further hinder public understanding of managed funds and the tax implications of their investments.

iii. Require less system development for both KiwiSaver and non-KiwiSaver funds, particularly as many fund managers apply a single registry system for both KiwiSaver and non-KiwiSaver funds (as is the case for ANZ).

4.3 We recommend that any incentives to promote New Zealand's private retirement savings remains on the agenda long term for the reasons highlights in our submission to the Group's Future of Tax: Submissions Background Paper.