Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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Submission to

The Tax Working Group

on the

Future of Tax: Interim Report

14 November 2018

1.0 INTRODUCTION

1.1 This submission has been prepared by Bank of New Zealand ("BNZ") in response to the Tax Working Group ("the Group") *Future of Tax: Interim Report* ("the Interim Report").

1.2 BNZ is a member of the Corporate Taxpayers Group ("CTG") and has been involved in the submissions the CTG has made on The Interim Report. While BNZ is aligned with the submissions made by the CTG, BNZ wishes to make an additional submission on certain specific aspects of the report.

2.0 EXECUTIVE SUMMARY

- BNZ is concerned about the economic disincentives for investment in productive businesses that could arise from a broad extension to the taxation of capital income. Accordingly, BNZ submits that if a capital gains tax regime is recommended, that a broad roll-over relief rule is included for active businesses and business assets.
- BNZ considers that there is no principled reason to ring-fence capital losses and submits that the Group should not recommend loss ring-fencing. BNZ acknowledges the concern over taxpayers claiming tax losses on certain assets while claiming roll-over relief on others, however there are simpler less distortionary means available to address this risk.
- If the Group does recommend an extension to the taxation of capital income, BNZ is particularly concerned at the potential timeframe for its introduction. If the introduction of legislation and its application date crosses the next general election there will be a significant amount of uncertainty as to whether the proposed legislation will be enacted. This will place many taxpayers in a difficult position of either investing in new systems for legislation that may never come into force, or delaying that investment and risk being non-compliant when the legislation comes into force (if it is enacted). BNZ submits that the Group include in its final report recommended/suggested appropriate timeframes for consultation, implementation and enactment of the Group's recommendations.
- BNZ supports a reduction in the lower Portfolio Investor Rates ("PIRs") as a means of encouraging savings and investment by low and middle-income earners. However, BNZ submits that the PIRs should remain consistent between KiwiSaver funds and non-KiwiSaver funds.
- While BNZ would not object in principle to extending GST to financial services, it supports the Group's decision to not recommend it. The practical challenges of doing so are considerable and the complexity that would result should not be underestimated.
- Finally, BNZ supports the Group in rejecting a Financial Transaction Tax.

3.0 Feedback on The Interim Report

Taxation of capital income

3.1 BNZ recognises the importance of the Group's role in considering the future of tax in New Zealand and to provide the Government with recommendations to improve the fairness, balance and structure of the tax system. However, BNZ is concerned at the potential economic disincentives that could arise for the productive sector of the economy if there is a broad extension of taxation of capital income. If the Group does conclude that a capital gains tax is in the best interests of New Zealand, then BNZ would prefer a targeted rather than broad approach.

3.2 Taxing capital income generated by the productive sector of the economy has potential to result in a suboptimal allocation of capital due to lock-in effects and the double tax on retained profits. A business that wishes to expand may need to dispose of an existing asset, a factory for example. If a gain arises on that disposal and is taxed, the business has less of the sales proceeds available to reinvest. Consequently, the business would need to borrow a larger amount to fund the acquisition of the new factory compared to the situation if the gain was not taxable. This increases the hurdle rate for new investment and the outcome has real potential to lock business owners into holding assets for longer than would otherwise be economically efficient. BNZ's concern is that this may inhibit investment in new technologies and new markets and has potential to lead to lower productivity growth.

3.3 BNZ acknowledges that many of these unwanted effects may be mitigated by allowing roll-over relief for business assets. However, to ensure that businesses are not disincentivised to invest and grow, any roll-over relief needs to have broad application and should not be unduly narrowed due to fiscal concerns. Roll-over relief concessions should also be designed to be as simple as possible to apply to keep compliance costs down. Importantly, BNZ does not consider loss ring-fencing is necessarily required if broad roll-over relief is available as discussed in the section below.

3.4 BNZ is also generally concerned at the potential for excessive complexity and therefore high compliance costs if the Group recommends a broad extension of capital income taxation. BNZ submits that the complexity needs to be carefully balanced with other objectives in the Group's recommendations. What has appeal from a pure tax policy perspective may require overly complex rules. The costs of complying with complex legislation, especially for large and complex business should not be underestimated.

Capital losses

3.5 BNZ understands that the Group is favouring the ring-fencing of tax losses on capital income due to concerns around taxpayers realising capital losses at the end of a tax year only to reacquire the same asset immediately following the commencement of the next tax year. In BNZ's view, if capital income is taxable there is no principled basis for ring-fencing capital losses. BNZ would prefer to see the Group recommend targeted anti-avoidance provisions to deal with cherry picking behaviour by taxpayers rather than adopt a general loss ring-fencing rule.

3.6 In addition, BNZ does not consider that loss ring-fencing is a necessity if extensive rollover relief is allowed. It should be possible to manage the base integrity concerns raised in the Interim Report through requiring that realised losses are first offset against rolled over capital gains. Taxpayers would not be able to gain the benefit of a tax loss on one asset while at the same time carrying forward an untaxed capital gain on another. Where a taxpayer's losses exceed any rolled over gains those losses should be able to be offset against other taxable income.

Timing of the introduction of the Group's recommendations

3.7 If a capital gains tax is to be introduced, BNZ is concerned at the indicated timeframe for its implementation. A broad extension of capital income taxation will necessarily involve very significant changes to tax legislation which will necessarily be complex, will contain many boundary issues and systems and process changes will be needed in order for taxpayers to comply.

3.8 If taxpayers will be incurring significant costs in developing systems and processes to comply with new legislation, there needs to be sufficient lead time between enactment of legislation and its commencement date for these systems changes to be implemented. The managed funds industry is likely to be deeply impacted if the Group's recommendations affect the operation of the Portfolio Investment Entity regime.

Savings and Investment

3.9 If the Group does recommend extending the taxation on capital income from share investments in its final report then BNZ submits that collective savings vehicles should be able to extend the application of the FDR method of taxation to Australasian share investments.

3.10 Taxing realised capital gains within Portfolio Investment Entities ("PIEs") would be hugely complex and is arguably incompatible with the existing in-fund taxation of investors interests. However, allowing FDR to be applied would enable managed funds to use existing systems to calculate tax on Australasian equity investments. Conversely, if Australasian equity investments are treated differently from foreign investment funds there will be significant costs associated with additional systems development work. Apart from the concerns we have already raised about timeframes, the costs to the industry of developing new systems are ultimately recovered over time through higher fees charged to investors. The compounding effect on investment earnings of higher fees should be a consideration when looking at the alternative design options.

3.11 In addition, the FDR method of taxation has been a component of New Zealand's tax legislation for more than a decade now and is reasonably well understood by investors – having vastly different taxing regimes for what are ostensibly identical types of assets is likely to be more confusing for investors. It could also lead to a flight of capital away from New Zealand companies and towards non-Australasian equities.

3.12 BNZ does support a reduction in the bottom Portfolio Investor Rates ("PIRs") as a means of encouraging savings for low and middle-income earners. However, BNZ also submits that PIRs for KiwiSaver and non-KiwiSaver PIEs should remain consistent. The potential that a single investor could have two PIRs applying on different investments with the same provider would mean complex systems development is required far beyond just introducing new PIRs to existing registry systems. In addition, maintaining parity of PIRs across KiwiSaver and non-KiwiSaver investments would not detract in any way from the objective of encouraging savings for low and middle-income earners.

3.13 To increase the overall level of savings in New Zealand BNZ considers that it is preferable that there is a range of investment options available. BNZ is concerned that providing a five-percentage point concession on the lower PIRs for KiwiSaver funds compared to other PIEs would effectively limit investor choice as the post-tax return differential would be quite high.

Goods and Services Tax

3.14 BNZ commends the Group for acknowledging the practical complexities inherent in extending Goods and Services Tax to financial services. BNZ does not object in principle to GST to apply to financial services however the systems required to charge GST on financial services, particularly to banking transactions would likely be incredibly complex.

Financial Transactions Taxes

3.15 BNZ supports the Group's decision to reject a Financial Transaction Tax. BNZ agrees that the impacts on the productive business sector and general efficiency impacts are undesirable.

4.0 CONCLUDING COMMENTS

4.1 BNZ is pleased to provide this submission and the information it contains. BNZ is available to discuss any issues raised.

4.2 Should the Group have any questions in relation to this submission, please contact:

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